Welcome to our Directors' Report, Accounts and Annual Business Statement

For the year ended 31st December 2018

HARPENDEN BUILDING SOCIETY

Contents

Society Information

Established and incorporated 1953
Firm Reference Number: 157260
Eligible for investments by trustees
Member of the Building Societies Association
Member of UK Finance

Head Office
Mardall House
9-11 Vaughan Road
Harpenden
Hertfordshire
AL5 4HU

Board of Directors

Stephen Richardson	Chair
Judith Mortimer Sykes	Vice Chair and Senior Independent Director
Peter Baynham	
Nigel Boothroyd (appointed 14 March 2019)	
Sarah Howe (appointed 14 March 2019)	
George McGrady	
Jill Robinson	
Paul Smith	

Senior Management

Roy Badcock	Society Secretary
Philip Bannister	Head of Operations
Kenneth Hale	Head of Lending
Sarah Howe	Chief Executive
Martin Langlands	Interim Head of Risk & Compliance
George McGrady	Finance Director
William Purdy	Head of IT

Solicitors

Neves
Tollgate House
69-71 High Street
Harpenden
Hertfordshire
AL5 2SL

Bankers

HSBC Bank plc
1 High Street
Harpenden
Hertfordshire
AL5 2RS

Auditor

KPMG LLP
One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH

Chair's Statement

"We will be investing to modernise, improve and grow the Society for the long term benefit of our members and customers."

I am very pleased to have this opportunity to provide you with an update on the progress your Society has made during 2018.

Market and Economic Background

As you will be aware, we are operating in an uncertain economic environment. A lack of clarity regarding Brexit is one of a range of factors that are expected to continue to add pressure to the main economic indicators including GDP growth and potential reductions in housing transactions and prices for some time to come. The latest data published across a broad spectrum of sources, all reference a slowing global economy that is further exacerbated by actions in some parts of the world that seem to promote protectionist policies over free trade. This creates an environment where both businesses and customers are nervous about making important investment decisions such as buying or moving to a new home or spending money refurbishing their existing home.

We recognise the impact that the uncertainty surrounding Brexit can have on our business and have assessed the potential risks specific to the Society. Further details of these risks are considered within the Business Review on page 12 and as part of the commentary on our Principle Risks and Uncertainties on page 17.

Despite the overall uncertainty these events create, house prices (with some regional variations) have remained broadly stable and unemployment has fallen to 4%, which is the lowest level since February 1975. Figures from the Building Societies Association show net mortgage lending for Building Societies and other specialist lenders increased by 2.7% in 2018 and I am pleased to report that growth of our mortgage book is significantly above this level.

In August 2018, the Bank of England raised the Bank Base rate to 0.75%, but this still means that interest rates have now been at historically low levels for over ten years. Whilst borrowers have benefited from low interest rates, they remain challenging for savers particularly if interest on cash deposits is an important part of their income. Inflation is currently falling but the growing demand for labour is putting upward pressure on wage levels. As a result, the Bank of England Monetary Policy Committee are forecasting modest, gradual increases to Bank Base Rate over the next two years.

Building a Robust, Sustainable Society

Despite this backdrop, I am pleased to report that profit before tax remains strong at £1.9m for the year, which compares to £2.0m for 2017.

The Society has a long history of generating good profitability, which has allowed us to strengthen our capital base and to grow the business to ensure it remains sustainable in an increasingly competitive market. The Society's costs are rising as a result and also as a direct result of being a highly regulated business. We have recently undertaken a strategic review of the business and, as a result, we will be investing more of our future profits to modernise, improve and grow the Society for the long term benefit of our members and customers.

Chair's Statement

The Society will remain focused on delivering the products customers need, combined with a personal service using the latest digital technology to enable customers to transact with us in the most convenient way for them.

Your Board is committed to ensuring the Society has a long term future as an independent regional building society, so long as we continue to remain relevant and offer good value to our members.

Mortgages and Savings

We continue to manually assess and underwrite each mortgage and this granular understanding and technical expertise remains at the core of our business. It ensures that we can meet the specific needs of our customers and take advantage of our specialist knowledge to assess and manage credit risk within our mortgage book. This focus has resulted in gross lending of £66.4m over the year and 7.3% growth in our mortgage book which is well above the sector average. This is ahead of our budgeted expectation and has helped to reduce the high levels of liquidity that we have historically held. We envisage that, as we continue to lend during 2019, this will reduce our excess liquidity sufficiently for us to undertake a review and refresh of our current range of savings products, which we recognise has been limited over recent years.

From a credit risk perspective, we continue to see low levels of arrears and we have had no property repossessions during 2018. Furthermore, the impairment provision has reduced significantly over the year.

I am also pleased to report that we have won the 2018 What Mortgage "Best Local Building Society" Award for an unprecedented fourth year running. These awards are voted for by customers and industry professionals and I would like to thank everyone who took the time to express their views as part of the voting process.

Board Changes

Since my last report, we have made a number of changes to the Board, including appointing a new Chief Executive.

Carl Astley, your previous Chief Executive, took the decision to leave the business in early 2018 and David Jervis, an experienced industry professional, provided support to the business, as the interim Chief Executive, whilst a permanent successor was recruited.

Your new Chief Executive, Sarah Howe, has significant experience gained from market leading companies. Sarah joined from Saffron Building Society where she was the Chief Customer Officer for the last four years, having joined in 2013 as Chief Marketing Officer. Prior to joining Saffron, Sarah was Marketing Director at RIAS Plc (a general insurance provider) and Chief Marketing Officer at BUPA.

Ali Crossley-Mintern left the Board at the end of October after nearly four years' service and I would like to take this opportunity to thank Ali for all the effort that she put into her role and wish her the very best for the future.

Ali has been replaced by Nigel Boothroyd, who has had an extensive career with HSBC Bank in a wide range of roles prior to his retirement in April 2017.

Employees and Management

We recognise the need to attract and retain talented staff. We have therefore recruited a number of additional employees during 2018 and are looking to attract further employees within specialist areas of the business during 2019.

Looking Forward

The Society has a long history of providing personal service to our mortgage and savings customers, generating good levels of profitability and has built up a strong capital base. However, the Board recognises that in a fast changing, very competitive world, the Society needs to invest and develop the business to enable it to grow and prosper for the benefit of our existing customers, members as well as future generations and the communities that we operate in and support.

Finally, I would like to take this opportunity to thank all our members, customers and professional partners for their support over the past year.

I would also like to thank all our employees across the Society whose dedication and hard work has enabled the Society to provide the highest levels of service.

Stephen Richardson

Chair
14 March 2019

Your Board of Directors

Stephen Richardson

Chair

Stephen joined the Society as a non-executive director in January 2014 and was appointed Chair in June 2016. He is a member of the Society's Remuneration & Nominations Committee.

Stephen brings a wealth of strategic leadership to the organisation and has over 35 years of management and leadership experience in financial services at Barclays, Flemings and the Bank of New York, where he was Chief Operating Officer for Europe.

He was Global Head of Wealth Management at the World Gold Council (trade body for global gold mining companies) covering China, India, Europe and the USA until mid-2013.

Stephen now has a range of non-executive and advisory/consulting roles.

Judith Mortimer Sykes

Vice Chair

Judith joined the Society in October 2011, and was appointed Vice Chair in March 2014 and became Senior Independent Director in January 2016. She is the Chair of the Society's Remuneration & Nominations Committee and a member of the Risk Committee.

She is an experienced non-executive director with substantial and varied board experience of corporate governance, strategy and risk.

Judith has significant financial services experience which has encompassed corporate banking at Bank of America. She also has extensive experience of retail banking in the mutual sector including six years as Head of Lending Control at the Nationwide Building Society where she spent 18 years of her career.

Your Board of Directors

Peter Baynham

Non-Executive Director

Peter joined the Society as a non-executive director in November 2014 and chairs the Society's Audit & Compliance Committee. He is also a member of the Risk Committee.

He is a Chartered Accountant and has previously held a number of senior positions in both financial services companies and other organisations. Until his retirement in 2011 he was, for over 10 years, a Partner in Mercer, the international consulting firm.

Peter holds a number of other non-executive positions including three other positions as Chairman of Audit and Risk Committees. He is a trustee of ABF The Soldiers' Charity.

Nigel Boothroyd

Non-Executive Director

Nigel joined the Society as a non-executive director in March 2019 and is a member of the Risk Committee and Audit & Compliance Committee.

He has significant executive-level experience within financial services, having spent some 38 years at HSBC Group. He has carried out a number of senior roles, with experience of Corporate and Commercial Banking; Credit Risk; Operational Risk; Retail Banking and Wealth Management. Nigel has served on a number of Executive and Risk Committees within the UK, Europe and North America. He was also the National Head of Corporate Banking with HSBC Canada between 2012 and 2015.

Nigel is currently the Chair of the Risk Committee at Redwood Bank and also chairs the Credit Committee at Reliance Bank.

Your Board of Directors

Sarah Howe

Chief Executive Officer

Sarah joined the Society in January 2019 from Saffron Building Society where she was an executive director.

With over 30 years' experience, Sarah has worked for market leading organisations in financial services and the retail home shopping sector. Sarah was the Chief Customer Officer at Saffron Building Society having joined them in 2013. Prior to that she was the Marketing Director for RIAS PLC (general insurance) and Chief Marketing Officer for Bupa where she worked for 10 years.

Sarah is currently the Independent Chair of the Openwork Client Panel, a post she has held since January 2017. The panel is advisory with focus on customer outcomes and providing recommendations to the board of Openwork Holdings Limited.

George McGrady

Finance Director

George joined the Society as Finance Director in May 2016 and joined the Board in January 2017.

George provides the Society with financial oversight and has been an active leader for the Society's strategic financial direction based on financial strength, sustainability and member value. His strong background means that he is also a key member of the leadership of the organisation.

He is a Chartered Accountant with a wealth of financial experience gained through extensive periods at a number of organisations including KPMG and, most recently, as Chief Financial Officer of Hornbuckle, the UK's largest independent pension administration provider. George has a strong background in the mutual sector having collectively spent 12 years with Nationwide and Lambeth building societies.

Jill Robinson

Non-Executive Director

Jill joined the Society as a non-executive director in September 2016 and is a member of the Risk Committee and the Audit & Compliance Committee.

She has gained considerable experience as Operations and Finance Director within large multi-national financial services companies and has a proven track record of transforming operations for the benefit of customers to align with corporate strategy.

Jill has held several senior roles including Transformation Director for Prudential plc, Head of Customer Service Delivery for Mercer and, more recently, Finance and Outsourcing Director dealing with the sale of Marine and General Mutual.

Paul Smith

Non-Executive Director

Paul joined the Society as a non-executive director in May 2011 and is the Chair of the Risk Committee. He is also a member of the Audit & Compliance Committee.

Paul has considerable non-executive experience within both the public sector and social housing sector including roles within the Department for Transport, HMRC, Ministry of Defence and the NHS.

Paul has significant experience from a finance career at Ford Motor Company including three years as Finance Director.

Directors' Report

The Directors have pleasure in presenting their 66th Annual Report and Accounts for the year ended 31 December 2018.

Business Review

The Society has performed well against a backdrop of uncertainty in the UK marketplace. The continued lack of clarity on Brexit, or more specifically the ongoing relationship of the UK with the EU after 29 March 2019, combined with a global slowdown and the increase in protectionist rhetoric and actions on trade tariffs, all create an environment that is expected to be challenging for the mortgage and savings market.

The Society has assessed the impact of Brexit together with the associated risks in order to ensure that it is well placed to operate effectively based on a range of scenarios; this includes the UK leaving the EU with no deal in place, commonly referred to as a "Hard Brexit". The Society continues to take a cautious approach to lending that provides protection in the event of a severe impact on the economy, whether through a reduction in activity, a sharp and sustained fall in house prices or an increase in interest rates placing pressure on affordability. In summary, the Board consider that the Society is well placed to withstand this impact.

The Society continues to focus on its core objective, namely, to provide a competitive mortgage range funded by retail savings, predominately through members local to our branch network. Despite the adverse conditions referenced above, this straight-forward strategy has helped us to grow the mortgage book by c.7.3% over the year.

Whilst the mortgage book has increased, the overall balance sheet has contracted by c.2.6% over the year, largely due to existing liquidity utilised to fund the book growth. We have previously noted that the Society has high levels of liquidity and we have continued to actively manage our liquidity levels downwards. Although liquidity still remains high, we envisage that during 2019 we will have substantially eliminated the excess liquidity on the Society's balance sheet.

The Bank of England's Bank Base Rate (BBR) increased to 0.75% in August 2018, however, the Society did not increase any mortgage or savings rates as a result. The Society assesses various factors when considering rate changes, one of which is the BBR, but other factors include competitive pressure, funding requirements, liquidity position, growth expectations and also balancing the competing needs of both mortgage and savings customers.

The Society aims to provide fair interest rates for both mortgage and savings customers. From a savings perspective, the Society's average interest rate continues to be in excess of Bank of England Base Rate and we consider our rates to be competitive in the marketplace. The Society monitors the market closely for interest rate changes amongst our key competitors' savings products.

The Chief Executive and other senior managers departed during the year which resulted in a period of significant change. David Jervis joined the business as the Society's interim Chief Executive and a number of other interim roles, covering risk, compliance and project management, were made. The strong financial results and mortgage book growth highlight that the business has responded well to the challenges this presented and a new Chief Executive, Sarah Howe, has now been appointed to lead the business forward.

