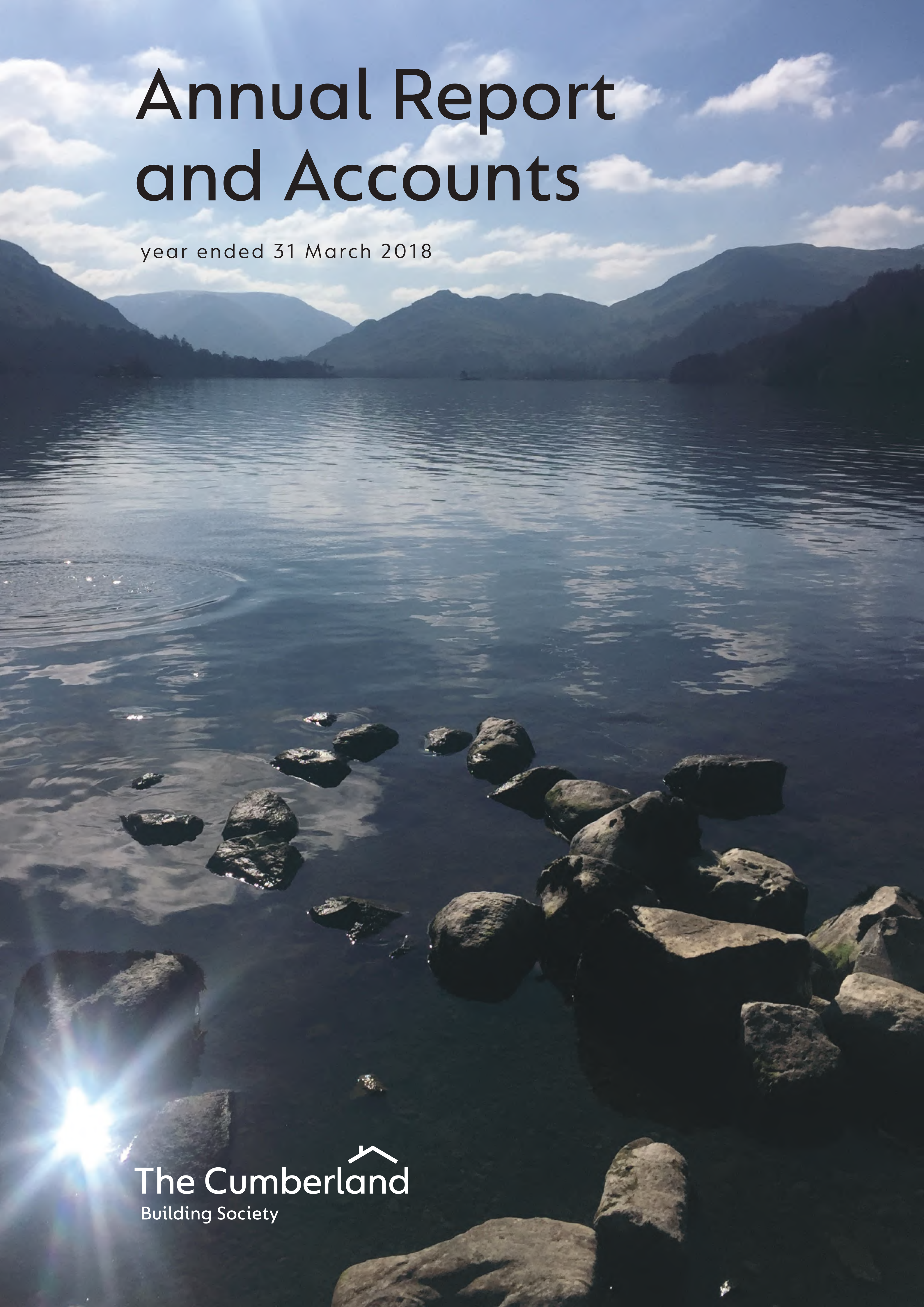
Annual Report and Accounts

year ended 31 March 2018



The Cumberland
Building Society

ANNUAL REPORT and ACCOUNTS

Year ended 31 March 2018

CHAIRMAN'S STATEMENT

I am pleased to report that the Cumberland has enjoyed another very successful year. Profitability has remained strong at £17.53 million after tax, 0.74% of mean assets; although this is slightly below last year's record, that was enhanced by the one off post-tax gain of £4.8 million from the sale of the Society's share in VISA Europe to VISA Inc. Mortgage balances grew by 8.05%, over £150 million, and share balances grew by 4.65%, with an inflow of funds of £78.6 million.

These achievements, building on those of previous years, have been based on the Society's successful long-term strategy of developing deep relationships with our members within our operating area, by providing them with a wide range of up to date financial products and services. A key source of the Cumberland's strength for many years has been its diversity, in that as well as residential mortgages and savings, it provides current accounts for both personal and business customers, commercial lending, estate agency and vehicle finance, and we will continue to strive to advance in all of these areas. Fundamental, however, remains our mutual status, and thus our commitment to provide the best possible value and service to our members.

With respect to value, for the fourth consecutive year, we were named 'Best Regional Building Society' at the Mortgage Finance Gazette Awards, for offering the most consistently competitive mortgage rates during the year. Although this highlights our competitiveness for new customers, we offer our existing borrowers the same or better products when their current mortgage deal expires. The Society's long established approach is also to ensure that existing savers receive variable rates which are the same as, or better than, those available to new customers.

With respect to service, we achieved the 'Best Customer Service' accolade at the same awards ceremony, following a submission which covered, amongst other things, our service and customer satisfaction levels. Using technology to improve service has been a strength of the Cumberland for many years. This year, we launched webchat to provide members with another means of engaging with our contact centre, and introduced Apple Pay and Google Pay for our current account customers, building on our track record of adopting mobile and internet banking innovations. Moreover, several of our branches have enjoyed significant increases in business volumes as the large banks have left a number of the towns in our operating area, and their personal and business customers are responding by joining the Cumberland to fulfil all of their financial services needs.

Further details of our financial and business performance, strategy, current view of our operating environment, service developments for members and community involvement are contained in the Strategic Report.

With respect to the Board, we are currently midway through some important changes in our Executive Director team. Kevin Parr stepped down from the Board on 31 March 2018 after over 24 years with the Society, including the last 15 as Chief Executive, during which time, the total assets of the Society have grown from £933 million to over £2.5 billion, and its retained profits have grown from £70 million to over £173 million. Those figures, spanning a period covering the financial crisis which saw the demise of a number of banks and building societies, speak volumes.

Chris McDonald left the Society on 30 April 2018 to pursue other opportunities after 12 years, including 11 as a member of the Society's Executive Committee, with the last four having been spent as Operations & Human Resources Director.

Peter Temple will retire on 31 August 2018 after 36 years with the Society, of which 20 were as a member of the Executive Committee, and having been a director for the last 11, most recently as Deputy Chief Executive.

Without being able to list their many achievements over their careers with the Society, which for each have featured direct involvement in almost all areas of the Society's operations, all three have made outstanding contributions to the Society's success and to its record of consistently being one of the most profitable in the sector for many years, combined with strong business growth. They have each been instrumental in the successful development of the Society's products and services, most notably as current accounts have changed out of all recognition over the last 15 years with the arrival of internet and mobile banking. Finally, but to them most importantly, they have been integral to the development of the Society's values and culture. This includes of course, the principle of putting members first and foremost in everything we do. They have also assisted in the development and progress of so many of the Society's team over the years, leading by their examples of enthusiasm, hard work and great care in respect of each and every decision taken.

Moving forward, Kevin has been succeeded by Des Moore, who joined us on 1 April 2018 from First Trust Bank which operates in Northern Ireland, and who thus has considerable experience of leading a regional banking institution which is very much rooted within the communities it serves. The Board is currently considering other changes to the senior management structure, being always mindful of the importance of the Society's mutual status and culture, together with the need to ensure the right balance of experience, knowledge and skills is in place to deliver the Society's strategy and business plan.

With respect to our non-executive directors, Peter Anstiss has stood down to pursue other opportunities, and Jackie Arnold joined the Board in March 2018, bringing with her a wealth of experience in finance, strategy and skills development, together with an in depth understanding of the local economy.

Whilst the Society's profitability over the last couple of years has been exceptional, it is not expected to continue at these levels. Going forward, it will face challenges from increasing costs as a result of burgeoning regulatory requirements from several sources, and in three years' time, from the interest margin impact of the withdrawal of the Government funding schemes. Nevertheless, underpinned by the solid foundations which have been put in place, and with its strong regional presence and terrific team of people throughout the business, allied with up to date technology and its track record of providing first class service and value for local people, I firmly believe that the Cumberland will continue to thrive and prosper and in doing so, assist our members to do so too.

Trevor Hebdon

Trevor Hebdon
Chairman 22 May 2018

STRATEGIC REPORT

The Directors have pleasure in presenting their 168th Annual Report, together with the Group Accounts and Annual Business Statement, for the year ended 31 March 2018.

BUSINESS OVERVIEW

Cumberland Building Society's vision is to continue to operate using a regional mutual banking model, growing on a sustainable and profitable basis for the benefit of existing and new members, being the preferred choice for financial services products in its operating area.

To achieve this, the Cumberland offers a wide range of financial services, principally through its branch offices, and delivers long term benefits to members through the provision of competitive products combined with excellent customer service.

The Cumberland Group, which principally consists of the Society along with subsidiaries which provide services to customers as set out below, aims to achieve sufficient profit to maintain its capital strength to safeguard the interests of members.

STRATEGY

The Society seeks to achieve its vision through its strategy based on the following elements:

- Mutual – remaining independent and mutual for the benefit of its members, treating them fairly and acting fairly in all that it does;
- Regional – offering products and services across its operating area;
- Direct – focusing on direct relationships with customers, particularly through digital channels, local branches and the local customer service team;
- Customer Focus – differentiating itself from its competitors by offering a market leading customer service and compelling customer experience to build long-term relationships with customers;
- Diversified – offering a broad range of products and services to customers. This includes money transmission services, estate agency sales and lettings and lending outside core residential / buy to let mortgages (holiday let, commercial lending, car finance); and
- Risk Focus – having an embedded culture and framework for ensuring that desired levels of risk are not exceeded in pursuit of the strategy and that risks are systematically managed throughout the business.

During 2017-18 the Board carried out its annual review of strategy which refined the Group's Corporate Plan. The Group's long-term strategy has been consistent for many years, based on the business model which follows, although naturally there are tactical adjustments to this in response to the operating environment of the time. Nevertheless, the strength of the strategy has been amply demonstrated over the last ten years, with the Group's profitability having remained amongst the strongest and steadiest in the building society sector throughout that time.

The Cumberland's strategic objectives include, as well as maintaining a strong capital position, achieving a suitable balance between profitability and the growth of the business, and the fair treatment of members with in particular, the maintenance of a fair balance between the interests of investing and borrowing members, both existing and new.

BUSINESS MODEL

The Society's business model is derived from the key elements of its strategy above.

The Board regards as essential, the establishment of direct relationships with members, and the deepening of these relationships through the provision of a wide range of services and excellent customer service. This is supported by:

- a strong branch network; the Society's branch operating area consists of Cumbria (with 26 branches), Dumfries and Galloway (5 branches), North Lancashire (with branches in Preston and Lancaster) and West Northumberland (a branch in Haltwhistle, with an area deemed to extend east to Hexham);
- a customer service centre within its Head Office in Carlisle; and
- the wide range of financial services offered, including a strong commitment to developing internet and mobile banking services for members as technology advances.

Therefore, as well as the traditional building society products such as residential mortgages and savings, the Group also operates:

- a full current account service, including internet banking for both personal and business customers, and a mobile app for personal customers;
- a commercial lending operation, focussed primarily on owner-occupied guest houses and hotels, holiday let and buy to let properties, with the majority of its lending located within the branch operating area and in particular, the Lake District;
- an estate agency and lettings service, through Cumberland Estate Agents Limited;
- motor vehicle finance, through Borderway Finance Limited; and
- financial advice, through Cumberland Financial Services Limited.

The Board considers that the concentration on relationships with local customers has been a source of strength for many years and is committed to continuing to develop this approach. The Cumberland continues to evolve its brand, marketing, products and services to ensure that it attracts new, younger members whilst remaining sensitive to the needs of existing members of all age groups.

The large majority of residential lending has been undertaken through the Society's branches or its estate agency and within the branch operating area, and this will continue to be the case as it is fundamental to the Society's vision and strategy. However, since 2012, additional residential lending has been undertaken in partnership with a limited number of carefully selected introducers, and as virtually all of this lending has been undertaken outside the branch operating area, it has broadened the geographical distribution of the mortgage book.

The Society is very strongly funded by its savings and current account members together with local business customers, with for many years, very little funding having been obtained from the financial markets, although between 2012 and February 2018, drawings have been made from the

Government's Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS) to supplement this. With very limited exceptions, the Society does not offer savings and current accounts to those living outside of its branch operating area.

The Group is very committed to developing its digital services over the next few years, by building on those which are already offered, such as internet and mobile banking, as it regards this as vital in ensuring that it continues to provide the services that members want.

THE OPERATING ENVIRONMENT

The outcome of the ongoing Brexit negotiations and the uncertainties relating to these have continued to dominate the news headlines. Although the economy has perhaps fared better thus far than some feared around the time of the EU referendum in June 2016, growth has been relatively muted and in 2017 fell behind that of the Eurozone for the first time since 2010, and also lagged behind the other major economies of the G7. Business investment was flat in the last three months of 2017, although unemployment has continued to be relatively low.

The Bank of England decided in November 2017 to reverse its 0.25% base rate reduction of August 2016, and the Society in turn, reversed the interest rate reductions for borrowers and savers which had been made then.

In addition, the window for drawings from the Term Funding Scheme, which had been introduced in August 2016, closed at the end of February 2018, although this will provide the Society and other financial institutions with funding at base rate until 2021-22. The Government funding schemes have both stimulated lower mortgage rates and depressed rates for savers since 2012. Since then, the Society has sought to utilise the opportunity afforded by the schemes, while seeking to strike a balance between competing strongly in the mortgage market and protecting its existing savings customers as far as possible. It is believed that its financial and business performance over the last few years has demonstrated its success in this respect.

The timing of the next interest rate change, most likely an increase, is highly uncertain. However, the very low interest rate environment of the last eight years, is not expected to change markedly. This has led to a strong preference by borrowers for fixed rate loans, and for savers to prefer variable rate products. The Cumberland's experience is wholly consistent with this, but with respect to fixed rate mortgages, it has continued to hedge these very closely with interest rate swaps, in order to ensure that its position is essentially protected should interest rates rise.

Within the Society's branch operating area both house prices and residential mortgage demand have been essentially flat. Owner occupier mortgage rates have continued to be extremely competitive, particularly for those customers with relatively large deposits. Savings rates in the market generally have remained low and the Society has maintained a strong competitive position in relation to them, although over the last few months there has been some evidence of these increasing in the market, as the ability to draw from the TFS has come to an end.

PRINCIPAL RISKS AND UNCERTAINTIES

Building societies operate in a highly competitive market, and with significant uncertainties arising from the general economic environment. Therefore the management of risk and strategic direction are key activities, vital for the success of the business.

The Board of Directors, aided by a number of committees, ensures risk management and strategic direction are considered thoroughly and appropriate actions implemented.

The principal risks facing the Group and the procedures put in place to manage them are described below.

Liquidity Risk

Liquidity risk is the risk of failing to meet demands and commitments to provide funds to customers and other third parties. The Society's Assets and Liabilities Committee (ALCO), assists the Society's management and the Board to manage this risk. Responsibility for the daily management of the risk lies with the Treasurer, who reports directly to the Finance Director. Monthly, the balance sheet is stress tested to confirm that the Group can withstand normal and extreme cash outflows. The Financial Risk Management Policy and the Individual Liquidity Adequacy Assessment Process, both regularly reviewed by the ALCO and agreed by the Board, ensure that the daily activities of the treasury team are conducted within a prudent framework and in line with the requirements of the Prudential Regulation Authority. The minutes of the monthly ALCO meeting are presented to the Board each month.

Market Risk

The primary market risk faced by the Group is interest rate risk. This is the risk of fluctuations in interest rates and changes in the value of derivative contracts impacting upon the value of the Group's assets and liabilities. The ALCO assists management and the Board to manage that risk. The balance sheet is stress tested on a monthly basis to inform the ALCO of the effects on income or costs of interest rates rising or falling. The Treasurer manages the daily position within a framework in accordance with the Financial Risk Management Policy. A detailed analysis of the Group's interest rate sensitivity at 31 March 2018 and 2017 can be found in note 26 to the accounts.

Quarterly, the Board assesses the Society's position in relation to its net interest margin, including sources of basis risk, and considers the exposure to negative scenarios in this respect.

Credit Risk

The Group is exposed to credit risk in respect of either mortgage customers or treasury counterparties being unable to meet their obligations as they become due. The Residential and Commercial Lending Policy Statements, approved by the Board, set out the approaches to residential and commercial mortgage lending.

In respect of residential mortgages, lending mandates are strictly controlled and all applications are reviewed by a specialist residential mortgage underwriting team. Applications outside individuals' mandates are considered by the Residential Credit Committee.

