STAFFORD RAILWAY
BUILDING SOCIETY

# Annual Report & Accounts

31 October 2018

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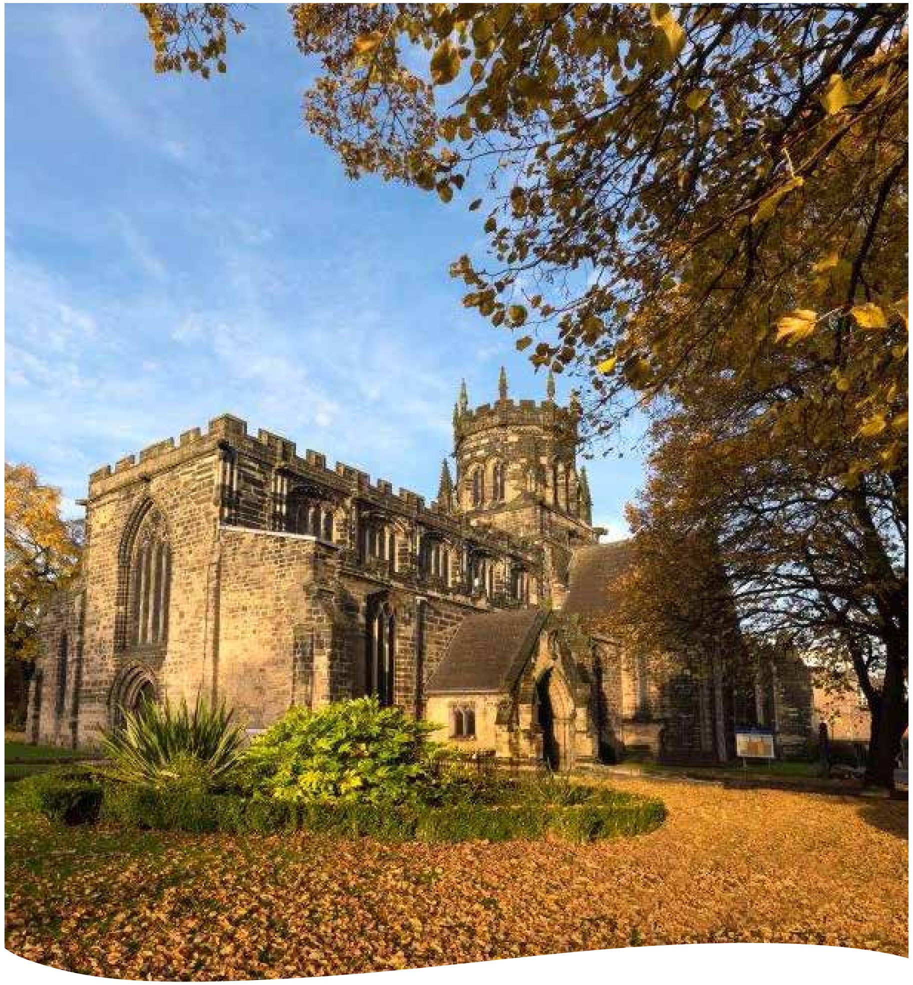
STAFFORD RAILWAY
BUILDING SOCIETY

# Chairman's Statement

# Chairman's Statement



2018 witnessed a major change for the Society, with the completion of our succession planning to a new full time Executive Team – Michael Smith as Chief Executive and Steven Jones, formerly of the Hanley Economic Building Society, as Deputy Chief Executive and Finance Director.

*I should like to thank Susan Whiting and Jeremy Hodgkiss for their loyal years of service and particularly for their professionalism and support during the time of transition, which allowed for a smooth handover of responsibilities. Both contributed considerable years of service and commitment to the Society - Susan for fourteen years, including seven as Chief Executive, and Jeremy for eight years, including five as Deputy Chief Executive.*

The new Executive Team have undertaken a thorough review of the Society's offering to members, with a clear mandate of ensuring the financial stability of the Society is continued for future generations. A renewed Corporate Plan is being developed to stimulate considered investment for the long-term sustainable development of the Society.



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The 2018 results show a growth in profitability, with the Society achieving pre-tax profit of £1.002m. Accumulated reserves have grown to £21.0m, in line with our objective of continuing to develop our financial strength. We believe a strong capital base provides real security to our members. Looking forward, a key feature of the Corporate Plan will be to deliver sustainable levels of profit and increase our capital reserves, whilst facilitating a period of investment to stimulate controlled growth.

It is important that the Society offers attractive mortgage products and I am delighted to report a positive growth in our mortgage assets. Despite the market remaining extremely competitive, gross mortgage lending increased by 35% during the year. A continued focus on manual underwriting and skilled due diligence ensures we continue to experience an extremely low level of arrears. Liquidity has reduced by 11.9%. This was in line with the Board appetite to redeploy liquidity into more value enhancing assets. Liquidity as a % of shares and borrowings remains at an extremely healthy 34.8%.

Our focus will remain to provide competitive products and high-quality services to both savers and borrowers. We will continue to develop our simple, yet very effective business model. We lend money and take deposits. We do not borrow money from other financial institutions nor undertake any financial trading, thus avoiding the risks experienced by other financial institutions.

The Society has been recognised for its high-quality service standards, by receiving four awards:

- What Mortgage Awards 2018 – Highly Commended, Best Local Building Society;
- Mortgage Finance Gazette Awards 2018 – Best Local Building Society;
- Mortgage Finance Gazette Awards 2019 – Highly Commended, Best Local Building Society; and
- Personal Finance Awards 2018/19 - Best Building Society for Customer Service.

These represent a welcome endorsement of our special Society.

This will be my last statement as Chairman of the Board, as I step down at the Annual General Meeting, I am particularly proud to have served the Society as Chairman for the last four years, and to have overseen the successful succession plan to a full time executive. I believe the Society is well placed for a long and sustainable future, and I look forward to supporting my successor as I continue as a Non-Executive Director.

I should like to thank my fellow Board members for their commitment and support.

Finally, on behalf of the Board, I wish to thank the members for the trust they place in the Society and the staff of the Society, for their hard work, commitment and professionalism in contributing to another successful year.

**James W Dean**
Chairman
20 December 2018



STAFFORD RAILWAY
BUILDING SOCIETY

# Reports



STAFFORD RAILWAY BUILDING SOCIETY

# Chief Executive's Report

In 2018 we said goodbye to Jeremy Hodgkiss and Susan Whiting and I would like to express my sincere thanks to both. In particular my thanks to Susan, for her years as Chief Executive of the Society and in providing invaluable assistance to me during both the transitional period and as the temporary Finance Director prior to Steven Jones the new Finance Director taking office in June. They both worked tirelessly for the benefit of the Society.

In my first twelve months as Chief Executive of Stafford Railway Building Society, I have undertaken a comprehensive review of both our offering to members and operating infrastructure with the prime aim of ensuring the Society continues to serve the needs of our members not only for today but also for our members of tomorrow, whilst remaining true to our core values of Service, Simplicity and Security.

To ensure the future long-term sustainability and building on the strong and financially stable position I have inherited, the Society is to embark on a considered transitional period of development and investment, in the following areas:

## Membership

I am pleased to advise we have fully re-opened all savings accounts, allowing new and existing members to benefit from our highly competitive range of savings products. A key aim in 2018/2019 will be to see an increase in our membership both savers and borrowers coupled with enhanced member engagement. We shall also be seeking to simplify our account opening processes.

We remain aware of the need to complement our Branch operation with an on-line savings proposition, I can confirm development on this has already commenced and will remain a priority during 2019.

## Mortgage Origination

We have increased our team of specialist underwriters and re-written our Lending Policy, to expand our lending criteria reflecting the changing needs of borrowers. It has enhanced our ability to accommodate company directors, self-employed and older borrowers. We have also increased our lending on Buy to Let and Self-Build projects. We shall remain disciplined in our affordability assessment to ensure we maintain our high credit quality.

We need to acknowledge the source of our mortgage business has changed. Historically we benefited from, compared to the market place, a disproportionately high level of walk in business, over the last three years this has reduced in line with the reduced footfall within the town centre, hence the need to develop our intermediary offering. The addition of a second Business Development Manager has added to our capability to develop the intermediary business, and we continue to nurture relationships as we anticipate further growth in this area. In 2018 we, for the first time, generated a greater volume of business from the Intermediary market than our traditional source.

## Products

The Society's core Standard Variable Rate continues to be the lowest Standard Variable Rate of all lenders in the residential UK market. It has become apparent, whilst this product has and still serves a need for members, the need for a greater range of choice is required if we are to continue to develop and provide the capacity to invest in the Society. With this in mind we are introducing Product Owners both for savers and borrowers who have the sole responsibility of developing an enhanced product range to serve both existing and new members. The mortgage market remains extremely competitive with headline pricing remaining a prime feature, we shall continue to seek to offer value for money and offer products tailored for the members benefit. The enhanced initiatives, together with the heightened focus on mortgage origination, have contributed to a strong lending performance with gross lending of £34.7m being achieved (2017: £25.6m) resulting in a growth in our mortgage book to £172.2m (2017: £170.6m), this together with an improved pipeline of £17.2m (2017: £8.4m) enables us to enter the new financial year with confidence of continued growth.

## Information Technology

In September 2017 the Society completed the implementation of its Core IT system to Mutual Vision. This provides the Society with improved capability to further develop both a more efficient, automated member facing process and significant scope for the automation of internal functionality. 2018 has seen a satisfactory consolidation of the system, we shall now commence a comprehensive programme of IT enhancements to stimulate increased operational efficiencies. The first significant enhancement being the introduction of Broker on Line, whereby the full benefits are anticipated in financial year 2018/2019.