Directors' Report (continued)

Key Performance Indicators

The Board and Executive monitor all aspects of the Society's financial performance on an ongoing basis. The key performance indicators (KPIs) used as measures are set out below and disclosed in more detail in the following pages:

Mortgage Asset Balances

2018	**£212.6m**
2017	£198.0m
2016	£201.0m
2015	£198.1m
2014	£189.4m

Total Assets

2018	**£306.6m**
2017	£314.7m
2016	£316.9m
2015	£307.3m
2014	£301.6m

Share Balances

2018	**£273.2m**
2017	£282.4m
2016	£285.6m
2015	£275.3m
2014	£267.5m

Liquid Assets as a Percentage of Shares and Borrowings

2018	**32.08%**
2017	38.97%
2016	38.13%
2015	36.85%
2014	38.50%

Profit After Tax as a Percentage of Mean Total Assets

2018	**0.51%**
2017	0.52%
2016	0.60%
2015	0.33%
2014	0.52%

Management Expenses as a Percentage of Mean Total Assets

2018	**1.82%**
2017	1.62%
2016	1.47%
2015	1.48%
2014	1.25%

Cost: Income Ratio

2018	**76.92%**
2017	70.38%
2016	66.82%
2015	74.78%
2014	65.67%

Capital

2018	**£27.8m**
2017	£25.7m
2016	£24.1m
2015	£22.2m
2014	£21.1m

Gross Capital as a percentage of Shares and Borrowings

2018	**9.99%**
2017	8.89%
2016	8.25%
2015	7.81%
2014	7.55%

Free Capital as a percentage of Shares and Borrowings

2018	**8.55%**
2017	7.68%
2016	7.04%
2015	6.56%
2014	6.22%

Customer Satisfaction Score

2018	**96.0%**
2017	94.5%
2016	92.0%
–	
–	

Staff Satisfaction Score (out of 5)

2018	**3.6**
2017	3.9
2016	3.8
2015	3.6
2014	3.3

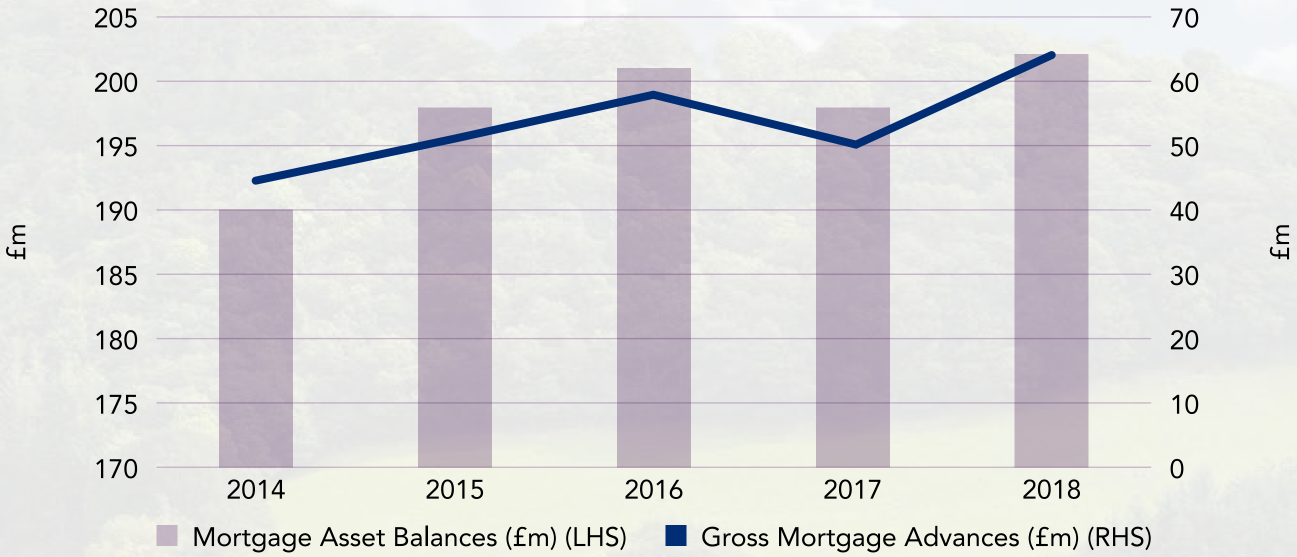
Directors' Report (continued)

Mortgage Asset Balances

The provision of mortgage finance for the purchase of owner-occupied residential property is the key objective for the Society. The Society continues to lead the way in finding pragmatic solutions to complex mortgage lending situations and has built a reputation for expertise and service excellence in this specialist part of the market. We continue to offer an individual approach to underwriting and take the time to understand borrower's circumstances and assess the affordability of each mortgage in a prudent and sensible manner.

During the year, £66.4m was advanced to new and existing borrowers (2017: £50.3m). Redemption levels were relatively consistent with 2017 and the combined effect resulted in mortgage balances increasing by £14.3m (2017: £3.0m decrease).

The increase is despite the managed reduction of the non-residential book, which fell in the year by a further £2.8m (2017: £2.8m). Excluding this impact, our core residential mortgage book size increased by c.7.5% on 2017.



At 31 December 2018, there were no mortgage accounts that were 12 months or more in arrears (2017: none). The Society had mortgage arrears balances greater than 3 months old at 31 December 2018 of 0.40% (2017: 0.32%), compared to a UK Finance industry average of 0.79% (2017: 0.84%). In addition, at 31 December 2018 the Society had no properties in possession (2017: none).

The Society may consider offering forbearance to mortgage borrowers who experience temporary payment difficulties as a result of serious illness, a change in employment circumstances or a significant life event. Arrangements considered include payment holidays, change in payment basis from repayment to interest only or amendment of the mortgage term. All arrangements are temporary and are regularly reviewed. At 31 December 2018, the Society offered such forbearance to four borrowers (2017: seven), representing a total mortgage balance of £0.3m (2017: £0.6m). Two of these cases were in arrears (2017: one), the value of arrears was £1k (2017: £1k) and the capital balance was £89k (2017: £26k).

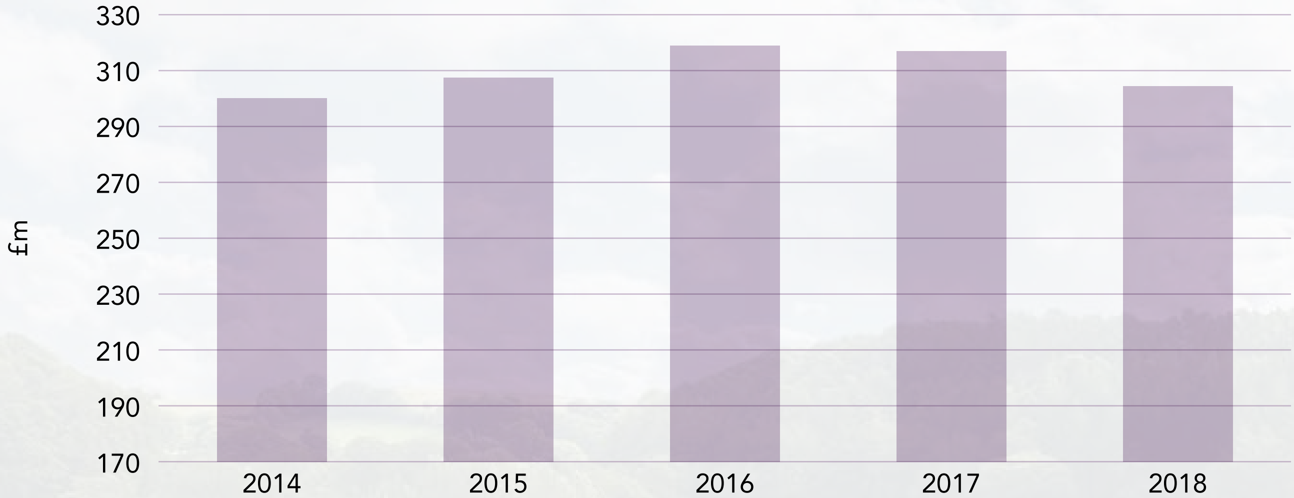
Individual provisions are made for loans and advances on a case-by-case basis to cover anticipated losses in respect of all accounts that have been identified as impaired. Anticipated losses on such accounts are calculated as the difference between the estimated current achievable market value of the security and the outstanding loan balance, after making appropriate allowance for costs. During the year, the one loan that was assessed under this approach was redeemed at "no loss" to the society, resulting in a £155k reduction in the impairment provision.

A collective mortgage provision is made against mortgage advances which have not been specifically identified as impaired but where general experience and market conditions may indicate that losses may ultimately be incurred. The collective provision reduced by £29k during 2018.

Directors' Report (continued)

Total Assets

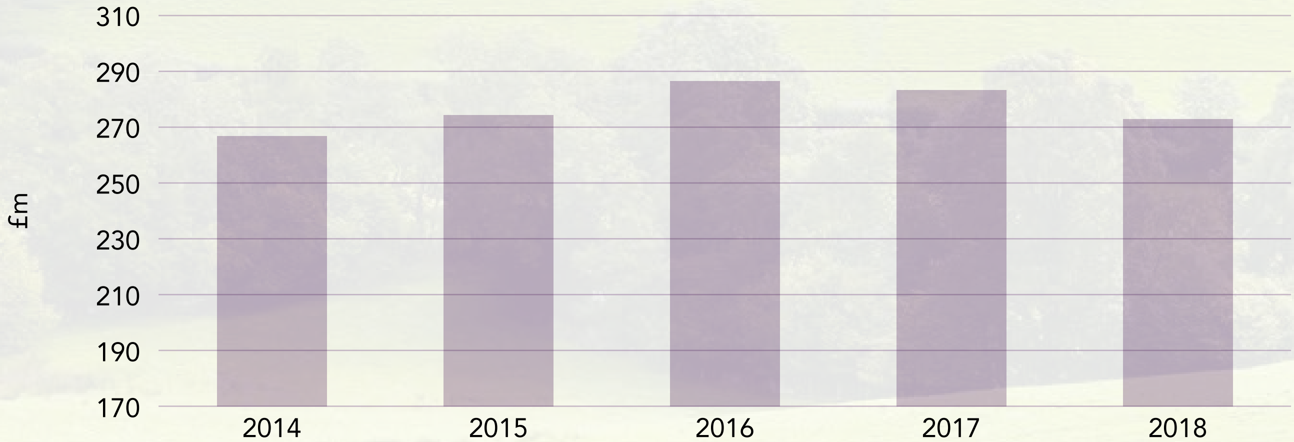
The Board considers that long term balance sheet growth, underpinned by increasing capital reserves improves the Society's strength and long term stability. However, the Board is cognisant that the Society has an elevated liquid asset position. Therefore in the short term, the Board recognises that the overall asset size can decrease without impacting the Society's long term objectives. In line with this, total assets decreased by £8.1m (2017: £2.2m decrease) to £306.6m (2017: £314.7m) at 31 December 2018, a decrease of 2.6% (2017: 0.7% decrease).



Share Balances

The Society strives to provide competitive interest rates in a sustained low interest rate environment. The Society elected to hold interest rates throughout 2018 and continues to maintain an average savings rate that is in excess of the current Bank of England's Base Rate.

The Society aims to maintain a stable and sustainable funding base that meets the Society's lending requirements through the provision of straight forward products that are consistently priced for all members. As noted above, the Society has historically held high levels of liquidity and this has been further managed down over the year through a combination of increased mortgage lending and a 3.3% reduction in share balances (2017: 1.1% decrease) to £273.2m at 31 December 2018 (2017: £282.4m).



Directors' Report (continued)

Liquid Assets as a Percentage of Shares and Borrowings

Liquidity ratios are monitored to ensure that they remain within Board approved limits and that adequate cash is held to meet liabilities as they fall due. In 2018, liquid assets reduced by £23.1m to £89.2m (2017: £112.3m) with the liquid asset ratio therefore decreasing to 32.08% (2017: 38.97%).

The Society considers it has had an elevated liquidity position over recent years. As such, action has been taken to address share inflows and reduce liquidity. These actions will continue into 2019 to reduce liquidity levels back to longer-term expectations.

Profit After Tax as a Percentage of Mean Total Assets

Accumulated profit after tax is the key source of additional capital for the Society and sufficient profit must be made to ensure its ongoing financial strength. The Society's overall margin and profitability are strong and ensure that future growth in lending can be supported.

Whilst the Society has been adversely impacted by the increase in costs during the year, the release in impairment provisions has largely offset this reduction with profit after tax broadly consistent with 2017. In aggregate, the impairment provisions have decreased by £184k to £283k.

At a more granular level, the decrease comprises a £155k reduction in the individual impairment provision due to the sale at "no loss" of the single loan with a specific provision held against it and a £29k net reduction in the collective provision. The reduction in the collective provision is based on an increase in the proportion represented by our residential book, partially offset by a reduction in the provision for the commercial lending portfolio, which at less than £5m, continues to reduce and perform in line with expectations. The increase in the residential collective impairment provision does not reflect a deterioration in credit quality, it is a result of book growth, current economic conditions and a view of the potential impact this exerts on the book.

Management Expenses as a Percentage of Mean Total Assets

This ratio measures how productively the assets of the Society are used. The ratio has increased during the year to 1.82% (2017: 1.62%). The increase is due to a combination of total assets reducing and the upward pressure on costs. The increase in costs reflects a combination of inflationary pressures, particularly with a significant element of management expenses relating to staff costs, as well as the increasing infrastructure, compliance and regulatory costs required by all regulated financial institutions. This an area that is expected to continue to be subjected to cost pressure. The Society has also incurred a significant increase in professional fees, particularly from the requirement to bring on board a number of interim professionals to support the business through its period of change.