In respect of commercial mortgages, the Society's specialist commercial lending managers produce detailed appraisals of each application. All applications of over £500,000 are considered by members of the Commercial Credit Committee.

The Chief Risk Officer attends Residential and Commercial Lending Credit Committee meetings to provide independent oversight.

The Financial Risk Management Policy contains limits on credit exposures to individual counterparties and these are monitored on an ongoing basis by the ALCO.

Operational and Conduct Risks

Operational risk is the risk of loss arising from inadequate or failed internal processes or systems, human error or external events and the Group Operational Risk Policy sets out the Group's approach to its management. Conduct risk is the risk arising from the Group's conduct in its relationship with customers, including failing to treat customers fairly with resulting detriment, or potential detriment, to those customers. The Society's Conduct Risk Policy Statement sets out its approach to the management of Conduct Risk.

Whilst line management is responsible for identifying and managing these risks, this is carried out using an agreed framework and methodology, with quarterly reporting to the Executive Risk Management Committee, which consists of all of the members of the Executive. The Committee meets on a quarterly basis and reports to the Board Risk Committee, which in turn reports to the Board.

Cyber risk continues to be a particular focus for the Society, which has taken this very seriously for many years and has committed significant resources, including further investments in the latest year, to ensure that both its business generally and our members' money and personal information in particular, are safe and secure. Whilst there can never be any guarantees in this respect as new threats emerge, everyone at the Society is highly conscious of the importance of this area and it is a key priority for the Board and senior management.

FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES

The Group's objective is to minimise the impact of financial risk upon its performance. An explanation of the financial risks and the controls in place to manage them is given in notes 25 to 28 to the annual accounts.

The disclosures required under Pillar 3 of the Capital Requirements Directive IV and the Capital Requirements (Country by Country Reporting) Regulations 2013 will be published on the Society's website, www.cumberland.co.uk.

KEY PERFORMANCE INDICATORS

Very many aspects of financial (and other) performance are monitored on a regular basis, but the table below focuses on those that are considered key to business success.

	2018	2017	2016
Including hedge accounting:			
Group Profit After Tax (£million)	17.53	19.67	12.62
Group Profit After Tax as a % of Mean Total Assets	0.74	0.90	0.62
Excluding hedge accounting:			
Group Profit After Tax (£million)	15.55	19.96	12.62
Group Profit After Tax as a % of Mean Total Assets	0.65	0.91	0.62
Interest Margin for Members (%)	1.72	1.78	1.70
Society Administrative Expenses and Depreciation as a % of Mean Total Assets	0.86	0.88	0.91
Gross Capital as a % of Shares and Borrowings	7.47	7.43	7.31
Loans and Advances to Customers - Balance change % #	8.05	5.28	12.83
Lending During the Year (£million) #	449.40	350.41	422.17
Inflow of Funds from Customers (£million)	78.55	118.50	74.60
Other Funding as a % of Shares and Borrowings	21.28	14.89	17.50

 # Excludes lending by Borderway Finance Limited and fair value adjustment for hedge risk.

It should also be noted that the 2017 results included the gain on equity share investment of £6.066 million (before tax), as a result of the sale of the Society's share in VISA Europe to VISA Inc. in June 2016. Without this, the Group's profit after tax including hedge accounting in that year would have been £14.82 million, 0.68% of mean assets, and without hedge accounting, £15.10 million, 0.69% of mean assets.

EXPLANATION OF INDICATORS

Group Profit After Tax

Group profit after tax is the net amount earned after taking into account all expenses and tax charges.

Group Profit After Tax as a % of Mean Total Assets

This relates the Group's profit after tax to its mean total assets, which are calculated as the simple average of total assets at the beginning and end of the financial year.

Gross Capital as a % of Shares and Borrowings

Gross capital comprises the general reserve and the available for sale reserve, and this ratio measures the proportion of this in relation to the Group's liabilities to holders of shares and borrowings. The Group's reserves consist of profits accumulated over many years. Capital provides a financial cushion against any difficulties that might arise in the Group's business and therefore protects investors.

Interest Margin for Members

This ratio takes the interest received from residential mortgage borrowers as a percentage of mean residential mortgage balances, minus the interest paid to members with share accounts as a percentage of mean share balances (after adjusting for net income or expense on financial instruments). It therefore primarily reflects the pricing of the Society's residential mortgage and savings products, but can also reflect in respect of fixed rate products the net income and expense on financial instruments. The measure shown excludes the impact of hedge accounting.

Society Administrative Expenses and Depreciation as a % of Mean Total Assets

Administrative expenses and depreciation consist mainly of the costs of running the Society's business, including staff costs. This ratio measures the proportion that these costs bear to mean total assets. It is an indication of the Society's efficiency and the aim is, over time, to see it reduce. In relation to its peers however, the Society's business model of offering a wide range of services, including current accounts with associated services such as internet and mobile banking, and obtaining the substantial majority of its residential mortgage and all of its savings business directly from customers rather than through intermediaries, means that its ratio will inevitably be higher than were that not the case.

Loans and Advances to Customers - Balance Change %

This shows the change in the Society's mortgage book (both residential and commercial) and reflects both the popularity of its products and services offered to new and existing borrowing members, and the Society's appetite for credit risk.

Lending During the Year

This figure reflects the same factors as mentioned above.

Inflow of Funds from Customers

This reflects the net movement of funds in and out of the Society's savings and current account products.

Other Funding as a % of Shares and Borrowings

This reflects the extent to which the Group is funded by deposits owed to credit institutions and other customers, rather than its members. The Group's aim is to be funded predominantly by its members, i.e. individual savers and current account customers, in line with the principal purpose of a building society.

FINANCIAL AND BUSINESS PERFORMANCE

Income and expenditure

Whilst as a mutual organisation, the maximisation of profit is not a key aim, the Group seeks to make sufficient profit to ensure its ongoing financial strength. The Group achieved a strong profit after tax of £17.53 million in 2017-18, representing 0.74% of mean total assets. This is reduced from the £19.67 million, 0.90% of mean assets, achieved in the previous year, but this was enhanced by the gain made in that year on the sale of the Society's share in VISA Europe to VISA Inc., without which, profit after tax would have been 0.68% of mean total assets. Excluding this, and the impact of hedge accounting in both years, the Society's profit after tax slightly increased from £15.10 million to £15.55 million, although as a percentage of mean assets, it fell slightly from 0.69% to 0.65%.

Linked to this, the 'net interest margin for members' key performance indicator reduced slightly in the latest year, as the fall in the mean interest rate percentage received in relation to residential mortgages was greater than the fall in the mean interest rate percentage paid on savings and current accounts.

With respect to the ratio of administrative expenses and depreciation as a proportion of mean total assets, this fell slightly in the year because Society administrative expenses and depreciation rose by 6.2% while mean total assets rose by 9.0%.

Subsidiary companies

Borderway Finance Limited, our motor finance business, enjoyed another successful year with a profit after tax of £748,000 (2017: £572,000), with its loan balances growing by 6.4% to £21.9 million.

The value of the restructuring of the operations of Cumberland Estate Agents Limited which took place in 2015-16 in order to respond to customer demand by providing extended opening hours in evenings and at weekends, and to develop a highly competitive offering to address the challenge posed by internet-only estate agencies, while still retaining a high street presence, has been clearly demonstrated in 2017-18. The company broke even, having made a post-tax loss of £134,000 in the previous year (as the new operating model was embedded), but very importantly given the Society's direct lending strategy within its branch operating area (it does not accept mortgage business introduced by brokers within this area), the value of mortgage approvals introduced to the Society has more than doubled in the last two years. It has also performed well against other metrics, with new sales instructions up by 20%, and houses sold up by 42% in the year. Data from Rightmove also shows the company's market share increasing strongly. The Group remains committed to strengthening the company, given its importance to its overall strategy and in particular, with respect to attracting first time buyers and home movers.

The Group's independent financial advisor firm, Cumberland Financial Services Limited, achieved a strong profit after tax of £61,000 (2017: £22,000).

The Group's two property company subsidiaries, Cumberland Property Services Limited and Cumberland Homes Limited, made losses after tax of £218,000 and

£7,000 respectively (2017: broke even and loss of £12,000), with the investment properties owned by the former having been revalued downwards at the year end.

Capital

In the latest year the gross capital ratio has increased slightly because the Group's reserves increased at a faster rate than its shares and borrowings. The Society has an extremely strong capital position and in particular, has no capital provided by outside parties which require remuneration.

The Group's Common Equity Tier 1 (CET1) ratio (which reflects accumulated profits to 31 March 2018 compared with risk weighted assets) was 18.42% at 31 March 2018 (2017: 17.24%).

The Regulator requires that the Group holds a certain amount of capital against the assets it holds, known as the Total Capital Requirement. At 31 March 2018, this was £143.9 million. The Group has maintained capital in excess of that required by the regulator throughout the year.

Further information on the Group's capital management can be found in the Pillar 3 document on www.cumberland.co.uk.

Assets – Loans and Liquid Assets

The Society achieved mortgage balance growth of 8.05% during the year with total lending of £449.40 million, a new record, with the Society's total mortgage balances now exceeding £2 billion, after growth of 63% in the last five years. With respect to owner occupier lending, the substantial majority of which is obtained directly through its branches and estate agency offices, the Society's products were very competitive throughout the year, as evidenced by the Society being named for the fourth consecutive year, 'Best Regional Building Society' at the Mortgage Finance Gazette Awards. The Society continues to offer existing customers whose mortgage products have reached the end of their term, new products which are the same as, or better than, those available to new customers. It also continued to develop its lending with a small number of introducer firms.

Our specialist commercial lending team enjoyed another successful year, participating strongly in the holiday let lending market, and in the buy to let market to a lesser extent, with lending on commercial properties continuing to be principally in the leisure and hospitality sectors, in line with our approach for many years.

Prudent and responsible lending has long been a key part of the Society's approach, with rigorous underwriting processes ensuring that loans are affordable. All loans are subject to manual underwriting by a specialist team within our Head Office rather than automated credit scoring. In line with the parameters set, many are then considered by the Residential and Commercial Lending Credit Committees. The success of this approach is reflected in that at 31 March 2018, only 0.16% of our residential mortgages were in arrears of three months or more; this compares with 0.47% for all building societies at 31 December 2017, the latest available data for the sector. The quality of the Cumberland's underwriting has been a long-term success story; over the last 12 years, the Society's individual impairment charges for residential loans have totalled £791,000, i.e. just under £66,000 per year, which is a remarkable achievement over that period which of course, included the financial crisis and subsequent recession.

Moreover, only three of our commercial mortgages were in arrears of three months or more at 31 March 2018. The Society had only one residential property in possession at the year end, and no commercial properties.

With respect to liquid assets, the Society maintained strong and readily available levels throughout the year, well in excess of its regulatory requirements.

Liabilities – Customer Shares and Deposits and Other Funding

The Society has historically been, and continues to be, very strongly funded by its individual members, virtually all of whom are located within its branch operating area. In 2017-18, the Cumberland achieved an inflow of funds of £78.6 million, a reduction on the record of the previous year, but very much in line with the two years prior to that. Again, there were strong receipts across a wide range of accounts, including both personal and business current accounts, bringing the total amount of inflow in the last five years to £426 million. As a member owned organisation, the Cumberland has been very conscious of the need to give its savers a good deal over a prolonged period of low interest rates, which has been very difficult for them. The strong inflow of funds over these years, sourced through our branches, is the result of not just of the competitiveness of our rates, but also our track record over many years of providing good long-term value. The Society's long established approach is to ensure that existing savers receive variable rates which are the same as, or better than, those available to new customers.

With respect to current accounts, balances increased by 15.0% for the second year in succession, continuing the Society's long-term success of growing these through the quality of the functionality offered by our internet and mobile banking services, alongside the high quality customer service provided by our branches and Head Office contact team. The Cumberland is one of only two building societies to offer current accounts and indeed, the only one to offer them to businesses. Furthermore, as mentioned in the Chairman's Statement, the large banks have left many of the towns in our branch operating area, which leads to many of their customers switching to the Cumberland.

Drawings from the Government funding schemes totalled £360 million at 31 March 2018, of which £40 million remained off balance sheet. Funding other than from individuals increased from 14.89% to 21.28%, as the Society participated strongly in the Term Funding Scheme, which closed to new drawings in February 2018. The Society also continues to actively undertake work on its options for when this scheme ends in 2022. Excluding the Government funding however, it should be noted that well over half of 'other funding' is from retail customers, principally small and medium sized businesses located within the Society's operating area, and therefore, the use of 'wholesale' funding from the money markets is relatively limited.

PEOPLE

Great importance is placed on the recruitment, training and retention of high calibre employees. It is recognised that its people will play a vital role in the continuing success of the Cumberland. Training and development policies are continuously reviewed and, where appropriate, updated to meet the organisation's needs.

The Cumberland is committed to effective communication with its employees, who are kept informed of matters relating to business performance and objectives, and are involved in regular team meetings with respect to matters affecting them directly.

The Cumberland has an equal opportunities policy and considers applications for employment from disabled persons. In the event of existing employees becoming disabled every effort is made to assist them in continuing to work for the organisation.

All employees are given opportunities for training, career development and promotion, taking into account their aptitudes, abilities and the particular demands of the job.

A feature of the Cumberland over many years has been the great progress that people make in their careers in the business; for example, four of the current Executive team and a further four of the senior management team, joined the Society directly either from school or university. To assist in ensuring that this continues to happen, for many years the Society has recognised that an extensive programme of high quality training throughout the business is vital. Most recently, in January 2018 13 people attended a leadership training course, and a further 14 attended a personal development course, to help them develop their potential. Many other training courses were provided during the year, covering amongst other topics, cyber security, customer communications and spreadsheet skills.

The directors very much appreciate the skill, dedication and enthusiasm of the Group's people and their role in achieving the excellent business and financial results. Whether in our branches, our Head Office or in our subsidiary companies, the team in all parts of the Group have continued to deliver a high level of performance, both in serving members directly and in the development of new products and services for them.

DEVELOPMENT OF SERVICES AND SYSTEMS

We continue to develop our services and systems to ensure that they remain up to date, relevant to the needs of our members and secure. Below is a review of the new developments undertaken during the year:

- the introduction of both Apple Pay and Google Pay for our current account customers;
- upgrades to the Society's mobile app, with features added including access to business accounts through the app, Touch ID for iOS devices, and a transaction searching capability;
- the ability to enquire and transact on savings accounts within our internet banking system or mobile app;
- the introduction of webchat, giving customers another way of engaging with our customer service contact team in our Carlisle Head Office at their convenience;
- further enhancements to our websites and in particular, the mortgage affordability calculator;
- completion of the roll out of contactless debit cards;
- the introduction of a Xero cloud based accounting service feed for our business customers; and
- the introduction of the ability for our customers to give feedback on our service to Feefo, with the ratings being published on our website; this will help us address any issues our members raise and improve our services further.

Behind the scenes, the following projects were undertaken:

- a wide ranging project to ensure compliance with the General Data Protection Regulation, which comes into force on 25 May 2018;
- improvements to the process for opening savings accounts in branches; and
- the integration of the lettings service into the mobile technology used by Cumberland Estate Agents.

Projects currently underway include:

- changes to comply with the Payment Services Regulation and in particular, to ensure that the Society is abreast of open access banking developments;
- upgrades to our transaction authorisation, fraud detection and correspondence management systems;
- working with the Cheque & Credit Clearing Company and the banking industry to introduce cheque imaging; and
- further enhancing our internet banking services and mobile banking app to introduce new features.

COMMUNITY INVOLVEMENT AND CHARITABLE DONATIONS

The Cumberland is an integral part of its local communities and therefore its involvement with them is regarded as very important. Further information on this can be found within the Annual Review booklet. Over £100,000 has been donated to charities, clubs and voluntary organisations within our operating area. As in previous years, a donation is made each year based on 50 pence for each vote recorded at our Annual General Meeting, and last year with over 21% of the eligible membership voting, over £10,900 was raised for Alzheimer's Society and Alzheimer Scotland. This year, MIND and Support in Mind Scotland will be the beneficiaries, in support of their work in our operating area.

GOING CONCERN AND VIABILITY STATEMENT

The Group's business activities and financial performance are set out earlier in this report, together with its principal risks and uncertainties, and further information on these is presented in notes 25 to 28 of the annual accounts. Having considered these, and reviewed the Group's plans and forecasts covering profitability, capital, liquidity and funding over its corporate planning period of the next three years (which the Board considers to be an appropriate timeframe for forecasting with the necessary degree of accuracy), the directors consider that the Group's financial and business performance will be such that it will have adequate resources to continue its operations and meet its liabilities, for the one year going concern and the three year viability assessment periods. Accordingly, the annual accounts continue to be prepared on the going concern basis.

Trevor Hebdon
Chairman

Alan Johnston
Vice-Chairman

Desmond Moore
Chief Executive

Peter Temple
Deputy Chief Executive

John Kidd
Finance Director

Gill Gardner
Non-executive Director

John Hooper
Non-executive Director

Michael Hulme
Non-executive Director

Eric Gunn
Non-executive Director

Jacqueline Arnold
Non-executive Director

OUTLOOK

The outlook for the UK economy is very unclear, and this will continue until certainty is reached as to how relations with the EU will operate in the future, particularly with respect to the terms of trade. There is an expectation that interest rates will increase, but the Bank of England has signalled that any such increases are likely to be made in a very gradual manner, and indeed, should the economy falter, they will become less likely.

