ANNUAL REPORT & ACCOUNTS

2012

Manchester
BUILDING SOCIETY

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CHAIRMAN'S STATEMENT

The financial statements for 2012 have seen a material write-down in the Society's opening reserves resulting from a change in the accounting treatment for certain financial instruments. Whilst the underlying business and profitability of the Society has remained unaltered, the accounting treatment was revised in order for the Society to comply with the requirements of International Financial Reporting Standards ("IFRS").

The accounting principles involved are complex. Included within the Society's range of mortgage products are a number where the borrower pays a fixed rate of interest. By offering fixed rate products, the Society is exposed to the risk that future movements in interest rates will see its interest margin eroded or otherwise adversely affected. The Society has entered into interest rate swap arrangements which, where terms match, lock in an interest rate, thereby gaining economic certainty as to the margin that it will earn on these products.

At each year end, the Society has calculated the "fair value" of both the swaps and the mortgages and historically reported the fair value of both in its balance sheet under the hedge accounting provisions of IFRS. The Society has now identified that this accounting treatment does not comply with IFRS hedge accounting requirements and the mortgages should be reported at their amortised cost.

The resulting accounting adjustments have been back-dated across a number of years in line with accounting conventions and the Society's opening reserves have been adjusted to take account of the pre-2012 effect of these adjustments. Prior to these adjustments, a pre-tax profit of £1.86 million was achieved in 2012; after adjustment this figure becomes a post-tax loss of £2.72 million. Remedial action has already been taken, in consultation with the Society's regulators, to rebuild the Society's capital by issuing, in April 2013, £18 million of new equity in the form of Profit Participating Deferred Shares.

In line with the Board's risk appetite, the size of the balance sheet was reduced during 2012. £4.8million of mortgages were sold at a small premium to book value. In addition, three key initiatives were taken during 2012: an application to participate in the Bank of England's Funding for Lending Scheme, a diversification of the Society's retail deposit base (via our North West Air Ambulance Affinity Account and a range of competitive SME Business Deposit Accounts) and the development of Introducer deposit accounts.

As already announced, Michael Prior, Chairman of the Board, retired on 17 April 2013 after 8 years and I should like to thank him for his contribution over this period.

D.A. Harding, Chairman
27 April 2013

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2012

The directors are pleased to present their 90th Annual Report together with the Accounts and Annual Business Statement of the Society and its subsidiary undertakings ("the Group") for the year ended 31 December 2012.

Subsidiary undertakings

The Group's subsidiary undertakings at 31 December 2012 were: MBS (Mortgages) Limited and MBS (Property) Limited.

Business objectives & activities

The principal business objectives of the Group remain the provision of competitive facilities for personal savings and for mortgage finance primarily to support owner occupation of residential property.

Emphasis in achieving these principal business objectives is placed on offering a secure home for retail depositors' savings and on high standards of customer services to support the Group's range of products.

The Board is committed to the Society's status as a mutual and independent Building Society and considers that it is in the long-term interest of members for that status to be maintained.

Restatement

The Society has restated its financial results in two areas: hedge accounting under IAS 39 – *Financial Instruments: Recognition and Disclosure* and in relation to the disclosure of its Permanent Interest Bearing Shares ("PIBS"). Further detail may be found within note 2.

IAS 39 – Financial Instruments: Recognition and Disclosure

The Society entered into simple-form interest rate swap arrangements. The swap and the designated mortgages were accounted for using the hedge accounting principles of IAS 39. Under the terms of IAS 39, the Society had calculated the fair value of the swaps and the fair values of the mortgages at each year end, since 2006 when it first adopted hedge accounting. The Society has now identified that the swap arrangements it had entered into in respect of these assets did not meet the technical requirements for hedge accounting under IAS 39. As a result of this, the fair value movements in the swaps remain to be recognised fully through the Statement of Comprehensive Income, whilst there is no fair value ascribed to the mortgage assets and they are recorded in the Statement of Financial Position at their amortised cost.

PIBS

A review during 2012 of the Society's PIBS Offering Circulars and the specific terms of IAS 32 - *Financial Instruments: Presentation*, highlighted that the instruments do not confer a contractual obligation on the Society to deliver cash in the form of interest payments. Such discretionary interest terms point towards the instruments being more suitably categorised as Equity and accordingly this reclassification has occurred. The effect of the restatement is that the interest payable on the PIBS is disclosed within the Statement of Changes in Equity, rather than within the Statement of Comprehensive Income. The impact of the restatement is that there is no change to the Society's total asset position or to its retained earnings.

Business review

Key performance indicators ("KPIs") monitored by the Board include the following:

- Capital
- Total assets
- Liquid assets
- Customer balances
- Mortgages and other loans
- Management expenses
- Profit

The KPIs are considered in more detail below, with indications as to why each metric is considered to be of importance in assessing financial performance. Additional commentary on the Group's performance is contained within the Chairman's Statement on page 4.

Capital

The purpose of the Society's capital is to support current and future mortgage lending, to absorb any losses that the Society may incur and to offer member protection as a regulated deposit taker. For KPI monitoring purposes capital includes:

- retained earnings
- Permanent Interest Bearing Shares ("PIBS")
- subordinated debt

The means by which general reserves and regulatory capital is enhanced is via the retention of post-tax profits.

At 31 December 2012 capital was £36.7m (2011: £40.2m); the decrease arose from the post-tax loss that accrued during 2012. Gross capital at 31 December 2012 was £36.7m (2011: £40.2m) including £15.7m (2011: £15.7m) of subordinated debt and £14.8m (2011: £14.8m) of subscribed capital.

As a result of the reduction in reserves arising from the cumulative effect of the restatement of financial position, concurrent with the approval of these accounts, the Society has issued further subscribed capital in April 2013 in the form of £18m of Profit Participating Deferred Shares ("PPDS"). These instruments, issued and subscribed at par, are classified as equity within the Financial Statements and included as Core Tier 1 capital for regulatory purposes. They have the effect of offsetting a significant proportion of the depletion in capital that arose as a result of the restatement. The £18m capital issuance will ensure a sound capital base for the Society in the light of the restatement.

In order to enhance its regulatory capital position and ratios, it is the Board's intention to actively manage the Society's assets so that they attract lower regulatory capital risk weightings. Improvement in this position will be targeted through a combination of:

- Overall shrinkage of the total mortgage book
- Re-profiling of the Society's mortgage assets
- Management of its interest rate risk
- A low risk approach to future lending activity
- Active management of net interest margins
- Focus on overhead management

Total assets

Measurement of Total Assets allows the Board to assess the size and strength of the Group's balance sheet position.

The Group's total assets at the end of 2012 were £780.1m (2011: £849.7m). This represented a reduction of 8.2% (2011: 3.8% reduction) and it was in line with the Board's expectations for the year.

The Group undertakes an annual Internal Capital Adequacy Assessment Process in order to assess the amount of regulatory capital that it needs to hold by reference to the credit and other risks that it faces. This process informs the regulator's view of the level of regulatory capital that is required.

During 2012, the Group's focus has been on the management of its existing assets and the improvement in its regulatory capital ratios rather than growing the size of the organisation.

Liquid assets

The Group's liquid assets allow it to meet the demands of its saving members, to advance loans to borrowers and to facilitate the smooth day-to-day operation of the business. Of the Society's total liquid funds, £50.4m is deposited with the Bank of England (2011: £50.1m) and £10.0m is held in UK Government issued Treasury Bills (2011: £10.1m).

Retail balances

Deposits made by savings members represented the primary source of funding for the Society during 2012. The range of savings products available during the year has been carefully managed in order to ensure a suitable level of funding is held and that the rates offered are in line with both the market norm and savers' expectations.

New Society funds were generated primarily through successful launches of the Premier Notice 1, Premier Instant 2 and Platinum Instant ISA 1 accounts.

The Society's mortgage balances were wholly funded by retail customer balances throughout 2012

Mortgages and other loans

The Society seeks to offer mortgage finance to borrowers at appropriate rates of interest where repayment will be made in line with their mortgage agreements and where it is considered that there is a very low risk of loss.

The Society has continued in its efforts to minimise mortgage arrears and to help borrowers in difficulties to resolve their situations. The Society takes a consultative approach with its borrowers who experience payment difficulties and it is believed that this has resulted in a more encouraging arrears position than might otherwise have been the case, especially given the current economic climate.

At 31 December 2012 there were 25 mortgage accounts (2011: 30) where payments were 12 or more months in arrears. Outstanding balances on these accounts amounted to £6.6m (2011: £7.1m) with total arrears of £0.7m (2011: £0.6m), representing 1.1% of total mortgage balances (2011:1.2%).

Provisions for potential mortgage losses have been calculated by assessing loss experience, arrears and other impairment indicators. Mortgage accounts in arrears by 3 months or more are reviewed regularly and the impairment provision requirements are assessed at each calendar quarter end accordingly.

Group mortgage balances, after provisions, were £574.4m (2011: £613.4m), representing a year on year decrease of 6.4% (2011: 3.8% reduction). The mortgage product range offered by the Group during 2012 was similar to that of the previous year, being a stable mix of residential and buy-to-let products. In recognition of the prevailing economic climate, tight underwriting criteria were maintained during 2012 in order to minimise the risk of financial loss to the Group.

The Group is committed to treating customers fairly by providing transparency of product pricing. As a result it does not feel the need to offer heavily discounted or incentivised products to new borrowers only, as these imply a cross-subsidy from existing borrowers.

During the year, the Society made advances to 78 new and 8 existing borrowers to a total value of £12.3m (2011: £27.3m).

Management expenses

The ratio of expenditure incurred in running the Society in comparison to the average total assets of the Society across the year is a measure of the efficiency of operating the business. A lower ratio is therefore desirable.

The Society's management expense ratio increased during the year to 0.55% (2011: 0.52%) of Mean Total Assets. Through a process of controlled cost management, the absolute value of management expenses only increased by £26k during 2012 to £4.48m, but as the Society's total assets reduced during the period, this had the impact of increasing the ratio.

Losses

After adjusting for corporation tax, the retained Group loss for the year was £2.72m (2011: £11.4m loss which includes a one-off gain of £6.0m arising on the disposal of the Society's banking subsidiary).

The Group's profit before tax from continuing operations before the change of accounting treatment removing the fair value adjustment for mortgage assets was £1.86m, showing a small improvement on the position of the previous year (2011: £1.67m). This is after adding back £4.19m of fair value movements on the mortgage assets (2011: £23.5m). The net interest income in 2011 had benefitted from the disposal at a profit of two financial instruments but this level of income was not repeated in 2012. Beneficially, the level of charge for impairment losses was far smaller in 2012.

Other assets

Included within Other assets is a sum of £42.3m (2011: £29.8m) relating to collateral deposited in the form of cash under credit annex support agreements with the Society's counterparty providers of derivative contracts. These sums are not treated as liquid assets as they are posted as collateral to offset the fair value liability to the counterparty recognised in the Statement of Financial Position. The value of the collateral deposited by the Society is calculated on a regular basis throughout the year by reference to underlying LIBOR rates. During the year, a reduction in LIBOR rates resulted in an increase in the level of collateral posted.

Society strategy and the means by which it generates and preserves value over the medium term

The Society is owned by its members. The means by which its value is preserved is by providing products that meet the financial needs of both existing and potential members. Offering a safe home for its individual and corporate deposits and making mortgage funding available on a cautious, controlled and appropriately remunerated basis allow for a suitable net interest margin to be reported, which in turn funds the increase in reserves. Increasing its capital reserves allows the Society to support additional mortgage lending and to accomodate the cost associated with any unforeseen mortgage losses.

Environmental and employee factors

The Group's staff are a key resource and it is committed to its policy of ensuring that all employees are treated fairly and equally at all times; this approach also extends to job applicants. The Group's policies ensure that discrimination on the grounds of race, colour, religion, belief, nationality, ethnic origin, sex, sexual orientation, marital status, age, part time status and membership (or otherwise) of a trade union is not tolerated. Further, the Group also holds to its policy on disability, which is achieved via a wider policy approach to equal opportunity in the workplace.

Training and development opportunities are presented to staff to allow them to acquire relevant professional qualifications, which, in turn, assist the Group in achieving its goals.

The Group recycles a significant proportion of the waste paper that it produces.

Charitable & political donations

The Society made charitable donations totalling £5,000 (2011: £5,000) during the year. No contributions were made for political purposes.

Supplier payment policy & practice

The Society's policy concerning the payment of its trade creditors is as follows:

a) to agree the terms of payment with a supplier
b) to ensure that suppliers are aware of the terms of payment
c) to pay invoices in conformity with the Society's contractual and other legal obligations

Trade creditors at 31 December 2012 amounted to 16 days of average supplies (2011: 23 days).

Financial risk management objectives and policies

The Group offers mortgage and savings products and also undertakes some limited wholesale money market related investments and borrowings. There are formal structures in place to monitor, report and manage the risks associated with these activities. In addition, the financial instruments used by the Society to manage appropriately the structure of the balance sheet and to mitigate risks are disclosed in note 1 of the financial statements. The key policies that the Group has deployed to manage the risks that it faces include a suite of Liquidity Risk Management policies, which includes a specific policy covering Financial Risk Management, a Lending Policy and an Operational Risk Policy, which are reviewed, amended and approved by the Board regularly.

The disclosure requirements of Pillar 3 may be found on the Society's website.

Principal risks and uncertainties

Every business faces risks as part of its day-to-day operation. The Board seeks to minimise the risks that the Society faces, by articulating that it has a low appetite for risk and by deploying a range of risk management procedures within an appropriate control environment in order to achieve such an outcome. It is recognised that there is always a remote possibility of the non-repayment of sums due to the Society, which could arise from a myriad of borrower circumstances. In order to ensure that the Group does not expose itself to too great a level of risk, the Group's strategies, policies, procedures and Board-approved risk appetite allow all of its directors and staff to focus on those areas that could expose the Group to wider loss.

The principal risks and uncertainties facing the Group are credit risk, liquidity risk, interest rate risk and currency risk. The macro economic environment influences the risks that the Society faces. The Board believe that the profile of risks that the Society will face in 2013 is similar to those experienced during 2012.

The risks that the Group faces are summarised below:

Credit risk

The Group is exposed to the risk that any borrowing counterparty will be unable to repay the sum borrowed when it falls due. Credit risk presents as more of a consideration in relation to the Society's mortgages and loans than with regards to its liquidity assets; the former involve relationships with individuals or small businesses, whilst the latter counterparties are either the Bank of England or UK High Street banks, where the risk is assessed as being very low. This risk is mitigated by appropriately underwriting all mortgage applications and by limiting the Group's exposure to particular market sectors or loans exhibiting particular attributes. Impairment provisions are made when it becomes evident that the Group is likely to incur losses. The Board monitors credit risk exposures, underlying security values and the level of impairment provisions on a regular basis.

Liquidity risk

The Group's strategy is to maintain sufficient funds in unencumbered liquid form at all times to ensure that its liabilities can be met as they fall due. Regular stress testing of liquidity is undertaken by separately using 20 week and 3 month time horizons. The Group operates within closely monitored Board-approved liquidity policy limits, which are reviewed on a daily basis by the Group's Finance and Treasury departments, reported to the executive directors every week and considered by the Board each month. During 2012, the Group continued to have notable sums deposited with the Bank of England. It should be noted that, by holding greater proportions of liquidity in UK Government instruments and Bank of England deposits, (as required by the Society's regulator) liquidity yields are lower than in previous years, thus adversely affecting profitability.