Cost: Income Ratio

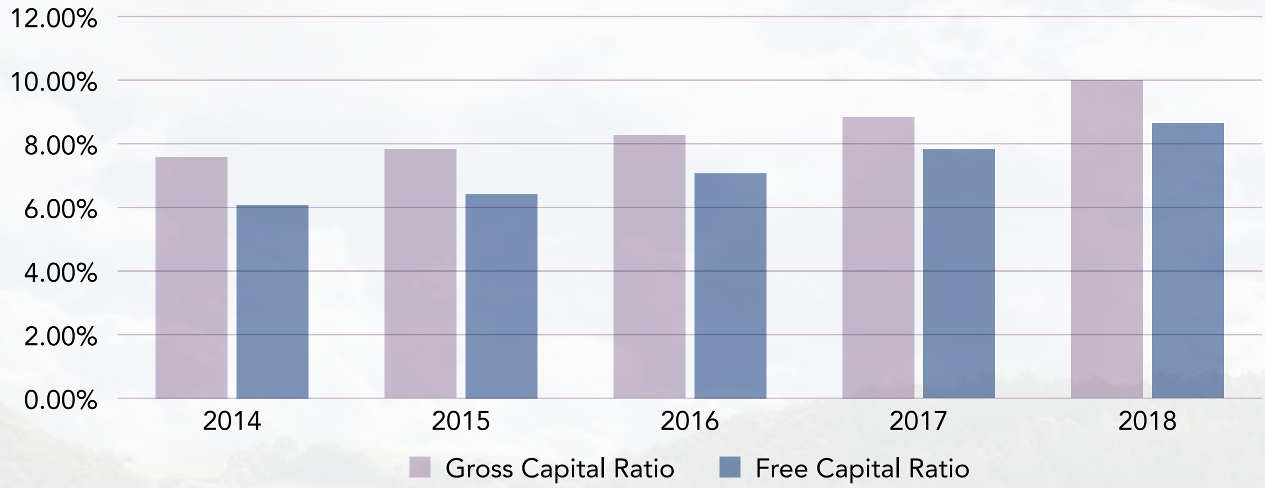
The cost to income ratio compares the operating costs within the business with the income that it generates and therefore it is a measure of how efficiently the Society utilises its resources. Similar to the previous measure the increase in the ratio to 76.92% (2017: 70.38%) is driven by the increase in management expenses, partially offset by an increase in net income driven by book growth and an increase in the interest margin.

Directors' Report (continued)

Capital

The Society generates capital to protect against risk and provide long-term security for members and the Gross and Free Capital ratios are monitored accordingly. These ratios are defined in the Annual Business Statement on page 31.

As a result of the profit after tax, the Society's capital ratios have increased in 2018, thereby improving the core financial stability of the Society.



Customer Satisfaction

We actively seek direct feedback from both our borrowers and savers and undertake regular monitoring of both our overall performance as well as a review of specific comments to continue to improve our service. The customer satisfaction score is a weighted average of our performance based on the percentage of all feedback from both borrowers and savers that rate our overall service as "good" or better. This measure has been in place since 2016 with a year-on-year improvement.

Staff Satisfaction

We value our staff's feedback and each year we conduct a Society wide survey for all staff to contribute their views on a wide range of areas with the overall staff satisfaction score representing a weighted average of the scores. We receive very high engagement as part of this process and the comments raised allow Senior Management to address any areas of concern or recommendations for improvement. After a period of increasing scores, 2018 has seen a reduction and follows a number of staff changes over the year with Senior Management actively engaging with staff to address the points highlighted.

Financial Risk Management Objectives and Policies

The Society has a formal structure for managing risk including establishing risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Board. Full details of the Society's approach to financial risk management and the key risks faced are given in note [26] to the accounts.

Principal Risks and Uncertainties

The Society has a formal risk management structure that includes its Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), policy statements, exposure limits, mandates and reporting lines together with an active and regular risk review process to mitigate risks.

Disclosure of the adequacy of the Society's capital, including Total Capital Requirement, is made in a document called Pillar 3 Disclosures. This document is available on our website; www.harpendenbs.co.uk. The principal risks and uncertainties arising from the Society's activities, and the Board approved policies and procedures put in place to manage them, are described below.

Directors' Report (continued)

Brexit Uncertainty

The Society is subject to the uncertainties resulting from the impact of the Brexit negotiations. This is covered in some detail within the Business Review on page 12 with the Society having assessed the potential impact this may have on the business. In summary, the Society considers that the credit risk impact of deteriorating economic conditions resulting in an increase in loan defaults and falling house price values is assessed as relatively low, due to the low indexed Loan-To-Values (LTVs) across the mortgage book. The key area of focus is therefore considered to be the impact on mortgage book growth in the short to medium term.

Credit Risk

The Society is exposed to credit risk in respect of either mortgage customers or money market counterparties being unable to meet their obligations as they fall due. All loan applications are assessed with reference to the Society's lending policy and lending mandates are strictly controlled. The Lending Policy is regularly reviewed by the Credit Committee and approved by the Risk Committee on an annual basis. The Society does not take a 'tick-box' approach to lending, rather, the Society ensures that the unique position and inherent risks of each application received are fully understood and assessed.

The Liquidity Policy includes limits on credit exposures to individual and groups of counterparties driven by credit ratings and an internal due diligence process. Whilst credit ratings can provide an indication of the creditworthiness of a counterparty, the Society supplements this information with market knowledge to generate a more complete view of its counterparties.

Liquidity Risk

Liquidity risk is the risk of being unable to meet demands and commitments to provide funds to customers and other third parties. 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 full public confidence in the solvency of the Society and to enable the Society to meet its financial obligations. This is achieved through maintaining a prudent level and sensible mix of liquid assets and through control of the growth of the business to provide flexibility in the management of liquidity. Stress tests are carried out regularly to confirm that the Society can withstand normal and abnormal cash outflows. The Liquidity Policy is regularly reviewed and approved by the Risk Committee.

Interest Rate Risk and Basis Risk

This is the risk of mismatches between the dates on which interest receivable on assets and interest payable on liabilities are reset to market rates. This also assesses the basis on which interest is payable and receivable, impacting on profitability and the value of the Society's assets and liabilities.

The Society manages this exposure continually by matching the maturity dates of assets and liabilities in line with its Financial Risk Management Policy, which is regularly reviewed and approved by the Board of Directors. A detailed analysis of the Society's interest rate sensitivity at both 31 December 2018 and 2017 can be found in note 26 on page 71.

Directors' Report (continued)

Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal processes or systems, human error or external events. The Society has controls in place which are designed to mitigate these risks. The Risk Committee is responsible for assessing the effectiveness of the risk management processes and the system of inspection and control.

Cyber Risk

This is the risk that a cyber attack results in financial loss, loss of data, business disruption or damage to the reputation of the Society due to the failure of its information technology systems.

Cyber risk is a key component of operational resilience and the Society has a Business Resilience Committee, which is as a sub-committee of the Executive Committee, to manage the threat of these risks. On a regular basis, the Business Resilience Committee reports its findings directly to the Risk Committee and the Board. The Society has employed specialist resources to monitor, test, maintain and continuously improve the effectiveness of the Society's cyber defences and operational resilience.

Conduct Risk

This is the risk arising from the Society's conduct in its direct relationship with retail customers such that the customer may be treated unfairly or that the Society may deliver an inappropriate outcome. Customer service and outcomes have always been at the heart of decision making and product design at the Society. The Society continues to develop its approach to ensure that products and services provide fair customer outcomes and operate as customers and members would expect.

Financial Services Compensation Scheme (FSCS) Risk

In common with all regulated UK deposit takers, the Society pays levies to the FSCS to enable claims to be met. The possibility therefore exists that the Society may be required to pay a higher level of levies if claims increase. A full explanation of this risk can be found in note 24 on page 61.

Directors' Report (continued)

Regulatory Risk

This is the risk that the volume and complexity of regulatory issues may impact the Society's ability to compete or the Society breaches a regulatory requirement. The Society has policies and procedures in place to ensure compliance with the regulations and the Board monitors regulatory changes to ensure the Society continues to meet all of its regulatory requirements.

Directors

The following persons were Directors of the Society during 2018:

S. J. Richardson (Chair)
C. D. Astley (resigned 14 May 2018)
P. F. Baynham
A. V. Crossley-Mintern (resigned 25 October 2018)
D. G. Jervis (Interim Chief Executive, appointed to the Board 25 October 2018, resigned 15 February 2019)
G. McGrady
J. Mortimer Sykes (Vice Chair and Senior Independent Director)
J. Robinson
P. V. Smith

Other Matters

Creditor Payment Policy

The Society's policy concerning the payment of its trade creditors is to pay in accordance with agreed terms where invoices are submitted for products or services which have conformed to requirements specified by the Society. Amounts due to the relevant creditors of the Society are paid on average within 21 days of receipt of invoice (2017: 14 days).

Charitable and Political Donations

The Society continues to operate the HBS Hertfordshire Community Foundation Trust. The balance in this fund at 31 December 2018 was £368k (2017: £438k). Additionally, funds in the HBS Charitable Trust, held at the Charities Aid Foundation to be used for the benefit of the community and local charities nominated by the Society totalled £63k as at 31 December 2018 (2017: £71k). During the year, £10k was donated through this foundation.

Charitable donations during the year amounted to £2k (2017: £2k). The incentive of charitable contribution of £1 for each member vote at the Annual General Meeting in April 2018 produced £1,746, (2017: £1,729) which was donated to The Alzheimer's Society.

The Directors confirm that no activities have been carried on during the year, which are outside the powers of the Society. No political donations have been made during 2018 (2017: £nil) which require disclosure under the Act.

Directors' Report (continued)

Events Since The Year End

There have been no post Balance Sheet events that would have a material effect on the financial position of the Society.

Going Concern

The Directors have prepared forecasts of the Society's capital, financial and liquidity position for the period ending 12 months from the date of approval of these financial statements. The Directors have also prepared forecasts to consider the effect on the Society's business, financial position, capital and liquidity of operating under stressed, but plausible, operating conditions with detailed assessments conducted as part of the Society's ICAAP and ILAAP reviews. This includes an assessment of the potential impact of Brexit on the Society's financial resources. The Directors are satisfied that the Society has adequate resources to continue in business for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the annual accounts.

Auditor

Our auditor, KPMG LLP, has expressed its willingness to continue in office and, in accordance with Section 77 of the Building Societies Act 1986, a resolution for its re-appointment will be proposed at the Annual General Meeting.

Country-by-country reporting

The country-by-country reporting requirements can be found in note 30 on page 73. The purpose of this reporting is to provide clarity on the source of the Society's income and the location of its operations.

Acknowledgements

The Directors wish to record their appreciation to the management and staff, as well as all our members, customers and professional partners for their continued support.

On behalf of the Board of Directors

Sarah Howe

Director and Chief Executive
14 March 2019

Corporate Governance Report

In April 2016 the Financial Reporting Council updated the UK Corporate Governance Code, which applies to companies listed on the London Stock Exchange. Whilst we are not required to follow the code, the Directors are committed to applying best practice in corporate governance. The Directors have therefore considered the codes recommendations and this report explains to members our approach to corporate governance.

Strategic Leadership

The Board

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

Board comment:
Your Board is committed to the principles of mutuality and good corporate governance. The Board meets regularly to review performance against strategic and operational objectives. In addition the Board has the following general responsibilities:

- providing overall leadership of the Society, including setting its culture and values
- managing the business of the Society
- determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives
- monitoring the key risks in the business model through appropriate Management Information
- oversight of governance, delegating responsibility to Board Committees, as it sees fit
- maintain proper accounting records which are established, documented and audited.

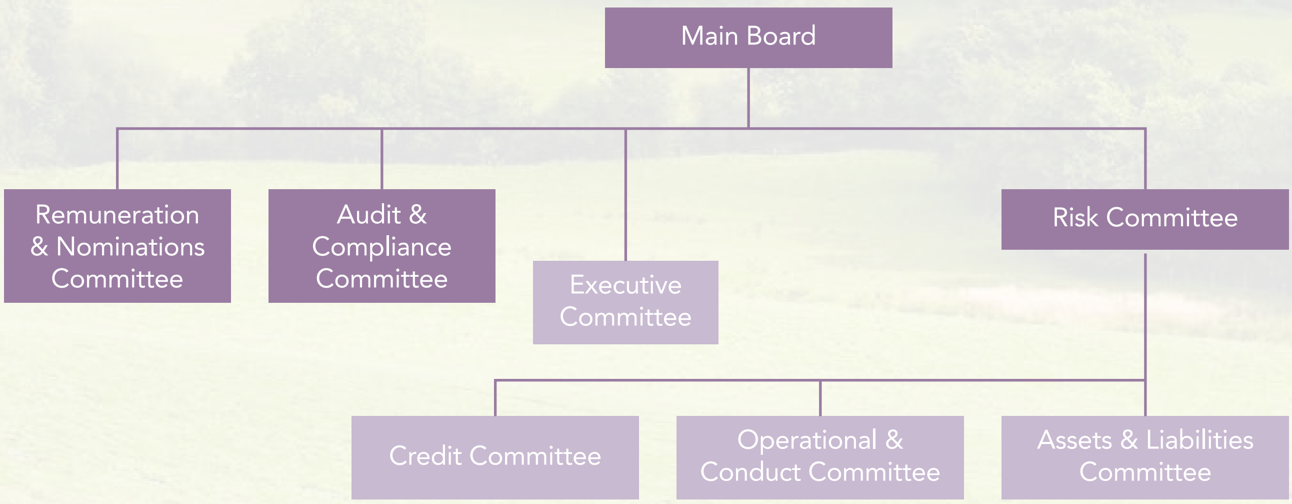
The Board establishes and monitors the high level principles and strategic aims of the Society and takes decisions on specific matters such as major investments and capital purchases. The Non-Executive Directors have the opportunity to meet without Executive Directors present. All Directors have an opportunity to meet without the Chair present at least once a year.

All Board members have the benefit of appropriate liability insurance at the Society's expense and have access to independent legal and other appropriate professional advice, if required.

The Board is effective because of its focus on strategy and risk management in an environment where constructive challenge is encouraged.

Board Committees

The Board of Directors now have three Committees (Risk, Audit & Compliance and Remunerations & Nominations) to help it discharge its duties at the reporting date:



Corporate Governance Report (continued)

The Executive, Credit Risk, Operational & Conduct Risk and Assets & Liabilities Committees are management committees and report to either the Board or Risk Committee.

The Board of Directors determines the responsibilities and composition of the Board Committees, which are authorised to make decisions within agreed parameters and/ or make recommendations to the full Board of Directors as appropriate.

The terms of reference for the following committees can be obtained by writing to the Secretary at the Society's Head Office.

Risk Committee

The committee is responsible for recommending to the Board the Society's risk appetite. It ensures that an appropriate risk management framework and underlying policies are in place and reviews the adequacy of the Society's risk reporting, including the Society's Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process.

It has oversight of the Society's Credit Risk, Operational & Conduct Risk and Assets & Liabilities Management Committees. Reports from the management committees are provided on a regular basis for review and action.

The Committee comprises four Non-Executive Directors and meets quarterly. The Chief Executive, Finance Director and Head of Risk & Compliance are normally invited to attend all, or part, of the meetings, but they are not members of the Committee.