## Staff and Working Environment

To ensure the long-term sustainability of the Society we have invested in key positions, notably a new and highly experienced Finance Director, Steven Jones, who joined us in June from the Hanley Economic Building Society. We have also increased staff across the Society, including Finance, the Branch, Mortgage Underwriting, Risk and Compliance and IT. This ensures we have the capability and capacity to develop the transitional plans without generating avoidable strain to our service standards.

We have also invested in improving the working environment. We have embarked on a four phase premises enhancement project, Phase One having been completed in 2018 with Phases Two and Three anticipated in 2019. These are fully costed and shall ensure the Society retains a great environment for our staff. We are also seeking to ensure we continue to build on our special model by stimulating a more empowered and member focused culture.

## Community

We remain committed to supporting the local community, and have by means of donations, sponsorship and our Affinity programme, gifted over £40k in 2018, which is the highest amount we have ever managed to offer. Additionally, the prime staff charity of Katharine House Hospice continues to receive our support.

We have secured sponsorship of both the Stafford 10k and Stafford Half Marathon for the next three years as we seek to support local events in Stafford Town Centre.

We are delighted to be a party to the Military Covenant supporting the local Ministry of Defence Stafford at Beacon Barracks.

## The Future

The macro economic environment continues to be uncertain, particularly with Brexit negotiations becoming more protracted. We remain hopeful there will be a smooth transition to a new relationship between the UK and the European Union (EU), although we do not anticipate this being of significant impact to the Society.

## Finally

I am pleased with our financial performance, which has ensured the Society achieved a key objective of increases to its already strong capital position, whilst delivering a more value enhancing liquidity base. The results have been balanced by being able to offer improved savings rates to most of our savers following the increases to Bank of England Base Rate and the increase to key staff costs in line with our planned re-investment.

I consider with our financial stability, quality of staff and our cost-efficient model the Society is well positioned to support our strategic investment for sustainable growth. My focus will remain in ensuring income grows faster than costs to enable us to remain a low-cost operator whilst optimising profits for the long-term benefit of our members.

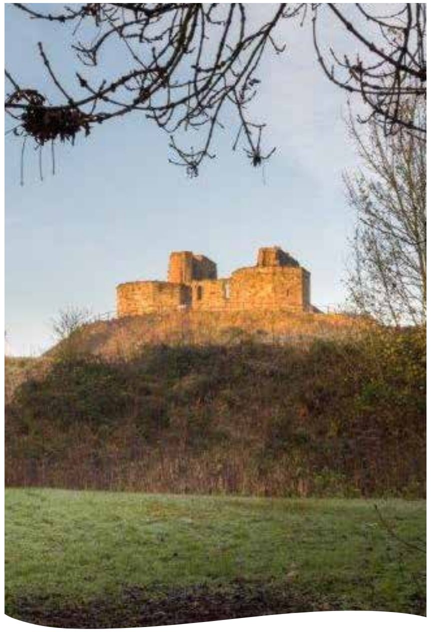
To achieve this in 2019, all our staff need to continue doing as they have done during the past year: working with commitment and attention to detail, each individual taking responsibility for advancing the Society and our business. Many thanks to all of you for doing just this.

I would also like to offer my warmest thanks to our members for the trust you have in the Society. In the coming years, we will continue to do our utmost to live up to – and preferably exceed – your expectations. How? By continuing to do what we have always done, to be people led whilst we embrace both new and existing delivery channels and products.

We embark on our strategic Corporate Plan with confidence.

**Michael R Smith**
Chief Executive
20 December 2018

# Strategic Report



The Directors are pleased to present their Annual Report, together with the Society's Accounts and Annual Business Statement for the year ended 31 October 2018.

## Business Objectives

The principal business objective of the Society is to provide a safe and secure home for members' savings whilst offering secured lending on residential property in order to support home ownership. Mortgage activity is funded by offering traditional retail savings products which are competitive, easy to understand and designed to attract savings from individuals and businesses alike.

The Society's strategy is driven by its core values, which are:

- *Simplicity and Availability*
  Ensuring front and back office processes embrace the balance of optimising technology and human interface consistent with the "Five make its" - Make it Right, Make it Friendly, Make it Special, Make it Helpful and Make it Clear - whilst observing the highest ethical standards;

- *Service*
  Having trust and respect for the individual, both member and employees. Ensuring the point of contact service is available both locally and digitally for the benefit of all members and employees, across a diversified demographic; and

- *Security*
  Governing ourselves as a self-sustaining prudent, financially and technologically resilient Society, in an environment of long term people development.

To enable us to adhere to our core values, we put the member at the centre of everything we do. The core purposes of the Society are principally:

- To help people to save for what they want in life; and

- To help people acquire their own home.

The Society also has the following secondary purposes:

- To carry out the principal purposes in a friendly but professional way, with personal service; and

- To provide savings accounts and mortgages at the best long-term rates that we can sustainably provide.

## Business Review and Key Performance Indicators

Against a backdrop of political uncertainty, dampening of UK economic growth forecast and increasingly challenging mortgage and savers markets the Society has continued with its planned reduction in overall liquidity, whilst securing positive growth in both mortgage balances and overall capital.

During the year mortgage advances were £34.7m (2017: £25.6m) which contributed to the observed increase in overall mortgage balances to £172.2m (2017: £170.6m). This has been achieved whilst maintaining a stable level of profitability which grew the Society's capital reserves by £0.8m (2017: £0.7m). This level of profitability is required not only to support ongoing growth in mortgage lending, but also to meet the Board's objective to maintain a strong level of capital reserves.

## Key Performance Indicators

The main Key Performance Indicators (KPIs) used by the Board to monitor the performance of the Society are detailed below

| | 2018 | 2017 |
|---|---|---|
| Net interest margin | 1.63% | 1.48% |
| Management expenses as a percentage of mean total assets | 1.24% | 1.16% |
| Management expenses excluding non-recurring IT system migration costs as a percentage of mean total assets | 1.24% | 0.99% |
| Cost income ratio percentage | 76.66% | 78.84% |
| Profit after taxation | £0.80m | £0.73m |
| Profit for the year as a percentage of mean total assets | 0.31% | 0.27% |
| Gross mortgage lending | £34.7m | £25.6m |
| Growth in mortgage assets | 0.90% | (0.88)% |
| Total arrears >2.5% of mortgage balance | £8k | £2k |
| Shares and deposits balance | £232.5m | £242.0m |
| Gross capital as a percentage of shares and borrowings | 9.03% | 8.34% |
| Free capital as a percentage of shares and borrowings | 8.78% | 8.18% |
| Liquid assets as a percentage of shares and borrowings | 34.83% | 37.96% |
| **Total assets** | **£254.1m** | **£263.1m** |

*Net interest margin*

This expresses the net amount arising from interest charged to borrowers and earned on liquid assets less the cost of interest paid to savers, as a percentage of mean total assets.

*Management expenses as a percentage of mean total assets*

Managing costs is part of an efficient business model and improved profitability.

*Cost income ratio*

Represents the aggregate of administration expenses and deprecation expressed as a percentage of total income less other operating charges. It forms a key measure in the Society's assessment of returning 'value for money'.

*Profit for the financial year*

This is the amount which is added to reserves and so increases the capital held by the Society.

*Profit for the year as a percentage of mean total assets*

This ratio is used both in the management and assessment of the Society's profitability by the Board.

*Gross mortgage lending*

Conservative lending ensures long-term security of the business.

*Growth in mortgage assets*

The mortgage book is the principal source of revenue for the Society.

*Total arrears > 2.5%*

The total amount of arrears greater than 2.5% of the balance. This provides a headline indication of arrears trends.

*Shares and deposits balance*

This is the main source of the Society's funding.

*Gross capital as a percentage of shares and borrowings*

Such capital provides a financial cushion against any losses that may arise in the Society's business and therefore protects Members.

*Free Capital as a percentage of shares and borrowings*

As with the gross capital % but focussed on short term coverage.

*Liquid Assets as a percentage of shares and borrowings*

Liquidity is essential for the Society to manage its obligations as they arise.

*Total Assets*

Asset levels indicate the resources available to the business to generate future returns.

## Statement of Comprehensive Income Overview

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Total net income | 4,198 | 3,941 |
| Administrative expenses | (3,143) | (2,574) |
| New core IT system migration costs | - | (473) |
| Depreciation and amortisation | (75) | (60) |
| Operating profit before impairment losses and provisions | 980 | 834 |
| Impairment losses on loans and advances | (6) | 84 |
| Provisions for liabilities - FSCS | 28 | (9) |
| **Profit before tax** | **1,002** | **909** |

*Net interest margin*

The Society's net interest margin reflects the surplus that remains after deducting the Society's funding costs in the form of interest paid to retail and commercial savers from its interest income which comprises mortgage interest and interest earned on the Society's investments. During the year the net interest margin increased to 1.63% (2017: 1.48%) achieved through the positive net lending in mortgages and structured reduction in surplus liquidity.

*Administrative expenses*

The Society has always recognised the need to prudently manage costs whilst returning value to its membership. During the year the Society has significantly invested in building its infrastructure, in terms of its people, systems and premises. As a result, overall management expenses have increased to £3.1m (2017: £2.6m). Management expenses for the year include a number of costs relating to the change in Executive structure, and the embedding of its IT systems, the implementation of which was achieved and reported on in the 2017 Accounts.

These, together with several transitional non-recurring costs, including recruitment, consultancy and costs associated with the GDPR implementation account for the reported increase in the management expenses ratio to 1.24% (2017: 0.99%). However, the Society's cost income ratio at 76.66% (2017: 78.84 %) has fallen, indicating that total income has increased to a greater extent than the Society cost base.