Interest rate risk

The Group is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the sums mature. The Group seeks to manage this exposure by using financial derivatives in order to reduce this area of risk within the parameters agreed by the Board. The Group has a range of interest rate swaps in place where their duration is longer than the current mortgage portfolio, which presents a risk.

Currency risk

The Group faces currency movement risks on its Euro-denominated mortgage balances which represent 7.3% of total mortgage assets. The exchange rate risk arising on these balances is managed and mitigated by transacting exchange rate swaps. The exchange rate risk position is reported to the executive directors on a weekly basis and to the Board each month.

Economic risk

The Group face the risk that its interest margin can become subjected to the pressure that is brought to bear from being an institution that is primarily funded through retail deposits. Within this market, there is great competition for attracting retail deposits at sustainable rates of interest. Following the launch of the Bank of England's Funding for Lending Scheme, it is apparent that there has been an easing in the rates that retail institutions pay to their saving members and as a consequence, the impact of this has been an improvement in the Society's interest margin towards the end of 2012.

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2012

Outlook

The Board's view is that the UK mortgage and savings markets will continue to be volatile over the short term as the impact of economic and inflationary pressures come to bear. It is expected that the Bank of England's Funding for Lending Scheme will result in further downward pressure on both retail savings rates and on the short term rates offered on new mortgage lending across the UK.

It is the Board's view that interest margins will improve further when Bank Base Rate starts to increase, although the timing of this remains uncertain.

The Group will continue with its approach of prudent underwriting of all mortgage applications.

The continued prudential management of the Group's capital, interest rate risk, interest margin and liquidity will be areas of focus during 2013 and beyond.

Directors

The following individuals served as directors during 2012:

J.P. Allen	Non-executive director
D.E. Cowie	Chief Executive
R.W. Dyson	Non-executive director
A. Finch	Non-executive director
C.W. Gee	Finance Director
P.A. Lynch	Operations Director
S.M. Molloy	Non-executive director
M.J. Prior	Chairman
I.M. Richardson	Executive Director
J. Smith	Vice Chairman

On 17 April 2013, Mr. M.J. Prior retired from the Board and Mr. D.A. Harding was appointed as Chairman.

At the Annual General Meeting:

Messrs. Allen, Cowie, Richardson and Smith will retire by rotation and being eligible, will offer themselves for re-election

At the year end no director had an interest in any shares or debentures of the Society's connected undertakings.

Auditors

Grant Thornton UK LLP have expressed their willingness to continue in office and a resolution for their re-appointment as auditors of the Society will be proposed at the Annual General Meeting.

On behalf of the Board of Directors

D.A. Harding
Chairman
27 April 2013

CORPORATE GOVERNANCE

Code of practice

The Group maintains a code of practice that complies with the principles of the UK Corporate Governance Code 2010 ("the Code") issued by the Financial Reporting Council. Compliance with the Code is voluntary for Building Societies; the Group complies with the appropriate Code provisions unless otherwise stated.

Included below in bold italics are the requirements of the Code, and a summary of the Society's approach to each area. As the Code's drafting is quoted verbatim, all references to "company" should be read in the context of the Society being a mutual organisation, owned by its members and not by shareholders.

THE ROLE OF THE BOARD

Main Principle: Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

The Board is responsible for setting the Group's strategy, ensuring that there is an appropriate resource structure and control environment in place and ensuring that appropriate financial controls and risk management processes are embedded.

In order to execute its responsibilities in an efficient manner, the Board has constituted six Committees, of which four (Audit, Nominations, Remuneration and Risk) are oversight committees and two (ALCO and Credit) are executive committees. The Board retains responsibility for the setting of strategy and the approval of all policy matters. The four oversight Committees are responsible for more detailed review of matters in their specialist areas, making recommendations to the Board as appropriate. The focus of the two executive committees is on more day-to-day matters, operating within the Board-approved policy framework. Operational matters are delegated to executive directors and staff, within specified mandates, in order to ensure that timely decisions can be taken in support of the Board's strategy and policy limits. In addition, the non-executive directors meet periodically to assess all aspects of governance, board responsibility and board performance.

ALCO (Assets and Liabilities Committee)

ALCO met monthly to consider matters relating to liquidity and treasury management, including interest rate risk, counterparty risk, exchange rate risk and interest margin management.

Membership as at 31 December 2012: D.E. Cowie (Chairman), C.W. Gee, P.A. Lynch, I.M. Richardson.

Audit Committee

The Committee met five times during the year to consider systems and controls including risk systems, compliance with statutory and regulatory requirements and to receive reports from the Group's internal and external auditors.

Membership as at 31 December 2012: A. Finch (Chairman), J.P. Allen, S.M. Molloy, J. Smith.

Credit Committee

The Committee met monthly to consider all lending policy matters, including lending product development, loan book profile, arrears management and provisioning matters.

Membership as at 31 December 2012: D.E. Cowie (Chairman), C.W. Gee, P.A. Lynch, I.M. Richardson.

Nominations Committee

The Committee is responsible for making recommendations to the Board in relation to the appointment of new directors and also relating to the mix of skills and experience of the Board.

Membership as at 31 December 2012: J. Smith (Chairman), D.E. Cowie, M. J. Prior.

Remuneration Committee

The report of the Remuneration Committee is on page 13.

Membership as at 31 December 2012: S.M. Molloy (Chairman), R.W. Dyson, M. J. Prior.

Risk Committee

In its oversight capacity, the Committee met quarterly to consider strategic issues affecting all areas of risk. Throughout the year, the Committee advised the Board on treasury, balance sheet and operational risk issues, including the vetting and review of the Group's Internal Capital Adequacy Assessment Process and Individual Liquidity Systems Assessment.

Membership as at 31 December 2012: J. Smith (Chairman), J.P. Allen, D.E. Cowie, R.W. Dyson, A. Finch, C.W. Gee, I.M. Richardson. As part of the ongoing training and development of all board members, other directors attended meetings during the year on a voluntary basis.

Terms of reference for all committees are available, on request, from the Society's Secretary.

Attendance at Board and Committee meetings throughout 2012 is scheduled below. Figures displayed in brackets represent the number of meetings that any individual director was due to attend.

	Board	ALCO	Audit	Credit	Nominations	Remuneration	Risk
J.P. Allen	11 (11)	-	4 (5)	-	-	-	6 (6)
D.E. Cowie	11 (11)	12 (12)	-	10 (12)	3 (3)	-	6 (6)
R.W. Dyson	10 (11)	-	-	-	-	3 (3)	6 (6)
A. Finch	11 (11)	-	4 (5)	-	-	-	4 (4)
C.W. Gee	11 (11)	11 (12)	-	11 (12)	-	-	6 (6)
P.A. Lynch	10 (11)	11 (12)	-	10 (12)	-	-	-
S.M. Molloy	10 (11)	-	5 (5)	-	-	3 (3)	-
M.J. Prior	11 (11)	-	-	-	3 (3)	3 (3)	-
I.M. Richardson	10 (11)	11 (12)	-	11 (12)	-	-	6 (6)
J. Smith	11 (11)	-	4 (4)	-	3 (3)	-	6 (6)

In instances where directors have chosen to attend a meeting at which their attendance was not strictly required, this has not been recorded in the above table.

DIVISION OF RESPONSIBILITIES

Main 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.

Two different individuals hold the roles of Chairman and Chief Executive.

The Chief Executive devotes the entirety of his time to the Group; the Chairman does not have a day-to-day involvement in the running of the business. Both individuals operate under job descriptions that are approved by the Board.

On matters where Board approval is required, each director has a single vote; there is a majority of non executive directors on the Board. Accordingly, it is the Board's view that no single director has unfettered powers of decision.

THE CHAIRMAN

Main Principle: The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

At the time of his appointment to the Board, Mr Prior was considered to be independent. Immediately preceding his appointment as Chairman, he had held the role of Senior Independent Director. When Mr Harding was appointed as Chairman of the Board in April 2013, he was considered to be independent.

NON EXECUTIVE DIRECTORS

Main Principle: As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

Mr. J. Smith was nominated by the Board as the Senior Independent Director. The role of the Senior Independent Director includes being available to members, where contact through the normal channels has failed or where such contact is inappropriate.

All directors receive an annual appraisal. The Senior Independent Director leads a meeting of the non-executive directors in order to assess the performance of the Chairman.

COMPOSITION OF THE BOARD

Main 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.

The Board consists of four executive directors and six non-executive directors.

All non-executive directors are considered to be independent, except for the Chairman who, by the nature of the role that he holds, is not considered to be wholly independent within the context of the Code.

APPOINTMENTS TO THE BOARD

Main Principle: There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

The primary role of the Nominations Committee is to manage the balance of skills and experience on the Board and to lead the process for the appointment of new directors. The Committee is responsible for considering succession planning matters for the Board and its committees.

The Nominations Committee undertakes its own selection process by focussing on members of the business community within the North West of England in order to identify a pool of suitable candidates. The Nominations Committee maintains a skills matrix for all directors and the selection process that it undertakes is by reference to both this matrix and the specific, relevant skills and experience of each potential candidate. Members are invited to register their interest in becoming a non executive director. Accordingly, search consultants are not used in the appointment of non-executive directors.

In order to maintain their objectivity and independent outlook, included within their appointment letter, each non-executive director is made aware of the expected maximum term that they might be expected to serve. Each non-executive director is subject to periodic re-election by the Society's members and in instances where they have served for longer than 9 years they will be subject to annual re-election by the members.

COMMITMENT

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

At the time of his appointment as Chairman, the Board noted that Mr. Prior's other time commitments were not significant and that he could devote the appropriate time to his role as Chairman of the Society; his non-Society external time commitments did not change to any significant degree from the time of his appointment to the time of his retirement.

When Mr. Harding was appointed as Chairman in April 2013, the Board noted that his other time commitments were not significant and that he could devote appropriate time to his role as Chairman.

When each non executive was appointed, their other external time commitments were disclosed to the Board; time committments are discussed at annual appraisals and any subsequent changes to these commitments have been reported to the Board.

DEVELOPMENT

Main Principle: All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

On joining the Board, each director is provided with an induction programme which includes reading material, recommended external training courses and training meetings with executive directors and senior managers.

Through a programme of self-managed continuing personal development, each director ensures that they maintain a level of knowledge and skill commensurate with their role within the Group. Each non executive director is encouraged to attend external training and development events that are relevant to their role within the Society. A training log is maintained for each director and this is summarised for review by the Chairman. Training and development matters are discussed with each director at their annual performance appraisal.

INFORMATION AND SUPPORT

Main 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.

Each Board and Committee receives accurate information on a timely basis in order to allow it to execute its duties.

EVALUATION

Main Principle: The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

On an annual basis, the Board and its Committees undertake a process of assessing and formally documenting their performance during the year using a checklist that covers all areas of operation. Contributions are sought from both Board and Committee members and other relevant parties. The Board reviews and approves the written assessments undertaken by all Committees and where required, amendments are made to the Board Procedures as a result of the assessment processes.

The non-executive directors led by the senior independant director, are responsible for the performance evaluation of the Chairman. The Chief Executive attends the Chairman's appraisal in order that executive views may be taken into consideration.

RE-ELECTION

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

The Code requires that all directors are subject to election at the first Annual General Meeting following their appointment to the Board. However, the Society's Rules require that for a director appointed to the Board during a given financial year, their election is proposed at the AGM that considers the Annual Report and Accounts for the year in which they were first appointed.

In addition, each director must submit to being re-elected by the members at least every three years.

Non-executive directors will not normally be expected to offer themselves for re-election once they have served more than nine years from the date of appointment.

FINANCIAL AND BUSINESS REPORTING

Main Principle: The board should present a balanced and understandable assessment of the company's position and prospects.

The respective responsibilities of the Directors and the Auditors for preparing and reporting on the Accounts are contained within the Statement of Directors' Responsibilities on page 14 and the Independent Auditors' Report on page 15.

The Directors' Report on page 6 includes an explanation of the Society's strategy and the means by which it generates and preserves value over the medium term.

RISK MANAGEMENT AND INTERNAL CONTROL

Main 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.

The Board is responsible for ensuring the effectiveness of the Group's systems of risk management and internal control. Such systems are designed proportionately to identify, monitor and manage the Group's risks, rather than to eliminate them completely. Through Board and Committee policies, procedures and with the implementation of a variety of operational control processes, the Board ensures that the Group's risks are within a managed proportionate control structure.

The Group's risk appetite statements are approved by the Board annually; risk management policies are approved half-yearly.

The Society has established a Risk Committee, which assesses, monitors and manages the significant risks faced by the Group, overseeing the promotion of a risk based approach to the Group's activities.

Directed by the Audit Committee, Internal Audit reviews the control environment throughout the year and report their findings to the Audit Committee. Following its annual review of the activities undertaken, the Audit Committee has satisfied itself that the Society's systems are effective.

AUDIT COMMITTEE AND AUDITORS

Main Principle: The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor.

Members of the Audit Committee are all non-executive directors. The Audit Committee Chairman has recent, relevant financial experience. The Chairman of the Board is not a member of the Audit Committee but may attend at the Committee's request. The Committee invites other attendees to meetings, as appropriate, including the executive directors.

The Audit Committee's responsibilities include:

- monitoring the integrity of the Group's Annual Report and Accounts, Summary Financial Statements, Half-yearly Financial Information and any other formal announcement relating to the Society's financial performance and reviewing the financial judgemental areas of such reporting
- reviewing the internal financial control process and risk management systems
- monitoring and reviewing the effectiveness of the internal audit function
- making recommendations to the Board regarding the appointment or removal of the external auditors and approving their levels of remuneration
- reviewing and monitoring the external auditor's independence and objectivity
- monitoring the provision of non-audit services by the external auditors

The Audit Committee has primary responsibility for making a recommendation to the Board for the appointment, re-appointment and removal of the external auditors.

The Committee receives details of the Group's whistleblowing arrangements.

A limited amount of non-audit work is undertaken by Grant Thornton UK LLP and this is scheduled within Note 8. The nature of the services has been restricted to assistance with tax matters, seeking professional advice on the accounting and tax implications of new or potential business opportunities and is requested with the full knowledge of the Board. The Audit Committee is satisfied that this non-audit work does not impair Grant Thornton UK LLP's independence.

THE LEVEL AND COMPONENTS OF REMUNERATION

Main Principle: Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

Executive directors' remuneration levels are set at such a level to reward and retain the skills and commitment necessary to enable the Group to develop within a competitive and challenging business sector. Their remuneration arrangements include salary, membership of the Group personal pension scheme and taxable benefits including a car allowance and private health care.

Non-executive directors are remunerated by way of fees, assessed on the basis of responsibility, experience, skill and time commitment and by comparison with other building societies and regional financial institutions.

Non-executive directors do not receive any other benefits; they do not have any pension arrangements through the Group.

There are no bonus arrangements in place for any director.

PROCEDURE

Main 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.