Remuneration and Nominations Committee

This committee is responsible for recommending the appointment and remuneration of Non-Executive Directors as well as the appointment, terms of employment and remuneration of Executive Directors.

Directors' remuneration is benchmarked annually against peers both within and outside the building society sector and the local area, taking Society performance into account.

The Committee comprises three Non-Executive Directors and meets as required but at least twice a year. The Chief Executive and Finance Director are normally invited to attend, but they are not members of the Committee.

No member is involved in setting their own remuneration and the remuneration of all Directors is agreed by the full Board.

The Directors' Remuneration Report is included on page 30.

Audit and Compliance Committee

The committee is responsible for reviewing the integrity of financial statements, providing appropriate oversight of financial reporting, the effectiveness of internal controls and compliance. It considers and recommends the appointment of the internal and external auditors and monitors their effectiveness and independence.

The Committee comprises three non-executive Directors. The Chief Executive and Finance Director are normally invited to attend, but they are not members of the Committee.

It meets quarterly with both the Society's Internal and External Auditors in attendance.

Corporate Governance Report (continued)

Attendance of Board and Board Committees

All Directors make the necessary time commitment required to prepare for and attend the scheduled Board and Board Committee meetings. The table below shows the number of meetings each Director attended and the total number of meetings the Director was eligible to attend.

Board and Committee Attendance				
Name	**Board[1]**	**Risk**	**Remuneration & Nominations**	**Audit & Compliance**
S. J. Richardson	8 of 8*	-	3 of 3	-
C. D. Astley	2 of 3	-	-	-
P. F. Baynham	8 of 8	4 of 5	-	4 of 4*
A. V. Crossley-Mintern	7 of 7	-	3 of 3	-
D. G. Jervis	2 of 2	-	-	-
G. McGrady	7 of 8	-	-	-
J. Mortimer Sykes	8 of 8	5 of 5	3 of 3*	-
J. Robinson	8 of 8	5 of 5	-	4 of 4
P. V. Smith	7 of 8	5 of 5*	2 of 2	2 of 4

* Indicates Chair of Board / Committee as at reporting date
[1] Includes two Board Strategy and Development days

Division of Responsibilities

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

Board comment:
The offices of Chair and Chief Executive are distinct and held by different people. The role of each is set out in their letter of appointment or service agreement and job description.

The Chair is responsible for leading the Board, setting its agenda and ensuring its effectiveness. The Chief Executive is responsible for managing the Society's business within the parameters set by the Board.

Chair

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

Board comment:
The Chair and Vice Chair are elected by the Board annually. The Chair sets the direction and culture of the Board, facilitating effective contribution from Directors, maintaining constructive relations between Executive and Non-Executive Directors and ensuring that Directors receive accurate, timely and clear advice and information.

Corporate Governance Report (continued)

Non-Executive Directors

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

Board comment:
The Non-Executive role at the Society requires understanding of the risks in the business; commercial leadership within a framework of prudent and effective risk management controls; providing an independent perspective, monitoring performance and resources; and developing, scrutinising, and constructively challenging strategic proposals, whilst supporting the executive management.

Judith Mortimer Sykes has been appointed as the Board's Senior Independent Director (Judith is also the Vice Chair). As Senior Independent Director Judith leads the annual review of the Chair's performance.

Effectiveness

The Composition of the Board

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

Board comment:
The Board comprise of two Executives and six Non-Executive Directors, providing a balance of skills and experience appropriate for the requirements of the business.

All Non-Executive Directors are considered to be independent in character and judgement and free of any relationship or circumstance which are likely to affect, or could appear to affect, their judgement.

The Chair and Chief Executive are satisfied that the sound judgement and challenging approach of its independent Non-Executive Directors make a significant contribution to the Society.

Appointments to the Board

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

Board comment:
On an annual basis the Remuneration and Nominations Committee reviews the balance of skill, aptitude and experience on the Board against the requirements of the Society.

Following an evaluation of the role and capabilities required for a particular appointment, new appointees to the Board are made on merit and against objective criteria. Candidates for Non Executive Directorship are identified in a variety of ways, including inviting applications from members, through professional search, press and online advertisements.

Eligible members of the Society have the right under the Society's Rules to apply for election to the Board. All Directors must meet the regulatory fitness and propriety standards. The Remuneration & Nominations Committee leads the process, and recommends a candidate. The Board decides whether to appoint the candidate.

Each Director must be approved by the PRA, with consent from the FCA, in order to fulfil their control function as a Director.

Commitment

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

Board comment:
The Remuneration and Nominations Committee evaluates the ability of Directors to commit the time required for their role, prior to appointment. The formal appraisal process carried out by the Chair each year also assesses whether Directors have demonstrated this ability during the year. The attendance record during the year of Board and Committee members is set out on page 24.

Development

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

Board comment:
All new Directors undergo a formal and tailored induction prior to joining the Board. All training and development needs are reviewed annually.

Corporate Governance Report (continued)

Information and Support

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

Board comment:
The Chair ensures that the Board receives accurate, clear and timely information sufficient to enable it to discharge its responsibilities. Directors are provided with a performance pack of information by senior management. The Secretary provides support on corporate governance matters and the Board has access to independent advice if required.

Evaluation

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

Board comment:
The performance and effectiveness of the Board and its committees is evaluated annually. Directors are evaluated by the Chair, taking into account the views of other directors. The Chair's review is led by the Senior Independent Director and is evaluated by the full Board.

Re-election

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

Board comment:
The Rules of the Society require that all Directors are submitted for election at the Annual General Meeting (AGM) following their first appointment to the Board and all Directors are required to seek re-election at least every three years after first being elected. Any term lasting beyond nine years after election will be approved by the Board following due consideration and then only on the basis of annual re-election.

Accountability

Financial and Business Reporting

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

Board comment:
The responsibilities of the Directors in relation to the preparation of the Society's accounts and a statement that the Society's business is a going concern are included within the Directors' Report on pages 12 to 21.

The Audit and Compliance Committee considers a wider range of issues in relation to the financial statements. During the year, the Committee considered significant areas where management judgement and estimates were required during the preparation of these financial statements. These areas are considered on page 31.

Risk Management and Internal Control

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

Board comment:
The Board is responsible for determining strategies for risk management and control of the Society. Senior management are responsible for designing, operating and monitoring risk management and internal control processes. The Risk Committee, on behalf of the Board, is responsible for reviewing the adequacy of these processes.

The Society has a strong compliance culture which is embraced by all staff. The system of internal control includes physical controls, authorisation limits and segregation of duties. There is an ongoing process for identifying, evaluating and managing the risks faced by the Society.

The Board has ultimate responsibility for ensuring the effectiveness of the Society's systems of risk management and internal control. Following review by the Audit and Risk Committees, it is satisfied that the Society's systems are effective and meet the requirements of the Code as far as it is relevant.

Corporate Governance Report (continued)

Three Lines of Defence Model

The Society operates a three lines of defence model to manage risk and controls across the business.

1st Line of Defence	2nd Line of Defence	3rd Line of Defence		
Department	**Internal Risk/ External Compliance Support**	**Internal Audit**	**External Audit**	**Regulator**
Day to Day Risk management				
Departmental managers perform daily checks and monitoring on activities and functions for which they have direct responsibility.	The Risk & Compliance function develop, embed and maintain a robust risk framework. They provide the first line of defence with support, oversight and challenge of the Society's risks and monitor and report the related management information.	The Internal Audit function performs an independent objective and critical assessment of the design and effectiveness of the overall system of internal control, providing independent assurance for the Audit & Compliance Committee as to the effectiveness of both first and second lines of defence.		

1) **First Line of Defence**
The first line is operated by the Society's management team which, through the implementation of the Risk Management Framework, identifies, assesses, mitigates and monitors those risks to which the Society is exposed. The Society's Senior Management Team has day-to-day responsibility for the management and control of risk relating to their area of operation.

2) **Second Line of Defence**
The second line of defence is achieved through the Society's risk and compliance activities. These activities are undertaken by the Risk Team and Compliance Function. The second line provides the frameworks and support to enable risk and compliance to be managed in the first line, conducts monitoring to judge how effectively they are undertaking it, and helps ensure consistency of the measurement of risk.

3) **Third Line of Defence**
The third line defence is provided by Internal Audit. The Society's Internal Audit function is outsourced under specific terms of reference and provides independent objective assurance that these control processes and systems are appropriate and applied effectively.

Corporate Governance Report (continued)

Sitting outside the risk management processes of the first two lines of defence, its main roles are to ensure that the first two lines are operating effectively and to advise on how they could be improved.

Internal audit is directed by, and reports to, the Audit & Compliance Committee. It provides an evaluation, through a risk-based approach, on the effectiveness of governance, risk management, and internal control across the Society. It can also give assurance to the Society's regulators and external auditors that appropriate controls and processes are in place and are operating effectively.

Audit and Compliance Committee and Auditors

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

Board comment:
The Board has an Audit and Compliance Committee which comprises three Non-Executive Directors. Other Non-Executive Directors and members of management may attend meetings of the Committee at their discretion.

The Board is satisfied that all members of the Committee have recent and relevant financial experience, specifically P. V. Smith, P. F. Baynham and J. Robinson. This Committee reviews financial statements, the effectiveness of internal controls and the performance of both internal and external auditors and it meets at least four times a year.

The Committee excludes all executives from part of its meetings and the Committee meets periodically with only the External Auditor and only the Internal Auditors. Minutes of the Committee's meetings are distributed to all Board members and the Chair of the Committee reports to the Board at each subsequent meeting. The Committee considers the objectivity and independence of the External Auditor and decides the policy for non-audit fees.

Estimates and Judgements

During the year, the Committee considered significant areas where management judgement and estimates were required during the preparation of these financial statements. These areas are considered below.

In addition, the uncertainty resulting from the impact of Brexit has also been considered by the Committee.

Loan loss provisioning

The Society estimates the level of mortgage loss provision required based on historic default and loss experience. The Committee examined and challenged the assumptions included within the Society's provisioning model and is satisfied with the approach and level of provisions made for the year.

Effective Interest Rate

Interest income and expense are recognised in profit and loss using the effective interest method. This requires the Society to estimate the average lives of mortgage products and future cash flows. The Committee has examined the approach taken and is satisfied with the estimates modelled.

Financial Services Compensation Scheme Levy ('FSCS') and other provisions

The Society estimates the FSCS provision, and other provisions as appropriate, using information available at the reporting date. The Committee reviewed and challenged the estimates and assumptions made by management and is satisfied with the approach and levels of provisions included. The FSCS levy and other provisions are not considered significant.

Remuneration

The Directors' Remuneration Report on page 30 explains how the Society complies with the Codes Principles relating to remuneration.

Corporate Governance Report (continued)

Relations with members

Dialogue with Shareholders

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

Board comment:
As a mutual organisation, the Society's membership consists of individuals who are also the Society's customers. The Society is committed to open communication with customers and welcomes views at the Branches and online.

Constructive Use of the AGM

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

Board comment:
Each year the Society sends details of the AGM to all members who are eligible to vote. Members are sent voting forms and are encouraged to vote online, by post, by proxy or in person at the AGM.

All proxy votes are counted under independent scrutiny.

A poll is called in relation to each resolution at the AGM and all valid proxy votes cast (excluding abstentions) are included in the published results of voting.

All members of the Board are present at the AGM each year (unless their absence is unavoidable) and the Chairs of the Audit & Compliance, Risk and Remuneration & Nominations Committees are therefore available to answer questions.

On behalf of the Board of Directors

Stephen Richardson
Chairman
14 March 2019

Directors' Remuneration Report

The purpose of this report is to explain how the Society complies with the principles relating to remuneration in the UK Corporate Governance Code April 2016. The Society has adopted a Remuneration Policy, which describes how the Society complies with the FCA's Remuneration Code. The remuneration of the individual Directors is detailed in note 7 on page 52.

The Level and Components of Remuneration

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

Board comment:
The Remuneration Policy is designed to attract, retain and encourage high calibre executives to manage and develop business for the Society. Basic salaries are reviewed annually by reference to jobs carrying similar responsibilities in comparable organisations and in the light of market conditions generally.

Executive Director Emoluments

The remuneration for Executive Directors is detailed in note 7 on page 52. Total remuneration includes basic salary, performance related pay bonus, benefits and pension.

a) Basic Salary - takes into account duties, responsibilities, performance and levels for comparable positions in other organisations.

b) Bonus – the annual performance-related pay scheme is linked to the achievement of the Society's corporate objectives including member satisfaction, profitability, residential mortgage book growth and staff engagement. This is reviewed by the committee annually to ensure the measures are appropriate. The 2019 scheme will be enhanced to include an element of personal as well as corporate performance. The bonus payment is not pensionable and the scheme is designed to deliver a maximum award of 15% of basic salary. Payments may be reduced or withdrawn if the Board considers there is an item or event of material importance or relevance to have a significant influence on the regulatory status, financial performance or financial statements of the Society. The Society does not operate a long-term incentive scheme.

c) Pension - the Executive Directors have defined contribution pension plans, to which the Society and employee both contribute. The Society makes a contribution of 10% of salary.

d) Benefits – the Executive Directors are entitled to a car allowance, family private medical insurance and Death-in-Service at the rate of three times annual salary.

e) Contractual Terms - S. Howe is employed on a Service Contract dated 13 December 2018, terminable by the Society or by the individual on six months' notice. G. McGrady is employed on a Service Contract dated 3 January 2017, terminable by the Society or by the individual on six months' notice.

Non-Executive Director Emoluments

Fees are based on comparable data from similar financial service organisations and are reviewed annually. Non-executive Directors do not qualify for a pension or a bonus but do qualify for Death-in-Service benefit at the rate of three times annual fees. Performance of individual Directors is assessed by the Chair and their fellow Board members. The Chair is assessed by all members of the Board.

The Procedure for Determining Remuneration

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

Board comment:
The Remuneration and Nominations Committee reviews the Society's Remuneration Policy annually. The Committee consists of three Non-Executive Directors, one of whom chairs the Committee. The Executive Directors attend by invitation but take no part in the discussion of their own salary. The Committee reviews Directors' remuneration annually using data from comparable organisations, and takes advice from external consultants, when appropriate.