*Financial Services Compensation Scheme Levy*

In March 2018, The Financial Services Compensation Scheme made a final payment to HM Treasury in respect of liabilities arising out of the resolution of Dunfermline Building Society. In May 2018, the capital balance on the Bradford and Bingley loan was fully repaid through the sale of certain Bradford and Bingley mortgage assets. Therefore, the Society has received the last FSCS levy raised in respect of the costs of the 2008/9 failures. Overall the reported net profit is stated after the £0.028m release of existing accrued provision.

## Statement of Financial Position at 31 October 2018

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Liquid assets | 80,961 | 91,870 |
| Loans and advances to customers | 172,228 | 170,598 |
| Tangible fixed assets | 763 | 560 |
| Deferred tax and other debtors | 124 | 110 |
| **Total assets** | **254,076** | **263,138** |
| Shares and amounts owed to other customers | 232,450 | 242,042 |
| Other liabilities, accruals and provisions | 634 | 907 |
| Reserves attributable to members of the Society | 20,992 | 20,189 |
| **Total reserves and liabilities** | **254,076** | **263,138** |

*Liquidity*

The Society maintains liquidity in a range of assets which are highly liquid or realisable, with counterparties chosen for the security. It has a liquidity buffer of high quality liquid assets comprising funds in a Bank of England Reserve Account, UK Government Gilts and UK Treasury Bills. Total liquid assets amounted to £81.0m (2017: £91.9m), representing 34.83% (2017: 37.96%) of total shares and deposit liabilities as at 31 October 2018.

The Society monitors and reports its levels of liquidity in relation to two new measures introduced by the Prudential Regulation Authority (PRA) under the Capital Requirements Directive IV (CRD IV). These measures are the Liquidity Coverage Ratio (LCR), which quantifies short term liquidity and the Net Stable Funding Ratio (NSFR) which measures liquidity in the longer term. The Society's liquidity is more than ample to meet regulatory requirements.

*Loans and advances to customers*

During the year the Society lent £34.7m (2017: £25.6m) to borrowers. Total advances secured on residential property and other loans increased during the year to £172.2m (2017: £170.6m).

As at 31 October 2018 the Society had no properties in possession (2017: one). The property in possession as at 31 October 2017 was disposed of during the current financial year utilising £5k of the impairment provision allocated to the exposure. During the year to 31 October 2018 the Society took possession of one case that was subsequently disposed of with no loss to the Society.

The Society identifies borrowers whose mortgage accounts have gone into arrears and consults with them about the reason for the arrears and to draw up a plan of action to bring the accounts up to date. Despite the Society's best efforts to help borrowers in such circumstances there are occasions when properties must be repossessed and sold, sometimes at a loss to the Society.

At 31 October 2018, there were two (2017: £nil) mortgage accounts twelve months or more in arrears, with a balance outstanding of £56k (2017: £nil), and total arrears of £6k (2017: £nil). There were two mortgage accounts over three months in arrears (2017: two).

In certain circumstances the Society uses forbearance measures to assist those borrowers who are experiencing financial difficulty, for example, agreeing a temporary transfer to interest only payment in order to reduce the borrower's financial pressures. In each case an individual assessment is made to ensure forbearance is in the best interests of both the borrower and the Society. It is expected that the borrowers will resume normal payments once they are able. The Society's Assets and

Liabilities Committee (ALCO) assesses the impact of forbearance and monitors whether there is a possibility of loss, in which case provision is made in accordance with the Society's policies. As at 31 October 2018, there were thirteen accounts under forbearance measures and two individual impairments were required.

*Shares and other investors*

Shares and other investors' balances at 31 October 2018 were £232.5m (2017: £242.0m), a decrease of £9.6m or 3.96% on the previous year. The reduction in overall savings balances was part of a strategy to reduce excess liquidity and preserve benefits for existing members in preference to accepting additional funds, by restricting large deposits.

*Total assets*

Total assets reduced during the year by £9.0m (2017: £8.3m) and as at 31 October 2018 amounted to £254.1m (2017: £263.1m). The movement in total assets is due primarily to the £10.9m controlled reduction in liquid assets to £81.0m (2017: £91.9m), which represented 34.83% (2017: 37.96%) of shares and deposit liabilities.

*Net profit and reserves*

An appropriate level of profit is required to ensure the sustainability of the business and to maintain the capital required to satisfy regulatory requirements. Net profit for the year of £0.80m (2017: £0.73m) represented 0.31% (2017: 0.27%) of mean total assets has been added the Society's Reserves.

Total reserves as at 31 October 2018 amounted to £20.99m (2017: £20.19m) and are considered to offer adequate support for the business.

Both the gross capital ratio of 9.03% (2017: 8.34%) and free capital ratio of 8.78% (2017: 8.18%), expressed as a percentage of shares and deposit liabilities, have increased during the year.

Also included in reserves is the Available-For-Sale Reserve which represents any unrealised gains or losses on Treasury Assets, which are accounted for at market value even though the intention is to hold them to maturity. At 31 October 2018 and 2017 the available-for-sale reserve stood at £(0.04)m.

*Capital (Basel III/CRD IV basis) (Unaudited)*

The Directors ensure that a satisfactory level of capital is maintained to protect the Society against adverse market movements or changes in economic conditions.

## Total Capital and Risk Weighted Assets

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Tier 1 capital | 20,992 | 20,189 |
| Tier 2 capital | 187 | 179 |
| **Total capital** | **21,179** | **20,368** |
| Risk weighted assets: | | |
| Liquid assets | 10,546 | 14,186 |
| Loans and advances to customers | 60,805 | 60,450 |
| Other assets | 1,131 | 820 |
| Mortgage commitments | 6,034 | 2,945 |
| Operational risk | 7,462 | 7,144 |
| **Total** | **85,978** | **85,545** |

## Capital Ratios

| | 2018 % | 2017 % |
|---|---|---|
| Core tier 1 | 24.42 | 23.60 |
| Gross capital ratio | 9.03 | 8.34 |
| Leverage ratio | 8.20 | 7.64 |

The Core Tier 1 Ratio expresses core tier 1 capital (reserves excluding mortgage impairments) as a percentage of risk weighted assets. The Leverage Ratio expresses Tier 1 capital as a percentage of total assets plus mortgage impairments plus a proportion of mortgage pipeline commitments.

As at 31 October 2018 the Core Tier 1 Ratio stood at 24.42% (2017: 23.60 %) and the Leverage Ratio stood at 8.20% (2017: 7.64%). Tier 1 Capital was £21.0m (2017: £20.2m) and Tier 2 Capital £0.2m (2017: £0.2m), providing total Capital Resources of £21.2m (2017: £20.4m).

The Board complies with the Basel IV Capital Requirements Directive (CRD) which requires the Society to assess the adequacy of its capital strength through an Internal Capital Adequacy Assessment Process (ICAAP). Through the ICAAP the Board is satisfied that the Society holds a level of capital more than sufficient to satisfy the CRD's Pillar 1 minimum capital requirements and additional Pillar 2 capital to mitigate the principal risks to which the Society is exposed. The Board approve the ICAAP on an annual basis, and it is reviewed by the Prudential Regulation Authority (PRA) in setting the Society's Total Capital Requirement (TCR).

Further details of the Society's approach to risk management can be found in the Society's Pillar 3 disclosures, required by the CRD, on the Society's website, www.srbs.co.uk.

## Risk Management Report

### *Risk governance and strategy*

The Society's Board has ultimate responsibility for developing an appropriate risk and control framework. The Board is responsible for setting the overall risk strategy and approving the design and implementation of risk management approaches, including the risk management framework policy, the risk appetite statements and metrics that underpin them. It delegates authority for cascading the setting and approval of the more granular limits and tolerances to the Chief Executive.

In principle, each of the Board Committees fulfil a similar role, in that, operating under a Board delegated mandate, they provide a forum for the direction and challenge of Management whilst monitoring business performance and risk exposures. Each of the Board Committees comprises Non-Executive Directors with other attendees being drawn from the Executive and Senior Management. Full details of the Society's Board and Committee structure are contained within the Corporate Governance Report.

### *Risk management framework*

The principal purpose of the Society is to make loans for the purchase and improvement of residential property and to encourage savings by offering our members competitive savings rates and a truly personal service.

The Society views risk management as an integral part of good internal control and corporate governance and puts the safety and security of members' deposits above everything else. This is achieved by appropriate management and minimisation of the risks arising from business activities.

The Society's Board of Directors has ultimate responsibility for developing an appropriate risk and control framework. The Society has developed a Board risk appetite statement and risk management framework that is designed to identify, assess, manage and mitigate risks that may influence the delivery of the Society's strategic objectives and has delegated powers to the Risk Committee to advise the Board on the overall risk appetite, tolerance, and strategy. It also oversees and advises the Board on the current risk exposures and future risk strategy.

The risk management framework policy is reviewed annually by the Risk Committee and then approved by the Board.

Risk management information includes a Risk Dashboard which reflects the Board's Risk Appetite Statement and is monitored by the Assets and Liabilities Committee (ALCO), the Risk Committee and the Board at all of their meetings. In addition, the higher risk items from the Risks and Controls Register are reviewed at each Board meeting. The risks in the Risks and Controls Register are an intrinsic part of the ICAAP process, which requires an assessment of key risks and a quantification of how much capital must be held to mitigate those risks.

Any changes to risks, or new and emerging risks, are identified and communicated to the Executive at management meetings. The Risk and Compliance Manager is responsible for updating risk documentation for presentation to the Risk Committee and Board. Decisions by the Board in respect of policies, risk appetite, management information required, limits and triggers on key risk indicators or risks and controls are communicated to the management team who amend the risk documentation, policies and operational procedures and train appropriate staff.