The Directors' Remuneration Report can be found on page 13. The remuneration policy is contained within the Remuneration Report and service contract details may be found in the Annual Business Statement on page 43. Details of directors' remuneration are contained in Note 10 to the Accounts.

The Remuneration Committee is responsible for the remuneration policy for all of the directors; its recommendations are considered by the full Board. No director is involved in the discussion of or Board voting activity that relates to their remuneration.

DIALOGUE WITH SHAREHOLDERS

Main 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.

The "shareholders" of the Group are its borrowing and investing members. Unlike a PLC, there are no "major" or "significant" shareholders, as a member can only have one vote; accordingly, there is no means by which "major" shareholders views can be canvassed for the Board, as such a shareholder group does not exist within a Building Society's constitution.

There are very few opportunities for the Group to consult with its members. The Annual General Meeting ("AGM") provides one such opportunity for the Group to interact with its members and all Board members are available at this Meeting in order to discuss Society matters with any attending members.

Outside of the AGM and in the ordinary course of business, members' views and feedback is captured by staff and summarised for the Board's review.

CONSTRUCTIVE USE OF THE AGM

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

Details of the AGM are sent out to every member; all are encouraged to vote, either in person or by proxy. The external auditors independently verify postal votes and proxy forms and are present at the AGM to scrutinise voting on each of the resolutions. All proxy votes cast are included within the voting results; the results of each resolution are published on the Society's website after the AGM.

At the AGM, the Chairman presents an overview of the Group's performance during the year and comments on the opportunities that the coming year is expected to present.

All Board members are present at the AGM and this allows the chairmen of the Board and all the Committees to be available to answer members' questions during the formal meeting itself. Board members are also available to discuss any issues with members both before and after the AGM. Members are also welcome to contact any member of the Board directly at any time during the year; contact details are available for all members and interested parties on the Society's website.

DIRECTORS' REMUNERATION REPORT

Introduction

The purpose of this report is to provide details of the Group's policy on the remuneration of its executive and non-executive directors and explains the process for setting the level of directors' remuneration.

Remuneration Committee

The Remuneration Committee is responsible for the remuneration policy for all of the directors; it also reviews the remuneration of senior managers. All recommendations made by the Remuneration Committee are considered by the full Board. The Committee is committed to compliance with best practice as set out in the UK Corporate Governance Code and with the PRA Remuneration Code to the extent that it is relevant to the Society, given that the Society is a mutual institution.

Executive directors

Remuneration levels are set for executive directors so as to reward and retain the skills and commitment necessary to manage the development of the Group within a competitive and challenging business sector. In accordance with best practice, the Remuneration Committee reviews the remuneration arrangements for the executive directors on a periodic basis and compares their range of benefits to those available within similar organisations. The Committee's objective is to promote suitable risk management arrangements, avoiding remuneration structures that promote excessive risk taking.

The executives remuneration arrangements include:

- salaries, reviewed by the Committee on an annual basis
- membership of the Group personal pension scheme, on the same terms as other eligible employees of the Group, save for the Chief Executive, whose membership of the scheme attracts an increased level of employer pension contributions
- taxable benefits which include a car allowance and private health care

Since 1 January 2011 there have been no bonus arrangements in place for any executive director.

Non-executive directors

Non-executive directors are remunerated by way of fees, which are recommended by the Remuneration Committee to the Board on an annual basis. The level of fees is assessed on the basis of responsibility, experience, skill and time commitment and by comparison with other building societies and regional financial institutions.

Non-executive directors do not receive any other benefits; they do not have any pension arrangements through the Group.

All directors

The Group does not make mortgage loans available to any director.

The above arrangements applied throughout 2012.

Other business interests

Details of directors' other business interests are shown in the Annual Business Statement on page 43.

Directors' emoluments

The full directors' emoluments table may be found in Note 10 to the Accounts.

Summary

This report, in addition to Note 10 to the Accounts and the table on page 9, is intended to provide a full explanation of the policy and application of directors' remuneration. A resolution will be put to the Annual General Meeting inviting members to vote on the Directors' Remuneration Report.

On behalf of the Remuneration Committee

S.M. Molloy
Chairman
27 April 2013

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Directors' responsibilities for preparing the Annual Accounts
The following statement, which should be read in conjunction with the statement of the Auditors' responsibilities on page 15, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 ("the Act") to prepare, for each financial year, Annual Accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of affairs of the Society and the Group as at the end of the financial year. The Act states that references to International Financial Reporting Standards giving a true and fair view are references to their achieving a fair presentation.

In preparing the accounts, the directors are required to:

- select appropriate accounting policies and apply them consistently
- make judgements and estimates that are reasonable and prudent
- state whether the accounts have been prepared in accordance with International Financial Reporting Standards
- prepare the accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business

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

Directors' responsibilities pursuant to the Disclosure and Transparency Rules

The directors confirm that to the best of each person's knowledge and belief:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and Society; and
- the Directors' Report and notes to the Annual Accounts includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Group:

- keeps accounting records in accordance with the Building Societies Act 1986; and
- 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 Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

In so far as each of the directors is aware:

- There is no relevant audit information of which the Society's auditors are unaware; and
- The directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

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

Going concern

The directors must satisfy themselves that it is reasonable to conclude that the financial statements should be prepared on a going concern basis.

The Group's business activities require it to manage carefully its liquidity and capital resources. In managing its key resources through the setting of Board policies and operating procedures, the directors are mindful of the principal risks and uncertainties that the Group faces; these are summarised on page 7.

In order to manage the operations of the Group, the directors prepare regular forecasts, covering profitability, liquidity and capital assessments. These forecasts include scenario analysis to consider eventualities that use more pessimistic business and economic assumptions than those used in the base case, including stresses applied to the interest margin and cost base, in order to assess the potential impact on the Group's key resources. The outputs of these projections, which include steps to reduce interest rate risks, support the Board's assertion that the Group can continue to operate on a going concern basis.

The directors are satisfied that, following the issue of PPDS and after consultation with its regulators, the Group now has adequate resources to continue in business for the foreseeable future. For this reason, the Financial Statements continue to be prepared on the going concern basis.

On behalf of the Board of Directors

D.A. Harding
Chairman
27 April 2013

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF MANCHESTER BUILDING SOCIETY

We have audited the Group and Society financial statements of Manchester Building Society for the year ended 31 December 2012 which comprise the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Changes in Equity, the Group and Society Statements of Financial Position, the Group and Society Statements of Cash Flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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.

Respective responsibilities of directors and auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 14, the directors are responsible for the preparation of the financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2012 and of the Group's and the Society income and expenditure for the year then ended;
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

- proper accounting records have not been kept by the Society, or
- the Society financial statements 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.

Julian Bartlett
Senior Statutory Auditor
for and on behalf of Grant Thornton UK LLP
Statutory Auditor, Chartered Accountants
London

27 April 2013

STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	Group 2012 £000	Group 2011* £000	Society 2012 £000	Society 2011* £000
Interest and similar income	3	28,775	31,823	27,619	30,617
Interest expense and similar charges	4	(17,021)	(16,495)	(17,021)	(16,495)
Net interest income		11,754	15,328	10,598	14,122
Fees and commission income		341	433	341	433
Fees and commission expense		(35)	(80)	(35)	(80)
Income from investments	7	-	83	-	83
Other operating income	5	23	163	950	1,045
Loss from derivatives	6	(8,277)	(28,955)	(8,277)	(28,955)
Total net income		3,806	(13,028)	3,577	(13,352)
Administrative expenses	8	(4,587)	(4,409)	(4,343)	(4,287)
Depreciation	18	(275)	(302)	(136)	(166)
Other operating charges	5	(77)	(94)	(200)	(209)
Impairment (loss)/gain	16	(503)	(3,882)	214	(3,882)
Financial Services Compensation Scheme Levy	33	(693)	(354)	(693)	(354)
Net (loss)/gain on financial assets designated at fair value through profit or loss	13	(1)	207	(1)	207
Loss on ordinary activities before income tax and disposal of investment		(2,330)	(21,862)	(1,582)	(22,043)
Profit on disposal of investment		-	-	-	5,233
Loss on ordinary activities before income tax		(2,330)	(21,862)	(1,582)	(16,810)
Income tax (expense)/credit	11	(393)	4,458	(535)	4,532
Loss for the year from continuing operations		(2,723)	(17,404)	(2,117)	(12,278)
Profit on discontinued operations	32	-	5,964	-	-
Loss and total comprehensive income for the year		(2,723)	(11,440)	(2,117)	(12,278)

The notes on pages 19 to 41 form part of these accounts.

STATEMENTS OF CHANGES IN EQUITY

	Group 2012 £000 Subscribed Capital	Group 2012 £000 Reserves	Group 2012 £000 Total	Society 2012 £000 Subscribed Capital	Society 2012 £000 Reserves	Society 2012 £000 Total
Balance at 1 January 2012	14,788	9,706	24,494	14,788	10,239	25,027
Total transactions with equity holders - interest payable to holders of PIBS	-	(1,075)	(1,075)	-	(1,075)	(1,075)
Tax credit relating to interest payable to holders of PIBS	-	263	263	-	263	263
Loss and total comprehensive income for the year	-	(2,723)	(2,723)	-	(2,117)	(2,117)
Balance at 31 December 2012	14,788	6,171	20,959	14,788	7,310	22,098

	Group 2011* £000 Subscribed Capital	Group 2011* £000 Reserves	Group 2011* £000 Total	Society 2011* £000 Subscribed Capital	Society 2011* £000 Reserves	Society 2011* £000 Total
Balance at 1 January 2011	14,788	21,936	36,724	14,788	23,307	38,095
Total transactions with equity holders - interest payable to holders of PIBS	-	(1,075)	(1,075)	-	(1,075)	(1,075)
Tax credit relating to interest payable to holders of PIBS	-	285	285	-	285	285
Loss and total comprehensive income for the year	-	(11,440)	(11,440)	-	(12,278)	(12,278)
Balance at 31 December 2011	14,788	9,706	24,494	14,788	10,239	25,027

*** Restated (see note 2)**

STATEMENTS OF FINANCIAL POSITION

AS AT 31 DECEMBER 2012

ASSETS	Note	Group 2012 £000	Group 2011* £000	Group 2010* £000	Society 2012 £000	Society 2011* £000	Society 2010* £000
Liquid assets							
Cash and balances with central banks		50,377	50,129	35,014	50,377	50,129	35,014
Loans and advances to credit institutions	12	24,992	49,745	68,043	24,942	49,695	67,921
Investment securities	13	67,561	85,236	106,700	67,561	85,236	106,700
		142,930	185,110	209,757	142,880	185,060	209,635
Derivative financial instruments	14	1,097	1,953	1,758	1,097	1,953	1,758
Loans and advances to customers							
Loans fully secured on residential property	15	532,176	567,375	586,022	517,639	551,398	559,846
Loans fully secured on land	15	39,486	42,243	43,462	39,486	42,243	38,974
Other loans	15	2,721	3,807	8,288	2,721	3,807	3,141
		574,383	613,425	637,772	559,846	597,448	601,961
Investments							
Subsidiary undertakings	17	-	-	-	24,468	25,018	35,763
Trade investments	17	250	250	250	250	250	250
		250	250	250	24,718	25,268	36,013
Property, plant and equipment	18	8,477	8,696	8,882	153	233	363
Deferred income tax assets	19	9,419	9,270	4,207	9,202	9,293	4,201
Other assets	20	43,522	30,988	1,057	43,183	30,847	1,014
Assets of Disposal Group classified as held for sale		-	-	20,025	-	-	-
Total assets		780,078	849,692	883,708	781,079	850,102	854,945
LIABILITIES							
Deposits from banks	21	22,604	25,103	24,727	22,604	25,103	24,727
Other deposits	22	58,973	49,355	35,194	58,973	49,355	35,194
Derivative financial instruments	14	42,101	37,875	17,569	42,101	37,875	17,569
Due to customers	23	617,009	693,522	720,896	617,009	693,522	720,896
Other borrowed funds	24	15,700	15,700	15,700	15,700	15,700	15,700
Other liabilities	25	1,653	2,837	2,646	1,611	2,772	2,394
Liabilities and charges	33	883	483	370	883	483	370
Current income tax liabilities		196	323	132	100	265	-
Liabilities of Disposal Group classified as held for sale		-	-	29,750	-	-	-
Total Liabilities		759,119	825,198	846,984	758,981	825,075	816,850
Equity							
Retained earnings		6,171	9,706	21,936	7,310	10,239	23,307
Subscribed capital	26	14,788	14,788	14,788	14,788	14,788	14,788
Total equity		20,959	24,494	36,724	22,098	25,027	38,095
Total equity and liabilities		780,078	849,692	883,708	781,079	850,102	854,945
MEMORANDUM ITEM							
Commitments	29	188	212	345	188	212	345

***The Statements of Financial Position for 2010 and 2011 are shown as a result of restatement (see note 2).**

The accounts on pages 16 to 41 were approved by the Board of Directors on 27 April 2013.

A. Finch
Chairman of Audit Committee

D.E. Cowie
Chief Executive

C.W. Gee
Finance Director

STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	Group 2012 £000	Group 2011* £000	Society 2012 £000	Society 2011* £000
Cash flows from operating activities					
Interest and commission received		30,466	33,161	29,310	28,769
Interest expense paid		(15,063)	(16,495)	(15,063)	(16,495)
Dividends received		-	83	-	83
Fees and commission paid		(112)	(174)	(235)	(289)
Net derivative interest paid		(4,504)	(7,302)	(4,504)	(7,302)
Net trading and other income		23	163	950	1,045
Cash payments to employees and suppliers		(5,280)	(4,763)	(5,036)	(4,641)
Income taxes paid		(406)	(117)	(346)	-
Cash flows from operating activities before changes in operating assets and liabilities		5,124	4,556	5,076	1,170
Changes in operating assets and liabilities					
Net (increase)/decrease in loans and advances to credit institutions		(538)	6,770	(538)	6,770
Net decrease in loans and advances to customers		38,068	2,283	37,345	610
Net (increase) in other assets		(12,832)	(29,961)	(12,634)	(29,863)
Net (decrease)/increase in deposits from banks		(2,499)	376	(2,499)	376
Net increase in other deposits		9,618	14,161	9,618	14,161
Net (decrease) in amounts due to customers		(78,471)	(27,374)	(78,471)	(27,374)
Net (decrease)/increase in other liabilities		(1,184)	191	(1,161)	378
Net increase in liabilities and charges		400	113	400	113
Net cash from operating activities		(42,314)	(28,885)	(42,864)	(33,659)
Cash flows from investing activities					
Sale of subsidiary		-	-	-	10,174
Investments in subsidiary undertakings		-	-	550	5,804
Purchase of property and equipment	18	(56)	(116)	(56)	(36)
Sale of securities		82,956	117,328	82,956	117,328
Investment in securities		(64,984)	(95,627)	(64,984)	(95,627)
Net cash used in investing activities		17,916	21,585	18,466	37,643
Cash flows from financing activities					
Interest paid on subscribed capital		(1,075)	(1,075)	(1,075)	(1,075)
Net cash used in financing activities		(1,075)	(1,075)	(1,075)	(1,075)
Net movement in cash and cash equivalents		(25,473)	(8,375)	(25,473)	2,909
Net cash from discontinued operations		-	(5,470)	-	-
Cash and cash equivalents at start of year		100,702	114,547	100,652	97,743
Cash and cash equivalents at end of year	27	75,229	100,702	75,179	100,652

*** Restated (see note 2)**

1. ACCOUNTING POLICIES AND FINANCIAL RISK MANAGEMENT

a. General information

The principal business objectives of the Group remain the provision of a safe home for personal and business savings and for mortgage finance primarily to support owner occupation of residential property. Emphasis is placed on offering high standards of customer service to support the Group's range of products.