As outlined in the Chairman's Statement, the Society's profitability is not expected to remain at the levels of the last couple of years as it faces in particular, additional costs arising from regulatory requirements and in three years' time, the interest margin impact of the ending of the Government funding schemes. Nevertheless, key strengths of the Cumberland are its well established strategy and distinctive business model, which have been highly successful in differing economic climates and which, we believe will continue to be so in the future.

Whatever challenges arise however, the Cumberland will continue to adhere to its fundamental principle of putting members first in everything we do. The very strong financial and business results of the last few years, which have been amongst the very best in the building society sector, show clearly that, although an organisation of a relatively modest size operating far from major centres of population, the Cumberland, being mutual, independent and proudly regional, can continue to thrive and in doing so, provide real competition to the major banks, especially as they leave many of the towns in our operating area. The Cumberland's track record over many years means that it can be trusted with respect to both fairness and providing long-term value for local people, and from our current strong position, we will continue to work hard to serve our members, whose support is greatly appreciated.

On behalf of the Board of Directors

Trevor Hebdon
Chairman
22 May 2018

DIRECTORS' REPORT

Information on the Group's strategy and its financial and business performance is provided within the Strategic Report on pages 3 to 9.

DIRECTORS

The directors at the date of this report are shown on page 9; Kevin Parr and Chris McDonald stepped down from the Board on 31 March 2018 and 30 April 2018 respectively. Further information on all of the directors as at 31 March 2018 is provided in the Annual Business Statement on page 48, and their attendance at the Board and Board Committees is set out in the Report on Corporate Governance on pages 12 to 14.

All directors will submit themselves for election or re-election at the Annual General Meeting, with the exception of Peter Temple, who will retire from the Society and step down from the Board on 31 August 2018. None of the directors had an interest in shares in, or debentures of, any subsidiary undertaking of the Society at any time during the financial year.

At 31 March 2018 three directors or persons connected to them had mortgage loans granted in the ordinary course of business, amounting to £882,000 (2017: three directors, £806,000). A register is maintained at the Principal Office of the Society, containing details of loans, transactions and arrangements between the Society and its directors and connected persons; requisite particulars from it are available for inspection.

In addition, directors and their connected persons have savings and current accounts with the Society, on the same terms as those available to all persons.

MORTGAGE ARREARS AND FORBEARANCE

At 31 March 2018, there were 2 accounts where payments were twelve months or more in arrears. The total amount outstanding on these accounts was £0.96 million, and the amount of arrears was £0.06 million, which represents less than 0.01% of mortgage balances.

In certain circumstances the Society uses forbearance measures to assist those borrowers who are experiencing financial difficulty. Such measures include agreeing a temporary transfer to interest only payments, or a capitalisation of arrears, in order to reduce the borrowers' financial pressures. We expect borrowers to resume normal payments once they are able. During the year, the Society undertook forbearance measures for 15 residential mortgage accounts which had total balances of £1.09 million at 31 March 2018 (2017: 24 accounts, balances of £1.24 million). 1 of these cases had arrears of less than £0.01 million at 31 March 2018 (2017: 9, less than £0.01 million). Where the Society considers that there is a possibility of a loss, a specific provision is made in accordance with the Society's policies, and the level of forbearance undertaken is also an element of the Society's collective provisioning methodology.

CREDITOR PAYMENT POLICY

The Group policy concerning the payment of trade creditors is to agree terms of payment, to ensure that suppliers fulfil their contractual obligations and to settle invoices for the provision of goods and services within the agreed payment terms. At 31 March 2018 the total amount owed to suppliers was equivalent to 5 days credit (2017: 5 days).

CHARITABLE AND POLITICAL DONATIONS

During the year, charitable donations of £101,402 were made to a number of organisations within our operating area, of which £25,000 was given to the Cumberland Building Society Charitable Foundation. No contributions were made for political purposes.

EVENTS SINCE THE YEAR END

The directors consider that there have been no events since the year end that have had a material effect on the position of the Society or any of its subsidiary undertakings.

GOING CONCERN

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason, the annual accounts continue to be prepared on the going concern basis.

AUDITOR

Deloitte LLP are eligible for re-appointment and have offered themselves for re-election.

On behalf of the Board of Directors

Trevor Hebdon
Chairman
22 May 2018

REPORT ON DIRECTORS' REMUNERATION

The purpose of this report is to provide information about the Group's policy for the remuneration of non-executive and executive directors and to give details of the process for determining the level of remuneration.

The remuneration of non-executive directors comprises only of fees and this is reviewed and agreed annually by the Board. The Chairman's remuneration is set by the Remuneration Committee and he does not attend the sections of the meetings at which his remuneration is set and takes no part in the consideration of this matter. The remuneration of the executive directors is determined by the Remuneration Committee, which consists of its chairman Michael Hulme and the other non-executive directors.

In determining non-executive and executive director remuneration, both the Board and the Remuneration Committee take account of fees and salaries payable and other benefits provided to non-executive directors, executive directors and chairmen of building societies that are similar in size and complexity to the Cumberland. To ensure that fees and salaries are set at a level to retain and attract individuals of the calibre necessary to operate an organisation such as the Society and which reflect the skills and time commitment required, the Committee periodically commissions an external review of executive and non-executive remuneration.

The Committee believes that bonus schemes relating to financial and business performance are an appropriate part of a balanced remuneration package, and for the year ended 31 March 2018, agreed a bonus based on overall business performance achieved, including customer service, mortgage growth, the increase in current accounts and Group profitability.

Mr. Temple and Mr. Kidd are deferred members of the Society's contributory defined benefit pension scheme which was closed to further accrual on 31 March 2015. All of the executive directors are members of a defined contribution scheme and are entitled to receive contributions towards this, although depending upon their individual circumstances they may be paid to them as a pension replacement amount. They are also provided with a car and membership of a private medical insurance scheme. They are employed under contracts terminable by the Society on twelve months' notice and by the individual on six months' notice. The same arrangements applied to Mr. Parr until he stepped down from the Board on 31 March 2018.

Full details of individual directors' remuneration are contained in note 8 to the accounts.

The Society's remuneration policy meets with the requirements of the Remuneration Code.

On behalf of the Remuneration Committee

Michael Hulme
Chairman 22 May 2018

STATEMENT OF DIRECTORS' RESPONSIBILITIES

DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND ACCOUNTS, THE STRATEGIC REPORT, THE DIRECTORS' REPORT AND THE ANNUAL BUSINESS STATEMENT

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

The Building Societies Act 1986 ('the Act') requires the directors to prepare Group and Society annual accounts for each financial year. Under the Act they have elected to prepare these in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) including FRS 102, 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'.

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

In preparing each of the Group and Society annual accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the annual accounts; and
- prepare the annual accounts on the going concern basis unless it is inappropriate to presume that the Group and Society will continue in business.

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

DIRECTORS' RESPONSIBILITIES FOR ACCOUNTING RECORDS AND INTERNAL CONTROL

The directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act; 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 under the Financial Services and Markets Act 2000.

The directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

CORPORATE GOVERNANCE

DIRECTORS' REPORT ON CORPORATE GOVERNANCE

Cumberland Building Society is committed to good practice in corporate governance and this report explains how the Society has regard to the principles in the UK Corporate Governance Code (the 'Code') issued by the Financial Reporting Council.

Whilst the Society is not required to comply with the Code, as it is not a listed company, the recommendations have been adopted where they are appropriate and proportionate to the Society.

THE BOARD

Code Principle A.1: Every company should be headed by an effective board, which is collectively responsible for the long term success of the company.

The principal functions of the Board are the development and monitoring of strategy, the review of business and financial performance, and to ensure that effective systems and controls are in place for risk management.

The Board meets every month and policy review meetings are held when required, normally once a year.

There is a formal schedule of matters reserved for the Board and the Board has full and timely access to all relevant information to enable it to discharge its duties effectively.

The non-executive directors meet without the executive directors present on a regular basis.

The Board normally conducts an annual self-assessment exercise to review its effectiveness and highlight any areas which should be improved. However, during 2017-18 an external firm conducted an independent review of the Board's effectiveness.

In addition, the Board has established four committees to consider specific areas in more detail than would be possible within Board Meetings. Each of the Board committees has Board approved terms of reference, which are published on the Society's website, www.cumberland.co.uk, or are available from the Society's Secretary on request.

The Board receives recommendations from the committees within their terms of reference and the minutes of the committee meetings are reported to the Board.

AUDIT COMMITTEE

The role and work of the Audit Committee is covered in the Report of the Audit Committee on pages 15 and 16.

RISK COMMITTEE

The Risk Committee is responsible for oversight of the Society's risk management framework to ensure there are adequate and effective arrangements in place for the identification, monitoring, measurement, control and mitigation of risk, for ensuring that effective arrangements are in place for compliance with regulatory requirements, for monitoring the Society's key risk exposures against appetite and for reviewing current and emerging risks that could impact upon the achievement of strategic goals.

The Committee consists of its Chairman John Hooper, and three other non-executive directors, Trevor Hebdon, Alan Johnston and Gill Gardner. The remaining three non-executive directors, the three executive directors, the Chief Risk Officer and the Head of Internal Audit also attend Committee meetings by invitation.

REMUNERATION COMMITTEE

This consists of its Chairman Michael Hulme and all of the other non-executive directors. The Committee's main role is to approve the level of remuneration for the Society's executive and senior management. The Committee is also responsible for determining, on behalf of the Board, the structure of any incentive schemes for staff. Details of the remuneration policy can be found in the Report on Directors' Remuneration on page 11.

NOMINATION COMMITTEE

This consists of all directors and is chaired by the Society's Chairman, Trevor Hebdon. The Committee is responsible for making recommendations to the Board on matters relating to the composition of the Board, including board and executive succession planning, the appointment of new directors and the election and re-election of directors.

Set out on page 13 are details of the directors during 2017-18 and their attendance record at Board meetings and Audit, Risk, Remuneration and Nomination Committee meetings.

DIVISION OF RESPONSIBILITIES

Code Principle A.2: 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.

The roles of Chairman and Chief Executive are held by different individuals, with a clear division of responsibilities. The Chairman, who is a part-time non-executive director, is responsible for leading the Board and ensuring it acts effectively. The Chief Executive has responsibility for managing the Society and for the implementation of the strategies and policies agreed by the Board.

THE CHAIRMAN

Code Principle A.3: The Chairman is responsible for leadership of the Board and ensuring its effectiveness on all aspects of its role.

The Chairman sets the direction of the Board and promotes a culture of openness and debate by facilitating the effective contribution of non-executive directors and maintaining constructive relations between executive and non-executive directors. The Chairman also ensures that directors receive accurate, timely and clear information.

NON-EXECUTIVE DIRECTORS

Code Principle A.4: As part of their role as members of a unitary Board, non-executive directors should constructively challenge and help develop proposals on strategy.

The non-executive directors of the Society are drawn from a wide range of backgrounds to provide the appropriate skills, knowledge and experience to ensure a robust level of challenge and debate. The role requires an understanding of the risks in a financial services business, commercial leadership within a framework of prudent and effective risk management controls and the ability to monitor performance and resources while providing support to executive management in developing the Society.

THE COMPOSITION OF THE BOARD

Code Principle B.1: 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.

Director	Board	Audit	Risk	Remuneration	Nomination
Trevor Hebdon	13 (13)		4 (4)	11 (11)	12 (12)
Alan Johnston	13 (13)	7 (7)	4 (4)	11 (11)	12 (12)
Peter Anstiss	10 (11)			8 (9)	9 (10)
Jackie Arnold	1 (1)			1 (1)	1 (1)
Gill Gardner	12 (13)		4 (4)	9 (11)	10 (12)
Eric Gunn	11 (13)	7 (7)		10 (11)	10 (12)
John Hooper	13 (13)		4 (4)	11 (11)	12 (12)
Michael Hulme	11 (13)	7 (7)		10 (11)	10 (12)
Kevin Parr	12 (13)				11 (12)
John Kidd	12 (13)				11 (12)
Peter Temple	11 (13)				10 (12)
Chris McDonald	12 (13)				11 (12)

Directors' attendance at Board and Board Committee meetings during the year ended 31 March 2018

The figure in brackets indicates the number of meetings that the director was eligible to attend during the year.

(shaded) not a member of the committee

At 31 March 2018 the Board consisted of four executive and seven non-executive directors; at the date of this report, there were three executive directors and seven non-executive directors.

All of the non-executive directors have served for less than the maximum of nine years recommended by the UK Corporate Governance Code and can be defined as independent under it.

In the view of the Board, all the non-executive directors are independent in character and judgement, are free of any relationship or circumstance that could interfere with the exercise of their judgement, and bring wide and varied commercial experience to Board deliberations.

Gill Gardner is the Society's Senior Independent Director and is available to members if they have concerns which they either have been unable to resolve, or feel cannot be resolved, by contact through the normal channels of the Chairman or the executive directors.

APPOINTMENTS TO THE BOARD

Code Principle B.2: There should be a formal, rigorous and transparent procedure for appointment of new directors to the Board.

The Nomination Committee leads the process for Board appointments and makes recommendations to the Board. The Board maintains a succession plan and develops a role profile for vacancies arising. Candidates are identified in a number of ways, including the use of external search consultants. A key consideration for the Nomination Committee is the diversity of the Society's workforce, especially at a senior level. The Group recognises the benefits that a diverse workforce can bring and is committed to a culture that attracts and retains talented people to deliver outstanding performance. Appointments are made on merit and against objective criteria, whilst still giving consideration to diversity in respect of gender and other characteristics.

All directors must meet and maintain the fitness and propriety standards of the Prudential Regulation Authority and Financial Conduct Authority and must be approved by them in order to hold a Senior Management Function. They are also subject to election by members at the Annual General Meeting following their appointment.

During 2017-18, to support it in the appointment of directors, the Committee has used the services of an external recruitment agency, Warren Partners, which is independent of the Society.

COMMITMENT

Code Principle B.3: All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

The Nomination Committee evaluates the ability of directors to commit the time required for their role prior to appointment. The formal appraisal process carried out by the Chairman each year also assesses whether directors have demonstrated this ability during the year.

DEVELOPMENT

Code Principle B.4: All directors should receive induction on joining the Board and should regularly update and refresh their skills and knowledge.

On appointment, directors are given appropriate induction and training. To ensure their skills remain updated, directors attend industry conferences, seminars and training courses and the Board regularly receives presentations from senior managers. Training and development needs are identified as part of the annual appraisal of directors.

INFORMATION AND SUPPORT

Code Principle B.5: 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.

The Chairman ensures that the Board receives sufficient accurate, timely and clear information to enable it to fulfil its responsibilities. The directors have access to the advice and services of the Secretary and, if necessary, are able to take independent professional advice at the Society's expense.

PERFORMANCE EVALUATION

Code Principle B.6: The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual directors.

The Society has a process to evaluate, at least annually, the performance and effectiveness of individual directors, the Chairman, the Board and Board Committees. The performance of the Chief Executive and non-executive directors is evaluated annually by the Chairman. The Chairman is evaluated by the Senior Independent Director, after consulting and obtaining the views of the other directors. Those non-executive directors who have served at least six years on the Board are subject to a particularly rigorous performance evaluation in line with the Code's requirements. Annually, the Board and the Board Committees evaluate their overall performance, and the membership and terms of reference of the committees are reviewed and agreed by the Board.

RE-ELECTION

Code Principle B.7: All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The Board should ensure planned and progressive refreshing of the Board.

The Board seeks to ensure planned and progressive refreshing of its membership. This year, all directors are subject to election by members at the Annual General Meeting with the exception of Mr. Temple, who will retire from the Society on 31 August 2018.

FINANCIAL AND BUSINESS REPORTING

Code Principle C.1: The Board should present a fair, balanced and understandable assessment of the company's position and prospects.

The Statement of Directors' Responsibilities on page 11 sets out the Board's responsibilities in relation to the preparation of the Group's Annual Report and Accounts. Business performance is reviewed in the Chairman's Statement and the Strategic Report and a statement that the Group's business is a going concern is included in the Directors' Report.

The Audit Committee has advised the Board that in its opinion, the Annual Report and Accounts are fair, balanced and understandable.

RISK MANAGEMENT AND INTERNAL CONTROL

Code Principle C.2: 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 has delegated responsibility for managing the Society's risk management framework and system of internal control to senior management. The Group Internal Audit and Risk functions provide independent assurance to the Board on the effectiveness of the system of internal control and risk management through their reporting to and attendance at, the Audit Committee and the Risk Committee respectively.

The information received and considered by the Audit Committee and the Risk Committee provided reasonable assurance that during the financial year there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate system of internal control. Further information on the Society's approach to risk management is included in the 'Principal Risks and Uncertainties' section of the Strategic Report.

AUDIT COMMITTEE AND AUDITORS

Code Principle C.3: The Board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the Society's auditors.

The role and membership of the Audit Committee is set out in the Report of the Audit Committee on pages 15 and 16.

REMUNERATION

Code Principle D.1: 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.

Code Principle D.2: 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 remuneration policies for executive and non-executive directors are set out in the Report on Directors' Remuneration on page 11. These policies explain the Society's application of the Code principles.