## Three Lines of Defence Approach:

The Society has adopted a "Three Lines of Defence" approach to the operational risk management of the firm. This approach ensures that staff are aware of their responsibilities and that an effective segregation of duties is in place across the Society.

The Society's risk management framework is based on the best practice "Three lines of defence" model, which is illustrated below.

*First line of defence – Operational Risk Management*

The Society's managers are in the best position to assess and manage the risk exposures within their teams. The management identify, assess, and manage risk through normal business operation. Any breaches are reported to Executive and through the governance structure as appropriate.

*Second line of defence – Risk and Compliance function*

The second line of defence is responsible for challenging of risks, policies and controls in place. This function is operationally independent from the business managers and can therefore uphold the principles and policies of the Society. They provide oversight of the first line functions and independently report to Risk and/or Audit Committees any policy breaches or control issues.

*Third line of defence – Internal Audit*

Internal Audit is independent of the operational functions of the Society and reports directly to the Audit Committee. The function is outsourced to Deloitte LLP to ensure further independence. Their role is to independently confirm that all activities are within policy, legal or regulatory requirements.

## Stress Testing

Stress tests are an integral part of the annual business planning process and annual review of risk appetite. Tests are designed to ensure that the Society's financial position and risk profile provide sufficient resilience to withstand the impact of severe economic stress on the market (systemic stress) or Society's specific stress events. Stress testing also informs early-warning triggers, management actions and contingency and recovery plans to mitigate or avoid potential stresses and vulnerabilities and as such is integral to the risk management framework. The stress testing framework also includes reverse stress testing techniques which aim to identify circumstances under which the Society's business model could be rendered unviable, leading to a significant change in business strategy. Examples include extreme macroeconomic downturn scenarios and a cyber-attack on the Society. Stress testing is used to identify, assess and quantify the potential effectiveness of management actions that could be taken to mitigate the impact of a stress.

## Principal Risks and Uncertainties

Managing risk is a necessary part of running a successful business, and many of the risks faced by the Society are similar to those involved in running any financial services business: competition, pressure on margin, ever-changing regulatory and statutory requirements, reputation, staff recruitment and retention and risks from changes in the wider economy. The Society has a risk-averse culture which ensures that it maintains a low exposure to risk and hence helps to protect members' interests.

The principal risks to which the Society is exposed include the following:

*Credit risk*

Credit risk is the risk that a borrower or counterparty to a contract will not be able or unwilling to meet their obligations as they fall due. For the Society, this normally means the risk that a borrower will not repay their mortgage loan, or that a financial institution will not repay funds invested by the Society in that institution. The Assets and Liabilities Committee (ALCO) is responsible for monitoring the arrears profile and treasury counterparty risk whilst the Board approves changes to Counterparties, Treasury or Lending Policies.

Mortgage credit risk is outlined in the Lending Policy and managed through the Society's underwriting process which seeks to ensure that borrowers only assume a debt that they can afford to repay. All mortgage applications are rigorously assessed with reference to the Society's Lending Policy. No matter how prudent lending is, however, some members can get into financial difficulties. In such circumstances the Society is highly proactive in providing support which can include working with them to clear arrears, making arrangements, or forbearance.

The Society's Lending Policy details the limits set on the Society's lending operations. The Society's lending book is predominantly secured on residential property. The criteria applied to individual mortgages, and the limits set on different types of mortgages, are designed to reduce to a minimum the probability of any loss from lending.

Counterparty and country limits mean that there is little concentration of treasury assets. The institutions that the Society invests in are highly rated (Fitch at least A-) or, in the case of Building Societies, are subject to a financial review and the asset types and limits have been agreed with the Regulator as compatible with their guidance to the Society under the Supervisory Statement (SS) 20/15 - Supervising building societies' treasury and lending activities. The limits are monitored through the weekly liquidity report.

*Concentration risk*

The types of concentration risks facing the Society are concentration in one product type, geographical concentration and over-exposure to single borrowers, investors, or counterparties.

The Society provides a range of variable rate mortgages and investment products, which are predominantly secured on residential property wholly within the UK, this concentration is of low risk because of the inherent nature of the assets and the controls in place as detailed in the Lending Policy.

The Society has no dependency on any one form of introduction for mortgages and there is no concentration risk in the type of property held as security.

As part of our stress testing, we quantified and provided capital for a severe economic downturn which for whatever reason affected only our core operating area. The Society accepts that Stafford and Staffordshire are its core areas and have stress tested the impact of this.

*Strategic risk*

This is the risk that the Society fails to execute its strategic plan or fails to effectively execute elements of its strategic plan due to poor planning or changes in the strategic environment.

Strategic risk is managed through regular review and development of key performance indicators, management oversight and an embedded corporate governance framework. This includes Recovery and Resolution plans. Stress Testing is undertaken on an annual basis to assess the impact on the Society's Corporate Plan. Strategic risk includes:

- *Business risk*
  Business risk means any risk to the Society arising from changes in the business or economic conditions, including the risk that the Society may not be able to carry out its business plan or implement required strategy. Business risk is managed through regular review and development of the business plan, management oversight and an embedded corporate governance framework.

- *Pension obligation risk*
  Pension obligation risk is the risk to the Society caused by its contractual or other liabilities to or with respect to a pension scheme (whether established for its employees or those of a related company or otherwise) or the risk that the Society will make payments or other contributions to or with respect to a pension scheme because of a moral obligation or because the Society considers that it needs to do so for some other reason.

The Society has only a defined contribution pension scheme which is open to all employees and so it has no exposure to pension obligation risk.

*Liquidity risk*

Liquidity risk is the risk that the Society is not able to meet its financial obligations as they fall due or can only do so at excessive cost. The Society's Board approved Liquidity Policy is to maintain sufficient liquid resources to cover cash flow requirements and fluctuations in funding, to maintain full public confidence in the solvency of the Society and to meet its financial obligations. This is achieved by maintaining a prudent level of liquid assets and through management control of the growth of the business. The Society holds a buffer of high quality liquid assets such as UK Treasury Bills, Government Securities and deposits in a Bank of England Reserve Account as part of regulatory requirements. The Society's approach to liquidity risk is documented in the Society's Internal Liquidity Adequacy Assessment Process (ILAAP).

The Society had no wholesale funded liabilities at any point during the year.

Liquidity is monitored daily by the Executive and senior management, reviewed at Assets and Liabilities Committee (ALCO) meetings, and included in the Management Information for Board meetings.

*Interest rate risk, basis and market risk*

The Society's Interest rate risk arises from the impact changes in interest rates have on the Society's cash flows. The Society does not have any fixed rate savings or mortgage products, only variable, and therefore the Interest Rate Risk for the Society is significantly less than for other similar institutions. The Society's main exposure to interest rates arises from its investment in Government Gilts and Certificates of Deposit with other financial institutions. The Society uses specialist external treasury advisers for investing surplus funds and has a good spread of maturity of its invested monies to manage this risk effectively.

Basis and market risk is the risk of an impact on economic value due to pricing assets and liabilities according to different interest rate bases. The Society's basis risk arises from assets and liabilities being linked to different interest rate types including fixed, tracker and administered.

A basis risk analysis is prepared monthly and reviewed by Assets and Liabilities Committee (ALCO). New products and treasury activities are assessed by Assets and Liabilities Committee (ALCO) taking into account their impact on the Society's basis risk exposure.

The interest rate sensitivity exposure of the Society is set out in note 21 of the accounts.

*Operational risk*

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes financial crime, fraud, data protection and technology and cyber risk amongst others. The Society manages this risk by having a strong and effective internal control environment in which risks are monitored and controlled on a timely basis. Controls have been established and are maintained for all business areas. These controls appropriately address identified risks and ensure good conduct of the business in accordance with the Society's policies and risk appetite and compliance with relevant laws, regulations and rules.

The Society is extremely mindful of the threats which cyber-crime presents to all businesses. Whilst taking all reasonable precautions to mitigate this risk, it also has a comprehensive insurance policy in place to protect members in the event of such criminal activity.

The Society provides a range of variable rate mortgage and investment products. The Society does not provide any other financial products and it has appropriate controls in place with respect to mortgage advice.

The Society considers that its simple product range, robust systems, policies and internal control framework are the major factors in the achievement of strong control of Operational risk. The main operations and controls are summarised in the Risks and Controls Register which is reviewed by the Risk Committee, both Internal and External Auditors and the Board.

*Regulatory risk*

This is the risk that the volume and complexity of regulatory issues may impact the Society's ability to compete and grow, or result in fines, public censure or restitution costs because of a failure to understand, interpret and comply with UK and EU regulatory requirements. The Society has an internal compliance function to monitor compliance with existing legislation, the implementation of controls and the impact of new requirements. This is overseen by the Audit Committee.

*Conduct risk*

This is the risk that the Society does not treat its members (customers) fairly and of inappropriate or unsatisfactory consumer outcomes. The Board acknowledges the requirement to fully embrace the Financial Conduct Authority (FCA)'s Principle 6, namely to ensure that the Society pays due regard to the interests of its customers and to treat them fairly at all times. These principles are firmly embedded within the Society's culture. This ethos has manifested itself into working practices throughout the Society.

The risk is monitored by the Audit Committee and the Board. In addition, the Risk Committee reviews and challenges the conduct risk management information. The Board reviews the Conduct Risk Policy annually and receives conduct risk monitoring information monthly.