The Board is committed to the Society's status as a mutual and independent Building Society and considers that it is in the long-term interest of members for that status to be maintained.

b. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, except for as noted in note 2.

Basis of presentation

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") pronouncements as issued by the International Accounting Standards Board and as adopted by the European Union. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of all derivative contracts and certain other assets.

The directors must satisfy themselves that it is reasonable to conclude that the financial statements should be prepared on a going concern basis.

The Group's business activities require it to manage carefully its liquidity and capital resources. In managing its key resources through the setting of Board policies and operating procedures, the directors are mindful of the principal risks and uncertainties that the Group faces; these are summarised on page 7.

In order to manage the operations of the Group, the directors prepare regular forecasts, covering profitability, liquidity and capital assessments. These forecasts include scenario analysis to consider eventualities that use more pessimistic business and economic assumptions than those used in the base case, including stresses applied to the interest margin and cost base, in order to assess the potential impact on the Group's key resources. The outputs of these projections, which include steps to reduce interest rate risks, support the Board's assertion that the Group can continue to operate on a going concern basis.

The directors are satisfied that, following the issue of PPDS and after consultation with its regulators, the Group now has adequate resources to continue in business for the foreseeable future. For this reason, the Financial Statements continue to be prepared on the going concern basis.

In the event of a restatement, IAS1 requires that a third Statement of Financial Position is presented for comparative purposes and that this additional disclosure should also extend to cover the relevant notes to the Financial Statements. On the 27th March 2013, the EU adopted an amendment removing the requirement to show a third balance sheet position for relevant notes. The Society has adopted early the amendment to IAS1 and accordingly, comparatives within the notes to the Financial Statement show the positions at December 2011 only.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies.

New standards and interpretations currently in issue but not effective for accounting periods commencing on or after 1 January 2012 are:

- IFRS 10 Consolidated Financial Statements (effective 1 January 2013)
- IFRS 11 Joint Arrangements (effective 1 January 2013)
- IFRS 12 Disclosure of Interests in Other Entities (effective 1 January 2013)
- IFRS 13 Fair Value Measurement (effective 1 January 2013)
- IAS 19 Employee Benefits (Revised June 2011) (effective 1 January 2013)
- IAS 27 (Revised), Separate Financial Statements (effective 1 January 2013)
- IAS 28 (Revised), Investments in Associates and Joint Ventures (effective 1 January 2013)
- Presentation of Items of Other Comprehensive Income - Amendments to IAS 1 (effective 1 July 2012)
- Disclosures - Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (effective 1 January 2013)
- Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (effective 1 January 2014)
- Mandatory Effective Date and Transition Disclosures - Amendments to IFRS 9 and IFRS 7 (effective 1 January 2015)
- Government Loans - Amendments to IFRS 1 (effective 1 January 2013)
- Annual Improvements 2009-2011 Cycle (effective 1 January 2013)
- Transition Guidance - Amendments to IFRS 10, IFRS 11 and IFRS 12 (effective 1 January 2013)
- Investment Entities - Amendments to IFRS 10, IFRS 12 and IAS 27 (effective 1 January 2014)

IFRS 13 will have an impact upon the measurement and disclosure of the Sociey's results, but none of the other standards or pronouncements are expected to have any significant impact on the Group financial statements in 2013. The impact of IFRS 13, which comes into force for next year's reporting, is expected to be that there will be enhanced disclosure, but there would not be any noticable change to the way in which items are valued.

Basis of consolidation

The Group's accounts include the accounts of the Society and its subsidiary undertakings. All internal costs and income associated with the subsidiaries are removed on consolidation. The Society's statement of financial position includes the investment in the subsidiary undertakings at cost.

Interest income and expense

Interest income and expense are recognised in the statements of comprehensive income for all financial instruments measured at amortised cost using the effective interest method.

Fees and commission income and expense

Fees and commissions are generally recognised on an accruals basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

Financial assets

The Group classifies its financial assets in the following categories:

(i) Financial assets at fair value through profit or loss.
The Society holds a restricted portfolio of derivative financial assets. These instruments are carried at their fair value with changes in fair value reflected in profit or loss.

(ii) Available-for-sale
Available-for-sale financial assets are carried at their market value which reflects the fair value of the asset. Changes in their fair value are recognised in other comprehensive income. Any gain or loss on disposal is taken through profit or loss.

(iii) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Purchases and sales of financial assets at fair value through profit or loss and available-for-sale are recognised on the trade-date being the date on which the Group legally commits to purchase or sell the asset. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are no longer recognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method. Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the profit or loss in the period in which they arise.

Impairment

a) Assets carried at amortised cost

The Group assesses at each financial position date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes accounts going in to arrears and other observable data that comes to the attention of the Group about the following loss events:

(i) the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;

(ii) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

(iii) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group, including:

– adverse changes in the payment status of borrowers in the Group; or
– national or local economic conditions that correlate with defaults on the assets in the Group.

The above assessment includes those mortgage assets which are subject to forbearance arrangements.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The impairment value is then reflected in a seperate account from the underlying assets in the Group's financial records.

The Group's policy in relation to any properties that it has taken into possession is that it will seek their disposal in as short a time period as possible, with a view to minimising the losses that it may incur.

b) Available-for-sale assets

The Group assesses at each financial position date whether there is objective evidence that a financial asset or a group of financial assets are impaired. In the case of trade investments classified as available-for-sale, a significant or prolonged decline in the fair value of the asset below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised - is recognised in profit or loss.

c) Other assets

Impairment provisions are made in relation to other balances receivable when it is estimated that a loss will materialise. Such provisions are assessed by reference to all relevant information available at the financial reporting date.

Property, plant and equipment

All property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in each asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives, as follows:

- Freehold office premises: over 50 years.
- Office premises structural alterations: over 20 years.
- Office fixtures and fittings: over 10 years.
- Computer and sundry equipment: over 5 years.
- Other assets: over 4 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each financial reporting date.

Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition including: cash and non-restricted balances with central banks, loans and advances to banks and amounts due from other banks.

Corporation tax

Corporation tax is charged at the current rate calculated on the basis of the profit on ordinary activities as adjusted in line with HMRC requirements for taxation purposes.

Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the financial position date.

The principal temporary differences arise from the depreciation of property, plant and equipment and the revaluation of certain financial assets and liabilities including derivative contracts.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which deductible temporary differences can be utilised.

Borrowings

Borrowings are initially recognised at fair value which is normally their issue proceeds (fair value of consideration received) net of transaction costs incurred. They are subsequently stated at amortised cost.

Derivative Financial Instruments

All derivative financial instruments are accounted for at fair value through profit or loss.

Pensions - Group defined contribution scheme

The Group operates a defined contribution pension scheme for its employees. All the costs incurred by the employer are included in profit or loss.

Foreign currency

Foreign currency transactions are translated into sterling, using the exchange rates prevailing at the dates of the transactions (spot exchange rate). Foreign exchange gains and losses resulting from the settlement of such transactions and from the remeasurement of monetary items at year-end exchange rates are recognised in profit or loss.

Leases

The Group has entered into operating lease agreements. Rental income and expenditure is recognised in profit or loss on a straight line basis.

Permanent Interest Bearing Shares

The Society has two tranches of Permanent Interest Bearing Shares ("PIBS") in issue. Both sets were issued with the intention of enhancing the Society's regulatory capital position. In accordance with the requirements of IAS32 - *Financial Instrument: Presentation*, it has been determined that, as a result of the particular terms of their issue, which include some discretion on the Board's part to cancel the coupon under certain circumstances, these instruments qualify as equity within the Statement of Financial Position. Accordingly, the PIBS interest is recognised through the Statement of Changes in Equity when paid.

c. Financial risk management

Strategy in using financial instruments

The Group accepts deposits from customers at both fixed and floating rates of interest, some of which are for fixed periods and others are open-ended and seeks to enhance its interest margins by investing these funds in high-quality mortgages, liquidity instruments and liquid assets.

The Society has more fixed rate mortgages than fixed rate savings accounts. Therefore, in order to reduce the interest rate risk that arises, it enters into simple-form interest rate swap arrangements with the intention of gaining some economic certainty as to its net interest margin position.

Credit risk - exposure

Credit risk is the risk that an individual or institutional counterparty to whom the Society has lent money will be unable to re-pay the sums in full when they fall due.

The Group manages the levels of credit risk it accepts by placing limits on the amount available in relation to individual borrowers and groups of borrowers. Such risks are monitored on a revolving basis and are subject to a regular review. Policy limits on the level of credit risk by product, industry sector and by country are approved half yearly by the Board. The exposure to any one borrower, including banking counterparties, is further restricted by sub-limits covering on and off balance sheet exposures. Actual exposures against limits are monitored daily.

The Group's most significant concentration of credit risk is within the loans secured on residential property in the UK. The following table shows the credit exposure, which is the maximum potential exposure before provisions and including committed facilities.

	Group	*	Society	*
	2012	2011	2012	2011
	£000	£000	£000	£000
Financial assets				
Loans and advances to credit institutions	24,992	49,745	24,942	49,695
Investment securities	67,561	85,236	67,561	85,236
Gross loans and advances-on residential property and land	469,336	505,983	453,784	489,708
-lifetime mortgages	112,822	115,051	112,822	115,051
Loans to subsidiary undertakings	-	-	24,466	25,016
Derivatives - Interest and exchange rate swaps	1,097	1,953	1,097	1,953
*** Restated**	675,808	757,968	684,672	766,659

Impairment provisions are provided for losses that have been incurred at the financial position date.

Credit risk - forbearance

The Society's forbearance strategy is to seek to agree with borrowers in financial difficulty the provision of short to medium term assistance with their monthly mortgage payments, in order to avoid or mitigate the risk of financial loss. The range of forbearance options available includes arrangements to clear the arrears over a reasonable period of time, payment concessions, deferment of interest and capitalisation of arrears. For mortgages that are not past due, conversion to interest only payment terms, an extension of term, or suspension of monthly payments pending sale of the property are available as options to reduce the monthly payment due and these seek to avoid a mortgage entering arrears and becoming past due, allowing time for a borrower to regularise their financial position.

As at 31 December 2012, the Society had 59 accounts (2011: 54) with balances of £7m (2011: £6m) where conversion to interest only or an extension of term had taken place. Of these, 36 accounts were neither past due or impaired, and 23 were past due and/or impaired (aggregate capital balance £3.7m; aggregate arrears £51k; aggregate provision for loss of £21k).

The overall forbearance strategy seeks to avoid arrears arising or further increasing and to allow account performance to be restored by supporting the mortgage payments being brought up to date or to provide a period of time for repayment of the amount owed.

There are no specific concentrations of accounts in forbearance in relation to portfolios or geographical areas.

Credit risk – Loans and advances to customers

The analysis shown below, in relation to loans and advances to customers is based on the Group's balances. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

Of the £582m in this class £538m (92.4%) (2011: 92.2%) is fully secured on residential property with a further £41m (7.1%) (2011: 7.1%) fully secured on land. £3m (0.5%) (2011: 0.7%) is unsecured personal loans. With balances of £110m, lifetime mortgages represent 18.9% of this class (2011: 19.7%).

Secured lending – fully secured on residential property

The average loan to valuation ("LTV") of the Group's lending that is fully secured on residential property is estimated at 40% (2011: 42%), whilst the average LTV of new residential property lending was 62% (2011: 67%). Further analysis of the Group's residential property lending is detailed below.

Loan to value analysis:	Lifetime Mortgages		All residential Properties (Including Lifetime Mortgages)	
	2012	2011	2012	2011
Total book	%	%	%	%
<70%	96	98	74	73
70% - 80%	2	1	13	14
80% - 90%	1	-	9	9
>90%	1	1	4	4
Average loan to value of stock	46	43	40	42
Average loan to value of new business			62	67
New business profile:				
First time buyers			16	21
Home movers			57	45
Remortgagers			9	15
Buy-to-let investors			18	19

The Group continues to review regularly the quality of its loans that are fully secured on residential property. The proportion of these loans more than 3 months in arrears is 3% (2011: 3%). There are no lifetime mortgages which are past due or impaired.

The table below provides further information on the payment due status of gross loans fully secured on residential property.

	2012		2011*	
	£m	%	£m	%
Not Impaired:				
Neither past due nor impaired	493.6	92	525.0	92
Past due up to 3 months	25.3	5	28.3	5
Past due 3 to 6 months	4.5	1	5.0	1
Past due 6 to 12 months	2.8	1	2.7	1
Past due over 12 months	1.1	-	2.1	-
Impaired:				
Past due up to 3 months	2.3	-	0.5	-
Past due 3 to 6 months	1.9	-	2.1	-
Past due 6 to 12 months	1.3	-	1.9	-
Past due over 12 months	2.2	-	2.6	1
Possessions**	2.9	1	2.5	-
*** Restated**	537.9	100	572.7	100

** For properties in possession, £4.0m (2011: £2.5m) of collateral is held. In the analysis above, for all past due loans, £83.9m of collateral is held.

In the analysis above, loans which are less than 3 months past due have collective impairment provisions of £1.9m (2011: £1.8m) set aside to cover losses.

At 31 December 2012 the Group held individually identified impairment provisions of £3.6m (2011: £3.3m).

Geographical Analysis

The table below provides information on the geographical split of the Group's gross lending on residential property.

	2012		2011*	
	£m	%	£m	%
East Midlands	13.6	2	14.1	2
Greater London	36.0	7	38.9	7
London	73.5	14	80.1	14
North	12.9	2	13.4	2
North West	187.9	35	200.0	35
Other	20.1	4	21.6	4
South East	58.6	11	65.3	11
South West	24.5	4	27.1	5
Spain	44.6	8	44.1	8
Wales	15.5	3	15.2	3
West Midlands	19.5	4	20.8	4
Yorkshire	31.2	6	32.1	5
*** Restated**	537.9	100	572.7	100

Spain: all lending is lifetime mortgages.

Secured lending – fully secured on land

The constitution of gross loans fully secured on land by industry type is as follows:

	2012		2011	
	£m	%	£m	%
Offices	12.0	29	12.6	28
Shops	9.9	24	10.5	25
Industrial	6.0	14	6.3	14
Restaurants, Hotels and other	13.5	33	14.6	33
	41.4	100	44.0	100

The table below provides further information on the payment due status of gross loans that are fully secured on land.

	2012		2011	
Not Impaired:	£m	%	£m	%
Neither past due nor impaired	32.2	78	34.8	79
Past due up to 3 months	1.5	4	3.6	8
Past due 3 to 6 months	1.2	3	0.5	1
Past due 6 to 12 months	0.9	2	0.7	2
Past due over 12 months	0.2	1	0.5	1
Impaired:				
Past due up to 3 months	0.8	2	-	-
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	0.6	1	0.4	1
Past due over 12 months	1.4	3	1.2	3
Possessions*	2.6	6	2.3	5
	41.4	100	44.0	100

* For properties in possession £2.4m of collateral is held (2011: £1.7m). In the analysis above, for all past due loans, £11.2m of collateral is held (2011: £10.7m).