DIALOGUE WITH SHAREHOLDERS

Code Principle E.1: 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.

As a mutual organisation, the Society has members rather than shareholders. The Society seeks the views of its members in a variety of ways, including customer feedback surveys. Members are invited to attend the Annual General Meeting, where they can ask questions and voice their opinions.

CONSTRUCTIVE USE OF THE ANNUAL GENERAL MEETING (AGM)

Code Principle E.2: The Board should use the AGM to communicate with investors and to encourage their participation.

Each year the Society sends details of the AGM to all members eligible to vote. Members are encouraged to vote by post, in branches or online (by appointing a proxy to vote on their behalf and in accordance with their instructions) or by attendance at the Meeting. For several years the Society has encouraged members to vote by linking the numbers of votes received to donations to local charities. This year, the Society will donate 50 pence for each vote to MIND and Support in Mind Scotland, for use within the Society's operating area.

All members of the Board are present at the AGM each year unless there are exceptional circumstances. The Chairs of the Board and of its committees are available to answer questions.

On behalf of the Board of Directors
Trevor Hebdon *Chairman*
22 May 2018

REPORT OF THE AUDIT COMMITTEE

The principal roles of the Audit Committee are to:

- Financial Reporting: Review and challenge where necessary, critical accounting policies, any changes to them and any significant estimates and judgements, and to review and challenge where necessary, the clarity and completeness of disclosures to be made in the Annual Report and Accounts and Annual Review Booklet;
- Internal Control and Risk Management: Keep under review the effectiveness of the Group's internal controls and risk management and governance frameworks established by management;
- External Audit: Assess the effectiveness of the external auditor, and to be responsible for the tender, appointment and re-appointment of external audit;
- Internal Audit: Approve the internal audit plan, and evaluate the performance of the internal audit function on a regular basis.

The Committee consists of its Chairman Alan Johnston and two other non-executive directors, Michael Hulme and Eric Gunn. The three executive directors, the Head of Internal Audit and the Chief Risk Officer also attend by invitation to assist in the Committee's deliberations. The Board is satisfied that the composition of the Committee includes Directors with recent, relevant financial experience to provide appropriate challenge to management.

A representative of the Group's external auditors attends all meetings, but would not normally attend that part of any meeting where matters relating to the appointment, remuneration, effectiveness or dismissal of the external auditors are discussed.

The Committee meets at least five times a year. The Committee holds one meeting per quarter to discuss regular business, plus an additional meeting in May in connection with the Group's Annual Report and Accounts.

FINANCIAL REPORTING

With respect to financial reporting, the Committee's role is to review and assess with management and the external auditor a range of issues relating to the financial statements. These cover the appropriateness of accounting policies and practices, disclosures, compliance with financial reporting standards and governance reporting requirements.

In preparing the accounts, there are inevitably material areas in which significant judgements are necessary, and the Committee considers these in detail. This year, these included:

- Loan loss provisions, involving the review of judgements used in respect of individual and collective impairment provisions;
- Revenue recognition, involving a review of the calculations of interest income and charges, and covering the timing of the recognition of fees receivable and payable under effective interest rate methodologies;
- Hedge accounting, with a review of the systems and processes used for this and its impact upon the financial statements;
- The assumptions for, and outcome of, the calculation of the defined benefit pension scheme FRS 102 accounting valuation produced by the actuary;
- Going concern and viability; to review whether the going concern basis was appropriate for the accounts, and the viability statement in the Strategic Report, involving consideration of both the Group's current financial position but also, its forecasts for the future.

The Committee assessed whether the Annual Report and Accounts, when taken as a whole, are fair, balanced and understandable and provide sufficient information for members so that they can assess the Group's performance, strategy and business model. It concluded that they are, and recommended that the Board approve them.

INTERNAL CONTROL AND RISK MANAGEMENT

The Board places a strong emphasis on ensuring that the Group has adequate and effective arrangements in place to manage risk. The Group has a Risk Management Framework, the purpose of which is to provide a structured and disciplined approach to risk management throughout the Group, and to document the overarching structure that is in place to facilitate the identification, assessment, management and reporting of all material risks. The framework is designed to assist the Board in ensuring that the Group's performance remains within agreed risk appetites and that the strategic objectives of the Group are met in a sustainable and controlled way.

Business areas are responsible for ensuring that controls are designed and operating effectively to manage risks.

The Audit Committee considers reports from internal audit and management in respect of the design and effectiveness of the systems in place to manage risk.

EXTERNAL AUDIT

The Audit Committee is responsible for the relationship with the Group's external auditors, Deloitte LLP. This responsibility includes:

- The appointment, re-appointment, remuneration and terms of engagement of the external auditors;
- Consideration of the nature and scope of the work planned for the forthcoming year, and for gaining assurance that the external auditors have the skills and resources to undertake the work and that independence is not compromised through relationships or business with the Group;
- Assessing and giving due consideration to the results of external audit's work;
- Assessing the performance of external audit;
- Annual consideration of policies regarding the engagement of the external auditors to supply non audit services, and the employment of former employees of the external auditor.

2017/18 represents Deloitte's fourth year as external auditors, with David Heaton as Partner. The Audit Committee considers the competence and suitability of the external auditors, including their independence, on an annual basis. In March 2018 the Committee concluded that it fully supported the continuation of Deloitte as the Group's external auditors.

External audit meets annually with the Audit Committee without the presence of Society management.

The external auditor undertook one non-audit assignment during the year.

INTERNAL AUDIT

The Audit Committee is responsible for providing oversight over, and ensuring the effectiveness of, internal audit. The Committee agrees the plan of work for internal audit, and is responsible for ensuring that there are appropriate resources in place for the plan to be completed. The Committee receives regular reports from the Head of Internal Audit with the results of assurance activity undertaken, and monitors the progress of actions taken in respect of audit recommendations.

The Audit Committee considers the performance of internal audit on an annual basis, with performance measured against internal audit industry standards and best practice. Also, an External Quality Assurance review of internal audit is commissioned at least once every five years, with actions resulting from these reviews monitored by the Audit Committee. The most recent review was undertaken by Deloitte in April 2015.

AUDIT COMMITTEE EFFECTIVENESS

The remit of the Audit Committee is set out in a Terms of Reference, which is considered annually by the Committee. The Audit Committee evaluates its own performance on an annual basis, which is undertaken through an assessment against the Financial Reporting Council's Guidance on Audit Committees. The result of the review is reported to the Board. As a result of the review, the Audit Committee considers itself to be effective.

On behalf of the Audit Committee
Alan Johnston *Chairman*
22 May 2018

INDEPENDENT AUDITOR'S REPORT

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

OPINION

In our opinion the financial statements:

- **give a true and fair view of the state of the Group's and the Society's affairs as at 31 March 2018 and of the Group's and the Society's income and expenditure for the year then ended;**
- **have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and,**
- **have been prepared in accordance with the requirements of the Building Societies Act 1986.**

We have audited the financial statements of Cumberland Building Society (the 'Society') and its subsidiaries (the 'Group') which comprise:

- the Group and Society Income and Expenditure Accounts;
- the Group and Society Statements of Comprehensive Income;
- the Group and Society Balance Sheets;
- the Group and Society Statements of Changes in Members' Interest;
- the Consolidated Cash Flow Statement; and
- the related notes 1 to 32.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach	
Key audit matters	The key audit matters that we identified in the current year were: • Loan impairment provisions • Hedge accounting • Revenue recognition
Materiality	The materiality that we used in the current year was £1.1 million which was determined on the basis of 5% of profit before tax.
Scoping	All trading subsidiaries were subject to full scope audit procedures performed to an appropriate materiality. All audit work was performed by the group audit team.

Conclusions relating to going concern	
We are required by ISAs (UK) to report in respect of the following matters where: • the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or • the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the Society's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.	We have nothing to report in respect of these matters.

Key audit matters
Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Loan impairment provisions	
Key audit matter description	The Society holds £1.8m (2017: £1.8m) of impairment provisions against the commercial mortgage book, which has a gross balance of £160.2m (2017: £157.0m). The Society's commercial loan book ("Loans fully secured on land") is secured primarily on guesthouses, smaller hotels and buy-to-let properties in the Cumbria region with some lending in other areas of the United Kingdom such as in the South West. The credit risk is therefore increased by the concentration in particular geographic areas, as well as by the potential volatility in the popularity of these tourist locations. As the determination of the impairment provision by management incorporates a significant level of judgement and thus is potentially susceptible to manipulation, a risk of fraud is inherently deemed to arise in this area. We have determined the significant areas of audit interest within the commercial provision to be the completeness of provisioning triggers, which are considered to be evidence that a loss event has occurred and the collateral valuations of properties since they can be highly subjective due to a lack of comparable properties or observable market data. The Society also holds £0.5m (2017: £0.3m) of impairment provisions against the residential mortgage book ("Loans fully secured on residential property"), which has a gross balance of £1,872.6m (2017: £1,724.4m). The Society's residential portfolio is focused upon low loan to value ("LTV"), first charge, owner-occupied lending. Our significant areas of audit interest within the residential provision are the completeness of provisioning triggers and the probability of default ("PD's") percentages used within the collective provision. Loan loss provision balances are detailed within note 13. Management's associated accounting policies are detailed on page 25 with detail about judgements in applying accounting policies and critical accounting estimates also on page 25.
How the scope of our audit responded to the key audit matter	We evaluated the design, and assessed the implementation of internal controls over the provisioning process. This included confirming that the accounting judgements and provisioning policies were reviewed and approved on a regular basis. We assessed the completeness and validity of the Society's identified impairment triggers in the residential and commercial loan book, testing a sample of performing loans to determine whether these had experienced any of the trigger events requiring specific provision. In addition we evaluated the adequacy of property valuations used in determining commercial loan provisions, including consultation with our commercial real estate specialists. As part of our risk assessment we reviewed and challenged key assumptions within the residential loan book by benchmarking to industry peers the impairment triggers applied within the forbearance provision against comparable societies. We recalculated the PD's applied by the Society using historic data to determine whether they were materially accurate. For both residential and commercial provisions we assessed the appropriateness, valuation and completeness of post model adjustments made by the Society which reflect the best estimate of losses incurred but which may not have been fully observed within the current arrears data.
Key observations	We have concluded that the majority of assumptions used within the commercial provisioning model are slightly conservative compared to historical evidence. However, through recalculation using actual experience we note that the provision is not materially sensitive to these assumptions. We have concluded that the level of provision is reasonable. We note that Management's PD percentages are slightly greater than historical experience for the residential book. When considering the impact of the PDs used by Management across the portfolio the aggregated impact is not material. Overall, we conclude that the Society's loan loss provision against the commercial and residential books is within a reasonable range.

Revenue recognition	
Key audit matter description	The calculation of the Effective Interest Rate ("EIR") used to allocate interest income on loans and receivables requires significant judgement in the determination of the key assumptions, which are the behavioural life of mortgages and prepayment rates. These calculations are based upon historic data and estimates of future economic conditions. The interest income recognised during the year is £57.6m (2017: 57.3m) Discounts, cashbacks, arrangement and valuation fees, and costs directly attributable to establishing the mortgage are held on the balance sheet and amortised over the expected life of the associated mortgage portfolios. Due to the high level of judgements involved in determining the behavioural life of mortgages, we have determined that there is a risk of fraud inherent in this balance through possible manipulation of this balance. The interest income balances are detailed within note 3. Management's associated accounting policies are detailed on page 25 with detail about judgements in applying accounting policies and critical accounting estimates also on page 25.
How the scope of our audit responded to the key audit matter	We evaluated the design and implementation of internal controls over the EIR calculation process. We have reviewed the approach to revenue recognition to determine whether it is consistent with the applicable accounting standards. We challenged Management's assumptions in relation to the application of the fixed rate period as an appropriate proxy to the behavioural life of mortgage products, under the rationale that customers move onto a fixed term product shortly after the previous product ending. We also considered the treatment of directly attributable fees and charges arising on mortgages, and independently verified the completeness and accuracy of the data used to perform the calculation. We have also reviewed new and existing products to assess whether revenue is recognised on a basis that is consistent with the Group's accounting policies and relevant accounting standards.
Key observations	The fee spreading by the Society is materially consistent with IAS 39 and the assumptions regarding the behavioural life of mortgage products are appropriate. We identified a misstatement relating to an EIR adjustment which was accounted for in deferred income and expense rather than offset against lending receivables, but concluded that in the context of the financial statements as a whole this was not material. The adjustments are appropriately accounted for in the income statement.

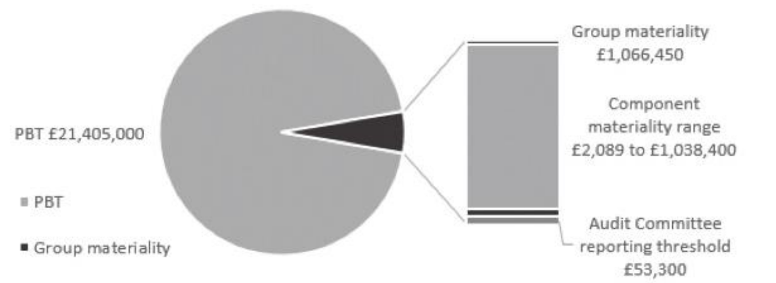
Hedge accounting	
Key audit matter description	The Society applies hedge accounting using fair value macro hedge relationships in order to minimise the volatility of fair value movement in the income statement. As the macro hedge evolves, hedged items and the associated derivative, incept and de-designate from the hedge relationship. The fair value adjustment to the hedged item at the year-end was a liability of £3.6m (2017: £9.5m asset). When hedge relationships are entered into it is possible they are not in compliance with IAS 39, this includes both the appropriate documentation being in place and that the items have been correctly designated into a hedge relationship. If subsequently a component of a hedging relationship is ineffective, it is removed from the hedge and any associated fair value of the hedged item should be amortised over the remaining life to maturity of the instrument. The fair value adjustment to hedged item and the fair value of derivatives are detailed within note 5. The Group's associated accounting policies are detailed on page 24 with detail about judgements in applying accounting policies and critical accounting estimates on page 25.
How the scope of our audit responded to the key audit matter	We evaluated the design and assessed the implementation of internal controls over the hedge accounting process. We tested the population of hedging instruments and hedged items on a sample basis, and recalculated the fair value adjustments on designation and de-designation of items from the hedge relationship. Our internal financial instrument specialists assessed The Society's prospective and retrospective hedge effectiveness testing to results confirm whether they met the required conditions under IAS 39 to continue applying hedge accounting. We also performed procedures upon source data extracted from the Society's core treasury system to identify whether the population of derivative data was accurate and complete, as well as reviewing confirmations received from counterparties and banks.
Key observations	The hedge relationships remained both prospectively and retrospectively effective during the period, meeting the requirements of IAS 39 to allow hedge accounting. The fair value adjustments posted with respect to the specific hedged items on both designation, and subsequent amortisation upon de-designation, were appropriate.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Society financial statements
Materiality	£1.1 million	£1.0 million
Basis for determining materiality	5% of profit before tax.	5% of profit before tax.
applied	This is an appropriate benchmark to use because the accumulation of profits is critical to maintaining and building capital for regulatory purposes and allowing the Group to invest in activities for its members.	This is an appropriate benchmark to use because the accumulation of profits is critical to maintaining and building capital for regulatory purposes and allowing the Society to invest in activities for its members.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £53,300 for the Group, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit
Our Group audit was scoped by obtaining an understanding of the Group and its environment, including group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we performed a full audit of the Society and all of its trading subsidiaries, executed at levels of materiality applicable to each individual entity which were lower than Group materiality and in the range of £2,089 to £1,038,400. We, as the Group auditor, were responsible for performing the audit of each subsidiary. At the Group level we also tested the consolidation process.

Other information	
The directors are responsible for the other information. The other information comprises the information included in the annual report including the Chairman's Statement, the Strategic Report, the Directors' Report, the Report on Directors' Remuneration and the Directors' Report on Corporate Governance , other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.	We have nothing to report in respect of these matters.

Responsibilities of directors
As explained more fully in the statement of directors' responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In preparing the financial statements, the directors are responsible for assessing the Group's and the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

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

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Building Societies Act 1986
In our opinion, based on the work undertaken in the course of the audit: • the annual business statement and the directors' report have been prepared in accordance with the requirements of the Building Societies Act 1986; • the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with 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. In the light of the knowledge and understanding of the Group and the Society and their environment obtained in the course of the audit, we have not identified any material misstatements in the directors' report.

Opinion on other matter prescribed by the Capital Requirements (Country-by-Country Reporting) Regulations 2013
In our opinion the information given on page 5 for the financial year ended 31 March 2018 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Matters on which we are required to report by exception	
Adequacy of explanations received and accounting records Under the Building Societies Act 1986 we are required to report to you if, in our opinion: • adequate accounting records have not been kept by the Society; or • the Society's 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.	We have nothing to report in respect of these matters.