Judith Mortimer Sykes

Chair of Remuneration & Nominations Committee
14 March 2019

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

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 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 FRS 102 the *Financial Reporting Standard applicable in the UK and Republic of Ireland.*

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

In preparing 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 related 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 Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The Directors are responsible for such internal control as they determine is necessary to enable the preparation of annual accounts 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 Harpenden Building Society

KPMG

1. Our opinion is unmodified

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

In our opinion the annual report:

- give a true and fair view of the state of the Society's affairs as at 31 December 2018 and of the Society's profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and
- have been prepared in accordance with the requirements of the Building Society Act 1986 and the regulations made under it.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were first appointed as auditor by the members in April 2011. The period of total uninterrupted engagement is for the eight financial years ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Society in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

£68k (2017: £90k) **4% (2017: 4%) of Profit before tax**	
Materiality: Society annual accounts as a whole	£68k (2017:£90k) 4% (2017: 4%) of Society Profit before tax
Key audit matters vs 2017	▲
Other matter The impact of uncertainties due to Britain exiting the European Union on our audit	◀▶
Recurring risks Impairment of loans and advances to customers Interest receivable on loans and advances to customers – effective interest rate adjustment	◀▶

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

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

Independent Auditor's Report to the Members of Harpenden Building Society (continued)

Key Audit Matter	The Risk	Our Response
The impact of uncertainties due to Britain exiting the European Union on our audit Refer to page 18 (principal risks), page 6 (Chair's Statement), page 12 (Business Review) and page 21 (Going Concern).	**Unprecedented levels of uncertainty** All audits assess and challenge the reasonableness of estimates, in particular as described in **impairment of loans and advances to customers, interest receivable on loans and advances to customers – effective interest rate adjustment**, and related disclosures and the appropriateness of the going concern basis of preparation of the annual accounts. All of these depend on assessments of the future economic environment and the Society's future prospects and performance. Brexit is one of the most significant 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 impairment of loans and advances to customers, interest receivable on loans and advances to customers – effective interest rate adjustment, and other areas that depend on forecasts, we compared the directors' sensitivity analysis to our assessment of the worst reasonably possible, known adverse scenario resulting from Brexit uncertainty and, where forecasts cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty; and • **Assessing transparency** – As well as assessing individual disclosures as part of our procedures on impairment of loans and advances to customers, interest receivable on loans and advances to customers – effective interest rate adjustment we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. **Our results:** As reported under impairment of loans and advances to customers, and interest receivable on loans and advances to customers – effective interest rate adjustment, we found the resulting estimates and related disclosures of sensitivity and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a Society and this is particularly the case in relation to Brexit.

Independent Auditor's Report to the Members of Harpenden Building Society (continued)

Key Audit Matter	The Risk	Our Response
Impairment of loans and advances to customers (£284k; 2017: £468k) Refer to page 45 (accounting policy) and page 57 (financial disclosures).	**Subjective Estimate:** The impairment provision relating to the Society's loan portfolio requires the directors to make significant judgements and estimates in order to determine incurred losses on loans and advances to customers. In making these judgements and estimates the directors have considered both the Society specific historical data as well as their experience and knowledge of their current mortgage book. Impairment provisions are assessed on an individual and collective basis. Individual impairment The directors judge individual impairments by reference to loans that have current or historical arrears, or are subject to forbearance flagging. The Society has determined that as a result of this assessment no individual impairment is required. Collective impairment For the purposes of the collective impairment assessment, due to the Society's limited loss experience, the Society leverages off external data to support its calculation. This includes the calculation of the probability of default ('PD') and loss given default ('LGD'). The external data is adjusted for current conditions specific to the Society. There is a risk that the collective impairment provision is not reflective of the incurred losses at the end of the period due to the time that it takes for incurred losses to emerge, changes in customer credit quality or other market factors not sufficiently incorporated into the judgement, such as house prices.	As the Society had no loans assessed on an individual basis, our procedures included: • **Test of detail:** For a sample of specific loans identified based on risk characteristics of current or historical arrears, forbearance and loan type we evaluated whether they have been adequately provided for. This included loans which were previously individually assessed. • For loans assessed on a collective basis, our procedures included: • **External data:** We critically assessed the reasonableness of the external data used by the Society, along with any adjustments made by management to reflect current conditions specific to the Society; • **Benchmarking assumptions:** We compared the Society's key assumptions, e.g. forced sales discounts against those of comparable lenders to assess both the level of impairment provision in comparison to industry norms and the continuing appropriateness of the assumptions used; • **Sensitivity analysis:** We performed sensitivity analysis over the Society's key assumptions on PDs; forced sales discounts, selling costs and time to sell to help us assess the reasonableness of the assumptions used; • **Test of detail:** We agreed the key data inputs in the model to the mortgage data system and external data reports; • **Independent re-performance:** We checked the mathematical accuracy of the collective impairment model through re-performance of the model calculations; and • **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 impairment of loans and advances to customers to be acceptable (2017: acceptable)

Independent Auditor's Report to the Members of Harpenden Building Society (continued)

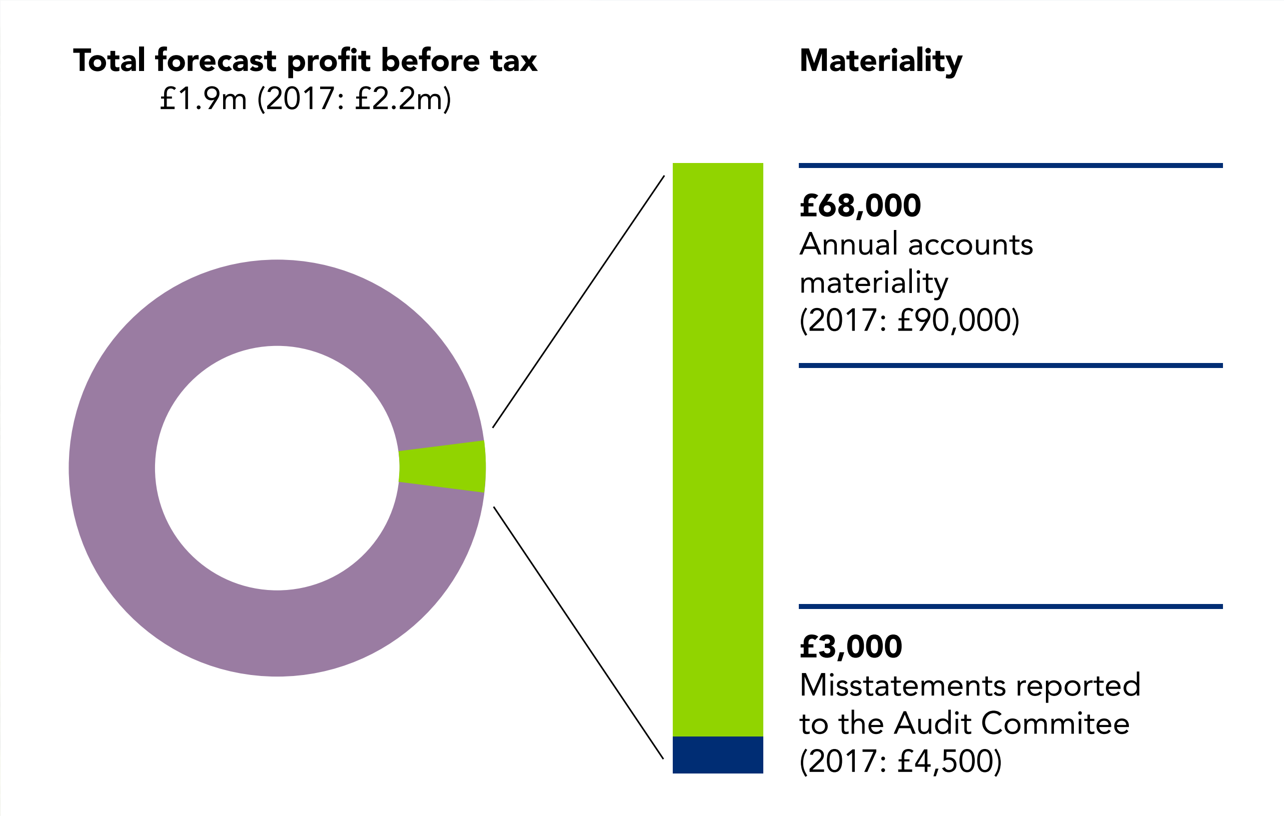
Key Audit Matter	The Risk	Our Response
Interest receivable on loans and advances to customers – effective interest rate adjustment (Balance sheet liability £434k; 2017: £532k) Refer to page 44 and 49 (accounting policy) and page 56 (financial disclosures).	**Subjective Estimate:** Accounting standards require interest receivable on loans and advances to customers to be recognised using the effective interest rate ('EIR') method. This results in all directly attributable interest, fees and costs being recognised on an even yield basis over the expected life of the loans. The recognition of interest receivable on loans and advances to customers under the effective interest rate method requires the directors to make significant judgements and estimates, with the most critical estimate being the loans' expected behavioural life. The directors have determined this estimate with reference to historical customer behaviour and, where applicable, management judgement. In addition, the directors apply judgement in determining whether or not fees and costs, including early redemption charges, should be included in the methodology.	Our procedures included: • **Historical comparison:** We assessed the reasonableness of the Society's behavioural life assumptions against actual customer behaviour; • **Test of detail:** We assessed the treatment of directly attributable fees and costs included in the effective interest rate against the requirements of the accounting standard; • **Independent re-performance:** We checked the mathematical accuracy of the EIR model through re-performance of the model calculations; • **Data capture:** We performed sample testing to assess the completeness and accuracy of the data inputs into the EIR model; • **Sensitivity analysis:** We assessed the model for its sensitivities to changes in the key assumptions by considering alternative behavioural lives to help us assess the criticality of the assumptions used and identify areas for potential audit focus; and • **Assessing transparency:** We assessed the adequacy of the Society's disclosures about the degree of estimation involved in arriving at the interest income on loans and advances to customers under the EIR method recognised. **Our results:** • We found the resulting estimate of interest income on loans and advances to customers recognised under the EIR method to be acceptable (2017: acceptable).

Independent Auditor's Report to the Members of Harpenden 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 £68,000 (2017: £90,000), determined with reference to a benchmark of the Society's profit before tax of £1.9million (2017: £2.2million), of which it represents 4.00% (2017: 4.00%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £3,000 (2017: £4,500), 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 Harpenden.



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.

Independent Auditor's Report to the Members of Harpenden Building Society (continued)

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

As these were risks that could potentially cast significant doubt on the Society's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Society's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the directors consider they would take to improve the position should the risks materialise.

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

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

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

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

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

Annual Business Statement and Directors' Report

In our opinion:

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

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

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

- adequate accounting records have not been kept by the Society; 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 Harpenden Building Society (continued)

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 31, the directors are responsible for: the preparation of the annual accounts including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error; assessing the Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

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

Irregularities – ability to detect

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

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

Secondly, the Society is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the annual accounts, for instance through the imposition of fines or litigation or the loss of the Society's licence to operate. We identified the following areas as those most likely to have such an effect: regulatory capital and liquidity and certain aspects of building society legislation recognising the financial and regulated nature of the Society's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and inspection of regulatory and legal correspondence, if any.

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

Independent Auditor's Report to the Members of Harpenden Building Society (continued)

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

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

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

Simon Clark
(Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants
One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH
14 March 2019

Statement of Comprehensive Income

for the year ended 31 December 2018

	Notes	2018 £000	2017 £000
Interest receivable and similar income	2	**9,748**	9,780
Interest payable and similar charges	3	**(2,602)**	(2,701)
Net interest income		**7,146**	7,079
Fee and commissions receivable		**265**	231
Fees and commissions payable		**(231)**	(191)
Other operating income	4	**159**	168
Total net income		**7,339**	7,287
Administrative expenses	5	**(5,460)**	(4,916)
Depreciation and amortisation	16, 17	**(185)**	(211)
Operating profit before impairments and provisions		**1,694**	2,160
Impairment (losses)/gains on loans and advances	14	**184**	(148)
Provisions for liabilities	24	**37**	14
Profit before tax		**1,915**	2,026
Tax expense	8	**(341)**	(402)
Profit for the financial year		**1,574**	1,624
Other comprehensive income			
Revaluation of property, plant and equipment	16	**589**	-
Movement in related deferred tax	23	**(266)**	-
Total comprehensive income for the year		**1,897**	1,624

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

The notes to these Accounts can be found on pages 44 to 73.

Statement of Financial Position

at 31 December 2018

	Notes	2018 £000	2017 £000
Assets			
Liquid assets			
Cash and balances at the Bank of England	9	**55,046**	59,726
Treasury bills and similar securities	10	**-**	-
Loans and advances to credit institutions	11	**17,081**	23,022
Debt securities	12	**17,069**	29,568
Loans and advances to customers			
Loans fully secured on residential property	13	**207,784**	192,775
Other loans	13	**4,769**	5,178
Investments			
Participating interests	15	**163**	194
Property, Plant and Equipment	16	**4,240**	3,764
Intangible assets	17	**36**	42
Deferred tax asset	23	**-**	4
Other debtors	18	**481**	426
Total assets		**306,669**	314,699
Liabilities			
Shares	19	**273,233**	282,446
Amounts owed to credit institutions	20	**11**	11
Amounts owed to other customers	21	**4,781**	5,760
Other liabilities	22	**462**	442
Deferred tax	23	**237**	-
Accruals and deferred income		**344**	279
Provisions for liabilities	24	**16**	73
Total liabilities		**279,084**	289,011
Reserves			
General reserve	25	**25,865**	24,291
Revaluation reserve	25	**1,720**	1,397
Total reserves attributable to members of the Society		**27,585**	25,688
Total reserves and liabilities		**306,669**	314,699

The accounting policies and notes to these Accounts can be found on pages 44 to 73.