On behalf of the Board of Directors
**James W Dean**
Chairman
20 December 2018

# Directors' Report

The Directors have pleasure in presenting their annual report, together with the annual accounts and annual business statement of the Society for the year ended 31 October 2018.

## Business Objectives and Activities

The Society, which was founded in 1877, is an independent building society based in Stafford, financed by and run for the benefit of its members. The mutual corporate form removes the need to consider returns for equity shareholders, making it easier for management to take a longer-term view and balance the needs of its members. The Board remains unanimous in its belief that the mutual form is the most appropriate and beneficial when the interests of all existing and potential members are taken into account.

As a mutual organisation, we aim only to earn sufficient profits to enable us to prudently achieve our main purposes, as described above under the Strategic Report. We are pleased to report that we have achieved a profit after tax of £0.80m which contributes to a healthy level of capital and supports the financial stability of the Society.

## Directors

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

*Non-Executive Directors*

James W Dean
FCA (Chairman);

Gary C D Crowe
FCIM CAifs ACIB MCIBS;

David J Grant
MBA FCIB FISMM FRSA;

Colin C Lloyd
ACIB (Senior Independent Director);

Karen E McCormick
ACIS PIIA; and

Nicholas H J Sandy
(Vice Chairman).

*Executive Directors*

Michael R Smith
ACIB (Chief Executive);

Steven Jones
BSc MBA FCA (Deputy Chief Executive and Finance Director). Appointed 6 June 2018;

Susan J Whiting
BA ACA CTA (Finance Director). Resigned 30 June 2018; and

Jeremy G Hodgkiss
FCA CF MSI (Executive Director). Resigned 31 March 2018.

The Directors who retire by rotation in accordance with rule 26(1) of the Society rules are Gary Crowe and Karen McCormick who offer themselves for re-election at the forthcoming Annual General Meeting. Steven Jones, having been appointed to the Board under rule 25, retires and offers himself for election.

| **Directors** | **Executive** | **Non-Executive** |
|---|---|---|
| **Tenure at year-end** | | |
| 0-3 years | 2 | 1 |
| Up to 6 years | - | 3 |
| Up to 9 years | - | 2 |
| Over 9 years | - | - |
| **Gender** | | |
| Female | - | 1 |
| Male | 2 | 5 |



STAFFORD RAILWAY
BUILDING SOCIETY

### Michael R Smith
*Chief Executive*

Appointed CEO in October 2017, Michael is a highly experienced corporate and retail banker, having previously served the Society as a Non Executive Director for eight years. He has been actively involved in a broad range of commercial and personal banking activities during his 33 year career with both Barclays Bank PLC and Svenska Handelsbanken.

### James W Dean
*Chairman*

James is a Chartered Accountant and former Ernst & Young partner. He joined the Board as a Non-Executive Director in August 2012. James Dean is a life-long member of the Building Society with a strong interest in its future success driven by a family association stretching back to his great-grandfather who was a founding member.

### David J Grant
*Director*

David has over 30 years experience in the Financial Services Industry, both in the UK and overseas. He has held a variety of positions, to Board level, in Banks, a Building Society, Pension Funds, and in Life and General Insurance. He is a strong supporter of mutuality and keen to see Building Societies adapt and thrive in the changing digital world.

### Karen E McCormick
*Non-Executive Director*

Karen is an established Chairman and Non-Executive Director with extensive experience working with senior executives and Boards to improve business performance from the formation of vision and strategy to delivery at the front line. She is also an effective coach with the ability to identify potential and develop talent. Karen is Chair of the Remuneration Committee.

### Steven Jones
*Deputy Chief Executive and Finance Director*

Steve has over 27 years' experience in the financial services sector, latterly as Finance Director & Deputy Chief Executive of Hanley Economic Building Society. He is a Governor of Newcastle and Stafford Colleges Group and is a Fellow of the Institute of Chartered Accountants. Steven has also held board roles on local housing associations and charities including Mind and Age UK.

### Nicholas H J Sandy
*Vice Chairman*

Nicholas has over 30 years' experience as a Chartered Surveyor and has extensive experience working in the Staffordshire housing market. He is able to provide an expert view of the existing and ever changing property markets. In the past Nicholas has also been Chairman of Staffordshire Blind and has been involved with the Stafford Round Table.

### Colin C Lloyd
*Senior Independent Director*

Colin has 38 years of experience within the financial services industry, with past roles including Head of Mortgages and Securities Services for HSBC in the UK, Head of Internal Audit at the Melton Mowbray Building Society and Operations Director for SBSLS Limited, a subsidiary of Melton Mowbray Building Society. He therefore brings to the Society a wealth of recent and relevant industry and sector experience.

### Gary Crowe
*Non-Executive Director*

Gary is an expert in commercial strategy, digital transformation and business innovation, holding a number of other Board positions as an experienced Chair and Non-Executive director. His career in Retail and Commercial financial services spans over 30 years, starting work at a local NatWest branch in Staffordshire. Gary is Chair of the Risk Committee.

## Creditor Payment Policy

The Society's continuing policy concerning the payment of its trade creditors is to pay invoices within the agreed terms of credit once suppliers have discharged their contractual obligations. Amounts due to relevant creditors of the Society are paid on average within 14 days of receipt of invoice (2017: 14 days).

## Charitable and Political Donations

During the year the Society made donations of £29,288 (2017: £26,801) to charities. No contributions were made for political purposes. The Society sponsors, and its staff commit their time to, a range of local charitable and community causes.

## Staff

The Directors are extremely appreciative of the contribution made by the staff to the Society's successful performance. The Society obtains feedback from both borrowers and investing members throughout the year in order to monitor our performance and make improvements where appropriate. The feedback we have received indicates a high level of satisfaction with the service provided by our staff.

## The Society in the Community

The Society remains firmly committed to conducting all its affairs in an ethical and socially responsible manner. In particular, it is recognised that the major part of the Society's business and membership is drawn from the local community within which it operates. Consequently, the Society actively endeavours to identify with and support the community. Society policy is to source purchases and services locally if possible, and to provide support in terms of both finance and practical assistance to local charities, worthwhile causes and community-based organisations.

The Society actively pursues environmentally friendly initiatives with the aim of mitigating the environmental impact of the business it undertakes. Members can play their part by registering to receive future Annual General Meeting packs online.

## Events since the Year End

The Directors consider that there has been no event since the end of the financial year that has a significant effect on the position of the Society.

## Going Concern

The Directors have prepared forecasts of the Society's capital position, financial position and liquidity for the period ending twelve months from the date of approval of these financial statements. The Directors have also prepared forecasts to consider the effect on the Society's business, financial position, capital and liquidity of operating under stressed, but plausible, operating conditions. The forecasts satisfy the Directors that the Society has adequate resources to continue in business for the foreseeable future. Accordingly, the accounts continue to be prepared on a going concern basis.

## Auditor

Each of the persons who is a Director at the date of approval of this report confirms that:

- So far as the Director is aware, there is no relevant audit information of which the Society's auditor is unaware; and
- The Director has taken all the steps that should be taken by a Director in order to be aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

KPMG LLP has expressed its willingness to continue in office as Auditor and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

## Capital Adequacy

As part of the Capital Requirements Directive (CRD), the Society has assessed the adequacy of its capital resources, and the Society's Pillar 3 disclosures, which are a requirement of the CRD, together with the disclosures to comply with the requirements of Article 89 of the Capital Requirements Directive IV (CRD IV), are provided on the Society's website, or are available from the Society's Secretary.

## Future Developments

The Directors are committed wholeheartedly to maintaining the Society's success by concentrating its efforts upon traditional Building Society business and offering a high standard of service to its investing and borrowing members.

On behalf of the Board of Directors
**James W Dean**
Chairman
20 December 2018

# Corporate Governance Report

The Directors of the Society are committed to best practice in corporate governance. The UK Corporate Governance Code (the ‘Code’) outlines that a principle of governance is to be “led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society”. As a mutual organisation, whilst not required to fully comply with the Code (effective for accounting periods beginning on or after 17 June 2016, with latest changes effecting from January 2019), the Society has regard to the principles of the  Code when establishing its governance arrangements, as required by our regulators the PRA and FCA. The Board supports the principles of the Code and has had regard to them in preparing this report.

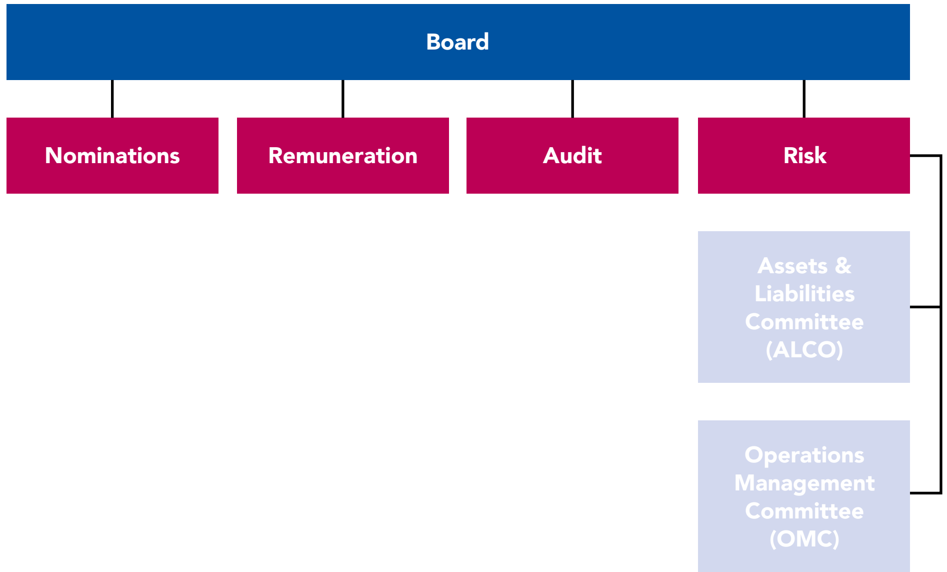
## The Board

*Code Principle A1: Every company should be headed by an effective Board, which is collectively responsible for the long-term success of the company.*

The full Board, which meets in eleven months of the year, provides leadership and direction with the strategic aim of promoting success within an effective and controlled framework. The Board sets the Society’s strategic aims and objectives, ensuring that sufficient human and financial resources are in place to meet them, whilst always acting in the best interests of the Society’s members. It satisfies itself on the integrity of financial information at the same time making sure that financial controls and risk management systems are robust. The risk management framework and internal controls are reviewed at least annually.