In the analysis above, loans which are less than 3 months past due have collective impairment provisions of £100k (2011: £100k) set aside to cover losses. At 31 December 2012 the Group held individually identified impairment provisions of £1.7m (2011: £1.6m).

Unsecured lending

The table below provides further information on the payment due status of gross unsecured loans.

	2012		2011	
Not Impaired:	£m	%	£m	%
Neither past due nor impaired	2.1	75	3.2	75
Past due up to 3 months	0.4	14	0.8	19
Past due 3 to 6 months	-	-	0.1	2
Past due 6 to 12 months	-	-	-	-
Past due over 12 months	0.1	3	-	-
Impaired:				
Past due up to 3 months	-	-	0.1	2
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	0.1	4	-	-
Past due over 12 months	0.1	4	0.1	2
	2.8	100	4.3	100

In the analysis above, loans which are less than 3 months past due have collective impairment provisions of £nil (2011: £nil) set aside to cover losses. At 31 December 2012 the Group held individually identified impairment provisions of £0.1m (2011: £0.5m).

Credit risk – loans and advances to banks and investment securities.

Credit risk within treasury assets arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes. This aspect of credit risk is managed by the Group's Risk Committee. The Committee also sets and monitors compliance with policy and limits. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

For credit purposes, the treasury portfolio comprises the following sub-portfolios as at 31 December:

	2012		2011	
	£m	%	£m	%
Financial Institutions	142.8	100	185.0	100
Mortgage backed securities	0.1	-	0.1	-
	142.9	100	185.1	100

The Group's Risk Committee monitors exposure concentrations against a variety of criteria including industry sector/asset class and country of counterparty.

Geographical exposure:	2012		2011	
	£m	%	£m	%
UK	142.9	100	183.0	99
Europe	-	-	2.1	1
	142.9	100	185.1	100

Industry sector/asset class exposure:	2012		2011	
	£m	%	£m	%
UK financial institutions	142.8	100	182.9	99
Overseas banks	-	-	2.1	1
Asset backed securities	0.1	-	0.1	-
	142.9	100	185.1	100

Collateral held as security for treasury assets is determined by the nature of the instrument. Loans and debt securities are generally unsecured with the exception of asset backed securities which are secured by pools of financial assets. The maximum individual counterparty exposure at the financial position date was £50m. The number of active counterparties at the financial position date was 7. All counterparties are UK 'High Street' blue chip banks; this is in support of the Board's low risk appetite approach to banking counterparty risk.

Cash flow and fair value interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest rate repricing that may be undertaken, which are monitored monthly.

The table below summarises the Group's exposure to interest rate risks. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The nominal value of derivative financial instruments are included in the "Impact of derivatives" total figures disclosed. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

The Group entered into long dated interest rate swap contracts, the purpose of which was to provide long term fixed rate funding at a time when interest rates were historically low. From the table it may be seen that the swaps have longer durations than the fixed rate assets and as a result, the Group has a much greater exposure, presently, to changes in interest rates in the longer-dated time periods as per the table below.

After taking into account the derivatives entered into by the Group, the interest rate sensitivity exposure at 31 December 2012 and 31 December 2011 was:

	Effective interest rate	0-3 months	3-6 months	6-12 months	1-5 years	5-10 years	10-20 years	20-30 years	Over 30 years	Non-interest bearing	Total
31 December 2012	**%**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Assets											
Cash and central banks balances	0.50	50,359	-	-	-	-	-	-	-	18	50,377
Due from other banks	1.35	24,970	-	-	-	-	-	-	-	22	24,992
Investment securities	2.86	15,017	-	17,293	34,604	-	-	-	-	647	67,561
Loans to customers	3.71	389,238	3,426	6,145	32,556	11,980	6,232	14,345	-	-	463,922
Lifetime mortgages - (estimated)	6.74	427	427	853	24,386	38,408	45,960	-	-	-	110,461
Other assets	-	43,352	-	-	-	-	-	-	-	19,413	62,765
Total assets		523,363	3,853	24,291	91,546	50,388	52,192	14,345	-	20,100	780,078
Liabilities											
Due to other banks	1.43	9,500	7,000	6,000	-	-	-	-	-	104	22,604
Other deposits	1.89	37,732	9,000	12,000	-	-	-	-	-	241	58,973
Due to customers	2.27	569,054	7,960	16,175	21,117	-	-	-	-	2,703	617,009
Other borrowed funds	4.36	9,200	-	-	1,500	5,000	-	-	-	-	15,700
Other liabilities	-	-	-	-	-	-	-	-	-	44,833	44,833
Reserves	-	-	-	-	-	-	-	-	-	6,171	6,171
Total liabilities		625,486	23,960	34,175	22,617	5,000	-	-	-	54,052	765,290
Impact of derivatives		134,533	37,156	(4,078)	(29,000)	(29,395)	(41,482)	(14,734)	(53,000)	-	-
Interest rate sensitivity gap		32,410	17,049	(13,962)	39,929	15,993	10,710	(389)	(53,000)	(33,952)	-
31 December 2011*	**%**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Assets											
Cash and central banks balances	0.50	50,115	-	-	-	-	-	-	-	14	50,129
Due from other banks	1.07	49,702	-	-	-	-	-	-	-	43	49,745
Investment securities	2.56	10,450	10,642	7,004	56,791	-	-	-	-	349	85,236
Loans to customers	3.71	412,496	2,432	10,256	40,117	12,618	5,537	16,504	-	-	499,960
Lifetime mortgages - (estimated)	6.78	439	439	876	25,049	39,453	47,209	-	-	-	113,465
Other assets	-	32,841	-	-	-	-	-	-	-	18,316	51,157
Total assets		556,043	13,513	18,136	121,957	52,071	52,746	16,504	-	18,722	849,692
Liabilities											
Due to other banks	1.40	15,500	7,500	2,000	-	-	-	-	-	103	25,103
Other deposits	1.95	36,205	4,500	8,444	-	-	-	-	-	206	49,355
Due to customers	2.36	602,050	54,010	8,251	27,770	-	-	-	-	1,441	693,522
Other borrowed funds	4.63	9,200	-	-	1,500	5,000	-	-	-	-	15,700
Other liabilities	-	-	-	-	-	-	-	-	-	41,518	41,518
Reserves	-	-	-	-	-	-	-	-	-	9,706	9,706
Total liabilities		662,955	66,010	18,695	29,270	5,000	-	-	-	52,974	834,904
Impact of derivatives		107,067	61,688	8,500	(41,688)	(29,670)	(42,021)	(10,876)	(53,000)	-	-
Interest rate sensitivity gap		155	9,191	7,941	50,999	17,401	10,725	5,628	(53,000)	(34,252)	-

*** Restated**

The Society's financial performance is sensitive to changes in interest rate in respect of the net interest income it earns and the change in fair value of financial instruments. Based on the assets and liabilities in the balance sheet at 31 December 2012 an immediate and sustained increase of 1% in market interest rates across all maturities would increase income and equity by £24.9m (2011: £23.3m) made up of a fair value increase of £23.8m (2011: £22.6m) and a net interest increase on variable rate financial assets and liabilities carried at amortised cost of £1.09m (2011: £0.68m). An equivalent immediate and sustained decrease of 1% would decrease income and equity by £31.36m (2011: £30.73m) made up of fair value decrease of £30.78m (2011: £30.48m) and a net interest decrease on variable rate financial assets and liabilities carried at amortised cost of £0.58m (2011: £0.25m). These amounts are for indication only and do not represent amounts that are at risk.

Liquidity risk

The Group is exposed to daily calls on its available cash resources from customer withdrawals, maturing deposits, loan draw-downs and guarantees, and from margin and other calls on cash-settled derivatives. The Group does not maintain immediately available cash resources to meet instantly all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the nature of the funds that are available to the Society on an instantly accessible basis; with the latter, the Board strategy has been to place notable sums with the Bank of England and with other UK "High Street" banks in order to ensure that it meets its objectives of ensuring that all such funds are highly liquid. The liquidity profile throughout 2012 has aligned with the Board's low risk appetite in this area and day-to-day operations of the liquidity portfolio saw compliance with all policy limits throughout the period. Such policy limits are reviewed on a daily basis and it should be noted that the Group has consistently maintained cash resources in excess of the policy minimum.

The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

The table below analyses the Group's contractual cash flows under financial liabilities except for derivatives which are disclosed at their fair value based on maturity dates.

	On demand	0-3 months	3-12 months	1-5 years	5-10 years	10-15 years	Over 15 years	Total
At 31 December 2012	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Due to customers	317,256	255,229	24,528	22,806	-	-	-	619,819
Due to other banks and depositors	548	31,962	34,837	15,457	-	-	-	82,804
Other liabilities	188	1,066	638	441	-	-	-	2,333
Derivatives	-	1,924	402	937	5,402	4,885	28,551	42,101
Subordinated liabilities	-	171	513	3,933	7,869	5,875	6,675	25,036
Total outflow	317,992	290,352	60,918	43,574	13,271	10,760	35,226	772,093

	On demand	0-3 months	3-12 months	1-5 years	5-10 years	10-15 years	Over 15 years	Total
At 31 December 2011*	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Due to customers	207,791	403,293	63,299	22,990	-	-	-	697,373
Due to other banks and depositors	705	36,348	23,104	15,963	-	-	-	76,120
Other liabilities	212	2,015	565	242	-	-	-	3,034
Derivatives	-	1,468	432	1,143	4,573	3,226	27,033	37,875
Subordinated liabilities	-	171	513	4,043	2,869	11,114	7,010	25,720
Total outflow	208,708	443,295	87,913	44,381	7,442	14,340	34,043	840,122

*** Restated**

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the financial position date to the contractual maturity date. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

	0-3 months	3-6 months	6-12 months	1-5 years	5-10 years	10-20 years	20-30 years	Over 30 years	Total
At 31 December 2012	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Assets									
Cash and central banks balances	50,377	-	-	-	-	-	-	-	50,377
Due from other banks	40,538	-	17,293	34,604	118	-	-	-	92,553
Derivative financial instruments	869	2	-	147	-	-	79	-	1,097
Loans to customers	2,667	1,223	4,602	40,338	80,361	253,700	79,275	1,756	463,922
Lifetime mortgages	427	427	853	24,386	38,408	45,960	-	-	110,461
Other assets	2,007	869	2,600	14,160	12,850	9,398	4,874	14,910	61,668
Total assets	96,885	2,521	25,348	113,635	131,737	309,058	84,228	16,666	780,078
Liabilities									
Due to other banks	9,528	7,046	6,030	-	-	-	-	-	22,604
Other deposits	22,858	9,058	12,056	15,001	-	-	-	-	58,973
Derivative financial instruments	1,924	275	127	937	5,402	11,003	3,703	18,730	42,101
Due to customers	571,747	7,959	16,171	21,132	-	-	-	-	617,009
Other borrowed funds	-	-	-	1,500	5,000	9,200	-	-	15,700
Other liabilities	2,094	442	196	-	-	-	-	-	2,732
Total liabilities	608,151	24,780	34,580	38,570	10,402	20,203	3,703	18,730	759,119
Net liquidity gap	(511,266)	(22,259)	(9,232)	75,065	121,335	288,855	80,525	(2,064)	20,959
At 31 December 2011*									
Total assets	116,022	13,538	17,209	125,604	130,381	306,048	126,034	14,856	849,692
Total liabilities	650,120	66,702	19,117	40,227	4,573	17,934	7,969	18,556	825,198
Net liquidity gap	(534,098)	(53,164)	(1,908)	85,377	125,808	288,114	118,065	(3,700)	24,494

*** Restated**

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. The Society does not expect to be completely matched, as transacted business is often of uncertain term and of different types. An unmatched position potentially enhances profitability but could also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

Currency risk

At 31 December 2012 the Group had a currency exposure of €57.1m (2011: €55.6m) in loans and receivables. This exposure is matched fully with exchange rate SWAPs. The Board sets limits on the level of exposures to foreign currency. These exposures are monitored daily.

Fair values of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The following methods and assumptions have been applied in determining the fair value of the financial instruments in these reports:

(i) Trade investments are measured at cost as the fair value cannot be estimated reliably. The investments are treated as available-for-sale and are grouped into the fair value heirarchy under level 3.

(ii) The fair value of derivatives and investment securities are calculated by utilising internal valuation models. External market data is used within these internal valuation models. Derivatives are held for trading. Investment securities are designated at fair value through profit or loss. Movements in the valuations of derivatives and investment securities are treated as fair value through profit and loss, and these financial assets and liabilities are grouped into the fair value hierarchy under level 2.

(iii) The fair value of loans and advances to customers at a variable rate of interest is assumed to approximate to their carrying amounts. The fair value of loans and advances at a fixed rate of interest is estimated by internal valuation models. External market data is used within these internal valuation models.

(iv) All other financial assets and liabilities are held at amortised cost.

The Group has disclosed within these financial statements all the assets and liabilities for which fair values are required. The Board does not believe it is necessary to place a fair value on the outstanding minimal amount of assets and liabilities on which a fair value has not been placed as these predominantly attract variable rates of interest and therefore their carrying value is deemed to reflect their fair value.

The accounting policies for financial instruments have been applied to the items below.

Group	2012		2011*	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets	£000	£000	£000	£000
Cash and balances with the Bank of England	50,377	50,377	50,129	50,129
Loans and advances to credit institutions	24,992	24,992	49,745	49,745
Investment securities	67,561	67,561	85,236	85,236
Derivative financial instruments	1,097	1,097	1,953	1,953
Loans and advances to customers	574,383	575,297	613,425	614,233
Investments	250	250	250	250
	718,660	719,574	800,738	801,546
Financial liabilities	£000	£000	£000	£000
Deposits from banks	22,604	22,604	25,103	25,103
Other deposits	58,973	58,973	49,355	49,355
Derivative financial instruments	42,101	42,101	37,875	37,875
Due to customers	617,009	618,842	693,522	697,286
Other borrowed funds	15,700	15,700	15,700	15,700
	756,387	758,220	821,555	825,319

Society	2012		2011*	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets	£000	£000	£000	£000
Cash and balances with the Bank of England	50,377	50,377	50,129	50,129
Loans and advances to credit institutions	24,942	24,942	49,745	49,745
Investment securities	67,561	67,561	85,236	85,236
Derivative financial instruments	1,097	1,097	1,953	1,953
Loans and advances to customers	559,846	560,654	597,448	598,256
Investments	250	250	250	250
	704,073	704,881	784,761	785,569
Financial liabilities	£000	£000	£000	£000
Deposits from banks	22,604	22,604	25,103	25,103
Other deposits	58,973	58,973	49,355	49,355
Derivative financial instruments	42,101	42,101	37,875	37,875
Due to customers	617,009	618,842	693,522	697,286
Other borrowed funds	15,700	15,700	15,700	15,700
	756,387	758,220	821,555	825,319

*** Restated**

d. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the financial year. Estimates and judgements are continually evaluated by reference to historical experience and other factors, including expectations of future events that are believed to be reasonable.