These accounts were approved by the Board of Directors on 14 March 2019 and signed on its behalf:

Stephen Richardson
Chair

Sarah Howe
Chief Executive

George McGrady
Finance Director

Statement of Changes in Members' Interests

	General reserve 2018 £000	Revaluation reserve 2018 £000	Total 2018 £000
Balance at 1 January 2018	**24,291**	**1,397**	**25,688**
Total comprehensive income for the year			
Profit for the financial year	**1,574**	**-**	**1,574**
Other comprehensive income (see note 25)	**-**	**323**	**323**
Total comprehensive income for the year	**1,574**	**323**	**1,897**
Balance at 31 December 2018	**25,865**	**1,720**	**27,585**

	General reserve 2017 £000	Revaluation reserve 2017 £000	Total 2017 £000
Balance at 1 January 2017	22,667	1,397	24,064
Total comprehensive income for the year			
Profit for the financial year	1,624	-	1,624
Other comprehensive income (see note 25)	-	-	-
Total comprehensive income for the year	1,624	-	1,624
Balance at 31 December 2017	24,291	1,397	25,688

Cash Flow Statement

	Notes	2018 £000	2017 £000
Cash flows from operating activities			
Profit before tax		**1,915**	2,026
Adjustments for			
Impairment on loans and advances		**(185)**	147
Depreciation and amortisation	16, 17	**185**	211
Total		**1,915**	2,384
Changes in operating assets and liabilities			
(Decrease)/increase in prepayments, accrued income and other assets		**(58)**	130
Increase in accruals, deferred income and other liabilities		**11**	7
(Increase)/decrease in loans and advances to customers		**(14,530)**	2,928
Decrease in shares		**(9,213)**	(3,178)
Decrease in amounts owed to other credit institutions and other customers		**(979)**	(618)
Decrease/(increase) in loans and advances to credit institutions		**5,000**	(2,000)
Increase in Depreciation balance in relation to revaluation		**143**	-
Taxation paid		**(346)**	(402)
Net cash (used in)/generated by operating activities		**(19,972)**	(3,133)
Cash flows from investing activities			
Purchase of financial fixed assets		**(22,490)**	(33,500)
Proceeds from sale of financial fixed assets		**34,990**	52,997
Purchase of tangible fixed assets		**(38)**	(163)
Purchase of intangible assets		**(28)**	(19)
Net cash generated by investing activities		**12,434**	19,315
Net (decrease)/increase in cash and cash equivalents		**(5,623)**	18,566
Cash and cash equivalents at 1 January		**65,721**	47,155
Cash and cash equivalents at 31 December		**60,098**	65,721

Reconciliation of cash balances:	2017 £000	Movement £000	2018 £000
Loans and advances to credit institutions repayable on demand	5,995	(943)	**5,052**
Cash and balances at the Bank of England	59,726	(4,680)	**55,046**
Total cash	65,721	(5,623)	**60,098**

The notes to these Accounts can be found on pages 44 to 73.

Notes to the Accounts

(forming part of the annual accounts)

1. Accounting policies

1.1 Measurement Convention

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

Harpenden Building Society (the "Society") has prepared these annual accounts under the historical cost convention as modified by the revaluation of freehold property. The annual accounts are prepared in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 and Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland ("FRS 102"). Harpenden Building Society (the "Society") has prepared these annual accounts under the historical cost convention as modified by the revaluation of freehold property. The presentation currency of these annual accounts is sterling. All amounts in the annual accounts have been rounded to the nearest £1,000.

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

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

1.2 Liquid Assets

Loans and advances to credit institutions are stated at cost to the Society adjusted for interest accrued at the date of purchase. A similar adjustment is made on realisation. Treasury bills and debt securities are intended for use on a continuing basis and are classified as financial fixed assets and are stated at cost, adjusted for accrued interest at the date of purchase, where applicable. A similar adjustment is made on realisation. Any premium or discount on purchase is amortised on an effective interest rate basis over the period to maturity. Where there is a permanent diminution in value of a financial fixed asset a provision is made to write down the cost of the security to its recoverable amount.

1.3 Interest

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

The calculation of the effective interest rate includes transaction costs, fee income and commission expense that are paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the issue of a financial asset.

Interest income and expense presented in the income statement and other comprehensive income include interest on financial assets measured at amortised cost calculated on an effective interest basis.

1.4 Fees and Commission

Fees and commissions associated with a mortgage that are directly incremental are recognised using the effective interest rate. All other fees are recognised as incurred.

1.5 Expenses

Operating lease

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

Notes to the Accounts (continued)

1.6 Taxation

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

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

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those they are included in the financial statements.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

1.7 Financial instruments

The Society has chosen to apply the provisions of FRS 102 sections 11 and 12 in full.

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.

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 arrangement and booking fees, which are recognised over the average life of mortgage assets, as noted above.

Throughout the year and at each year end, the mortgage life assumptions for each product 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.

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 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)

Financial liabilities

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

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

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

Identification and measurement of impairment

At each reporting date, the Society assesses whether there is objective evidence that financial assets measured at amortised cost are impaired. A financial asset or a group of financial assets is 'impaired' when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired includes:

- significant financial difficulty of the borrower or issuer;
- default or delinquency by a borrower;
- the restructuring of a loan or advance by the Society on terms that the Society would not otherwise consider;
- indications that a borrower or issuer will enter bankruptcy;
- the disappearance of an active market for a security; or
- observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

The Society considers evidence of impairment for assets carried at amortised cost at both an individual asset and a collective level. All individually significant assets are assessed for individual impairment. Those found not to be individually impaired are then collectively assessed for any impairment that has been incurred but not yet identified.

In assessing collective impairment, the Society uses statistical modelling of internal and external information to assess the probability of default, and the amount of loss likely to be incurred and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater than the model suggests. 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.

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.

Notes to the Accounts (continued)

Forbearance strategies and renegotiated loans

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

- Temporary switch from a repayment loan to an interest only loan, and
- Reduced monthly payments.

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

Loans that are subject to restructuring may only be classified as restructured and up-to-date once a specified number and/or amount of qualifying payments have been received. These qualifying payments are set at a level appropriate to the nature of the loan and the customer's ability to make the repayment going forward. Loans that have been restructured and would otherwise have been past due or impaired are classified as renegotiated.

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

Derecognition

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

On derecognition of the financial asset, the difference between the carrying amount of the asset (or carrying amount allocated to the portion of the asset derecognised) and the sum of i). the consideration received (including any new asset obtained less any new liability assumed) and ii). any cumulative gain or loss that had been recognised in profit or loss. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Society is recognised as a separate asset or liability.

The Society enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred asset is not derecognised. Examples of such transactions are securities lending and sale and repurchase transactions.

1.8 Cash and cash equivalents

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

The Statement of Cash Flows has been prepared using the indirect method.

Notes to the Accounts (continued)

1.9 Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses. Freehold property assets are stated at fair value less subsequent accumulated depreciation.

Leases in which the entity assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. All other leases are classified as operating leases.

Depreciation is charged to the profit and loss account on either a straight-line or reducing balance basis over the assets estimated useful life. Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives are as follows:

- Freehold premises - over fifty years on a straight line basis
- Lease hold premises - over the life of the lease on a straight line basis
- Computer equipment - over three years on a straight line basis; and
- Office equipment - 15% a year on a reducing balance basis

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

Revaluation gains/losses

Freehold property assets are stated at fair value less any subsequent accumulated depreciation and impairment losses. Gains or losses on revaluation are recognised in other comprehensive income and accumulated in the revaluation reserve.

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

1.10 Intangible assets

Intangible assets that are acquired by the Society are stated at cost less accumulated amortisation and impairment losses.

Amortisation is charged to the profit and loss on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

- Software - 3 years

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

1.11 Employee benefits

Defined contribution plans and other long term employee benefits

The Society offers its employees a defined contribution pension plan. A defined contribution plan is a post-employment benefit plan under which the Society pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. These payments into the plan are recognised as an expense in the profit and loss account in the periods during which services are rendered by employees.

Termination benefits

Termination benefits are recognised as an expense when the entity is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date.

1.12 Provisions

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

1.13 Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2018 are set out below in relation to the impairment of financial instruments.

Impairment losses on loans and advances

The Society holds provisions for impairment losses against loans on an individual and collective basis. The level of impairment requires a significant degree of judgement and estimation. Provisions are calculated using the historic loss experience of the Society as well as external indicators, however a number of assumptions are required such as realisable values and customer behaviour.

The most critical estimation is of the level of house prices where a reduction of 10% impacts the provision by £260k. Other sensitivities include a forced sale discount increase of 10% which equates to £192k, and the emergence period, where an increase of six months equates to £17k.

Effective interest rate

The calculation of an effective interest rate requires the Society to make assumptions about the expected average lives of mortgages. Interest income is a mortised over the expected average life, so if the average life of the mortgage book increased by 6 months then the carrying value of mortgages would change by £23k with a corresponding change to income.

Notes to the Accounts (continued)

2. Interest receivable and similar income

	2018 £000	2017 £000
On loans fully secured on residential property	**8,794**	8,945
On other loans	**275**	331
On debt securities	**203**	224
On other liquid assets	**476**	280
	9,748	9,780

3. Interest payable and similar charges

	2018 £000	2017 £000
On shares held by individuals	**2,602**	2,695
On deposits and other borrowings	**-**	6
	2,602	2,701

4. Other operating income

	2018 £000	2017 £000
Rents receivable	**156**	165
Other operating income / (expense)	**3**	3
	159	168

Notes to the Accounts (continued)

5. Administrative expenses

	2018	2017
	£000	£000
Wages and salaries	**2,486**	2,203
Social security costs	**246**	224
Contributions to defined contribution plans	**333**	289
	3,065	2,716
Other administrative expenses	**2,395**	2,200
	5,460	4,916

The remuneration of the External Auditor, which is included within other administrative expenses above, is set out below (excluding VAT):

Other administrative expenses	**2018**	2017
Auditor's remuneration	**£000**	£000
Audit of these annual accounts	**65**	63
Other services related to taxation	**-**	-
All other services	**-**	-
	65	63

6. Employee numbers

The average number of persons employed by the Society during the year was as follows:

	2018	**2018**	2017	2017
	Full-time	**Part-time**	Full-time	Part-time
Head Office	**37**	**4**	36	4
Branch Offices	**9**	**19**	8	18
	46	**23**	44	22

The aggregate costs of these persons are shown in note 5.

Notes to the Accounts (continued)

7. Directors' remuneration

The total emoluments for both Executive and Non-Executive Directors for the year amounted to £488,527 (2017: £521,067).

2018	Salaries	Bonus	Benefits	Pension Contributions	Total
	£000	**£000**	**£000**	**£000**	**£000**
C.D. Astley (Chief Executive)	**56**	**-**	**4**	**6**	**66**
G. McGrady (Finance Director)	**133**	**15**	**13**	**13**	**174**
	189	**15**	**17**	**19**	**240**

Mr C.D. Astley resigned from the Board on 14 May 2018, with additional contractual payments paid to him during the year of £94k until leaving the business on 13 November 2018. Mr D.G. Jervis was appointed to the Board on 25 October 2018 and received fees of £56k for the period until 31 December 2018. Mr D.G. Jervis also received fees prior to his appointment to the Board as interim Chief Executive, amounting to £88k.

2017	Salaries	Bonus	Benefits	Pension Contributions	Total
	£000	£000	£000	£000	£000
C.D. Astley (Chief Executive)	150	15	7	15	187
G. McGrady (Finance Director)	120	12	6	12	150
	270	27	13	27	337

Non-Executive Director Emoluments (comprising fees only):

	2018	2017
	£000	£000
S.J. Richardson	**45**	39
J. Mortimer Sykes	**32**	32
P.F. Baynham	**34**	26
A.V. Crossley-Mintern	**22**	26
J. Robinson	**26**	26
P.V. Smith	**32**	32
	191	181

As at 31 December 2018, there were no outstanding mortgage loans granted in the ordinary course of business to Directors and connected persons (2017: Nil) representing loans to nil (2017: Nil) persons. A register is maintained at the Head Office of the Society, under Section 68 of the Building Societies Act 1986, which shows details of all loans, transactions and arrangements with Directors and connected persons. A statement for the current financial year of the appropriate details contained in the register will be available for inspection at the Head Office for a period of 15 days up to, and including the date of the Annual General Meeting.

Notes to the Accounts (continued)

8. Taxation

Total tax expense recognised in the profit and loss account, other comprehensive income and equity.

	2018 £000	2017 £000
Current tax		
Current tax on income for the period	**369**	386
Adjustments in respect of prior periods	**(3)**	-
Total current tax	**366**	386
Deferred tax		
Origination and reversal of timing differences	**(4)**	16
Change in tax rate	**(21)**	
Total deferred tax	**(25)**	16
Total tax	**341**	402

Reconciliation of effective tax rate	2018 £000	2017 £000
Profit for the year	**1,574**	1,624
Total tax expense	**341**	402
Profit excluding taxation	**1,915**	2,026
Tax using the UK corporation tax rate of 19.00% (2017: 19.25%)	**364**	390
Fixed asset differences	**-**	15
Adjustments to tax charge in respect of previous periods	**-**	1
Non-deductible expenses	**(23)**	(4)
Total tax expense included in profit or loss	**341**	402

Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) were substantively enacted on 26 October 2015. Further reductions to 18% (effective 1 April 2020) were substantively enacted on 26 October 2015. This will reduce the company's future current tax charge accordingly. The deferred tax asset at 31 December 2018 has been calculated based on these rates.

Notes to the Accounts (continued)

9. Cash and cash equivalents

	2018 £000	2017 £000
Cash and balances at the Bank of England	**55,046**	59,726
Loans and advances to credit institutions	**5,052**	5,995
As at 31 December	**60,098**	65,721

10. Treasury bills

	2018 £000	2017 £000
Treasury bills have remaining maturities as follows:		
Accrued interest	**-**	-
In not more than three months	**-**	-
	-	-

The Directors of the Society consider that the primary purpose of holding such securities is prudential. The securities are held as liquid assets with the intention of use on a continuing basis in the Society's activities and are therefore classified as financial fixed assets rather than current assets.