In line with the Society’s Rule as at 31 October 2018 the Board consisted of two Executive Directors and six Non-Executive Directors who provide the appropriate mix of skills and professional expertise required. Changes to executive team are outlined in the Directors’ Report section.

The Board has four key Board Committees and two Sub-Committees, the structure is shown below together with summaries of the terms of reference. Full details are available from the Secretary or can be found on the website at www.srbs.co.uk.



## Audit Committee

This Committee consists entirely of Non-Executive Directors under the chairmanship of Colin Lloyd and meets at least four times per year. Membership of the Committee include Karen McCormick and Nicholas Sandy, as well as attendees from the Society Executive and Risk and Compliance functions together with the Society's internal and external auditors. Members of the Audit Committee have experience of the sector, with at least one member having recent and relevant financial and audit experience. The Committee considers all matters of an audit and compliance nature applying to the Society, including internal controls, compliance reports, scope and content of internal and external audit work, financial reporting and other relevant systems and controls requirements. It validates the financial statements of the Society. The Chair of Audit Committee discharges a role of Whistleblowing Champion providing the Board with an annual report on whistleblowing arrangements within the Society.
A dotted reporting line exists directly between the Chairman of the Audit Committee and the Risk and Compliance Manager.

## Risk Committee

The Risk Committee is chaired by Gary Crowe, it meets six times or at least quarterly during the year and advises the Board on the overall risk appetite, tolerance and strategy and reviews the risk management framework and policies. The other members of the Committee are James Dean (Chairman of the Board) and David Grant. In particular, the Committee monitors and reviews the consolidated risk picture across the Society. It is responsible for the ongoing development and maintenance of the ILAAP, ICAAP and Recovery Plans as well as the risk management framework. It also provides support and challenge for the development of the strategic plan and adequate stress testing strategy. The Committee receives standing reports on the risk register along with detailed risk management information that enables it to track performance against the risk appetite.

A dotted reporting line exists directly between the Chairman of the Risk Committee and the Risk and Compliance Manager.

## Nominations Committee

The Nominations Committee is chaired by the Chairman of the Board, James Dean. It also comprises Nicholas Sandy (Vice Chairman) and Colin Lloyd (Senior Independent Director). The Committee leads the process for appointments, ensures plans are in place for orderly succession to the Board and senior management positions, and oversees the development of a diverse pipeline for succession.

It meets when there is an appropriate vacancy to fill and at least twice a year to review the skills mix of the Board and succession policy.

## Remuneration Committee

The Remuneration Committee is chaired by Karen McCormick. The Committee have delegated responsibility for determining the policy for Executive Director remuneration and setting remuneration for the chair, Executive Directors and senior management. Further details of this Committee are provided within the Directors' Remuneration Report on page 28.
In addition to its terms of reference relating to Directors, it approves the remuneration of the Risk and Compliance Manager.

## Assets and Liabilities Committee (ALCO)

Comprising both Executive Directors and members of the management team, this Committee meets on a monthly basis and monitors and controls balance sheet risk, funding and liquidity in line with the Society's policies. The Committee is chaired by Steven Jones, Finance Director, following the resignation of Susan Whiting and reports to the Risk Committee. Other members of staff and Non-Executive Directors attend as required. The Committee is responsible for ensuring that the Society's treasury risks (liquidity, treasury counterparty risk, interest rate risk in the banking book) are managed and mitigated in line with the Board's risk appetite and related policies. The Committee also ensures that all (non-treasury) lending undertaken by the Society is in line with the Board's risk appetite. The Committee reviews ongoing management information and is responsible for recommending changes to the credit and Lending Policy for Board approval.

The Committee reports and escalates breaches to the Risk Committee.

### Operations Management Committee (OMC)

Comprising members of the management team and chaired by Michael Smith, Chief Executive, this Committee meets monthly and is responsible for organising and co-ordinating the day-to-day management of the Society, including financial crime, operational risk, and conduct risk and information technology, in line with the Board's risk appetite, Corporate Plan and overall strategic direction. Other members of staff and Non-Executive Directors attend as required. The Committee reports and escalates breaches to the Risk Committee.

*Code Principle A2: 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 offices of Chairman and Chief Executive are distinct and held by different people. The Chairman's role is described in Code Principle A3. The Chief Executive is responsible for leading the development and execution of the Board's strategy in the day-to-day management of the Society.

*Code Principle A3: The Chairman is responsible for leadership of the Board and ensuring its effectiveness in all aspects of its role.*

The Chairman is responsible for leadership of the Board and ensuring its effectiveness on all aspects of its role. He is responsible for setting the Board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues, and for promoting a culture of openness and debate.

*Code Principle A4: As part of their role as members of a unitary Board, Non-Executive Directors should constructively challenge and help develop proposals on strategy.*

The Society's Non-Executive Directors are recruited from a range of appropriate backgrounds, ensuring they have the necessary breadth of skills, knowledge and experience to monitor the performance of the Society and to challenge the Executive in a constructive manner.

*Code Principle B1: The Board and its Committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.*

The Board considers that all its Non-Executive Directors are independent and free of any relationship which could materially interfere with the exercise of their judgement. Under the terms of the Code, factors to be taken into account when assessing independence include the length of service and whether the Director has recently been an employee of the Society. Colin Lloyd is the Senior Independent Director to whom members may address any concerns or issues they may wish to raise. However, all Directors are happy to make themselves available to members for such purposes.

*Code Principle B2: There should be a formal, rigorous and transparent procedure for the appointment of new Directors to the Board.*

All Non-Executive vacancies are advertised to members and the Nominations Committee make appointments having considered the balance of skills and experience required. All Directors must meet the test of fitness and propriety as laid down by the PRA as Approved Persons to fulfil their roles as Directors. The Board is mindful of the Davies Report on diversity and has disclosed information on gender mix in the Directors' Report.

*Code Principle B3: All Directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.*

During the recruitment process applicants are advised on the time requirement for proper discharge of their duties. Their ability to commit sufficient time is assessed during their evaluation on appointment and as part of the formal appraisal process. Details of Board and Committee attendance throughout the year are shown at the end of this report.

*Code Principle B4: All Directors should receive induction on joining the Board and should regularly update and refresh their skills and knowledge.*

New Directors receive full and formal induction training and all Directors are provided with on-going training and professional development to provide continual updating of their skills. Training is provided in a range of appropriate forms including in-house training, industry events, seminars and conferences.

*Code Principle B5: 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.*

Through the Executive, the Chairman ensures that Directors receive accurate, timely and clear information to enable them to make effective contributions to Board meetings. All Directors have access to the advice of the Secretary and, if necessary, are able to take independent professional advice at the Society's expense.

*Code Principle B6: The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors.*

All Directors are subject to annual performance and evaluation review to ensure they continue to meet the Society's stringent requirements and in addition there is also an annual evaluation of the Board as a whole and the individual Committees. The performance of the Chairman is separately assessed by the Senior Independent Director, Colin Lloyd.

*Code Principle B7: All Directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.*

The Society's Rules require all Directors to submit themselves for re-election at the first opportunity after their appointment and for re-election every three years. Non-Executive Directors will normally serve for no more than nine years, after which they are subject to annual re-election in line with best corporate governance practice.

## Internal control and responsibilities

*Code Principle C1: The Board should present a fair, balanced and understandable assessment of the company's position and prospects.*

The Board considers that it has properly carried out its requirements in connection with the production of the annual report and accounts, and that the accounts are fair, balanced and understandable. The Board has identified no material uncertainties as to the Society's ability to continue to adopt the going concern basis of accounting over the coming period.

Further information is given in the Statement of Directors' Responsibilities.

*Code Principle C2: The Board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The Board should maintain sound risk management and internal control systems.*

The Board is responsible for determining a framework for risk management and control. Senior management have the tasks of designing, operating and monitoring risk management and internal control processes whilst the Risk and Audit Committees, on behalf of the Board, are responsible for reviewing the adequacy and effective operation of such processes.

The Board has carried out a robust assessment of the principal risks facing the Society. The Board has assessed the prospects of the Society and has set out the strategy for the next five years from 31 October 2018 within the Society's Corporate Plan, during which time the Society is expected to continue in operation and meet its liabilities as they fall due.

Further detail is contained within the Strategic Report under Risk Management Report.

*Code Principle C3: The Board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.*

The system of internal control is designed to enable the Society to achieve its corporate objectives within a managed risk profile, not to eliminate risk. Internal Audit provides independent and objective assurance that these processes are appropriate and effectively applied.

## Communication with Members and the Annual General Meeting

*Code Principle E1: 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.*

Member newsletters are produced on a periodic basis to ensure that members are kept informed regarding developments at the Society, with reaction and feedback encouraged. Member satisfaction surveys and questionnaires are issued as part of the Annual General Meeting. Communication with members is also conducted via the Society's website.