Other matters
Auditor tenure Following the recommendation of the audit committee, we were appointed by the Directors of Cumberland Building Society on 24 June 2014 to audit the financial statements for the year ending 31 March 2015 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 4 years covering the years ending 31 March 2015 to 31 March 2018.
Consistency of the audit report with the additional report to the audit committee Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

David Heaton (Senior statutory auditor)

For and on behalf of Deloitte LLP, Statutory Auditor, Manchester, United Kingdom 22 May 2018

GROUP AND SOCIETY INCOME AND EXPENDITURE ACCOUNTS

For the year ended 31 March 2018

	Notes	**Group 2018 £000**	Group 2017 £000	**Society 2018 £000**	Society 2017 £000
Interest receivable and similar income	3	**59,725**	59,049	**57,640**	57,310
Interest payable and similar charges	4	**(20,501)**	(21,634)	**(20,502)**	(21,635)
Net interest receivable		**39,224**	37,415	**37,138**	35,675
Fair value gains/(losses) on financial instruments	5	**2,450**	(358)	**2,380**	(361)
Pension finance charge	24	**(482)**	(321)	**(482)**	(321)
Fees and commissions receivable		**2,912**	2,875	**1,530**	1,658
Fees and commissions payable		**(2,370)**	(2,216)	**(2,090)**	(1,975)
Other operating income		**3,161**	3,047	**3,161**	3,050
Gain on equity share investment	31	**-**	6,066	**-**	6,066
Total Income		**44,895**	46,508	**41,637**	43,792
Administrative expenses	6	**(21,033)**	(19,763)	**(18,649)**	(17,631)
Depreciation and profit on sale of tangible fixed assets		**(1,895)**	(1,721)	**(1,819)**	(1,644)
Loss on revaluation of investment properties		**(376)**	(56)	**(156)**	(116)
Provisions for bad and doubtful debts	13	**(77)**	(353)	**(59)**	(326)
Provisions for contingent liabilities and commitments - FSCS Levy	22	**(109)**	130	**(109)**	130
Write off of amount owed by subsidiary		**-**	-	**-**	(172)
Profit on ordinary activities before tax		**21,405**	24,745	**20,845**	24,033
Tax on profit on ordinary activities	9	**(3,871)**	(5,075)	**(3,877)**	(5,045)
Profit for the financial year		**17,534**	19,670	**16,968**	18,988

The above results are derived from continuing operations of the business.

STATEMENTS OF COMPREHENSIVE INCOME

For the year ended 31 March 2018

	Notes	**Group 2018 £000**	Group 2017 £000	**Society 2018 £000**	Society 2017 £000
Profit for the financial year		**17,534**	19,670	**16,968**	18,988
Items that may subsequently be reclassified to income and expenditure:					
Available for sale investment securities (loss)/gain	11	**(3)**	4	**(3)**	4
Movement in deferred tax relating to investment securities		**1**	(1)	**1**	(1)
Movement in gain on equity share investment	31	**650**	(2,534)	**650**	(2,534)
Movement in deferred tax relating to equity share investment		**(111)**	532	**(111)**	532
Items that may not subsequently be reclassified to income and expenditure:					
Actuarial gain/(loss) on retirement benefit obligations	24	**3,587**	(10,096)	**3,587**	(10,096)
Movement in deferred tax relating to retirement benefit obligations		**(610)**	1,716	**(610)**	1,716
Total comprehensive income for the year		**21,048**	9,291	**20,482**	8,609

The notes on pages 24 to 46 form part of these accounts.

GROUP AND SOCIETY BALANCE SHEETS

As at 31 March 2018

Assets	**Notes**	**Group 2018 £000**	Group 2017 £000	**Society 2018 £000**	Society 2017 £000
Cash in hand and balances with the Bank of England	10	**291,097**	162,882	**291,097**	162,882
Loans and advances to credit institutions	25	**114,049**	118,817	**114,049**	118,817
Debt securities	11	**34,900**	24,077	**34,900**	24,077
		440,046	305,776	**440,046**	305,776
Derivative financial instruments	29	**7,519**	677	**7,472**	670
Loans and advances to customers	12				
Loans fully secured on residential property		**1,868,413**	1,733,482	**1,868,413**	1,733,482
Other loans		**182,076**	177,036	**160,219**	156,484
		2,050,489	1,910,518	**2,028,632**	1,889,966
Investments in subsidiary undertakings	14	**-**	-	**22,573**	21,823
Investment in equity shares	31	**3,913**	3,263	**3,913**	3,263
Tangible fixed assets	15	**12,185**	12,194	**11,926**	11,913
Investment properties	16	**3,803**	4,179	**2,528**	2,684
Other assets	17	**3,175**	4,031	**3,575**	4,675
Prepayments and accrued income		**1,640**	1,339	**1,240**	921
Total Assets		**2,522,770**	2,241,977	**2,521,905**	2,241,691

Liabilities					
Shares	19	**1,824,878**	1,743,879	**1,824,878**	1,743,879
Derivative financial instruments	29	**2,617**	11,314	**2,615**	11,283
Amounts owed to credit institutions	25	**349,557**	204,356	**349,557**	204,356
Amounts owed to other customers	25	**143,841**	100,763	**145,035**	102,094
Other liabilities	20	**6,671**	4,390	**6,574**	4,221
Accruals and deferred income	21	**5,598**	5,245	**5,479**	5,103
Provisions for liabilities	22	**214**	372	**214**	372
Pension liability	24	**16,112**	19,424	**16,112**	19,424
Total Liabilities		**2,349,488**	2,089,743	**2,350,464**	2,090,732
Total equity attributable to members		**173,282**	152,234	**171,441**	150,959
Total Equity and Liabilities		**2,522,770**	2,241,977	**2,521,905**	2,241,691
Memorandum items					
Commitments	23	**7,331**	7,187	**7,331**	7,187

The notes on pages 24 to 46 form part of these accounts.

These accounts were approved by the Board of Directors on 22 May 2018
T. Hebdon, Chairman
A. Johnston, Vice-Chairman and Chairman of the Audit Committee
D. Moore, Director and Chief Executive

STATEMENTS OF CHANGES IN MEMBERS' INTEREST

Group	General Reserve £000	Available for Sale Reserve £000	Total Equity attributable to members £000
At 1 April 2016	140,248	2,695	142,943
Comprehensive income for the year	11,290	(1,999)	9,291
At 31 March 2017	151,538	696	152,234
Comprehensive income for the year	20,511	537	21,048
At 31 March 2018	172,049	1,233	173,282

Society	General Reserve £000	Available for Sale Reserve £000	Total Equity attributable to members £000
At 1 April 2016	139,655	2,695	142,350
Comprehensive income for the year	10,608	(1,999)	8,609
At 31 March 2017	150,263	696	150,959
Comprehensive income for the year	19,945	537	20,482
At 31 March 2018	170,208	1,233	171,441

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 March 2018

	2018 **£000**	2017 £000
Cash flows from operating activities		
Profit before tax	**21,405**	24,745
Depreciation and profit on sale of tangible fixed assets	**1,895**	1,721
Loss on revaluation of investment properties	**376**	56
Changes in fair values	**(2,450)**	358
Provisions for bad and doubtful debts	**77**	353
Value of VISA Inc. preference shares at date of sale of VISA Europe	**-**	(2,428)
Pension contributions	**(1,142)**	(1,250)
Pension charges	**1,288**	1,040
Operating cash flow before movements in operating assets and liabilities	**21,449**	24,595
Movements in operating assets and liabilities		
Loans and advances to customers	**(153,007)**	(99,223)
Shares	**81,059**	130,610
Loans and advances to credit institutions and other liquid assets	**11,648**	(21,313)
Amounts owed to credit institutions and other customers	**188,279**	(37,198)
Prepayments and accrued income	**(343)**	51
Other assets	**42**	201
Accruals and deferred income	**353**	(1,401)
Other liabilities and provisions for contingent liabilities and commitments	**2,502**	(754)
Other non-cash movements	**(185)**	(135)
Taxation paid	**(4,158)**	(4,087)
Net cash used in movements in operating assets and liabilities	**126,190**	(33,249)
Cash flows from investing activities		
Net purchase and maturity of debt securities	**(10,700)**	(24,000)
Purchase of tangible fixed assets	**(1,933)**	(1,951)
Sale of tangible fixed assets	**47**	121
Net cash used in investing activities	**(12,586)**	(25,830)
Net increase/(decrease) in cash and cash equivalents	**135,053**	(34,484)
Cash and cash equivalents at beginning of year	**180,965**	215,449
Cash and cash equivalents at end of year	**316,018**	180,965
Represented by:		
Cash and balances with the Bank of England	**291,097**	162,882
Loans and advances to credit institutions repayable on demand	**24,921**	18,083
	316,018	180,965

1. Accounting Policies

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and to the preceding year.

Basis of Preparation

The financial statements have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council. During the year, the Group has also adopted IAS 39 Financial Instruments: Recognition and Measurement, as permitted by FRS 102.

Basis of Consolidation

The consolidated financial statements include the financial statements of the Society and its subsidiary undertakings made up to 31 March 2018. All intra-group transactions are eliminated on consolidation.

Going Concern

The Group's financial position and business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report.

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason, the annual accounts continue to be prepared on the going concern basis.

Corporation Tax

Corporation tax is charged in the accounts on the profit for the year as adjusted for taxation purposes. Current tax is the expected tax payable on the taxable income for the year, using tax rates applicable at the balance sheet date and any adjustment to tax payable in respect of previous years.

Deferred Taxation

Provision for deferred tax is made in respect of all timing differences that have originated but not reversed by the balance sheet date. Timing differences represent differences between gains and losses recognised for tax purposes in periods different from those in which they are recognised in financial statements. No deferred tax is recognised on permanent differences between the Group's taxable gains and losses and its results as stated in the financial statements. Deferred tax assets and liabilities are stated without discounting and are calculated at the tax rates that are substantively enacted at the time the timing differences are expected to reverse.

Fixed Assets and Depreciation

The cost of additions and major alterations to freehold land and buildings and equipment is capitalised. Freehold land and buildings are depreciated at 1% per annum on cost. In addition, included in freehold land and buildings are amounts in respect of refurbishment and plant which are depreciated over their estimated useful lives on a straight line basis at rates between 5% and 20%.

The costs less estimated residual values of fixed assets other than freehold land and buildings are written off over their estimated useful lives on a straight line basis using the following annual rates:

Fixtures and Fittings and Office Furniture	20%
Computer Equipment	20% to 50%
Office Equipment	20%
Motor Vehicles	20%

Pension Costs

The Group operates a defined benefit pension scheme and three defined contribution pension schemes for staff. The assets of the schemes are held separately from those of the Group in independently administered funds.

The defined benefit pension scheme's assets are measured at market value at each balance sheet date and the liabilities are measured using the projected unit method with a suitable control period which reflects the expected ageing of the scheme, discounted using the current rate of return on a high quality corporate bond of equivalent term of the liability.

The resultant surplus or deficit is carried on the balance sheet, as is the associated deferred tax.

Increases in the present value of scheme liabilities from employee service or service benefit improvements, are charged to the income and expenditure account as administrative expenses. The expected return on the scheme's assets less the increase in the scheme's liabilities, arising from the passage of time, is disclosed as a pension finance income or charge.

Any resulting actuarial gains or losses, that is gains or losses arising from differences in the expected return on scheme assets compared to the actual return and changes in assumptions, or factors which affect those assumptions, used in measuring the scheme liabilities, are recognised immediately in the Statement of Comprehensive Income.

Contributions to the defined contribution pension schemes are charged to the income and expenditure account as incurred.

Investment Properties

When land and buildings are held for rental purposes or capital appreciation, they are classified as investment properties and held in the balance sheet at their open market valuation and not depreciated. Changes in the fair value are included in the income and expenditure account in the period in which they arise.

Financial Instruments

Purchases and sales of financial assets are accounted for at settlement date. In accordance with IAS 39 the financial instruments of the Group have been classified into the following categories:

i) Loans and advances

Interest in respect of all loans is measured using the effective interest rate method.

ii) At fair value through income and expenditure

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. The need for credit valuation adjustments is considered in the determination of the fair value of derivatives. All derivatives are carried as assets when their fair values are positive and as liabilities when their fair values are negative.

Derivatives can be designated as fair value hedges.

iii) Available for sale

Available for sale assets are non-derivative financial assets that are not classified into either of the two categories above. The available for sale assets are held at fair value with changes in the fair value recognised in other comprehensive income. Impairment losses are recognised in the income and expenditure account when they arise.

The premia and discounts arising from the purchase of available for sale assets are amortised over the period to the maturity date of the security on an effective yield basis. Any amounts amortised are charged or credited to the income and expenditure account in the relevant financial years.

iv) Financial liabilities

All financial liabilities are measured at amortised cost using the effective interest rate method, except for those financial liabilities measured at fair value through income and expenditure, e.g. derivative liabilities.

v) Derecognition of financial assets and liabilities

Financial assets are only derecognised when the contractual rights to receive cash flows from them have expired or when the Group has transferred substantially all risks and rewards of ownership. Financial liabilities are only derecognised when the obligation is discharged, cancelled or has expired.

vi) Fair value hedges

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans and investment products. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income and expenditure account, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income and expenditure account over the period to maturity.

If derivatives are not designated as hedges then changes in fair values are recognised immediately in the income and expenditure account.

Provisions for bad and doubtful debts

Provisions are made to reduce the value of loans and advances to the amount which the directors consider is likely ultimately to be received.

Throughout the year and at the year end, individual assessments are made of all loans and advances on properties which are in possession or in arrears by three months or more. Specific provision is made against those loans and advances which are considered to be impaired. In considering the specific provision for impaired loans, account is taken of any discount which may be needed against the value of the property at the balance sheet date to agree a sale, the anticipated realisation costs and the amount recoverable under mortgage indemnity policies. The directors recognise that not all accounts in arrears will result in possession and apply a factor based on recent experience to reflect this probability when calculating the provision for accounts in arrears.

In addition, a collective provision is made against those loans and advances to customers where objective evidence, including forbearance measures taken to assist borrowers who are, or could be experiencing financial difficulty, indicates that it is likely that losses may ultimately be realised and thus a loss event has occurred. These factors take into account the Group's experience of default and delinquency rate, loss emergence periods, regional house price movements and adjustments to allow for forced sale values.

Loans and advances in the balance sheet are shown net of provisions, specific and collective. The charge or credit to the income and expenditure account comprises the movement in the provisions together with losses written off in the year.

Interest income and expense

Interest income and expense on financial assets and liabilities held at amortised cost is measured using the effective interest rate method. The effective interest rate method is a method of allocating the interest income or interest 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. Fees integral to the loan yield are included within interest income and expense.

Fees and commission income

Fees and commissions are generally recognised on an accruals basis when the service has been provided.

2. Critical Accounting Estimates and Judgements

Some asset and liability amounts reported in the accounts are based on management estimates, judgements and assumptions. There is, therefore, a risk of changes to the carrying amounts for these assets and liabilities within the next financial year.

There are no critical judgements involved in applying the Group's accounting policies which affect the amounts recognised in the financial statements. The accounting estimates and assumptions which affect the reported amounts of assets and liabilities within the financial statements are set out below.

Provisions for bad and doubtful debts

The Group reviews its loan portfolios to assess impairment on a monthly basis, to determine whether an impairment loss should be recorded in the income and expenditure account. In undertaking this review, 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 such decrease in an individual loan can be identified. This evidence may include observable data indicating that there has been an adverse change in the payment status or borrower's position, including forbearance measures such as a transfer to interest only products and term extensions. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment. Management also assesses the expected loss on loans and advances as a result of the movement in house price indices and the discount on the sale of possession properties. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to minimise any differences between loss estimates and actual loss experience.

Fair value of derivatives and collateral loans

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. All models are certified before they are used and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk, volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Effective interest rate

IAS 39 requires that financial instruments carried at amortised cost be accounted for on an effective interest rate basis. Revenue on financial instruments classified as loans and receivables, available for sale, or financial liabilities at amortised cost, is recognised on an effective interest rate basis. This calculation takes into account interest received or paid and fees and commissions paid or received that are integral to the yield as well as incremental transaction costs. The effective interest rate recognises the expected future cash flows over the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial instrument at initial recognition.

In respect of residential mortgages, incremental fees and costs associated with the origination of a mortgage are deferred and amortised over the mortgage product life.

Pensions

The Group operates a defined benefit pension scheme. Significant judgements (on areas such as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme.

These judgements, which are based upon the Board receiving external advice from the Scheme Actuary, are outlined in note 24 to the Accounts.

3. Interest Receivable and Similar Income	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
On loans fully secured on residential property	**56,601**	56,360	**56,233**	56,133
On other loans	**8,920**	8,520	**7,168**	6,966
On debt securities				
Interest and other income	**138**	154	**138**	154
On other liquid assets				
Interest and other income	**1,267**	1,181	**1,267**	1,181
Net expense on derivatives	**(7,201)**	(7,166)	**(7,166)**	(7,124)
Total interest receivable	**59,725**	59,049	**57,640**	57,310

All income is derived from operations within the UK.