(i) Impairment losses on loans and advances

The Group reviews its portfolio of loans to assess potential impairment at least on a quarterly basis. For any account that is three months or more in arrears, the recoverability of the balance due is assessed by reference to the sum outstanding, the estimated value of the property and, if appropriate, the costs of disposal if possession is deemed likely. Further, in determining whether an impairment loss should be recorded in profit or loss, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the Group. The methodology used and assumptions made are reviewed periodically.

(ii) Effective Interest Rate ("EIR")

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, or when appropriate a shorter period, to the net carrying amount of the financial asset or financial liability. Estimates and judgements need to be applied by management in order to determine a suitable EIR. In order to calculate the effective interest rate, the Group needs to estimate cash flows that will arise; to do so, the assessment process includes the consideration of all contractual terms of the financial instrument but it excludes the potential for future credit losses. The EIR calculation includes all fees paid or received, all transaction costs and any other premia or discounts.

(iii) Financial Services Compensation Scheme ("FSCS")

During 2008, claims were made on the FSCS following the failure of Bradford & Bingley plc in September, Heritable Bank plc and Kaupthing Singer and Friedlander Limited in October and London Scottish Bank plc in November. In order to fund the claims made under its terms of operation, the FSCS has borrowed from the Bank of England and HM Treasury. In relation to costs incurred, the FSCS pays interest on its borrowings, it incurs operating expenses in its own right and incurs capital losses where shortfalls arise on the realisations of assets that it is managing from the failed banks detailed above. The costs of the FSCS are passed on to all UK banks and building societies.

The Society makes provision for the charge based on estimates of its share of the total levy that the FSCS will raise by comparing its level of "protected deposits" with those of all deposit taking institutions covered by the FSCS. The Society's estimates are sensitive to the level of estimated management expenditure incurred by the FSCS and the level of capital losses that will arise in future periods as the FSCS undertake the management of the assets of the failed banks.

(iv) Treasury counterparty instruments

The Group's risk appetite for losses arising from its treasury activities is low. The current liquidity profile includes simple form instruments whilst other liquidity is deposited with the Bank of England or with a small number of UK counterparty banks on an instant-access basis. Periodically, the Society reviews the credit worthiness of its banking counterparties. Historic balances are held with two failed Icelandic banking institutions and these have been written down to reflect their impairment. In order to validate the carrying values of these balances, the Society reviews the information and data that is provided on a half yearly basis by the UK administrators of the failed banks. It reviews and, where appropriate, revises its recoverability estimates on these balances by reference to this data.

(v) Lifetime mortgage loans

The Society's lifetime mortgages total £112.8m. The loans offer borrowers the ability to release an element of equity from their property, subject to tightly controlled underwriting criteria. All loans are at rates of interest that are fixed for the duration of the mortgage; at inception, LTVs are low and borrowers are all above the age of 60. Borrowers do not make monthly repayments; instead under their contractual terms, interest is capitalised within the balance and becomes repayable on redemption of the loan. Recoverability is assessed by projecting balances due on accounts by reference to expected future lives of borrowers and making assumptions regarding future values of the properties offered as security. The risk of loss is mitigated through the underwriting criteria applied. By lending to older borrowers at low LTV this reduces the chance of the value of the mortgage debt at the redemption date being in excess of the value of the property at that time. Across the book, the average rate of interest is 6.74%. As the product is designed for individuals who have passed normal retirement age, it is expected that a significant proportion of repayment events will arise following the death of the borrower. In assessing the recoverability of its lifetime mortgages, the Society forecasts the expected repayment sums due over a range of possible maturity dates using actuarial mortality tables. Future property values are assessed using publicly available current and long-run house price inflation data. Where there are any shortfalls in current or expected recoverability, a provision is made. Therefore, the assessment of recoverability is subject to some volatility, associated with the future value of the property.

(vi) Deferred tax

An asset is recognised to the extent that is it probable that future taxable profits will be available for utilisation of the deferred tax value concerned. The most critical element of judgement applied is that relating to the Society's forecast profitability. The profitability forecasts use a modelling application wherein assumptions relating to future interest margin and levels of other income and expense are combined to produce both balance sheet and profit and loss projection data. The assumptions regarding underlying interest margin are consistent with those of previous years and are further supported by the current levels of interest margin being reported. Further details may be found in note 19.

e. Segmental Analysis

The Group's results are predominately derived from the Society's principal activities. The Group's other income streams are not sufficiently material to require segmental reporting.

2. RESTATEMENT

Hedge Accounting: IAS 39 – Financial Instruments: Recognition and Disclosure

Included within the range of mortgage products that it offers to its members, the Society has a number where the rate of interest paid by the borrower is fixed. By offering fixed rate products, the Society is exposed to the risk that future movements in interest rates will see its interest margin adversely affected; this is termed interest rate risk. In order to reduce its interest rate risk, the Society entered into simple-form interest rate swap arrangements; by so doing, it agrees with its counterparties that it will transform this risk from a fixed rate of interest to a floating rate, thereby locking in an interest margin and gaining some certainty as to the fixed margin that it will earn on such fixed rate lending. The total value of mortgages at 31 December 2012 that had been subject to interest rate swaps was £167.7m. The swap and the designated mortgages were accounted for using the hedge accounting principles of IAS 39. Under the terms of IAS 39, the Society had calculated the fair value of the swaps and the fair values of the mortgages at each year end, since 2006 when it first adopted hedge accounting. As the fair values of both the swaps and the mortgages vary over time by reference to LIBOR rates, there was some volatility in these values at each year end. IAS 39 requires that, when there is an effective hedging relationship in place, the volatility in the market value of the swaps are offset in the Society's accounts by the fair value adjustment to the mortgages – in practise, these fair values offset each other as they are in opposite directions, with limited volatility remaining in the Statement of Comprehensive Income.

The Society has now identified that the swap arrangements it had entered into in respect of these assets did not meet the technical requirements for hedge accounting under IAS 39. As a result of this, the fair value movements in the swaps remain to be recognised fully through the Statement of Comprehensive Income, whilst there is no fair value ascribed to the mortgage assets and they are recorded in the Statement of Financial Position at their amortised cost. At 31 December 2011, the fair value that had been ascribed to the mortgages was £39.2m; this position has now been reversed through a restatement.

As a consequence of this change in treatment a deferred tax asset has also been recognised.

Permanent Interest Bearing Shares

The Society has two tranches of Permanent Interest Bearing Shares ("PIBS") in issue – dated 1999 and 2005. Both sets of instruments do not have any innovative features and were issued with the intention of enhancing the Society's regulatory capital position. They are governed by separate Offering Circular documents. In previous years, the PIBS have been classified within the Liabilities section of the Statement of Financial Position. A review during 2012 of the Offering Circulars and the specific terms of IAS 32 - *Financial Instruments: Presentation,* now suggests that the instruments do not confer a contractual obligation on the Society to deliver cash in the form of interest payments, as there is discretion on the part of the Board to cancel in part or in whole any interest payment due. Whilst it is not the Board's intention to avail itself of these cancellation rights, such discretionary interest terms point towards the instruments being more suitably categorised as Equity. Accordingly, the £14.788m has been re-classified as Equity within the 2012 results and the positions for 2011 and earlier years have been restated to show a similar treatment and disclosure. The effect of the restatement is that the interest payable on the PIBS is disclosed within the Statement of Changes in Equity, rather than within the Statement of Comprehensive Income. The impact of the restatement is that there is no change to the Society's total asset position or to its retained earnings.

2. Restatement (continued)

The effect of the restatement in the Income Statements and Balance Sheets is as follows:

Income statement	Original 2011 £000	*Reclassification and restatement*	Restated 2011 £000
Interest and similar income	31,823	-	31,823
Interest expense and similar charges	(22,143)	5,648	(16,495)
Net interest income	9,680	5,648	15,328
Fees and commission income	433	-	433
Fees and commission expense	(80)	-	(80)
Income from investment	83	-	83
Other operating income	163	-	163
Loss from derivatives	(855)	(28,100)	(28,955)
Total net income	9,424	(22,452)	(13,028)
Administrative expenses	(4,409)	-	(4,409)
Depreciation	(302)	-	(302)
Other operating charges	(94)	-	(94)
Impairment losses	(3,882)	-	(3,882)
FSCS Levy	(354)	-	(354)
Net gain on financial assets designated at fair value through profit or loss	207	-	207
Profit/(loss) on ordinary activity before income tax and disposal of investment	590	(22,452)	(21,862)
Income tax (expense)/credit	(201)	4,659	4,458
Profit/(loss) on continuing operations	389	(17,793)	(17,404)
Profit on discontinued operations	5,964	-	5,964
Profit/(loss) for this year	6,353	(17,793)	(11,440)

Balance sheet	Original 2010 £000	*Movement relating to earlier yrs £000*	*Movement relating to 2010 £000*	Restated 2010 £000	Original 2011 £000	*Movement relating to earlier yrs £000*	*Movement relating to 2011 £000*	Restated 2011 £000
Assets								
Liquid assets	209,757	-	-	209,757	185,110	-	-	185,110
Derivative financial instruments	1,758	-	-	1,758	1,953	-	-	1,953
Loans and advances to customers	651,837	(8,699)	(5,366)	637,772	651,017	(14,065)	(23,527)	613,425
Investments	250	-	-	250	250	-	-	250
Property, plant and equipment	8,882	-	-	8,882	8,696	-	-	8,696
Deferred income tax assets	268	2,705	1,234	4,207	190	3,939	5,141	9,270
Other assets	21,082	-	-	21,082	30,988	-	-	30,988
	893,834	(5,994)	(4,132)	883,708	878,204	(10,126)	(18,386)	849,692
Liabilities								
Deposits from banks	24,727	-	-	24,727	25,103	-	-	25,103
Other deposits	35,194	-	-	35,194	49,355	-	-	49,355
Derivative financial instruments	17,569	-	-	17,569	37,875	-	-	37,875
Due to customers	720,896	-	-	720,896	693,522	-	-	693,522
Other borrowed funds	15,700	-	-	15,700	15,700	-	-	15,700
Other liabilities	32,393	-	3	32,396	2,834	3	-	2,837
Current income tax liabilities	132	-	-	132	126	-	197	323
Liabilities and charges	370	-	-	370	483	-	-	483
Subscribed capital	14,788	-	(14,788)	-	14,788	-	(14,788)	-
	861,769	-	(14,785)	846,984	839,786	3	(14,591)	825,198
Equity								
Retained earnings	32,065	(5,994)	(4,135)	21,936	38,418	(10,129)	(18,583)	9,706
Subscribed capital	-	-	14,788	14,788	-	-	14,788	14,788
Total equity	32,065	(5,994)	10,653	36,724	38,418	(10,129)	(3,795)	24,494
Total equity & liabilities	893,834	(5,994)	(4,132)	883,708	878,204	(10,126)	(18,386)	849,692

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

3. Interest and similar income

	Group 2012 £000	Group 2011* £000	Society 2012 £000	Society 2011* £000
On loans fully secured on residential property	24,122	24,855	22,966	23,649
On other loans	1,807	1,971	1,807	1,971
On debt securities	1,993	2,836	1,993	2,836
On other liquid assets	758	768	758	768
Sale of negotiable treasury instruments	95	1,393	95	1,393
	28,775	31,823	27,619	30,617

***Restated**

Periodically the Society reviews its liquidity instrument portfolio and occassionally it divests of instruments if deemed appropriate. During 2011, this approach delivered a gain of £1.39m, but the position for 2012 was much lower, at £95k.

Other than £3.1m (2011: £3.1m) generated on loans originating in Spain, all interest receivable and similar income has been generated within the United Kingdom.

4. Interest expense and similar charges

	Group 2012 £000	Group 2011* £000	Society 2012 £000	Society 2011* £000
On shares held by individuals	14,972	14,801	14,972	14,801
On deposits and other borrowings				
Subordinated liabilities	719	714	719	714
Other	1,330	980	1,330	980
	17,021	16,495	17,021	16,495

***Restated**

5. Other operating income and charges

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Income				
Rents receivable	23	163	-	-
Other	-	-	950	1,045
	23	163	950	1,045
Charges				
Rents payable	43	52	189	209
Other	34	42	11	-
	77	94	200	209

6. Loss from derivatives

	Group 2012 £000	Group 2011* £000	Society 2012 £000	Society 2011* £000
Fair value loss from derivatives	(3,773)	(24,382)	(3,773)	(24,382)
During the period the following interest receipts and payments were completed in respect of:				
Interest rate swaps: receipts	3,422	4,090	3,422	4,090
payments	(7,926)	(8,663)	(7,926)	(8,663)
Loss from derivatives	(8,277)	(28,955)	(8,277)	(28,955)

***Restated**

7. Income from investments

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Income from equity shares	-	83	-	83
	-	83	-	83

8. Administrative expenses

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Employee costs				
Wages and salaries	2,188	2,075	2,188	2,075
Social security costs	233	226	233	226
Pension costs	201	183	201	183
	2,622	2,484	2,622	2,484
Other administrative expenses	1,965	1,925	1,721	1,803
	4,587	4,409	4,343	4,287
Other administrative expenses include:				
Auditors' remuneration				
Audit fees				
Audit of parent and group by parent company auditors	69	67	65	62
	69	67	65	62
Non-audit fees				
Tax services	22	14	18	14
Other services pursuant to legislation	-	6	-	6
	22	20	18	20

9. Employees

The average number of persons employed during the year for continuing operations was:

	Group 2012 Number	Group 2011 Number	Society 2012 Number	Society 2011 Number
Full-time	65	65	65	65
Part-time	5	6	5	6
Total	70	71	70	71

10. Directors' emoluments

Executive directors	Salary £000	Pension Contributions £000	Bonus* £000	Benefits £000	Total £000
2012					
D.E. Cowie	194	33	-	17	244
C.W. Gee	117	14	-	11	142
P.A. Lynch	117	14	-	11	142
I.M. Richardson	117	14	-	10	141
	545	75	-	49	669
2011					
D.E. Cowie	192	30	16	17	255
C.W. Gee	115	13	-	11	139
P.A. Lynch	115	13	-	11	139
I.M. Richardson	115	13	-	10	138
	537	69	16	49	671

** represents final payment made in relation to historic bonus scheme arrangements; entitlement to future bonuses ceased with effect from 1 January 2011.*

Non-executive directors	Fees 2012 £000	Fees 2011 £000
J.P. Allen	29	28
R.W. Dyson	29	28
A. Finch	29	28
S.M. Molloy	29	28
M.J. Prior	50	49
J. Smith	35	35
	201	196
Total directors’ emoluments	870	867

Directors’ loans and transactions:

The Board’s continuing policy is not to provide loans to any director. In accordance with sections 68 and 69 of the Building Societies Act 1986 a register of transactions is maintained at the Society's head office which shows details of all loans, transactions and arrangements with directors and connected persons. Mrs S. M. Molloy is a partner in Gateley LLP who provide legal services to the Group. In 2012 Gateley LLP have been paid £74,148 inclusive of VAT for legal services rendered.