*Code Principle E2: The Board should use the general meetings to communicate with investors and to encourage their participation.*

The Society encourages all eligible members to participate in the Annual General Meeting, either by attending in person, voting by proxy or by voting online. All Board members are normally present at the AGM and are therefore available to meet with members, discuss issues and answer questions.

## Attendance at the Board and Committee meetings

All Committee meetings are minuted formally with the minutes being considered at the next Board meeting. Attendance of members of the Board and Committees at meetings for the year to 31 October 2018 is as follows:

| Name | Board | Remuneration | Audit | Risk | Nominations |
|---|---|---|---|---|---|
| James W Dean | 11 (11) | 2 (2) | 1 (1) | 6 (6) | 4 (4) |
| Nicholas HJ Sandy | 11 (11) | 2 (2) | 4 (4) | * | 4 (4) |
| Gary CD Crowe | 10 (11) | 2 (2) | * | 5 (6) | * |
| David J Grant | 11 (11) | 2 (2) | * | 6 (6) | * |
| Colin C Lloyd | 11 (11) | 2 (2) | 4 (4) | * | 3 (3) |
| Karen E McCormick | 8(11) | 2 (2) | 2 (4) | * | 1 (1) |
| Susan J Whiting | 7 (8) | * | 2 (2) | 3 (4) | 1 (1) |
| Jeremy G Hodgkiss | 4 (7) | * | 1 (1) | 1 (2) | * |
| Michael R Smith | 11 (11) | * | 3 (3) | 6 (6) | 4 (4) |
| Steven Jones | 4 (4) | * | 2 (2) | 2 (2) | * |

*(Figures in brackets represent maximum possible attendance)* **Denotes not a member of the Committee*

On behalf of the Board of Directors
**James W Dean**
Chairman
20 December 2018



STAFFORD RAILWAY BUILDING SOCIETY

# Audit Committee Report

The Audit Committee forms part of the Society's corporate governance framework.

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

- The integrity of the financial statements, any formal announcements relating to financial performance and significant financial reporting judgements contained therein;
- The effectiveness of the system of internal controls;
- The internal audit and external audit functions, including:
  - The performance and independence of both Internal and External Auditor; and
  - The engagement of the External Auditor for non-audit work.

Following each Committee meeting, the minutes are distributed to the Board, and the Committee Chairman provides a report to the Board on key matters discussed by the Committee.

The composition of the Committee is detailed within the corporate governance section of this report. The Chief Executive, Finance Director, the Risk and Compliance Manager and the Financial Risk Manager attend the meeting by invitation. Both the Internal and External Auditors are also invited to each meeting. The Committee holds a periodic discussion without the Executive Directors being present.

## Key areas reviewed during 2018

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

*Financial Reporting*

The primary role of the Committee in relation to financial reporting is to review and assess with the Executive, Compliance Function and the external auditor the integrity and appropriateness of the annual financial statements concentrating on amongst other things:

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

The primary areas of judgement considered by the Committee in relation to the 2018 accounts were:

- Loan loss provisions: review of judgements used to determine timing of recognition and valuation of loan loss provisions in line with FRS102;
- Revenue recognition: review of the design, implementation and effectiveness of controls around the calculation of interest income and charges, including the timing of fees and commission recognition under effective interest rate methodologies; and
- Review of the recognition, accounting treatment and disclosure of the costs relating to the ongoing Head Office building refurbishment.

The Committee considers that it has properly carried out its requirements in connection with the financial reporting of the annual report and accounts, and that the accounts are fair, balanced and understandable. The Committee has identified no material uncertainties as to the Society's ability to continue to adopt the going concern basis of accounting over the coming period.

*Internal Audit*

The Committee is responsible for monitoring internal audit activities and effectiveness and ensuring that sufficient resources are in place. In common with other Building Societies of its size and structure, the Society outsources this role to an independent firm of accountants with appropriate specialist expertise and resource. The firm currently providing this service is Deloitte LLP.

Key reviews were completed through their agreed work programme during the year including areas of internal control significance, specifically savings operations, IT governance and change management, lending controls, compliance function, ICAAP, recovery planning and PRA certification arrangements as part of the PRA Thematic Review.

In addition to the planned programme of audit work, the Committee commissioned Deloitte to undertake a review of the controls in place for the production and output of the Single Customer View (SCV) following the core system migration.

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

The Committee considers guidance from the Chartered Institute of Internal Auditors entitled "Effective Internal Audit in the Financial Services Sector" when ensuring that internal auditors and the Committee are properly fulfilling their obligations.

The Committee also approved the fee for the programme of internal audit work for the year having reviewed the scope of the work programme in detail and any thematic reviews undertaken by the regulators in which the Society was asked to participate.

*System of Internal Controls*

The Board recognises that robust systems of internal control are essential to the achievement of its objectives and the safeguarding of Members' and the Society's assets. Internal control also contributes to the effectiveness and efficiency of operations, helping to ensure the reliability of internal and external reporting and enables compliance with applicable laws and regulations.

The Board is responsible for determining a framework for risk management and control. Senior management have the tasks of designing, operating and monitoring risk management and internal control processes whilst the Risk and Audit Committees, on behalf of the Board, are responsible for reviewing the adequacy and effective operation of such processes.

The Board has carried out a robust assessment of the principal risks facing the Society. The Board has assessed the prospects of the Society and has set out the strategy for the next five years from 31 October 2018 within the Society's Corporate Plan, during which time the Society is expected to continue in operation and meet its liabilities as they fall due.

The system of internal control is designed to enable the Society to achieve its corporate objectives within a managed risk profile, not to eliminate risk. Internal Audit provides independent and objective assurance that these processes are appropriate and effectively applied.

The Committee review the internal control framework through regular reporting from the Senior Management Team, Internal and External Auditors. The main internal control matters which were reviewed by the Committee in 2018 were:

- Prudential and conduct related;
- Internal audit plans;
- Reports from the Internal Auditor;
- Reports from the Risk and Compliance Manager;
- Reports from the Society's internal Money Laundering Reporting Officer;
- The status of any issues raised in control reports to ensure a timely resolution;
- Whistleblowing arrangements; and
- PRA Certification systems and controls.

The information received and considered by the Committee provided "adequate and effective" assurance that during 2018 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate internal control framework.

*External Audit*

The effectiveness of the external audit process is dependent on appropriate audit risk identification. At the start of the audit cycle the Committee receives from the External Auditor a detailed audit plan, identifying their assessment of the key risks.

The Committee holds regular private meetings with the External Auditor. This provides the opportunity for open dialogue and feedback from the Committee and the Auditor without the Executive Directors being present. Matters typically include the Auditor's assessment of financial reporting risks and key financial reporting judgements, the transparency and openness of interactions with the Senior Management Team, confirmation that there has been no restriction in scope placed on them and the independence of their audit.

The Committee approved the fees for audit services for 2018 after a review of the level and nature of the work to be performed and having been satisfied that the fees were appropriate for the scope of work required. The Board accepted the Committee's recommendation to continue with services of the External Auditor, including rotation of the Audit Partner, and also assessed their independence as appropriate as no material non-audit services were provided during this reporting year.

*Compliance*

The Society's compliance team provides second line assurance. The Committee approves the compliance monitoring plan and reviews reports and assess progress against agreed actions.

*Audit Committee effectiveness*

The Committee conducts a self-assessment review annually to monitor performance against its Terms of Reference. The Committee's Terms of Reference were reviewed during the year and found to be appropriate.

**C C Lloyd**
Chair of Audit Committee
20 December 2018

# Directors' Remuneration Report


The purpose of this report is to inform members of The Stafford Railway Building Society of our policy on the remuneration of Executive and Non-Executive Directors, and to explain how we comply with the principles in the UK Corporate Governance Code 2016 (the Code) relating to remuneration, as far as they are applicable to a mutual organisation of our size. The remuneration policy complies with the relevant elements of the FCA's remuneration code.

*Code Principle D1: Executive Directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.*

As reported in the Annual report and accounts for 31 October 2017 the Society had a formal contract with Deans (Staffordshire) Limited for the provision of Executive Services. Notice, in line with the terms of the contract, was served by Deans (Staffordshire) Limited in September 2016. The contract formally ended on 31 March 2018, although was extended to 30 June 2018 to assist with the transition of the new Executive Team.

## Policy for Executive Directors

The Society's policy is to set remuneration levels which will attract and retain Executive Directors with appropriately high levels of skill and expertise and to reward the achievement of stretching objectives in line with the Society's Corporate Plan. It comprises a basic salary, participation in a bonus scheme, pension and various benefits.

*Basic Salary*

Salaries are reviewed by benchmarking against jobs carrying similar responsibilities, from external salary benchmarking data from within the building society sector and financial services sector. This encompasses consideration as to the responsibility and complexity of the role, market conditions and demands and the Society's very high-quality standards.

Notwithstanding the current very competitive market for high quality financial services directors during the year the Society was delighted to appoint a new Deputy Chief Executive and Finance Director. The role was externally advertised, and the salary was set at a benchmarked level in accordance with the comparison criteria above.

*Bonus*

A Bonus scheme is determined by the Remuneration Committee and based on a range of financial and non-financial corporate performance objectives including appropriate risk management objectives. Bonus payments are payable annually and set at a maximum of 20% for the Chief Executive and 15% for the Deputy Chief Executive and Finance Director. In respect of the financial years ended 31 October 2018 and 2019, the Deputy Chief Executive and Finance Director has a minimum guaranteed element.

*Pensions*

The Society contributes to the Executive Directors arrangements. The Chief Executive has opted out of the Pension Scheme.