4. Interest Payable and Similar Charges	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
On shares held by individuals	**17,970**	19,316	**17,970**	19,316
On deposits and other borrowings	**2,573**	2,412	**2,574**	2,413
Net income on derivatives	**(42)**	(94)	**(42)**	(94)
Total interest payable	**20,501**	21,634	**20,502**	21,635

5. Fair Value Gains less Losses	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Change in fair value derivatives in designated fair value hedge accounting relationships	**14,627**	187	**14,627**	187
Change in fair value derivatives not in designated fair value hedge accounting relationships	**70**	3	**-**	-
Adjustment to hedged items in designated fair value hedge accounting relationships	**(12,247)**	(548)	**(12,247)**	(548)
	2,450	(358)	**2,380**	(361)

The fair value accounting volatility loss above represents the net fair value movement on derivative instruments that are matching risk exposures on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items.

6. Administrative Expenses	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Staff costs (note 7)	**13,300**	12,197	**11,767**	10,877
The analysis of the auditor's remuneration is as follows:				
Fees payable to the Group's auditor for the audit of the annual accounts	**87**	78	**69**	60
Other Services:				
Other assurance services	**29**	52	**29**	52
Other expenses	**7,617**	7,436	**6,784**	6,642
	21,033	19,763	**18,649**	17,631

7. Staff Numbers and Costs

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

	Full time 2018	Full time 2017	Part time 2018	Part time 2017
Society's principal office	**166**	157	**71**	71
Society's branches	**113**	115	**104**	109
Subsidiaries	**43**	35	**12**	12
	322	307	**187**	192

The aggregate costs of these persons were as follows:	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Wages and salaries	**11,442**	10,668	**10,118**	9,504
Social security costs	**1,052**	810	**924**	715
Other pension costs (note 24)	**806**	719	**725**	658
	13,300	12,197	**11,767**	10,877

The Group operates a salary sacrifice scheme whereby the employee agrees to a reduction in salary in return for the Group making the pension contributions that were previously paid by the employee. The amounts shown above under wages and salaries include the headline salary (i.e. before the salary sacrifice deduction) and other pension costs exclude the additional contributions made by the Group as a result of the salary sacrifice scheme. This also applies to the executive directors' remuneration disclosures in note 8.

8. Directors' Remuneration

	2018 £000	2017 £000
Total directors' remuneration	**1,301**	1,191
Non-executive directors' remuneration		
Trevor Hebdon (Chairman from 24 September 2016, Chairman of the Audit Committee to 14 September 2016 and Vice-Chairman to 23 September 2016)	**54**	47
Michael Pratt (Chairman, retired 23 September 2016)	**-**	26
Alan Johnston (Chairman of the Audit Committee from 15 September 2016 and Vice-Chairman from 24 September 2016)	**42**	36
Peter Anstiss (resigned 2 February 2018)	**29**	30
Jackie Arnold (appointed 16 March 2018)	**3**	-
David Clarke (retired 5 July 2016)	**-**	7
Gill Gardner	**33**	31
Eric Gunn (appointed 9 November 2016)	**33**	15
John Hooper (Chairman of the Board Risk Committee)	**39**	37
Michael Hulme (Chairman of the Remuneration Committee)	**37**	34
	270	263

Executive directors' remuneration **2018**	**Salary £000**	**Bonus £000**	**Pension Contributions £000**	**Pension Replacement Amounts £000**	**Taxable Benefits £000**	**Total £000**
Kevin Parr	**247**	**43**	**-**	**34**	**8**	**332**
Peter Temple	**163**	**29**	**10**	**16**	**9**	**227**
John Kidd	**163**	**29**	**10**	**16**	**8**	**226**
Chris McDonald	**153**	**27**	**10**	**16**	**8**	**214**
	726	**128**	**30**	**82**	**33**	**999**

Mr. McDonald has also received £30,000 in compensation for loss of office in respect of his resignation from the Board and the Society on 30 April 2018. The Remuneration Committee has also agreed that Mr. Temple will receive a compensatory payment in respect of loss of office, but this has not yet been finalised; details will be provided in the 2018-19 financial statements.

2017	Salary £000	Bonus £000	Pension Contributions £000	Pension Replacement Amounts £000	Taxable Benefits £000	Total £000
Kevin Parr	234	41	-	33	7	315
Peter Temple	156	27	21	-	9	213
John Kidd	159	27	21	-	8	215
Chris McDonald	134	23	14	4	8	183
	683	118	56	37	32	926

Defined Benefit Pension Scheme Pension benefits earned by directors:	**Accumulated total accrued pension at 31 March 2018 £000**	**Increase in accrued pension in year to 31 March 2018 £000**	Increase in accrued pension in year to 31 March 2017 £000
Kevin Parr	**76**	**2**	2
Peter Temple	**61**	**-**	-
John Kidd	**51**	**-**	-

None of the directors had an interest in shares in, or debentures of, any subsidiary undertaking of the Society at any time during the financial year.

9. Taxation

	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
(a) Analysis of charge in year:				
Current tax				
Corporation tax at 19% (2017 - 20%)	**4,176**	5,043	**4,118**	5,021
Over provision of corporation tax in prior years	**(399)**	(10)	**(380)**	(6)
Total current tax	**3,777**	5,033	**3,738**	5,015
Deferred tax at 17%				
Origination and reversal of timing differences	**94**	42	**139**	30
Tax on profit on ordinary activities	**3,871**	5,075	**3,877**	5,045
Total deferred tax relating to items of other comprehensive income	**720**	(2,247)	**720**	(2,247)

(b) Factors affecting tax charge in year:
The differences between the total tax charge shown above and the amount calculated by applying the standard rate of UK corporation tax is as follows:

	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Profit on ordinary activities before tax	**21,405**	24,745	**20,845**	24,033
Tax on profit on ordinary activities at UK standard rate of 19% (2017 - 20%)	**4,067**	4,949	**3,961**	4,807
Effects of:				
Expenses not deductible for tax purposes	**203**	136	**296**	244
Over provision of corporation tax in prior years	**(399)**	(10)	**(380)**	(6)
Total tax charge for year	**3,871**	5,075	**3,877**	5,045

10. Cash in Hand and Balances with the Bank of England

	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Cash in hand	**3,126**	3,215	**3,126**	3,215
Balances with the Bank of England	**287,971**	159,667	**287,971**	159,667
Included in cash and cash equivalents	**291,097**	162,882	**291,097**	162,882

Balances with the Bank of England do not include cash ratio deposits of £2.12 million (2017 - £1.86 million) which are not available for use in the Group's day to day operations. Such deposits are included within Loans and Advances to Credit Institutions in the Balance Sheet.

For the purpose of the cash flow statement, cash and cash equivalents comprise the following balances which are repayable on demand:

	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Cash in hand and balances with the Bank of England (as above)	**291,097**	162,882	**291,097**	162,882
Loans and advances to credit institutions	**24,921**	18,083	**24,921**	18,083
	316,018	180,965	**316,018**	180,965

11. Debt Securities

	Group and Society 2018 £000	2017 £000
(a) Debt securities are repayable from the date of the balance sheet in the ordinary course of business as follows:		
Unlisted - In not more than one year	**34,700**	24,000
Accrued interest	**199**	73
Fair value adjustment	**1**	4
	34,900	24,077

Debt securities are held as available for sale assets and carried at their fair value.

	2018 £000	2017 £000
(b) The movement in available for sale debt securities is summarised as follows:		
At 1 April	**24,077**	-
Additions	**51,700**	60,000
Maturities	**(41,000)**	(36,000)
(Losses)/gains from changes in fair value	**(3)**	4
Increase in accrued interest	**126**	73
At 31 March	**34,900**	24,077

In addition, at 31 March 2018 the Society had drawn £70 million (2017 - £325 million) of Treasury Bills under the Bank of England's Funding for Lending Scheme; £40 million (2017 - £133 million) were held off balance sheet.

12. Loans and Advances to Customers

	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Loans and advances to customers comprise:				
Loans fully secured on residential property	**1,872,566**	1,724,418	**1,872,566**	1,724,418
Other loans				
Loans fully secured on land	**160,289**	156,967	**160,289**	156,967
Other loans	**23,452**	21,915	**1,585**	1,363
Fair value adjustment for hedge risk	**(3,602)**	9,548	**(3,602)**	9,548
	2,052,705	1,912,848	**2,030,838**	1,892,296
Less: Provisions for bad and doubtful debts (note 13)	**(2,216)**	(2,330)	**(2,206)**	(2,330)
	2,050,489	1,910,518	**2,028,632**	1,889,966

At 31 March 2018 £560.3 million (2017 - £471.7 million) of loans had been pledged as collateral to the Bank of England under the Funding for Lending and Term Funding Schemes.

13. Provisions for bad and doubtful debts

	Group and Society 2018			
	Loans fully secured on residential property £000	Loans fully secured on land £000	Other loans £000	Total £000
At 1 April 2017				
Collective impairment	396	1,161	40	1,597
Individual impairment	88	611	34	733
	484	1,772	74	2,330
Income and expenditure account				
Charge/(release) for the year				
Collective impairment	(25)	69	-	44
Individual impairment	174	(165)	6	15
	149	(96)	6	59
Amount written off during the year				
Individual impairment	(82)	(97)	(4)	(183)
At 31 March 2018				
Collective impairment	371	1,230	40	1,641
Individual impairment	180	349	36	565
	551	1,579	76	2,206

The table above relates to the Society.
Borderway Finance Limited had individual impairment provisions of £10,000 at 31 March 2018, and a charge in the year of £16,000.
Cumberland Estate Agents Limited had a charge in the year of £2,000.

	Group and Society 2017			
At 1 April 2016				
Collective impairment	196	1,250	40	1,486
Individual impairment	67	577	29	673
	263	1,827	69	2,159
Income and expenditure account				
Charge/(release) for the year				
Collective impairment	200	(89)	-	111
Individual impairment	39	160	8	207
	239	71	8	318
Amount written off during the year				
Individual impairment	(18)	(126)	(3)	(147)
At 31 March 2017				
Collective impairment	396	1,161	40	1,597
Individual impairment	88	611	34	733
	484	1,772	74	2,330

The total charge of £326,000 in the income and expenditure account consisted of the charge of £318,000 shown above, and a net charge of £8,000 in respect of additional costs and recoveries against loans which had been written off in prior years. Borderway Finance Limited had a charge of £10,000 and Cumberland Estate Agents Limited a charge of £17,000.

14. Fixed Asset Investments

	Shares £000	Loans £000	Total £000
Investments by the Society in subsidiary undertakings			
Cost at 1 April 2017	1,890	19,933	21,823
Advances	-	750	750
Cost at 31 March 2018	1,890	20,683	22,573

Subsidiary undertakings

The Society has ordinary share investments in the following subsidiary undertakings, all registered in England at the Society's Principal Office, Cumberland House, Cooper Way, Parkhouse, Carlisle, CA3 0JF, and in each case the interest of the Society is 100%.

	Principal Activity
Direct	
Cumberland Holdings Ltd	Holding Company
Indirect	
Borderway Finance Ltd	Motor Vehicle Finance
Cumberland Estate Agents Ltd	Estate Agents
Cumberland Financial Services Ltd	Independent Financial Adviser
Cumberland Homes Ltd	Development Company
Cumberland Property Services Ltd	Property Company
Cumberland Financial Planning Ltd	Dormant
Cumberland Building Society Insurance Ltd	Dormant
Cumberland Leasing Ltd	Dormant
Cumberland Conveyancing Services Ltd	Dormant
Cumberland Insurance Services Ltd	Dormant
Solway Mortgage Solutions Ltd	Dormant

15. Tangible Fixed Assets (Group)

	Freehold Land and Buildings £000	Equipment, Fixtures and Fittings and Vehicles £000	Total £000
Cost			
At 1 April 2017	16,828	9,326	26,154
Additions	81	1,852	1,933
Disposals	-	(377)	(377)
At 31 March 2018	16,909	10,801	27,710
Depreciation			
At 1 April 2017	8,507	5,453	13,960
Charge for year	374	1,558	1,932
Disposals	-	(367)	(367)
At 31 March 2018	8,881	6,644	15,525
Net book value			
At 31 March 2018	8,028	4,157	12,185
At 31 March 2017	8,321	3,873	12,194

Tangible Fixed Assets (Society)

	Freehold Land and Buildings £000	Equipment, Fixtures and Fittings and Vehicles £000	Total £000
Cost			
At 1 April 2017	16,537	9,086	25,623
Additions	81	1,770	1,851
Disposals	-	(240)	(240)
At 31 March 2018	16,618	10,616	27,234
Depreciation			
At 1 April 2017	8,221	5,489	13,710
Charge for year	372	1,460	1,832
Disposals	-	(234)	(234)
At 31 March 2018	8,593	6,715	15,308
Net book value			
At 31 March 2018	8,025	3,901	11,926
At 31 March 2017	8,316	3,597	11,913

The net book value of land and buildings occupied by the Group for its own activities at 31 March 2018 was £7,832,000 (Society £7,829,000) (2017 - Group £8,120,000, Society £8,115,000).

16. Investment Properties	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
At 1 April	**4,179**	4,235	**2,684**	2,800
Revaluation	**(376)**	(56)	**(156)**	(116)
At 31 March	**3,803**	4,179	**2,528**	2,684

Valuations of all investment properties were carried out on an open market value basis by an independent valuer, R. Richardson, BSc MRICS, Director of Hyde Harrington Ltd, as at 31 March 2018.

If investment properties had not been revalued they would have been included at the following amounts:

Cost	**4,587**	4,587	**3,375**	3,375
Depreciation	**1,722**	1,676	**1,658**	1,624
	2,865	2,911	**1,717**	1,751

At the balance sheet date, the Group had contracted with tenants for the following future minimum lease payments:

	Group and Society	
	2018 £000	2017 £000
Within one year	**138**	94
In the second to fifth years inclusive	**190**	118
After five years	**12**	3
	340	215

The Group is additionally contractually obliged to carry out annual repairs and maintenance in respect of investment properties, which in the current year amounted to £52,000 (2017 - £16,000).

17. Other Assets	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Deferred taxation asset (note 18)	**3,054**	3,868	**3,042**	3,901
Other	**121**	163	**533**	774
	3,175	4,031	**3,575**	4,675

18. Deferred Taxation				
At 1 April	**3,868**	1,663	**3,901**	1,684
Charge to the income and expenditure account (note 9)	**(94)**	(42)	**(139)**	(30)
(Charge)/credit to other comprehensive income	**(720)**	2,247	**(720)**	2,247
At 31 March	**3,054**	3,868	**3,042**	3,901
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Difference between accumulated depreciation and amortisation and capital allowances	**370**	322	**346**	303
Collective mortgage loss provisions	**-**	271	**-**	271
Revaluation of investment properties	**(26)**	(85)	**(57)**	(79)
Pension scheme	**2,739**	3,302	**2,739**	3,302
Investment in equity shares	**(252)**	(142)	**(252)**	(142)
Debt securities	**1**	(1)	**1**	(1)
Differences arising from transition to FRS 102	**222**	201	**265**	247
	3,054	3,868	**3,042**	3,901

Deferred tax assets and liabilities are offset only where the Group has a legally enforceable right to do so and where assets and liabilities relate to income taxes levied by the same taxation authority on the same taxable entity or another entity within the Group.

19. Shares

	Group and Society 2018 £000	Group and Society 2017 £000
Held by individuals	**1,824,878**	1,743,819
Other	**7**	7
Fair value adjustment for hedged risk	**(7)**	53
	1,824,878	1,743,879

20. Other Liabilities

	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Other liabilities falling due within one year:				
Corporation tax	**2,097**	2,478	**2,008**	2,318
Income tax	**2**	-	**2**	-
Other creditors	**4,572**	1,912	**4,564**	1,903
	6,671	4,390	**6,574**	4,221

21. Accruals and Deferred Income

	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Accruals	**1,775**	1,558	**1,657**	1,422
Accrued interest relating to derivative financial instruments	**541**	738	**541**	738
Other deferred income	**3,282**	2,949	**3,281**	2,943
	5,598	5,245	**5,479**	5,103

Accruals and deferred income includes £3.13 million (2017 - £2.71 million) relating to deferred income arising as a result of the effective interest rate method in line with FRS 102.

22. Provisions for Liabilities

	Group and Society 2018 £000	Group and Society 2017 £000
Financial Services Compensation Scheme Levy:		
At 1 April	**372**	954
Paid	**(267)**	(452)
Charged/(credited) to income and expenditure account	**109**	(130)
At 31 March	**214**	372

The Financial Services Compensation Scheme (FSCS) makes annual levies on all regulated UK deposit-takers in relation to its running expenses (the management expenses levy) and any compensation claims made against it (the compensation levy). The levies for each deposit-taker are based on its share of the total of protected deposits.

The management expenses levy includes the cost of interest on sums borrowed by the FSCS from the Bank of England, and eventually HM Treasury, in order to fund the exceptional compensation payments arising from deposit-taker failures during 2008 and 2009. Levies were made in relation to Bradford and Bingley plc, the UK retail deposit-taking arms of Icelandic banks (Heritable, Kaupthing Edge and Icesave), London Scottish Bank plc and Dunfermline Building Society.

Interest is charged on each outstanding loan at the higher of 12 months LIBOR plus 100 basis points and the relevant gilt rate published by the Debt Management Office, on which the management expenses levies for scheme years 2017-18 and 2018-19 have been based.

In the current year, the Society paid £267,000 in respect of the levy for 2016-17.

The charge of £109,000 in the latest year reflects an under provision in respect of the scheme year 2017-18, which was accrued for at 31 March 2017, and the Society's estimated share of the management expenses levy for 2018-19.