11. Income tax expense

	Group 2012 £000	Group 2011* £000	Society 2012 £000	Society 2011* £000
Results for the year before tax	(2,330)	(15,898)	(1,582)	(16,810)
Tax rate	24.5%	26.5%	24.5%	26.5%
Expected tax expense	(571)	(4,213)	(387)	(4,455)
Adjustment for non-deductible items	43	41	17	12
Income not taxable	-	(1,601)	-	(1,408)
Other adjustments	-	12	-	12
Reversal of fair value adjustments	1,026	6,232	1,025	6,232
Allowable loss on fair value adjustments	-	-	-	-
Deferred tax on derivative contracts	(903)	(5,635)	(903)	(5,635)
Effect of current year events on current tax prior year balances	(2)	(71)	(3)	(71)
Adjust deferred tax balances to average rate	800	778	786	781
Marginal relief	-	(1)	-	-
Actual tax expense, net	393	(4,458)	535	(4,532)
Comprising				
Current tax expense	544	690	447	631
Current tax adjustment in respect of prior periods	(2)	(71)	(3)	(71)
Deferred tax expenses	(891)	(5,526)	(652)	(5,542)
Effect of tax rate change on opening balance	742	449	743	450
	393	(4,458)	535	(4,532)

***Restated**

12. Loans and advances to credit institutions

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Accrued interest	22	43	22	43
Repayable on demand	25,422	50,573	25,372	50,523
Other loans and advances by residual maturity repayable:				
More than five years	118	129	118	129
Impairment	(570)	(1,000)	(570)	(1,000)
	24,992	49,745	24,942	49,695

13. Investment securities

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Government investment securities	9,995	10,115	9,995	10,115
Listed private sector investment securities	57,566	75,121	57,566	75,121
	67,561	85,236	67,561	85,236
Investment securities have remaining maturities as follows:				
Accrued interest	647	349	647	349
In not more than three months	15,017	10,450	15,017	10,450
In more than three months but not more than one year	17,293	17,647	17,293	17,647
In more than one year but not more than 5 years	34,604	56,790	34,604	56,790
	67,561	85,236	67,561	85,236

Investment securities are designated at fair value through profit and loss.
The directors of the Society consider that the primary purpose of holding investment securities is prudential.
The securities are held as liquid assets with the intention of use on a continuing basis in the Group's activities.

The movement excluding accrued interest in investment securities is summarised as follows:

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
At 1 January	84,887	106,381	84,887	106,381
Additions	64,984	95,627	64,984	95,627
Fair value adjustment	(1)	207	(1)	207
Disposals	(82,956)	(117,328)	(82,956)	(117,328)
At 31 December	66,914	84,887	66,914	84,887

14. Derivative financial instruments and trading liabilities - Group and Society

The Group uses interest rate swap derivative instruments for both hedging and non-hedging purposes. The Group uses foreign exchange forward contracts for hedging purposes.

Interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of interest rates (for example, fixed rate for floating rate). No exchange of principal takes place. The Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligations. This risk is monitored on an ongoing basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Group assesses counterparties using similar techniques as for its lending activities. The fair value is based on the current discounted cash flows of the swaps when compared with the current interest rate yields.

All derivative financial instruments are held for economic purposes.

	Notional Amount	Fair Values Assets	Fair Values Liabilities
Derivatives held as at 31 December 2012	**£000**	**£000**	**£000**
Interest rate swaps	186,189	344	41,756
Exchange rate swaps	46,526	753	345
	232,715	1,097	42,101
Derivatives have remaining maturities as follows:			
Up to 3 months	7,871	870	1,924
3 to 6 months	16,656	-	275
6 to 12 months	16,964	-	127
1 to 5 years	52,613	148	937
5 to 10 years	29,395	-	5,402
10 to 20 years	41,482	-	11,003
20 to 30 years	14,734	79	3,703
Over 30 years	53,000	-	18,730
	232,715	1,097	42,101
Derivatives held as at 31 December 2011			
Interest rate swaps	214,755	543	37,583
Exchange rate swaps	46,486	1,410	292
	261,241	1,953	37,875

The following table describes the significant activities undertaken by the Group, the risks associated with such activities and the types of derivatives which are typically used in managing such risks.

Activity	Risk	Type of derivative instruments used
Fixed rate savings products and funding activities in Sterling involving fixed rate instruments	Sensitivity to changes in interest rates	Interest rate swaps
Fixed and capped rate mortgage lending	Sensitivity to changes in interest rates	Interest rate swaps
Mortgage lending in Euros	Sensitivity to changes in exchange rates	Exchange rate swaps

15. Loans and advances to customers

	Group 2012 £000	Group 2011* £000	Society 2012 £000	Society 2011* £000
Loans fully secured on residential property	532,176	567,375	517,639	551,398
Loans fully secured on land	39,486	42,243	39,486	42,243
Other loans	2,721	3,807	2,721	3,807
	574,383	613,425	559,846	597,448

At 31 December 2012 the Group had €57.1m (2011: €55.6m) of loans denominated in Euros. These were converted into £ Sterling at a rate of €1.2261 to the £.

Maturity analysis

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

	Group 2012 £000	Group 2011* £000	Society 2012 £000	Society 2011* £000
Repayable on demand	9,224	7,362	9,224	7,362
Other loans and advances secured by residual maturity repayable:				
In not more than three months	2,767	3,672	2,767	3,519
In more than three months but not more than one year	7,132	18,032	6,561	17,346
In more than one year but not more than five years	65,502	96,718	63,011	94,224
In more than five years	497,533	495,250	485,043	482,308
	582,158	621,034	566,606	604,759
Less: Allowance for impairment losses on loans and advances				
Capital (see overleaf)	(7,389)	(7,265)	(6,374)	(6,967)
Interest	(386)	(344)	(386)	(344)
***Restated**	574,383	613,425	559,846	597,448

The Group's experience is that, in many cases, mortgages are redeemed before their natural redemption date. As a consequence, the maturity analysis above may not reflect actual experience.

15. Loans and advances to customers (continued)

Impairment losses on loans and advances	Other Loans	Loans fully secured on residential property	Other Loans fully secured on land	Total
Group	**£000**	**£000**	**£000**	**£000**
At 1 January 2012				
Individually identified	519	3,301	1,589	5,409
Collectively identified	-	1,756	100	1,856
	519	5,057	1,689	7,265
Amounts written off during the year				
Individually identified	(352)	(457)	-	(809)
Collectively identified	-	-	-	-
	(352)	(457)	-	(809)
Statement of Comprehensive Income - Impairment losses on loans and advances				
Individually identified	(86)	708	119	741
Collectively identified	-	192	-	192
Charge for the year	(86)	900	119	933
At 31 December 2012				
Individually identified	81	3,552	1,708	5,341
Collectively identified	-	1,948	100	2,048
	81	5,500	1,808	7,389

	Other Loans	Loans fully secured on residential property	Other Loans fully secured on land	Total
Society	**£000**	**£000**	**£000**	**£000**
At 1 January 2012				
Individually identified	519	3,003	1,589	5,111
Collectively identified	-	1,756	100	1,856
	519	4,759	1,689	6,967
Amounts written off during the year				
Individually identified	(352)	(457)	-	(809)
Collectively identified	-	-	-	-
	(352)	(457)	-	(809)
Statement of Comprehensive Income - Impairment losses on loans and advances				
Individually identified	(86)	1,006	119	1,039
Collectively identified	-	(823)	-	(823)
Charge for the year	(86)	183	119	216
At 31 December 2012				
Individually identified	81	3,552	1,708	5,341
Collectively identified	-	933	100	1,033
	81	4,485	1,808	6,374

15. Loans and advances to customers (continued)

Impairment losses on loans and advances	Other Loans	Loans fully secured on residential property	Other Loans fully secured on land	Total
Group	**£000**	**£000**	**£000**	**£000**
At 1 January 2011				
Individually identified	3,216	2,011	230	5,457
Collectively identified	-	861	100	961
	3,216	2,872	330	6,418
Amounts written off during the year				
Individually identified	(1,703)	(195)	-	(1,898)
Collectively identified	-	-	-	-
	(1,703)	(195)	-	(1,898)
Statement of Comprehensive Income - Impairment losses on loans and advances				
Individually identified	433	1,195	1,359	2,987
Collectively identified	-	895	-	895
Charge for the year	433	2,090	1,359	3,882
(Unwind)/acquired on disposal of subsidiary*				
Individually identified	(1,427)	290	-	(1,137)
Collectively identified	-	-	-	-
	(1,427)	290	-	(1,137)
At 31 December 2011				
Individually identified	519	3,301	1,589	5,409
Collectively identified	-	1,756	100	1,856
	519	5,057	1,689	7,265

	Other Loans	Loans fully secured on residential property	Other Loans fully secured on land	Total
Society	**£000**	**£000**	**£000**	**£000**
At 1 January 2011				
Individually identified	1,789	1,713	230	3,732
Collectively identified	-	861	100	961
	1,789	2,574	330	4,693
Amounts written off during the year				
Individually identified	(1,703)	(195)	-	(1,898)
Collectively identified	-	-	-	-
	(1,703)	(195)	-	(1,898)
Statement of Comprehensive Income - Impairment losses on loans and advances				
Individually identified	433	1,195	1,359	2,987
Collectively identified	-	895	-	895
Charge for the year	433	2,090	1,359	3,882
Acquired on disposal of subsidiary*				
Individually identified	-	290	-	290
Collectively identified	-	-	-	-
	-	290	-	290
At 31 December 2011				
Individually identified	519	3,003	1,589	5,111
Collectively identified	-	1,756	100	1,856
	519	4,759	1,689	6,967

**These provision movements relate to the provisions of the Society's wholly owned subsidiary Whiteaway Laidlaw Bank which was sold on 31 January 2011.*

16. Impairment losses

	Group		Society	
	2012 £000	2011 £000	2012 £000	2011 £000
Impairment losses on loans and advances to customers-on residential property & land (see note 15)	353	3,322	(364)	3,322
-lifetime mortgages	580	560	580	560
Reversal of Impairment losses on loans and advances to credit institutions (see note 12)	(430)	-	(430)	-
	503	3,882	(214)	3,882

17. Investments

Investments in subsidiary undertakings - Society	Shares £000	Loans £000	Total £000
At 1 January 2012	2	25,016	25,018
Repayments	-	(550)	(550)
At 31 December 2012	2	24,466	24,468

100% held subsidiary undertakings	Nature of Business	Country of Incorporation
MBS (Mortgages) Limited	Mortgage lending	England
MBS (Property) Limited	Property ownership	England

Trade Investments - Group and Society	2012 £000	2011 £000
At 1 January	250	250
At 31 December	250	250

The above trade investment represents a minority share in an unquoted investment for which there is no active market. This investment is therefore carried at historic cost.

18. Property, plant and equipment

Group	Land and buildings £000	Alterations, fixtures and equipment £000	Total £000
Cost			
As at 1 January 2012	8,538	1,508	10,046
Additions	-	56	56
As at 31 December 2012	8,538	1,564	10,102
Accumulated Depreciation			
As at 1 January 2012	539	811	1,350
Charge for the year	111	164	275
As at 31 December 2012	650	975	1,625
Carrying amount			
As at 31 December 2012	7,888	589	8,477
As at 31 December 2011	7,999	697	8,696

Society	Land and buildings £000	Alterations, fixtures and equipment £000	Total £000
Cost			
As at 1 January 2012	-	1,274	1,274
Additions	-	56	56
As at 31 December 2012	-	1,330	1,330
Accumulated Depreciation			
As at 1 January 2012	-	1,041	1,041
Charge for the year	-	136	136
As at 31 December 2012	-	1,177	1,177
Carrying amount			
As at 31 December 2012	-	153	153
As at 31 December 2011	-	233	233

Freehold land and buildings occupied by the Group and Society for its own activities as at 31 December 2012.	7,888

18. Property, plant and equipment (continued)

Group	Land and buildings £000	Alterations, fixtures and equipment £000	Total £000
Cost			
As at 1 January 2011	8,538	1,392	9,930
Additions	-	116	116
As at 31 December 2011	8,538	1,508	10,046
Accumulated Depreciation			
As at 1 January 2011	429	619	1,048
Charge for the year	110	192	302
As at 31 December 2011	539	811	1,350
Carrying amount			
As at 31 December 2011	7,999	697	8,696
As at 31 December 2010	8,109	773	8,882

Society	Land and buildings £000	Alterations, fixtures and equipment £000	Total £000
Cost			
As at 1 January 2011	-	1,238	1,238
Additions	-	36	36
As at 31 December 2011	-	1,274	1,274
Accumulated Depreciation			
As at 1 January 2011	-	875	875
Charge for the year	-	166	166
As at 31 December 2011	-	1,041	1,041
Carrying amount			
As at 31 December 2011	-	233	233
As at 31 December 2010	-	363	363

19. Deferred income taxes

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 24.5% (2011: 26.5%). The movement on the deferred income tax account is as follows:

	Group		Society	
	2012 £000	* 2011 £000	2012 £000	* 2011 £000
At 1 January	9,270	4,207	9,293	4,201
Statement of comprehensive income	149	5,077	(91)	5,092
Disposal Group	-	(14)	-	-
At 31 December	9,419	9,270	9,202	9,293
Other provisions	(26)	(36)	(26)	(36)
Provision for loan impairment	471	464	238	464
Accelerated tax depreciation	16	18	32	41
Tax losses	-	-	-	-
Deferred tax asset on derivative contracts	8,958	8,824	8,958	8,824
Net deferred tax income tax assets	9,419	9,270	9,202	9,293

The deferred tax credit/(expense) in the statement of comprehensive income comprises the following temporary differences:

	Group 2012	Group 2011	Society 2012	Society 2011
Other provisions	10	14	11	14
Prior year adjustment	-	-	-	-
Provision for loan impairment	7	195	(227)	195
Accelerated tax depreciation	(2)	(18)	(9)	(3)
Deferred tax movement on derivative contracts	134	4,886	134	4,886
Net deferred income tax credit/(expense)	149	5,077	(91)	5,092

***Restated**

The Group prepares financial forecasts over short, medium and long term time horizons. It is recognised that the projections that show longer term positions are more susceptible to change and therefore, they are used to indicate the Group's direction-of-travel for strategic planning purposes. Notwithstanding this, when adverse stresses are applied to the Group's longer term forecasts, a continued and sustained level of underlying profitability continues to be projected. With these projections in mind, the deferred income tax asset is substantially recovered over a period of twenty years. The tax asset is projected for a greater rate of recovery in earlier years, with approximately 80% of the tax asset forecast for recovery within the next 10 years.

20. Other assets

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Amounts due within one year				
Credit support annex	42,255	29,822	42,255	29,822
Prepayments	1,217	1,066	878	925
Other assets	50	100	50	100
	43,522	30,988	43,183	30,847

The Credit support annex balances represent the sums deposited by the Society with its interest rate swap counterparties to collateralise the derivatives issued. The balances, whilst in cash form, are not included within Liquid Assets. Whilst the nominal balance of derivatives remained unchanged, the balance increased during 2012 as a result of a downward movement in yield curves.