Movement during the year of treasury bills held as financial fixed assets are analysed as follows (excluding accrued interest):

	2018 £000	2017 £000
As at 1 January	**-**	5,990
Additions	**3,490**	-
Maturities	**(3,490)**	(5,990)
As at 31 December	**-**	-

Notes to the Accounts (continued)

11. Loans and advances to credit institutions

	2018 £000	2017 £000
Accrued interest	**29**	27
Repayable on demand	**5,052**	5,995
Other loans and advances by residual maturity repayable:		
In not more than three months	**1,000**	5,000
In more than three months but not more than one year	**11,000**	12,000
Total loans and advances to credit institutions	**17,081**	23,022

12. Debt securities

	2018 £000	2017 £000
Issued by public bodies	**-**	-
Issued by other borrowers	**17,069**	29,568
	17,069	29,568

Debt securities have remaining maturities as follows:

	2018	2017
Accrued interest	**69**	68
In not more than three months	**4,000**	4,000
In not more than one year	**13,000**	25,500
In more than one year	**-**	-
Total loans and advances to credit institutions	**17,069**	29,568

All the above are unlisted transferable debt securities.

The Directors of the Society consider that the primary purpose of holding such securities is prudential. The securities are held as liquid assets with the intention of use on a continuing basis in the Society's activities and are therefore classified as financial fixed assets rather than current assets.

Movement during the year of debt securities held as financial fixed assets are analysed as follows (excluding accrued interest):

	2018 £000	2017 £000
As at 1 January	**29,500**	43,007
Additions	**19,000**	33,500
Maturities	**(31,500)**	(47,007)
As at 31 December	**17,000**	29,500

Notes to the Accounts (continued)

13. Loans and advances to customers

	2018 £000	2017 £000
Loans fully secured on residential property	**207,784**	192,775
Loans fully secured on land	**4,769**	5,178
	212,553	**197,953**

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

	2018 £000	2017 £000
On call and at short notice	**61**	1,884
In not more than three months	**5,565**	1,535
In more than three months but not more than one year	**16,853**	18,098
In more than one year but not more than five years	**54,890**	53,700
In more than five years	**135,902**	123,736
	213,271	198,953
Less: allowance for impairment (note 14)	**(284)**	(468)
Less: effective interest rate adjustment	**(434)**	(532)
	212,553	197,953

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

Notes to the Accounts (continued)

14. Allowance for impairment

	Loans fully secured on residential property	Other loans fully secured on land	Total
	£000	£000	£000
At 1 January 2018			
Individual impairment	155	-	155
Collective impairment	169	144	313
	324	144	468
Income statement			
Charge/(credit) for the year			
Individual impairment	(155)	-	(155)
Collective impairment	96	(126)	(30)
	(59)	(126)	(185)
At 31 December 2018			
Individual impairment	-	-	-
Collective impairment	265	18	283
	265	18	283

15. Investments

The Society holds directly the following interest in Mutual Vision Technologies Limited a company registered in England and operating in the United Kingdom, originally formed by a consortium of Building Societies to acquire the trade of their existing computer software supplier. This company has a 31 December year end. On 31 December, the Society's investment, which is a participating interest, was represented by:

	2018	2017
	£000	£000
Shares in participating interest	8	8
Loans to participating interest	155	186
At 31 December	163	194

The shares are fully paid Ordinary Shares and represent a 14.9% interest (2017: 14.9%).

Notes to the Accounts (continued)

16. Tangible fixed assets

	Freehold land and buildings	Short leasehold buildings	Office & computer equipment	Total
	£000	**£000**	**£000**	**£000**
Cost or valuation				
Balance at 1 January 2018	3,580	120	846	**4,546**
Additions	-	-	38	**38**
Disposals	-	-	-	**-**
Revaluation	375	-	-	**375**
Balance at 31 December 2018	**3,955**	**120**	**884**	**4,959**
Depreciation and impairment				
Balance at 1 January 2018	143	70	569	**782**
Depreciation charge for the year	71	5	75	**151**
Disposals	-	-	-	**-**
Revaluation adjustment	(214)	-	-	**(214)**
Balance at 31 December 2018	**0**	**75**	**644**	**719**
Net book value				
At 1 January 2018	3,437	50	277	**3,764**
At 31 December 2018	**3,955**	**45**	**240**	**4,240**

Freehold land and buildings were independently and professionally valued by McNeill Lowe & Palmer, Chartered Surveyor, on an existing use basis as at December 2018. This Valuation was £3,955,000 compared to a previous net book value of £3,437,000. The surveyor has valued the properties using the comparative method, taking account other commercial sales and lettings in their respective areas. As part of this assessment, the surveyor has assumed that, in the present market, a yield of 7% is appropriate. The carrying value of the freehold land and buildings on a historical cost method is £2,120,000 as at December 2018.

17. Intangible assets

	Software	Total
	£000	**£000**
Cost		
Balance at 1 January 2018	272	**272**
Additions	28	**28**
Balance at 31 December 2018	**300**	**300**
Depreciation and impairment		
Balance at 1 January 2018	230	**230**
Depreciation charge for the year	34	**34**
Balance at 31 December 2018	**264**	**264**
Net book value		
At 1 January 2018	42	**42**
At 31 December 2018	**36**	**36**

Notes to the Accounts (continued)

18. Other debtors

	2018 £000	2017 £000
Trade debtors	**2**	2
Prepayments and accrued income	**479**	424
	481	426

There are no prepayments and accrued income that are due after more than one year (2017: £nil).

19. Shares

	2018 £000	2017 £000
Held by individuals	**273,233**	282,446

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

	2018 £000	2017 £000
Accrued interest	**576**	610
On demand	**247,587**	257,613
In not more than three months	**1,051**	722
In more than three months but not more than one year	**3,224**	2,610
In more than one year but not more than five years	**14,424**	12,197
In more than five years	**6,371**	8,694
	273,233	282,446

20. Amounts owed to credit institutions

	2018 £000	2017 £000
Repayable on demand	**11**	11

Notes to the Accounts (continued)

21. Amounts owed to other customers

	2018 £000	2017 £000
Accrued interest	-	-
Repayable on demand	4,781	5,760
With agreed maturity dates or periods of notice		
In not more than three months	-	-
In more than three months but not more than one year	-	-
	4,781	5,760

22. Other liabilities

	2018 £000	2017 £000
Income tax	-	-
Corporation tax	204	184
Other creditors	258	258
	462	442

23. Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	2018 £000	2017 £000
Accelerated capital allowances	50	88
Short term timing differences	(79)	(92)
Other	266	-
Net tax liabilities/(assets)	237	(4)

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. The recognition of the deferred tax asset is dependent upon the projection of future taxable profits and future reversals of existing taxable temporary differences.

The deferred tax asset has arisen due to temporary factors rather than a permanent decline in earnings.

During 2018, the Society identified that deferred tax had not previously been provided on revaluation gains on Land and Buildings. Included above is an amount of £166k, which is in respect of deferred tax on the revaluation during 2015. The directors do not consider this to be a material item in the context of the general reserve and have therefore made the adjustment in other comprehensive income in the current year in line with the current year revaluation.

Notes to the Accounts (continued)

24. Provisions for liabilities

	FSCS £000	Customer Claims £000	Total £000
Balance at 1 January 2018	53	20	73
Paid in year	(12)	(8)	(20)
Income and Expenditure account:			
Decrease in provision	(37)	-	(37)
Balance at 31 December 2018	**4**	**12**	**16**

Financial Services Compensation Scheme

In common with all regulated UK deposit takers, the Society pays levies to the FSCS to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. The FSCS meets these claims by way of loans received from HM Treasury.

Customer Claims

This relates to a provision for potential regulatory claims.

25. Reserves

	General reserve 2018 £000	Revaluation reserve 2018 £000	Total 2018 £000
At 1 January	24,291	1,397	25,688
Profit for the financial year	1,574	323	1,897
At 31 December	**25,865**	**1,720**	**27,585**

26. 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 to 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 of Directors.

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

The Society does not currently use any derivative financial instruments, since the Society does not currently offer any capped or fixed rate mortgage or savings products that would give rise to a balance sheet exposure. The Society does not participate in any financial instruments for trading or speculative purposes. The Society 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.

Categories of financial assets and liabilities

Financial assets and liabilities are measured on an on-going basis at amortised cost. Note 1.7 ‘Financial instruments’ describes how the classes of financial instruments are measured, and how income and expenses are recognised. The tables below analyse the Society’s assets and liabilities by financial classification:

Notes to the Accounts (continued)

26. Financial instruments (continued)

Carrying values by category 31 December 2018	**Loans and receivables £000**	**Financial assets and liabilities at amortised cost £000**	**Other non-financial assets £000**	**Total £000**
Financial assets				
Cash and balances at the Bank of England	55,046	-	-	55,046
Loans and advances to credit institutions	17,081	-	-	17,081
Treasury bills and similar securities	-	-	-	-
Debt securities	-	17,069	-	17,069
Loans and advances to customers	212,553	-	-	212,553
Investment loans	163	-	-	163
Total financial assets	**284,843**	**17,069**	**-**	**301,912**
Non-financial assets	-	-	4,757	4,757
Total assets	**284,843**	**17,069**	**4,757**	**306,673**
Financial liabilities				
Shares	-	273,233	-	273,233
Amounts owed to credit institutions	-	11	-	11
Amounts owed to other customers	-	4,781	-	4,781
Total financial assets	**-**	**278,025**	**-**	**278,025**
Non-financial assets	-	-	1,059	1,059
Total liabilities	**-**	**278,025**	**1,059**	**279,084**

Carrying values by category 31 December 2017	**Loans and receivables £000**	**Financial assets and liabilities at amortised cost £000**	**Other non-financial assets £000**	**Total £000**
Financial assets				
Cash and balances at the Bank of England	59,726	-	-	59,726
Loans and advances to credit institutions	23,022	-	-	23,022
Treasury bills and similar securities	-	-	-	-
Debt securities	-	29,568	-	29,568
Loans and advances to customers	197,953	-	-	197,953
Investment loans	194	-	-	194
Total financial assets	**280,895**	**29,568**	**-**	**310,463**
Non-financial assets	-	-	4,236	4,236
Total assets	**280,895**	**29,568**	**4,236**	**314,699**
Financial liabilities				
Shares	-	282,446	-	282,446
Amounts owed to credit institutions	-	11	-	11
Amounts owed to other customers	-	5,760	-	5,760
Total financial assets	**-**	**288,217**	**-**	**288,217**
Non-financial assets	-	-	794	794
Total liabilities	**-**	**288,217**	**794**	**289,011**

At the year end, the Society has loan commitments of £21,570k (2017: £22,833k) measured at cost.

Notes to the Accounts (continued)

26. Financial instruments (continued)

Financial assets pledged as collateral

As at 31 December 2018 no assets had been pledged as collateral (2017: £nil).

Credit risk

'Credit risk' is the risk that a financial loss will arise from a borrower or counterparty failing to meet their obligations. This risk arises from the Society's lending and treasury management activities.

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 of Directors.

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

Credit risk

	2018	2017
	£000	£000
Cash and balances at the Bank of England	**55,046**	59,726
Loans and advances to credit institutions	**17,081**	23,022
Treasury bills and similar securities	**-**	-
Debt securities	**17,069**	29,568
Loans and advances to customers	**213,271**	198,953
Investment loans	**163**	194
Total statement of financial position exposure	**302,630**	311,463
Off-balance sheet exposure - mortgage commitments	**21,570**	22,833
	324,200	334,296

Details on collateral held as security that mitigate the Society's exposure to credit risk are provided on page 67. The Society does not use credit derivatives, or similar instruments, to manage its credit risk.

The Society offers a range of mortgage products tailored to the needs and demands of our customers. The concentration of loans and advances to customers is detailed in the table below:

	2018	2017
	£000	£000
Prime owner-occupied	**146,414**	128,438
Buy to let	**21,186**	25,564
Land	**4,788**	5,023
Other loans and advances to customers	**40,883**	39,928
Total loans and advances to customers	**213,271**	198,953

Notes to the Accounts (continued)

26. Financial instruments (continued)

Credit risk (continued)

Credit quality analysis of loans and advances to customers

The tables below set out information about the credit quality of financial assets and the allowance for impairment/loss held by the Society against those assets.

	2018	**2018**	**2018**	2017	2017	2017
	Loans fully secured on residential property	**Loans fully secured on land**	**Total**	Loans fully secured on residential property	Loans fully secured on land	Total
	£000	**£000**	**£000**	£000	£000	£000
Neither past due nor impaired	**206,229**	**4,553**	**210,782**	190,464	3,924	194,388
Past due but not impaired						
30 - 60 days	**661**	**235**	**896**	571	453	1,024
60 - 90 days	**306**	**-**	**306**	995	506	1,501
90 - 180 days	**799**	**-**	**799**	767	92	859
180 days+	**54**	**-**	**54**	176	325	501
	1,820	**235**	**2,055**	2,509	1,376	3,885
Individually impaired						
60 - 90 days	**-**	**-**	**-**	-	-	-
	-	**-**	**-**	-	-	-
Allowance for impairment						
Individual	**-**	**-**	**-**	-	-	-
Collective	**265**	**19**	**284**	198	122	320
Total allowance for impairment	**265**	**19**	**284**	198	122	320
Total loans & advances to customers including impairment	**207,784**	**4,769**	**212,553**	192,775	5,178	197,953

Notes to the Accounts (continued)

26. Financial instruments (continued)

Credit risk (continued)

Credit quality analysis of loans and advances to customers (continued)

Collateral held and other credit enhancements

The Society holds collateral to reduce credit exposures. The table below sets out the principal types of collateral held.

	2018	2017	Principal type of collateral held
	%	%	
Percentage of exposure that is subject to collateral requirements	**100**	100	Property

Individual assessments are made on all mortgage loans where objective evidence indicates that losses are likely (for example when loans are past due) or the property is in possession. Further consideration is given in note 1.7 to the accounts.

The Society's policy is to pursue timely realisation of the collateral in an orderly manner. The Society does not use the non-cash collateral for its own operations.

Loan-to-value ratios of mortgage book loans and advances to customers

The table below details credit exposures from mortgage loans and advances to customers by loan-to-value (LTV) ratios. LTV is calculated as the ratio of the gross amount of the loan to the value of the asset (collateral).