23. Financial Commitments

(a) The Society has undertaken to discharge the liabilities of all its subsidiary undertakings, in so far as they are unable to discharge them out of their own assets.

(b) Financial Services Compensation Scheme
The Society has a contingent liability in respect of contributions to the Financial Services Compensation Scheme as outlined in note 22.

(c) Capital commitments at 31 March for which no provision has been made in the accounts were as follows:

	Group and Society	
	2018 £000	2017 £000
Contracted but not provided for	**630**	-

(d) Memorandum items

Irrevocable mortgage commitments	**7,331**	7,187

24. Pensions

The Group operates a defined benefit pension scheme and three defined contribution schemes.

Defined contribution schemes

The Group operates three defined contribution schemes funded by contributions from the Group and its staff. One scheme is open to all new employees. The total expense charged to income and expenditure in the year ended 31 March 2018 was £643,000 (2017 - £587,000).

Defined benefit scheme

The Group operates a defined benefit scheme which was closed to new entrants in April 2000, and to further accrual at 31 March 2015.

All of the following details relate solely to the defined benefit scheme.

The valuation used for FRS 102 disclosures has been prepared by a qualified independent actuary to take account of the requirements of FRS 102 in order to assess the liabilities of the scheme at 31 March 2018 using the projected unit method with a suitable control period which reflects the expected ageing of the scheme.

Scheme assets are stated at their market value at 31 March 2018.

The most recent full actuarial valuation was as at 27 August 2015 and showed a deficit of £113,000.

Key assumptions used:	**Valuation at**	
	2018 %	2017 %
Rate of increase in pensions in payment	**2.30 - 3.00**	2.30 - 3.00
Discount rate	**2.60**	2.50
Inflation assumptions - RPI	**3.10**	3.10
- CPI	**2.10**	2.10

Mortality assumptions:
Post-retirement mortality is based on 95% of the 2017 S2PA year of birth tables, projected assuming medium cohort improvements with a minimum improvement of 1.25% per annum. No allowance is made for pre-retirement mortality.

The number of years' life expectancy, retiring at 62, is as follows:	**2018**	2017
Retiring today:		
Males	**87.1**	87.5
Females	**89.1**	89.6
Retiring in 20 years:		
Males	**88.6**	89.3
Females	**90.7**	91.6

The Group has not contributed in the current and previous financial years following the closure of the scheme to further accrual at 31 March 2015, other than in respect of payments under the Scheme's recovery plan and the augmentations which have resulted in the service cost charges.

The amount included in the balance sheet arising from the Group's obligations in respect of its defined benefit scheme is as follows:	2018 £000	2017 £000
Present value of defined benefit obligations	**(72,116)**	(75,561)
Fair value of scheme assets	**56,004**	56,137
Liability recognised in the balance sheet	**(16,112)**	(19,424)
Movements in the present value of defined benefit obligations were as follows:		
At 1 April	**75,561**	61,050
Interest cost	**1,874**	2,117
Service cost	**104**	94
Benefits paid	**(1,238)**	(1,158)
Actuarial (gain)/loss	**(4,185)**	13,458
At 31 March	**72,116**	75,561
Movements in the fair value of scheme assets were as follows:		
At 1 April	**56,137**	51,634
Actuarial (loss)/gain	**(598)**	3,362
Expected return on assets	**1,392**	1,796
Contributions from employers	**440**	645
Benefits paid	**(1,238)**	(1,158)
Expenses paid	**(129)**	(142)
At 31 March	**56,004**	56,137
The analysis of the scheme assets at the balance sheet date was as follows:		
Growth assets	**48,857**	36,386
Liability driven investments	**5,170**	16,904
Cash	**153**	280
Other assets	**1,824**	2,567
	56,004	56,137

The scheme's assets are not intended to be realised in the short term and their market values may be subject to significant change before the assets are realised.

Amounts recognised in the performance statements under the requirements of FRS 102

a) Administrative expenses

Service cost	**104**	94

The service costs in the current and prior years have arisen as a result of an augmentation of the retirement benefits of two executive directors, Mr. Parr and Mr. Kidd, as part of the Board's succession planning.
The operating charge of £104,000 (2017 - £94,000), plus the Group's contributions to the defined contribution schemes of £643,000 (2017 - £587,000) and life assurance premiums of £59,000 (2017 - £38,000), comprise the Group's other pension costs total of £806,000 (2017 - £719,000) shown in note 7.

b) Pension finance charge

Expected return on pension scheme assets	**1,392**	1,796
Interest on pension scheme liabilities	**(1,874)**	(2,117)
Net charge	**(482)**	(321)

c) Statement of Comprehensive Income

Actual return less expected return on pension scheme assets	**(598)**	3,362
Actuarial gain/(loss) on defined benefit obligation	**4,185**	(13,458)
Actuarial gain/(loss)	**3,587**	(10,096)
Movement in deferred taxation relating to pension scheme	**(610)**	1,716
Actuarial gain/(loss) recognised in the Statement of Comprehensive Income	**2,977**	(8,380)

d) Movement in the deficit in the scheme during the year	**2018 £000**	2017 £000
Deficit in scheme at beginning of year	**(19,424)**	(9,416)
Movement in year:		
Service cost	**(104)**	(94)
Contributions net of expenses paid	**311**	503
Pension finance charge	**(482)**	(321)
Actuarial gain/(loss)	**3,587**	(10,096)
Deficit in scheme at end of year	**(16,112)**	(19,424)

History of experience gains and losses	**2018**	2017	2016	2015	2014
Actual return less expected return on pension scheme assets (£000)	**(598)**	3,362	(3,976)	4,833	(441)
Percentage of scheme assets	**1.1**	6.0	7.7	8.8	0.9
Actuarial gain/(loss) on defined benefit obligation (£000)	**4,185**	(13,458)	932	(9,956)	973
Percentage of scheme liabilities	**5.8**	17.8	1.5	16.3	2.0

Note: all figures in the table above are on the FRS 102 basis, other than with respect to 2014, which is on the UK GAAP basis.

25. Liquidity Risk

The Group's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets, wholesale funding facilities and management control of the growth of the business.

It is Group policy to ensure that sufficient liquid assets are at all times available to meet the Group's statutory, regulatory and operational obligations.

The development and implementation of liquidity policy is the responsibility of the ALCO and approved by the Board. The day-to-day management of liquidity is the responsibility of Treasury, with oversight from the independent Risk Function.

A series of liquidity stress tests are performed each month to confirm that liquidity levels in relation to the limits remain appropriate. The ALCO is responsible for setting limits over the level and maturity profile of wholesale funding and for monitoring the composition of the Group balance sheet.

Limits on potential cash flow mismatches over defined time horizons are the principal basis of liquidity control.

The size of the Group's holdings of readily realisable liquid assets is primarily driven by such potential outflows and access to contingent funding from the Bank of England.

Contractual Maturity and Derivatives

The following table details the Group's expected maturity for its derivative financial instruments. The table has been drawn up based on the undiscounted net cash inflows/(outflows) on the derivative instruments that settle on a net basis and the undiscounted gross inflows and (outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the conditions existing at the reporting date. For these calculations, interest rates have been projected based on the yield curves existing at the reporting date and where the amount varies with changes in an index, the amount disclosed may be based on the level of the index at the reporting date.

At 31 March 2018:	Not more than 3 months £000	More than 3 months but not more than 6 months £000	More than 6 months but not more than 1 year £000	More than 1 year but not more than 5 years £000
Swap contracts	(1,142)	(1,654)	(2,953)	(7,414)
At 31 March 2017:				
Swap contracts	(1,847)	(1,923)	(3,598)	(10,032)

Maturity profile of financial instruments

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. The Society's maturity grouping is not materially different to the Group position.

At 31 March 2018:	Repayable on demand £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	Over 5 years £000	Non-interest bearing £000	Total £000
Assets							
Cash in hand and balances with the Bank of England	291,057	-	-	-	-	40	291,097
Loans and advances to credit institutions	24,921	35,117	53,500	370	-	141	114,049
Debt securities	-	34,700	-	-	-	200	34,900
Derivative financial instruments	-	-	-	-	-	7,519	7,519
Loans and advances to customers							
Loans fully secured on residential property and land	2,870	20,111	63,090	360,509	1,586,275	(5,732)	2,027,123
Other loans	1,585	93	790	20,984	-	(86)	23,366
Liabilities							
Shares	1,293,642	207,429	286,618	33,551	-	3,638	1,824,878
Derivative financial instruments	-	-	-	-	-	2,617	2,617
Amounts owed to credit institutions	-	54,715	4,500	290,000	-	342	349,557
Amounts owed to other customers	66,640	48,991	27,471	496	-	243	143,841
At 31 March 2017:							
Assets							
Cash in hand and balances with the Bank of England	162,865	-	-	-	-	17	162,882
Loans and advances to credit institutions	18,083	62,357	27,000	11,278	-	99	118,817
Debt securities	-	24,000	-	-	-	77	24,077
Derivative financial instruments	-	-	-	-	-	677	677
Loans and advances to customers							
Loans fully secured on residential property and land	2,634	18,980	62,714	326,340	1,470,717	7,292	1,888,677
Other loans	1,363	49	571	19,932	-	(74)	21,841
Liabilities							
Shares	1,185,650	190,901	339,983	22,630	-	4,715	1,743,879
Derivative financial instruments	-	-	-	-	-	11,314	11,314
Amounts owed to credit institutions	-	14,250	-	189,991	-	115	204,356
Amounts owed to other customers	55,505	32,727	11,903	420	-	208	100,763

Included within Other loans are balances of £21,867,000 (2017 - £20,552,000) relating to loans and advances to customers of Borderway Finance Limited.

26. Interest Rate Risk

The primary market risk faced by the Group is interest rate risk. The net interest income of the Group is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using a combination of derivatives. There has been no change to the way that interest rate risk is managed during the year.

The Group does not run a trading book and therefore does not have the type of higher risk exposure incurred by many banking institutions.

The Group uses interest rate stress testing and gap analysis to analyse and manage its interest rate position.

The following table provides a summary of the interest rate re-pricing profile of the Group's assets and liabilities. Assets and liabilities have been allocated to time bands by reference to the earlier of the next interest rate reset date and the contractual maturity date.

The table takes account of derivative financial instruments which alter the interest basis of Group assets and liabilities. The non-interest bearing balances have been included in a separate column.

At 31 March 2018:	Not more than 3 months £000	More than 3 months but less than 6 months £000	More than 6 months but less than 1 year £000	More than 1 year but not more than 5 years £000	Non-interest bearing £000	Total £000
Assets						
Liquid assets	398,165	25,500	16,000	-	381	440,046
Derivative financial instruments	-	-	-	-	7,519	7,519
Loans and advances to customers	962,305	93,936	199,217	800,849	(5,818)	2,050,489
Tangible fixed assets	-	-	-	-	12,185	12,185
Other assets	-	-	-	-	12,531	12,531
Total assets	1,360,470	119,436	215,217	800,849	26,798	2,522,770
Liabilities						
Shares	1,629,322	67,039	91,502	33,377	3,638	1,824,878
Derivative financial instruments	-	-	-	-	2,617	2,617
Amounts owed to credit institutions and other customers	468,854	14,564	8,726	669	585	493,398
Other liabilities, pension liability, accruals and deferred income	-	-	-	-	28,595	28,595
Reserves	-	-	-	-	173,282	173,282
Total liabilities	2,098,176	81,603	100,228	34,046	208,717	2,522,770
Net assets / (liabilities)	(737,706)	37,833	114,989	766,803	(181,919)	-
Derivative instruments	1,077,250	(77,200)	(163,250)	(836,800)	-	-
Interest rate sensitivity gap	339,544	(39,367)	(48,261)	(69,997)	(181,919)	-
Cumulative gap	339,544	300,177	251,916	181,919	-	-

At 31 March 2017:	Not more than 3 months £000	More than 3 months but less than 6 months £000	More than 6 months but less than 1 year £000	More than 1 year but not more than 5 years £000	Non-interest bearing £000	Total £000
Assets						
Liquid assets	289,583	3,000	13,000	-	193	305,776
Derivative financial instruments	-	-	-	-	677	677
Loans and advances to customers	825,075	66,740	156,576	854,909	7,218	1,910,518
Tangible fixed assets	-	-	-	-	12,194	12,194
Other assets	-	-	-	-	12,812	12,812
Total assets	1,114,658	69,740	169,576	854,909	33,094	2,241,977
Liabilities						
Shares	1,500,550	55,774	94,774	73,465	19,316	1,743,879
Derivative financial instruments	-	-	-	-	11,314	11,314
Amounts owed to credit institutions and other customers	300,046	581	1,246	834	2,412	305,119
Other liabilities, pension liability, accruals and deferred income	-	-	-	-	29,431	29,431
Reserves	-	-	-	-	152,234	152,234
Total liabilities	1,800,596	56,355	96,020	74,299	214,707	2,241,977
Net assets / (liabilities)	(685,938)	13,385	73,556	780,610	(181,613)	-
Derivative instruments	1,053,025	(61,325)	(165,900)	(825,800)	-	-
Interest rate sensitivity gap	367,087	(47,940)	(92,344)	(45,190)	(181,613)	-
Cumulative gap	367,087	319,147	226,803	181,613	-	-

The Society's interest rate re-pricing profile is not materially different to the Group's position. The following table details the Group's and Society's sensitivity to a 200 basis point change in interest rates at the year end with all other variables held constant. A positive number indicates an increase to equity reserves.

	Group and Society +200bps 2018 £000	Group and Society +200bps 2017 £000	**Group and Society -200bps 2018 £000**	Group and Society -200bps 2017 £000
Impact on equity reserves	**(1,937)**	(1,957)	**1,937**	2,214

The above interest rate risk represents the market value movement, calculated using a discounted cash flow basis, on all of the Society's financial assets and liabilities, resulting from an immediate 200 basis points parallel shift in interest rates. Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics, such as LIBOR and Bank of England Base Rate) and prepayment risk (the risk of loss arising from early repayments of fixed rate mortgages or withdrawal of fixed rate savings) are also monitored closely and regularly reported to the ALCO.

27. Wholesale Credit Risk

The Society holds various investments in order to satisfy operational demand at the same time as to meet current and future liquidity regulatory requirements. Credit risk arises because of factors such as deterioration in the counterparty's financial health and uncertainty within the wholesale market generally.
Wholesale lending credit risk is managed through setting strict limits to each type of investment in relation to time to maturity, credit rating and country of origin. These limits are set by the ALCO, approved by the Board and monitored by the treasury team on a continuous basis.
Comprehensive management information ensures that credit risk is effectively controlled, and any adverse trends are identified before they impact on performance.
There has been no change in the year to the manner in which the Group manages and measures wholesale credit risk.
At 31 March 2018 none of the Group's treasury portfolio exposure was either past due or impaired. There are no assets that would otherwise be past due or impaired whose terms have been renegotiated. 83% (2017 - 73%) of the Group's treasury investments are rated A3 or better.

The table below provides ratings details for the Group's treasury investment portfolio as at 31 March 2018:

	Group and Society	
	2018 %	2017 %
Aa3-A3	**16**	19
Sovereign exposure to the UK	**67**	54
Other	**17**	27
	100	100

All wholesale exposures are to UK financial institutions. The largest exposure to a single institution other than the UK Government was £31.4 million (2017 - £23.7 million).
The Group's agreements to enter derivatives transactions with counterparties are all documented through the International Swaps and Derivatives Association (ISDA) Master Agreement. In addition, the Group's agreements in respect of repurchase contracts are documented through the Global Master Repurchase Agreement (GMRA). Credit Support Annexes are in place with all of the Group's ISDA and GMRA counterparties. These provide the legal basis for measuring the extent of any credit risk exposures and govern how cash is moved as collateral between the Group and the counterparty to offset these exposures, which arise as a result of movements in interest rates.

Wholesale credit risk is recorded in the extracts from the balance sheet below:

	Group and Society	
	2018 £000	2017 £000
Cash in hand and balances with the Bank of England	**291,097**	162,882
Loans and advances to credit institutions	**114,049**	118,817
Debt securities	**34,900**	24,077
Total wholesale credit risk	**440,046**	305,776

28. Credit Risk on Loans and Advances to Customers

Experienced credit risk functions operate within the Group and comprehensive management information on movements and performance within the various loan portfolios ensures that credit risk is effectively controlled, and any adverse trends are identified before they impact on performance.

The Group's exposure to retail credit risk can be broken down as follows:

	Group	
	2018 £000	2017 £000
Loans fully secured on residential property	**1,872,566**	1,724,418
Loans fully secured on land	**160,289**	156,967
Other loans	**23,452**	21,915
Total gross exposure (contractual amounts)	**2,056,307**	1,903,300
Impairment and hedging adjustments	**(5,818)**	7,218
Total net exposure	**2,050,489**	1,910,518

Loans fully secured on residential property

The Group is firmly committed to the management of this risk at all stages of the lending cycle. The Group monitors closely customer affordability and income multiples at the application and underwriting stage and takes a proactive approach to the control of bad and doubtful debt, which is managed by a specialist team dedicated solely to the collections and recovery process.