21. Deposits from banks

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Amounts owed to credit institutions are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	104	103	104	103
Other amounts owed to credit institutions by residual maturity repayable:				
In not more than three months	9,500	15,500	9,500	15,500
In more than three months but not more than one year	13,000	9,500	13,000	9,500
	22,604	25,103	22,604	25,103

22. Other deposits

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Amounts owed to other deposit customers are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	241	206	241	206
Repayable on demand	548	705	548	705
Other amounts owed to other deposit customers by residual maturity repayable:				
In not more than three months	22,184	20,500	22,184	20,500
In more than three months but not more than one year	21,000	12,944	21,000	12,944
In more than one year but not more than five years	15,000	15,000	15,000	15,000
	58,973	49,355	58,973	49,355

£24m nominal value of UK Lifetime Mortgages is pledged as collateral for £15m of deposits that are repayable in more than one year but not more than five years; the collateral is released upon repayment.

23. Due to customers

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Held by individuals	617,009	693,522	617,009	693,522
Shares are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	2,703	745	2,703	745
Repayable on demand	317,256	207,790	317,256	207,790
Other shares by residual maturity repayable:				
In not more than three months	251,788	400,143	251,788	400,143
In more than three months but not more than one year	24,130	62,262	24,130	62,262
In more than one year but not more than five years	21,132	22,582	21,132	22,582
	617,009	693,522	617,009	693,522

24. Other borrowed funds

Subordinated loans		Group and Society 2012 £000	Group and Society 2011 £000
Loan repayable 2015	(Fixed interest rate of 7.362%)	1,500	1,500
Loan repayable 2022	(Variable interest rate of 3 month LIBOR plus 1.75%)	5,000	5,000
Loan repayable 2023	(Variable interest rate of 3 month LIBOR plus 2.45%)	4,200	4,200
Loan repayable 2032	(Fixed interest rate of 6.70%)	5,000	5,000
		15,700	15,700

The subordinated loans were taken to assist the financing of future development.
The loans exist for a fixed period and the Society has the option to prepay the loans at par 5 years prior to the final repayment dates.

25. Other liabilities

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
Amounts falling due within one year:				
Income tax - deducted from interest payments to customers	705	1,557	705	1,557
Taxation and social security	75	102	75	102
Creditors	286	356	283	354
Interest accrued on subordinated liabilities	159	164	159	164
Accruals	428	658	389	595
	1,653	2,837	1,611	2,772

26. Subscribed capital

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
8.00% Permanent Interest Bearing Shares	5,000	5,000	5,000	5,000
6.75% Permanent Interest Bearing Shares	9,788	9,788	9,788	9,788
	14,788	14,788	14,788	14,788

The Society's two tranches of PIBS are unsecured and rank pari passu with each other. In priority terms, the PIBS holders rank behind the Society's depositing members, its wholesale counterparties and all subordinated note holders.

Under the terms of offer, the Board may, subject to a resolution, cancel in whole or in part any scheduled interest payment due to holders of the PIBS. Whilst the Board does not intend to avail itself of this discretion, the facility to do so results in the assertion that the PIBS should be considered not to confer a contractual obligation on the Society to deliver cash in the form of interest payments. As such, the PIBS are now treated as forming a part of the Society's equity, rather than being classified within the Liabilities section of the Statement of Financial Position.

27. Cash and cash equivalents

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
For the purposes of the cash flow statement, cash and cash equivalents comprises the following balances with less than three months maturity from the date of acquisition.				
Cash and balances with central banks	50,377	50,129	50,377	50,129
Loans and advances to credit institutions	24,852	50,573	24,802	50,523
	75,229	100,702	75,179	100,652

28. Related party transactions

The Society had the following transactions with its subsidiary undertakings during the year.

	2012 £000	2011 £000
(i) Subordinated loans		
As at 1 January	-	5,000
Disposal of subsidiary	-	(5,000)
As at 31 December	-	-
(ii) Current loan accounts - unsecured		
As at 1 January	25,016	25,820
Loans issued during the year	1,653	1,682
Loan repayments during the year	(2,203)	(2,464)
Disposal of subsidiary	-	(22)
As at 31 December	24,466	25,016
(iii) Interest income charged to subsidiaries	950	1,045
Interest is charged at pre-agreed rates which are either fixed, track the Bank of England base rate, or track LIBOR rates.		
(iv) Society recharge to subsidiaries of head office expenses	18	9

29. Financial commitments

	Group 2012 £000	Group 2011 £000	Society 2012 £000	Society 2011 £000
(i) Capital commitments				
Capital expenditure contracted for but not provided	188	-	188	-
(ii) Memorandum item				
Irrevocable undrawn loan facilities	-	212	-	212

(iii) Financial Services Compensation Scheme

The Society has a contingent liability which cannot be fully quantified in respect of contributions to the Financial Services Compensation Scheme ("FSCS") required by the Financial Services and Markets Act. A provision is included within the accounts and commentary on the accounting judgements that surround its calculation may be found in Note 1 (d).

In the event that other UK deposit taking institutions fail, there may be further claims made on the FSCS.

(iv) Lease commitments

At the financial position date, the Group had outstanding commitments as both lessor and lessee under operating leases. The financial commitments are shown below.

	Lessor 2012 £000	Lessee 2012 £000
Less than 1 year	-	50
1 to 5 years	-	192
Total	-	242

(v) Contingent liabilities

The Group does not have any other contingent liabilities.

30. Capital management

The Group's approach to capital management is summarised within the Business Review on page 5. Regulatory capital requirements are laid down by the Society's regulator; they are calculated, forecast and stress tested on a regular basis for the Board and period end positions are reported to the regulator.

The regulatory capital reported to the society's regulator at each year end is set out below. As a result of the restatement, the Group's capital was subsequently reduced. The Board issued £18m of new capital in April 2013 in the form of the PPDS in order to achieve a sound capital base and will take further actions to reduce risk and rebuild its reserves over the coming years.

	Group 2012 £000	Group 2011 £000
Tier 1 Capital		
General reserves	36,424	34,642
Subscribed capital	14,788	14,788
Total	51,212	49,430
Tier 2 Capital		
Subordinated debt	14,800	15,100
Collectively identified provisions	1,364	1,364
Total	16,164	16,464
Total regulatory capital as reported at 31 December	67,376	65,894

31. Non-adjusting events after the balance sheet date

During April 2013, the Society issued further subscribed capital in the form of £18m of PPDS. These instruments, issued and subscribed at par, are classified as equity within the Financial Statements and treated, for regulatory purposes as Core Equity Tier 1 capital. They have the effect of increasing the Society's total equity by £18m during 2013 thereby offsetting some of the depletion in capital that arose as a result of the restatement.

32. Disposal of subsidiary undertakings

	2011 £000
On 31 January 2011 the Group disposed of its 100% holding in Whiteaway Laidlaw Bank.	
The comprehensive income transactions of the disposal group were as follows:	
Revenue	105
Expenses	(205)
Loss before tax on Disposal Group assets classified as held for sale	(100)
Tax	11
Loss after tax on Disposal Group assets classified as held for sale	(89)
Profit on disposal of subsidiary	6,053
Net profit on disposal of subsidiary	5,964

The net asset position of Whiteaway Laidlaw Bank at 31 January 2011 was as follows:

Liquid assets	13,688
Loans and advances to customers	2,651
Property plant and equipment	12
Other assets	20,019
Deposits	(32,047)
Other liabilities	(226)
Net assets	4,097
Net proceeds of sale	10,150
Profit on disposal	6,053

Prior to the disposal of Whiteaway Laidlaw Bank, the Society acquired £19.7m of loans and advances from the Disposal Group.

The cash flows generated by the Disposal Group for the reporting periods under review are summarised as follows.

	2011 £000
Operating activities	-
Investing activities	10,150
Cashflow from discontinued operations	10,150

33. Liabilities and charges

	Group		Society	
Financial Services Compensation Scheme	2012 £000	2011 £000	2012 £000	2011 £000
At 1 January	483	370	483	370
Charge for the year	693	354	693	354
Provisions utilised	(293)	(241)	(293)	(241)
At 31 December	883	483	883	483

The Society's provision for FSCS charges arises from its operation as a UK deposit taker. In previous years, it had been expected that repayment of the FSCS' borrowings from HM Treasury would arise from amounts recovered from the failed institutions, whilst the interest cost of such borrowings would be passed on to all deposit-taking institutions covered by the FSCS in the form of a management expenses levy. During 2012 this position changed, as the FSCS announced that there was likely to be a shortfall in their overall level of recoverability; it indicated that it would levy this shortfall on deposit-taking institutions over the next three years. As a result of this, the provision at the end of 2012 includes the expected management expenses levy for the FSCS scheme year 2012/2013 and the estimate of the management expenses levy and the shortfall capital levy for the FSCS scheme year 2013/2014. No provision is made for scheme years beyond these periods. The levy is paid during Q3 each year and the Society does not expect to recover any sums paid.

ANNUAL BUSINESS STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2012

1. Statutory limits

	2012 %	Statutory % limit
Lending limit	15.49	25.0
Funding limit	11.68	50.0

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 Group plus provisions for bad and doubtful debts less liquid assets, tangible fixed assets and intangible assets as shown in the Group accounts.

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

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 or any subsidiary undertaking of the Society;
(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 or any such undertaking 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.

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

2. Other ratios

	2012 %	2011 %
As a percentage of shares and borrowings:		
Gross capital	5.2	5.2
Free capital	4.3	4.3
Liquid assets	20.5	24.1
As a percentage of mean total assets:		
Profit after taxation	(0.33)	(1.32)
Group management expenses	0.60	0.54
Society management expenses	0.55	0.52

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

'Shares and borrowings' represent the total of amounts due to customers, amounts owed to banks, amounts owed to other depositors and debt securities in issue in the Group statement of financial position.

'Gross capital' represents the aggregate of reserves, other borrowed funds and subscribed capital as shown in the Group statement of financial position.

'Free capital' represents the aggregate of gross capital and general loss provisions for bad and doubtful debts less property, plant and equipment in the Group statement of financial position.

'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year for the Group/Society.

'Liquid assets' represent the total of cash and balances with central banks, loans and advances to banks and debt trading securities in the Group statement of financial position.

'Management expenses' represent the aggregate of administrative expenses and depreciation taken from the Group/Society statement of comprehensive income.

3. Information relating to the directors and officers as at 31 December 2012

Name	Date of birth	Date of appointment	Occupation	Other directorships
Directors				
J.P. Allen	3.6.1953	Nov 2009	Consultant	Emerson Developments (Holdings) Ltd. J & JA Associates Ltd. Jones Homes Ltd. Pallet-Track Ltd.
D.E. Cowie	17.10.1951	Jul 1991	Building Society Executive	MBS (Mortgages) Ltd. MBS (Property) Ltd.
R.W. Dyson	10.1.1949	Jul 2008	Chartered Surveyor	Terrace Hill Group plc. Barncabin Ltd. Pennine Land Ltd.
A. Finch	14.8.1947	Jan 2007	Chartered Insurance Broker	Technical Risk Services Holdings Ltd. Technical Risk Ltd. British Insurance Brokers Association Ltd. AFL Insurance Brokers Ltd. Higher Lydgate Park Management Company Ltd. Purple Partnership Ltd. Worldwide Broker Network Ltd. AFL Risk Consulting Ltd.
C.W. Gee	22.6.1968	Jan 2005	Building Society Executive	MBS (Property) Ltd. MBS (Mortgages) Ltd.
P.A. Lynch	31.8.1969	Apr 2002	Building Society Executive	
S.M. Molloy	3.4.1951	Oct 2007	Solicitor	
M.J. Prior	22.7.1945	Jan 2005	Chartered Accountant	Catew Ltd. Bright Futures Educational Trust
I.M. Richardson	3.7.1966	Oct 2006	Building Society Executive	MBS (Property) Ltd. MBS (Mortgages) Ltd.
J. Smith	5.12.1950	May 2006	Certified Accountant	Rubicon West plc. JJF Services Ltd. Bright Tribe Trust Ltd.

Directors	Position	Date of signing service contract
D.E. Cowie	Chief Executive	22.11.2000
C.W. Gee	Finance Director	7.12.2004
P.A. Lynch	Operations Director	3.4.2002
I.M. Richardson	Executive Director	31.3.2007

All of the executive directors have employment contracts which are terminable by the Society by giving 12 months notice. The executive directors are required to give 6 months notice to the Society to terminate their contract.

Any documents may be served on the above named directors at the following address: Lyons Wilson, 1 Central Street, Manchester M2 5WR.

GLOSSARY

GLOSSARY OF TERMS USED BY BUILDING SOCIETIES

Administered Rate	An interest rate offered on mortgage or savings products that is set by the Society; it is varied at the Society's discretion, subject to any specific product terms.
BBR	Bank of England Base Rate; the rate of interest set by the Bank of England.
BoE	Bank of England.
BTL	Buy to Let; a mortgage product specifically offered for rented residential property.
Derivative	A security whose price is dependant upon or derived from one or more underlying assets.
DIP	Decision in Principle; request from an intermediary for a decision in principle which ordinarily includes a credit search. Positive responses, whilst not binding, provide reassurance to an adviser that an application would provide successful. A positive response issued is accompanied by a request for any other information that would be needed.
FOS	Financial Ombudsman Service.
FTB	First time buyer.
FRC	Financial Reporting Council.
FSA	Financial Services Authority.
Fully Secured On Land **Fully Secured On Residential Property**	These terms are defined in great detail within the Building Society Act 1986 and make clear the nature of security that is pledged when a mortgage loan is granted. The Act indicates that all mortgage loans are secured on land, but that in a number of cases (most notably where the borrower intends to occupy the property themselves), then the loan should be treated as being secured on residential property, whilst lending to commercial entities (albeit secured against commercial property) is classified as being Fully Secured On Land.
IFRS	International Financial Reporting Standards.
Interest margin	The difference between the interest that the Group earns on its mortgage and liquid assets, less the interest that it pays to its savers and on any wholesale funds that it borrows. It may be expressed as a percentage also.
LIBOR	London Inter-Bank Offered Rate; the average rate of interest that London banks charge each other for borrowing funds. The rates are considered to be external benchmark rates and are available for a number of different time periods.
Lifetime mortgage	A mortgage offered to borrowers above a certain age, where no capital or interest repayments are made during the life of the loan. Interest is rolled up and the total balance is repaid on redemption of the account. Also known as an equity release mortgage.
LTI	Loan to Income; the amount lent to a borrower expressed as a multiple of the value of the borrowers' income.
LTV	Loan to Value; the amount lent to a borrower expressed as a percentage of the value of the property offered as security.
Management expenses ratio	The management expense ratio measures the proportion that administration expenses bears to the average of total assets during the year. A lower ratio is desirable.
MPC	Bank of England Monetary Policy Committee.
PIP	Property in Possession.
SDLT	Stamp Duty Land Tax.
SVR	Standard Variable Rate; a rate of interest that is set by the Society and varied at its discretion (subject to any specific product terms) and which is not linked to an external benchmark rate such as BBR or LIBOR.
Swap	The exchange of one security for another. This could be for different interest rate basis, exchange rates, bonds etc.

External Auditors	Grant Thornton UK LLP. Grant Thornton House, Melton Street, Euston Square, London. NW1 2EP
Internal Auditors	Deloitte LLP. 2 Hardman Street, Manchester. M60 2AT

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