The valuation of the collateral excludes any adjustments for obtaining and selling the asset and also excludes any impairment allowance and EIR adjustments. The collateral value is based on the original value of the asset when the loan was issued and is subsequently indexed using the Nationwide House Price Index.

	2018	2017
	£000	£000
LTV ratio		
Less than 50%	**147,019**	151,325
50% < 70%	**50,156**	42,077
70% < 90%	**15,987**	5,442
90% < 100%	**-**	-
More than 100%	**109**	109
Total loans and advances to customers (gross of impairments and EIR adjustments)	**213,271**	198,953

Notes to the Accounts (continued)

26. Financial instruments (continued)

Credit risk (continued)

Forbearance

A range of forbearance options are available to support customers who are in financial difficulty. For further information on forbearance please refer to note 1.7. The table below analyses the number of mortgage borrowers with renegotiated terms at the year-end date:

	2018	2017
Forbearance		
Short-term conversion from repayment loan to interest only loan	**1**	1
Short-term reduced monthly repayment plan	**3**	6
	4	7

There are no individual impairment provisions held in respect of these mortgages at 31 December 2018 (2017: £nil).

Concentration risk

The tables below show the relative concentrations of the Society's treasury portfolio.

Concentration by credit grading	**2018 £000**	2017 £000
AAA	**-**	-
AA+ to AA-	**63,454**	76,067
A+ to A-	**12,609**	18,146
Building societies	**13,022**	18,017
Other	**114**	89
	89,199	112,319

Concentration by sector	**2018 £000**	2017 £000
Financial institutions	**34,252**	52,665
Supranational institutions	**-**	-
Sovereign	**54,947**	59,654
	87,199	112,319

Concentration by region	**2018 £000**	2017 £000
UK	**85,175**	101,289
Europe (excluding UK)	**2,014**	8,009
North America	**2,010**	3,021
Supranational	**-**	-
	89,199	112,319

Notes to the Accounts (continued)

26. Financial instruments (continued)

Liquidity risk

Interest rate risk

This is the risk of mismatches between the dates on which interest receivable on assets and interest payable on liabilities are reset to market rates. The Society manages this exposure continually by matching the maturity dates of assets and liabilities in line with its Financial Risk Management Policy.

Maturity analysis for financial assets and financial liabilities

The tables below set out the remaining contractual maturities of the Society's financial liabilities and financial assets. In practice, contractual maturities are not always reflected in actual experience. For example loans and advances to customers tend to repay ahead of contractual maturity and customer deposits (for example shares) are likely to be repaid later than on the earliest date on which repayment can be required.

As at 31 December 2018	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
	£000	£000	£000	£000	£000	£000
Financial assets						
Cash and balances at the Bank of England	55,046	-	-	-	-	55,046
Loans and advances to credit institutions	5,052	1,000	11,000	-	-	17,052
Debt securities	-	4,000	13,000	-	-	17,000
Treasury bills and similar securities	-	-	-	-	-	-
Loans and advances to customers	61	5,565	16,853	54,890	135,902	213,271
Investment loans	-	-	-	-	163	163
Total financial assets	**60,159**	**10,565**	**40,853**	**54,890**	**136,065**	**302,532**
Financial liabilities						
Shares	247,587	1,051	3,224	14,424	6,371	272,657
Amounts owed to credit institutions	11	-	-	-	-	11
Amounts owed to other customers	4,781	-	-	-	-	4,781
Total financial liabilities	**252,379**	**1,051**	**3,224**	**14,424**	**6,371**	**277,449**

Notes to the Accounts (continued)

26. Financial instruments (continued)

Liquidity risk (continued)

As at 31 December 2017

	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
	£000	£000	£000	£000	£000	£000
Financial assets						
Cash and balances at the Bank of England	59,726	-	-	-	-	59,726
Loans and advances to credit institutions	5,995	5,000	12,000	-	-	22,995
Debt securities	-	4,000	25,500	-	-	29,500
Treasury bills and similar securities	-	-	-	-	-	-
Loans and advances to customers	1,884	1,535	18,098	53,700	123,736	198,953
Investment loans	-	-	-	-	194	194
Total financial assets	67,605	10,535	55,598	53,700	123,930	311,368
Financial liabilities						
Shares	257,613	722	2,610	12,197	8,694	281,836
Amounts owed to credit institutions	11	-	-	-	-	11
Amounts owed to other customers	5,760	-	-	-	-	5,760
Total financial liabilities	263,384	722	2,610	12,197	8,694	287,607

The tables below sets out maturity analysis for financial liabilities that shows the remaining contractual maturities at undiscounted amounts. The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates, for the average period until maturity on the amounts outstanding at the statement of financial position date.

As at 31 December 2018	**On demand**	**Not more than three months**	**More than three months but not more than one year**	**More than one year but not more than five years**	**More than five years**	**Total**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Financial liabilities						
Shares	247,587	1,051	3,226	14,663	8,099	274,626
Amounts owed to credit institutions	11	-	-	-	-	11
Amounts owed to other customers	4,781	-	-	-	-	4,781
Total financial liabilities	**252,379**	**1,051**	**3,226**	**14,663**	**8,099**	**279,418**

Notes to the Accounts (continued)

26. Financial instruments (continued)

Liquidity risk (continued)

As at 31 December 2017

	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
	£000	£000	£000	£000	£000	£000
Financial liabilities						
Shares	257,613	722	2,612	12,399	11,052	284,398
Amounts owed to credit institutions	11	-	-	-	-	11
Amounts owed to other customers	5,760	52	76	-	-	5,888
Total financial liabilities	**263,384**	**774**	**2,688**	**12,399**	**11,052**	**290,297**

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 not directly subject to currency risk as all products are sterling denominated. The Society's products are also only interest orientated products so are not exposed to other pricing risks.

Interest rate risk is managed through policies and procedures the Society has in place. The Assets & Liabilities Committee is responsible for overseeing and setting the counterparty credit, market, liquidity and interest rate risk.

The Society's treasury function manages interest rate risk on a daily basis and ensures the Society has appropriate liquid assets and spread of maturities over time buckets to effectively manage risk.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Society's financial assets and financial liabilities to interest rate scenarios. The following is an analysis of the sensitivity to an increase or decrease in market interest rates, assuming no asymmetrical movement in yield curves and a constant financial position.

Notes to the Accounts (continued)

26. Financial instruments (continued)

Market risk (continued)

	2018 100bp parallel increase £000	2018 100bp parallel decrease £000	2017 100bp parallel increase £000	2017 100bp parallel decrease £000
Sensitivity of projected net interest income				
At 31 December	(87)	88	(165)	168
Average for the period	(124)	126	(137)	139
Maximum for the period	(177)	181	(178)	181
Minimum for the period	(87)	88	(96)	97

The Society only deals with products in sterling so is not directly affected by currency risk. The Society's products are also only interest orientated products so are not exposed to other pricing risks.

Capital management

The purpose of the Society's capital is to protect members from any losses that may arise from lending activities of the Society. The Board sets the internal level of capital with the aim of ensuring Society capital always exceeds the minimum regulatory requirements.

As part of the Society's formal risk management framework, capital management is covered by the Internal Capital Adequacy Assessment Process (ICAAP). This is used to assess the Society's capital adequacy and to determine the levels of capital required to support current and future risks.

The below table sets out the Society's capital.

	2018 £000	2017 £000
Common Equity Tier 1 capital		
General reserve	25,865	24,291
Revaluation reserve	1,720	1,397
Intangible assets	(36)	(42)
Common Equity Tier 1 capital	27,549	25,646
Tier 2 capital		
Collective provision	283	312
Total capital	27,832	25,958

Notes to the Accounts (continued)

27. Operating leases

As at 31 December the Society had annual commitments in respect of non-cancellable operating leases for land and buildings as follows:

	2018 £000	2017 £000
Not later than one year	24	32
Later than one year and not later than five years	29	29
Later than five years	-	-
	53	61

During the year £60k lease payments were recognised as an expense (2017: £60k).

28. Related party transactions

Mutual Vision Technologies Limited ('MVT')

The Society is a shareholder of MVT, the Society's computer software provider, as detailed in note 15 on page 57. Under the terms of the shareholder agreement the Society is permitted to appoint an individual to represent the Society on the Board of MVT and, consequently, Carl Astley was the Society's representative as a non-executive director of MVT during the first half of the year.

During the year, a total of £222,809 (2017: 200,428) was paid to MVT in respect of software maintenance services.

At 31 December 2018 there are no related party liabilities (2017: £nil).

The loan due from MVT, as detailed in note 15, bears interest at Bank of England base rate plus 1%, subject to a minimum rate of 1.5%, and is credited to the Society annually. In 2018 this interest totalled £2,600 (2017: £2,795). There is no fixed maturity date for this loan. The Society holds no security on any assets of MVT in respect of this loan.

Transactions with key management personnel

The Society considers its key management personnel to be its directors.

Mortgage loans made to key management personnel were granted in the ordinary course of business and are subject to repayment under normal lending terms. The maximum outstanding balance during the year was (£Nil) 2017: (£200,021).

Key management personnel hold £3,629 in share accounts with the Society (2017: £9,577). Amounts deposited by key management personnel earn interest at the same rates offered to the public.

Notes to the Accounts (continued)

29. Post Balance Sheet events

There are no subsequent events to the balance sheet date.

30. Country-by-country reporting

Article 89 of CRD IV requires the Society to disclose the following information for the year ended 31 December 2018.

Name: Harpenden Building Society

Type of entity: Building Society

Nature of activity: Secured lending and deposit taking

Location: United Kingdom

Turnover: £9.7m (interest receivable and similar income), £7.1 m (total net income)

Profit before tax: £1,915k

Tax paid: £341k

Public subsidies received: £nil

Number of employees: 59 FTE

Annual Business Statement

for the year ended 31 December 2018

1. Statutory percentages

	31.12.2018	Statutory Limit
Proportion of business assets not in the form of loans fully secured on residential property ("The Lending Limit")	**2.20%**	25%
Proportion of shares and borrowings not in the form of shares held by individuals ("The Funding Limit")	**1.72%**	50%

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 total assets of the Society plus provisions for bad and doubtful debts less liquid assets and tangible 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 as at 31 December 2018.

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

X = shares and borrowings, being the aggregate of

i) the principal value of, and interest accrued on, shares in the Society;

ii) the principal value of, and interest accrued on, sums deposited with the Society; and

iii) the principal value of, and interest accrued under, bills of exchange, instruments or agreements creating or acknowledging indebtedness and accepted , made, issued or entered into by the Society less any amounts qualifying as own funds.

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 as at 31 December 2018.

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.

Annual Business Statement (continued)

2. Other percentages

	2018	2017
As percentage of shares and borrowings:		
Gross capital	**9.99%**	8.89%
Free capital	**8.55%**	7.68%
Liquid assets	**32.08%**	38.97%

	2018	2017
As percentage of mean total assets:		
Profit for the financial year	**0.51%**	0.52%
Management expenses	**1.82%**	1.62%

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 aggregate of general reserves and revaluation reserve.
- 'Free capital' represents the aggregate of gross capital and general loss provisions for bad and doubtful debts less tangible fixed assets.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Liquid assets' represent the total of cash and balances at The Bank of England, loans and advances to credit institutions, treasury bills and debt securities.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

3. Information relating to the Directors at 31 December 2018

Name and Year of Birth	Date of Appointment and Committee Membership	Business Occupation	Other Directorships
C.D. Astley 1975 (Resigned from role in May 2018)	21 January 2010	Building Society Executive	Mutual Vision Technologies Limited (Resigned on 13th June 2018)
P.F. Baynham 1953	27 November 2014 Audit & Compliance and Risk Committees	Non Executive Director	Baynham Consulting Associates Limited North Norfolk Housing Company Limited Swan Housing Association Swan Housing Capital PLC The Association of Independent Professionals and the Self Employed Limited Victory Housing Trust Berwick Court Management Limited Coroscoba Limited Cygne Limited
A.V. Crossley-Mintern 1963 (Resigned from role in October 2018)	29 January 2015 Remuneration & Nominations Committee	Executive Director, Financial Services	Celebrity Blue Limited BGL Group Limited
D.G. Jervis 1964	25 October 2018	Consultant	Acclaim Business Solutions Ltd
G McGrady 1967	1 January 2017	Building Society Executive	
J. Mortimer Sykes 1957	27 October 2011 Risk and Remuneration & Nominations Committees	Non Executive Director	The ExtraCare Charitable Trust
S.J. Richardson 1953	30 January 2014 Remuneration & Nominations Committee	Non Executive Director	Bethrob Limited i-Financial Services Group plc LCP Solutions Limited Lend and Borrow Trust Company Limited Goodholm Finance Limited
J. Robinson 1953	1 September 2016 Audit & Compliance and Risk Committees	Non Executive Director	Age UK Enterprises
P.V. Smith 1957	26 May 2011 Audit & Compliance and Risk Committees	Non Executive Director	Herts Valley Clinical Commissioning Group Defence Equipment & Support, Ministry of Defence

Annual Business Statement (continued)

Documents may be served on the above named Directors: Ref. "Harpenden Building Society", c/o, Neves Solicitors at Tollgate House, 69-71 High Street, Harpenden, Hertfordshire, AL5 2SL.

Mr. P. V. Smith entered a service contract upon his appointment dated 26 May 2011.

Mrs. J. Mortimer Sykes entered a service contract upon her appointment date 1 October 2011.

Mr. S. J. Richardson entered a service contract upon his appointment dated 15 January 2014.

Mr. P. F. Baynham entered a service contract upon his appointment dated 27 November 2014.

Ms. J. Robinson entered a service contract upon her appointment dated 1 September 2016.

The contracts are terminable by the Society or by the individual on three months' notice, pursuant to the Society's rules.

Mr. D. G. Jervis was employed on a Service Contract dated 30 July 2018, terminable by the Society or by the individual on one months' notice.

Mr. G. McGrady is employed on a Service Contract dated 3 January 2017, terminable by the Society or by the individual on six months' notice.

We hope you have enjoyed the journey, please share your feedback.

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HARPENDEN
BUILDING SOCIETY

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