	Group and Society	
Geographical distribution	**2018 %**	2017 %
North West	**55**	56
Scotland	**11**	10
London	**10**	10
South East	**8**	9
South West	**7**	7
Yorkshire & Humberside	**2**	2
East of England	**2**	2
North East	**2**	1
West Midlands	**1**	1
East Midlands	**1**	1
Wales	**1**	1
	100	100

Loan to value distribution:

The indexed loan to value analysis on the Group's residential loan portfolio is as follows:

<70%	**78**	76
70%-80%	**11**	12
80%-90%	**10**	9
>90%	**1**	3
	100	100

The overall indexed loan to value of the residential portfolio is 43% (2017 - 43%).

Payment due status	Group and Society 2018 £000	2018 %	Group and Society 2017 £000	2017 %
Not impaired:				
Neither past due nor impaired	**1,863,774**	**99**	1,715,343	99
Past due up to 3 months but not impaired	**4,860**	**1**	6,064	1
Impaired:				
Past due 3 to 6 months	**2,088**	**-**	979	-
Past due 6 to 12 months	**904**	**-**	1,862	-
Possessions	**940**	**-**	170	-
	1,872,566	**100**	1,724,418	100

Note: Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears.

Forbearance strategies

The Group continues to invest in developing and enhancing its arrears management strategies to minimise credit risk whilst ensuring that customers are treated fairly. Such forbearance strategies include the use of arrangements to assist borrowers in arrears who are now able to meet agreed repayment strategies, and aim to avoid repossession.

At 31 March 2018:	Interest only concession £000	Arrears capitalised £000	Transfer to interest only £000	Term extension £000	Total forbearance £000
Neither past due nor impaired	95	137	132	750	1,114
Past due up to 3 months	168	-	-	22	190
Past due more than 3 months	37	-	-	-	37
Total loans and advances	300	137	132	772	1,341
At 31 March 2017:					
Neither past due nor impaired	602	44	204	497	1,347
Past due up to 3 months	-	-	21	28	49
Past due more than 3 months	113	-	-	-	113
Total loans and advances	715	44	225	525	1,509

Loans fully secured on land

Credit risk associated with lending fully secured on land is affected by similar factors as for residential mortgages, although on average loans are generally larger. Loans fully secured on land are split by industry type as follows:

Industry type	Group and Society 2018 %	2017 %
Leisure and hotel	**73**	74
Commercial investment and industrial units	**18**	17
Retail	**2**	2
Offices	**1**	1
Others, including mixed use	**6**	6
	100	100
Unindexed loan to value distribution		
<70%	**94**	96
70%-80%	**3**	1
80%-90%	**2**	2
>90%	**1**	1
	100	100

The following table provides further information on the Groups's loans fully secured on land by payment due status. The balances exclude the fair value adjustment for hedge risk and impairment losses.

Payment due status	**Group and Society 2018 £000**	**Group and Society 2018 %**	Group and Society 2017 £000	Group and Society 2017 %
Not impaired:				
Neither past due nor impaired	**156,795**	**98**	154,280	98
Past due up to 3 months but not impaired	**2,827**	**1**	1,845	1
Impaired:				
Past due 3 to 6 months	**507**	**1**	343	1
Past due 6 to 12 months	**160**	**-**	215	-
Possessions	**-**	**-**	284	-
	160,289	**100**	156,967	100

Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears.

29. Derivative Financial Instruments

Derivative financial instruments are contracts or arrangements whose value is derived from one or more underlying price, rate or index inherent in the contract or arrangement, such as interest rates, exchange rates, or stock market indices. These types of instruments tend to have a smaller or no initial net investment relative to financial assets/liabilities offering the same risk/return as cash flows and are generally settled at a future date.
Derivatives are only used by the Group in accordance with section 9A of the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors specified in the legislation. Derivatives are not used in trading activity or for speculative purposes.

Types of derivatives
The main derivatives used by the Group are interest rate swaps. The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. These risks may alternatively be managed using on balance sheet instruments or natural hedges that exist within the Group balance sheet.

Activity	**Risk**	**Types of Derivative**
Fixed rate savings products	Sensitivity to falls in interest rates	Receive fixed interest swaps
Fixed rate lending	Sensitivity to increases in interest rates	Pay fixed interest rate swaps

The following table shows the notional principal amounts of the different types of derivatives held, and their positive and negative market values.

	Group 2018			Group 2017		
	Notional principal amount £000	**Positive market value £000**	**Negative market value £000**	Notional principal amount £000	Positive market value £000	Negative market value £000
Interest rate swaps designated as fair value hedges	**1,127,450**	**7,472**	**(2,615)**	1,099,725	670	(11,283)
Interest rate swaps not designated as hedges	**15,800**	**47**	**(2)**	13,700	7	(31)
Total derivatives held for hedging	**1,143,250**	**7,519**	**(2,617)**	1,113,425	677	(11,314)

	Society 2018			Society 2017		
	Notional principal amount £000	**Positive market value £000**	**Negative market value £000**	Notional principal amount £000	Positive market value £000	Negative market value £000
Interest rate swaps designated as fair value hedges	**1,127,450**	**7,472**	**(2,615)**	1,099,725	670	(11,283)

The following table shows the notional principal and credit risk weighted amounts, and the replacement costs of the derivatives, and their residual maturity.

	Group 2018			Group 2017		
	Notional principal amount £000	**Credit risk weighted amount £000**	**Replacement cost £000**	Notional principal amount £000	Credit risk weighted amount £000	Replacement cost £000
Interest rate swaps:						
Under one year	**306,450**	**96**	**372**	287,625	46	112
Between one and five years	**836,800**	**3,174**	**6,245**	825,800	1,886	709
	1,143,250	**3,270**	**6,617**	1,113,425	1,932	821

	Society 2018			Society 2017		
	Notional principal amount £000	**Credit risk weighted amount £000**	**Replacement cost £000**	Notional principal amount £000	Credit risk weighted amount £000	Replacement cost £000
Interest rate swaps:						
Under one year	**304,450**	**96**	**370**	286,925	46	112
Between one and five years	**823,000**	**3,140**	**6,202**	812,800	1,856	703
	1,127,450	**3,236**	**6,572**	1,099,725	1,902	815

30. Fair Values

The following tables summarise the carrying amounts and fair values of those financial assets and liabilities by category where these are different. Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated for other financial instruments by discounting cash flows at prevailing interest rates.

	Group and Society	
At 31 March 2018:	**Carrying Value £000**	**Fair Value £000**
Financial assets:		
Loans and advances to customers		
Loans fully secured on residential property	1,872,015	1,882,288
Loans fully secured on land	158,710	156,985
Financial liabilities:		
Shares	1,824,885	1,824,118

	Group and Society	
At 31 March 2017:	Carrying Value £000	Fair Value £000
Financial assets:		
Loans and advances to customers		
Loans fully secured on residential property	1,723,934	1,745,755
Loans fully secured on land	155,195	152,819
Financial liabilities:		
Shares	1,743,826	1,741,584

The fair value and carrying value of balance sheet items not included in the table above are the same, as shown on the balance sheet.
Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arms-length transaction.
Loans and advances to customers and shares are calculated using the effective interest rate method, less provisions for impairment together with fair value adjustments using discounted cash flow principles set out in IAS 39.
The fair value of derivatives is calculated using discounted cash flow models. Future cash flows are estimated based on forward interest rates (from observable yield curves at the end of the reporting period) and contract interest rates, discounted at a rate that reflects the credit risk exposure to the various counterparties.
The above are Level 2 assets, as defined in FRS 102. In addition, the 'investment in equity shares' which is shown in the balance sheet at fair value (see note 31) is a Level 3 asset, as its valuation includes certain assumptions which are deemed to be unobservable.

The following table analyses the Group's assets and liabilities by the class of financial instrument to which they are assigned by the measurement basis:

At 31 March 2018:	Financial assets/ liabilities at fair value through Income and Expenditure £000	Financial assets available for sale £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Non-financial assets/ liabilities £000	Total £000
Financial Assets:						
Cash and balances with the Bank of England	-	-	291,097	-	-	291,097
Loans and advances to credit institutions	-	-	114,049	-	-	114,049
Debt securities	-	34,900	-	-	-	34,900
Derivative financial instruments	7,519	-	-	-	-	7,519
Loans and advances to customers						
Loans fully secured on residential property	(3,602)	-	1,872,015	-	-	1,868,413
Loans fully secured on land	-	-	158,710	-	-	158,710
Other loans	-	-	23,366	-	-	23,366
Investment in equity shares	-	3,913	-	-	-	3,913
Non-financial assets	-	-	-	-	20,803	20,803
Total assets	**3,917**	**38,813**	**2,459,237**	-	**20,803**	**2,522,770**

Financial Liabilities:						
Shares	(7)	-	-	1,824,885	-	1,824,878
Derivative financial instruments	2,617	-	-	-	-	2,617
Amounts owed to credit institutions	-	-	-	349,557	-	349,557
Amounts owed to other customers	-	-	-	143,841	-	143,841
Non-financial liabilities	-	-	-	-	28,595	28,595
General and other reserves	-	-	-	173,282	-	173,282
Total reserves and liabilities	**2,610**	**-**	**-**	**2,491,565**	**28,595**	**2,522,770**

At 31 March 2017:						
Financial Assets:						
Cash and balances with the Bank of England	-	-	162,882	-	-	162,882
Loans and advances to credit institutions	-	-	118,817	-	-	118,817
Debt securities	-	24,077	-	-	-	24,077
Derivative financial instruments	677	-	-	-	-	677
Loans and advances to customers						
Loans fully secured on residential property	9,548	-	1,723,934	-	-	1,733,482
Loans fully secured on land	-	-	155,195	-	-	155,195
Other loans	-	-	21,841	-	-	21,841
Investment in equity shares	-	3,263	-	-	-	3,263
Non-financial assets	-	-	-	-	21,743	21,743
Total assets	**10,225**	**27,340**	**2,182,669**	**-**	**21,743**	**2,241,977**

Financial Liabilities:						
Shares	53	-	-	1,743,826	-	1,743,879
Derivative financial instruments	11,314	-	-	-	-	11,314
Amounts owed to credit institutions	-	-	-	204,356	-	204,356
Amounts owed to other customers	-	-	-	100,763	-	100,763
Non-financial liabilities	-	-	-	-	29,431	29,431
General and other reserves	-	-	-	152,234	-	152,234
Total reserves and liabilities	**11,367**	**-**	**-**	**2,201,179**	**29,431**	**2,241,977**

31. Investment in equity shares

The investment in equity shares is in respect of Visa Inc. preference shares.

The Visa Inc. preference shares were received as part of the consideration for the sale of the Society's share in Visa Europe in June 2016. At 31 March 2018 the preference shares have been recognised at a fair value of £3.913 million (2017 - £3.263 million). The gain for the year has been recognised in the available for sale reserve, net of deferred tax.

The preference shares are convertible into Class A common shares of VISA Inc. at a future date subject to conditions including that the conversion rate may be reduced to cover certain litigation costs (primarily the setting of interchange fees).

In addition, the Society may receive deferred cash consideration in 2020 which is contingent upon certain performance thresholds being met. As this cannot currently be reliably measured, this has been valued at nil (2017 - nil).

32. Capital Structure

The Group's policy is to maintain a strong capital base to maintain member and market confidence and sustain its future development. The Internal Capital Adequacy Assessment Process (ICAAP) assesses the Society's capital adequacy and determines the levels of capital required going forward to support the current and future risks in the business. The Board monitors the Group's actual and projected capital position through its quarterly reporting to ensure that it is maintained at a level above its Individual Capital Guidance (ICG) as determined by the Prudential Regulation Authority (PRA).

The Total Capital Requirement required by the regulator as at 31 March 2018 was £143.9 million. The Group has maintained capital in excess of that required by the regulator throughout the year and in doing so, has complied with the requirements included within the EU Capital Requirements Directive IV (Basel III).

In managing the Group's capital against regulatory requirements, the Board monitors:

- Lending and business decisions – the use of strict underwriting criteria establishes whether mortgage, current account overdraft, vehicle finance and secured personal loan applications fit within its appetite for credit risk;
- Pricing – pricing models are utilised for all mortgage product launches;
- Concentration risk – product design takes into account the overall mix of products to ensure that exposure to market risk is within permitted parameters;
- Counterparty risk – wholesale lending is only carried out with approved counterparties in line with the Group's lending criteria and limits, which are monitored daily to ensure that the Society remains within its risk appetite.

Regular stress tests ensure the Group maintains sufficient capital for possible future events.

There have been no material changes in the Group's management of capital during the year.

Under Basel III Pillar 3 the Group is required to publish further information regarding its capital position and exposures, and the Group's Pillar 3 disclosures are available on www.cumberland.co.uk.

ANNUAL BUSINESS STATEMENT

For the year ended 31 March 2018

1. Statutory Percentages	31 March 2018 %	Statutory Limit %
Lending Limit	**9.46**	25
Funding Limit	**21.28**	50

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

The Lending Limit measures the proportion of business assets not in the form of loans fully secured on residential property. Business assets comprise Group total assets plus provision for bad and doubtful debts, less liquid assets and tangible fixed assets.

The Funding Limit measures the proportion of shares and other borrowings not in the form of shares held by individuals.

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

2. Other Percentages	Group 31 March 2018 %	Group 31 March 2017 %
As percentage of shares and borrowings:		
Gross capital	**7.47**	7.43
Free capital	**7.02**	6.91
Liquid assets	**18.98**	14.92
Profit for the financial year as a percentage of mean total assets*	**0.74**	0.90
Management expenses as a percentage of mean total assets	**0.96**	0.98

	Society 31 March 2018 %	Society 31 March 2017 %
Management expenses as a percentage of mean total assets	**0.86**	0.88

*Profit for the financial year ended 31 March 2017 as a percentage of mean total assets excluding the gain on equity share investment (note 31) was 0.68%.

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

'Shares and borrowings'	represent the total value of shares, amounts owed to credit institutions and amounts owed to other customers.
'Gross capital'	represents the general reserve and the available for sale reserve.
'Free capital'	represents the aggregate of gross capital and collective loss provisions for bad and doubtful debts less tangible fixed assets.
'Mean total assets'	represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
'Liquid assets'	represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
'Management expenses'	represent the aggregate of administrative expenses and depreciation.

3. Information relating to the Directors as at 31 March 2018

Name	Occupation	Date of Birth	Date of Appointment	Other Directorships (excluding dormant companies)
DIRECTORS				
T. Hebdon, ACIB	Business Consultant	21.3.54	11.12.09	Carlisle Cathedral Development Trust
A. J. Johnston, BA, FCA	Chartered Accountant	13.2.60	15.2.11	Armstrong Watson Financial Planning Ltd Future Money Ltd Armstrong Watson Accountants Armstrong Watson General Partner Ltd Armstrong Watson Audit Ltd Carlisle Cathedral Development Trust
J. Arnold, FCMA, FGMA	Management Consultant	31.10.58	16.3.18	Jackie at Eastwood Ltd
G. F. Gardner, MA (Cantab)	Council Secretary of the Co-operative Group	28.9.64	17.9.12	
E. R. Gunn, FCIBS	Retired Bank Executive	4.1.61	9.11.16	
J. Hooper Member of the Australian Institute of Directors	Company Director/Advisor	26.5.61	20.11.15	The Leasing Industry Philanthropic and Research Foundation Ltd Sarhon Developments Ltd Sarhon Homes Ltd John Hooper Consulting Ltd
M. K. Hulme, MPhil	Company Director	10.5.57	3.9.15	
J. C. N. Kidd, BA, ACA	Building Society Finance Director	10.6.65	28.3.02	Cumberland Homes Ltd Cumberland Property Services Ltd Borderway Finance Ltd
C. McDonald, BSc	Building Society Operations and Human Resources Director	6.11.62	13.10.14	Mobile Payments Service Company Ltd
K. Parr, BA, FCCA	Building Society Chief Executive	27.5.60	26.7.94	Cumberland Holdings Ltd Cumberland Financial Services Ltd Cumberland Property Services Ltd Cumberland Estate Agents Ltd Cumberland Homes Ltd Cumberland Financial Planning Ltd Borderway Finance Ltd
P. R. Temple, BSc, MBA	Building Society Deputy Chief Executive	9.3.61	1.9.07	Cumberland Estate Agents Ltd Cumberland Financial Services Ltd Cumberland Holdings Ltd Cumberland Financial Planning Ltd Borderway Finance Ltd

Mr K. Parr, Mr J.C.N. Kidd, Mr P.R. Temple and Mr C. McDonald are employed under contracts terminable by the Society on twelve months' notice or by the individual on six months' notice. Mr Parr's contract was signed on 28 January 1997, Mr Kidd's on 16 May 2002 and Mr Temple's on 30 January 2008, and all were varied by a side letter determining the notice periods above on 26 March 2013. Mr McDonald's contract was signed on 18 December 2014.

Correspondence to the Directors jointly or individually should be addressed 'Private and Confidential' and c/o Deloitte LLP, 2 Hardman Street, Manchester, M3 3HF.

94%

OF OUR CUSTOMERS WOULD **RECOMMEND US** TO THEIR FRIENDS AND FAMILY

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When asked how likely they would be to recommend us, 355 out of 374 customers responded with a score of 7 or more out of 10.

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cumberland.co.uk

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Building Society