*Benefits*

Executive Directors receive other benefits as afforded to staff generally notably Death in Service and Income Protection. The Society does not provide concessionary home loans to Directors.

## Contractual Terms

The Executive Directors are employed on open-ended service contracts. Notice period for the Chief Executive is twelve months, to be given by both the Society and the Individual. The notice period for the Deputy Chief Executive and Finance Director is six months to be given by both Society and the individual.

As at 31 October 2018 no notices had been served by any of the parties.



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BUILDING SOCIETY

## Policy for Non-Executive Directors

The remuneration of all Non-Executive Directors is reviewed annually. There are no bonus schemes for Non-Executive Directors and they do not qualify for pension entitlement or other benefits. Non-Executive Directors do not have service contracts but serve under letters of appointment following election by the Society's membership.

*Code Principle D2: 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 responsible for setting his or her own remuneration.*

## The Remuneration Committee

This Committee comprises all the Non-Executive Directors under the chairmanship of Mrs Karen McCormick and is responsible for compliance with relevant elements of the Financial Conduct Authority (FCA) Remuneration Code.

The Chief Executive attends by invitation only and takes no part in the discussion relating to his remuneration.

The basis of remuneration is consistent with sound and effective risk management and does not encourage excessive risk taking. The Committee meets at least once per year to consider the remuneration and other terms of service of the Executive Directors.

The over-arching purpose of the Committee is to set remuneration policies to ensure that they are in line with the Society's business strategy, risk appetite and long-term objectives. This includes designing and implementing the reward structure of the Society and ensures that effective risk management is a key component of remuneration and incentive structures.

The remuneration of the Chairman is set at a meeting of the Board where the Chairman is not present. The remuneration of all other Non-Executive Directors is set by the Chief Executive and Chairman.

## Total emoluments of the Society's Directors (excluding national insurance):

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Non-Executive Directors' fees | 136.3 | 124.2 |
| Executive Directors' remuneration | 255.8 | 10.7 |
| | **392.1** | **134.9** |

## Non-Executive Directors

| | 2018 £'000 Fees | 2017 £'000 Fees |
|---|---|---|
| James W Dean (Chairman) | 29.0 | 27.0 |
| Nicholas H J Sandy (Vice Chairman) | 23.0 | 19.7 |
| Gary C D Crowe | 23.0 | 19.7 |
| David J Grant | 19.0 | 8.5 |
| David J Gage (retired 15 February 2017) | - | 8.3 |
| Colin C Lloyd | 23.3 | 24.0 |
| Karen E McCormick | 19.0 | 17.0 |
| | **136.3** | **124.2** |

## Executive Directors

| 31 October 2018 | Salary £'000 | Annual Bonus £'000 | Pension £'000 | Total £'000 |
|---|---|---|---|---|
| Michael R Smith | 165.0 | 24.0 | - | 189.0 |
| Steven Jones (appointed 6 June 2018) | 52.0 | 10.0 | 4.8 | 66.8 |
| | **217.0** | **34.0** | **4.8** | **255.8** |

| 31 October 2017 | Salary £'000 | Annual Bonus £'000 | Pension £'000 | Total £'000 |
|---|---|---|---|---|
| Michael R Smith (appointed 9 Oct 2017) | 10.7 | - | - | 10.7 |

As previously reported the Society had a contract with Deans (Staffordshire) Limited, for the provision of Executive services. Amounts paid for Executive services for the year ended 31 October 2017 and the 8 months to 30 June 2018 are as follows:

## Remuneration for Executive Services

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Base fee | 162.7 | 235.2 |
| Bonus | 24.6 | 27.6 |
| VAT | 37.5 | 52.6 |
| | **224.8** | **315.4** |


**James W Dean**
Chairman
20 December 2018

# Directors' Responsibilities



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# Statement of Directors' Responsibilities

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

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

The Building Societies Act 1986 (the Act) requires the Directors to prepare annual accounts for each financial year. Under that law they have elected to prepare the annual accounts in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

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

In preparing these Annual Accounts, the Directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable 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 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 Society.

## Directors' responsibilities for accounting records and internal control

The Directors are responsible for ensuring that the Society:

- Keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Society, in accordance with the Act; and
- Takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Conduct Authority and Prudential Regulation Authority 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 Society and to prevent and detect fraud and other irregularities.

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

# Auditor's Report



STAFFORD RAILWAY
BUILDING SOCIETY

# Independent Auditor's Report *– to the members of Stafford Railway Building Society*

## 1. Our opinion is unmodified

We have audited the society annual accounts of Stafford Railway Building Society for the year ended 31 October 2018 which comprise the statement of comprehensive income, statement of financial position, Society statement of changes in members' interests, cash flow statement and the related notes, including the accounting policies in note 1.

*In our opinion the annual accounts:*

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

*Basis for opinion*

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

We were appointed as auditor by the Society before 1990. The period of total uninterrupted engagement is for more than the 28 financial years ended 31 October 2018.

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

**Overview**

| | |
|---|---|
| **Materiality:** financial statements as a whole | £45,100 (2017:£56,000)<br>4.5% of profit before tax (2017: 4% of profit before tax before one off items) |
| **Risks of material misstatement** | **vs 2017** |
| **Recurring risks** Impairment of loans and advances to customers | <> |

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

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matter considered in arriving at our audit opinion above, together with our key audit procedures to address that matter and, as required for public interest entities, our results from those procedures. The matter was addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently is incidental to that opinion, and we do not provide a separate opinion on this matter. In the previous year, we included an additional key audit matter relating to the IT migration. Following the completion of the core mortgage and savings platform migration from one outsourced provider to another in 2017, this matter has been removed from our audit report.

## The risk

**Impairment of loans and advances to customers**

(£193,000; 2017: £192,000)

Refer to page 26 (Audit Committee Report), page 46 (accounting policy) and page 54 (financial disclosures)

**Subjective estimate:**

Impairment provisions cover loans specifically identified as impaired and a collective impairment provision. The collective impairment provision includes all other loans where impairments have not yet specifically been identified.

The directors judge individual impairments by reference to loans that have suffered significant financial difficulty of the borrower, default or delinquency by a borrower or the restructuring of a loan or advance by the Society on terms that the Society would not consider otherwise.

The impairment provision is derived from a model which uses a combination of the Society's historical experience and, due to the Society's limited loss experience, external data, adjusted for current conditions. In particular, judgement is required on the key assumptions of probability of default and forced sale discount against collateral.

The impairment model is most sensitive to movements in the propensity to default applied to mortgaged properties.

## Our response

**Our procedures included:**

*Control testing*

We tested controls over the acceptance and monitoring of credit risk.

*Benchmarking assumptions*

We compared the key assumptions used in the impairment provision model, being probability of default and forced sale discount, with those applied at peer organisations.

*Our sector experience*

We challenged the key assumptions used in the impairment provision model, being probability of default and forced sale discount, using our knowledge of recent impairment experience in this industry, including that of the Society.

*Sensitivity analysis*

We assessed the impairment provision model for its sensitivity to changes in the key assumptions of probability of default and forced sale discount by performing stress testing to help us assess the reasonableness of the assumptions and identify areas of potential additional focus.

*Tests of detail*

We identified a selection of loans by filtering data from loan book reports and examined accounts with higher loan to values to identify individual loans which may have unidentified impairments. We tested the provision attached to these loans by reference to relevant supporting information such as the client dialogue/ correspondence in addition to other items such as the existence of additional collateral to challenge the completeness and accuracy of the Society's impairment provision estimate.

*Assessing transparency*

We assessed the adequacy of the Society's disclosures in respect of the degree of estimation involved in arriving at the provision.

**Our results:**

We found the assumptions used in the calculation of the impairment provision in respect of loans and advances to customers to be acceptable (2017: acceptable).



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### The risk

**Data Capture:**

The collective and individual impairment provision models use a combination of static (e.g. original collateral valuations) and dynamic data (e.g. current balance/ interest rates/valuations) in respect of the Society's loans as well as from external sources (e.g. house price index (HPI) tables to derive indexed valuations). Owing to the risk of incorrect data in the underlying system there is risk that the data used in the collective provision model are inaccurate and incomplete.

### Our response

**Our procedures included:**

*Control testing*

We tested controls over the lending process that capture certain static data used in the impairment model (e.g. initial collateral valuation, loan amounts and product interest rates) by observing the operation of the controls over these processes, and inspecting underwriting documents.

*Data comparison*

We agreed data for individual accounts in the model back to the mortgage system and ensured that all accounts had been appropriately captured in the model. We also agreed the external inputs of HPI to external sources.

**Our results:**

We found the data used in the calculation of the impairment provision in respect of loans and advances to customers to be acceptable (2017: acceptable).

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

Materiality for the annual accounts as a whole was set at £45,100 (2017: £56,000), determined with reference to a benchmark of profit before tax, of which it represents 4.5% (2017: 4%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £2,200 (2017: £2,800), in addition to other identified misstatements that warranted reporting on qualitative grounds.

## 4. We have nothing to report on going concern

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

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

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Society's business model and analysed how those risks might affect the Society's financial resources or ability to continue operations over the going concern period.

As these were risks that could potentially cast significant doubt on the the Society's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Society's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as the impact of a disorderly Brexit and the erosion of customer or supplier confidence, which could result in a rapid reduction of available financial resources.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.

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



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

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

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

*Annual Business Statement and Directors' Report*

In our opinion:

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

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

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

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

We have nothing to report in these respects.

## 7. Respective responsibilities

*Directors' responsibilities*

As explained more fully in their statement set out on page 32, the directors are responsible for: the preparation of annual accounts which give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Society or to cease operations, or have no realistic alternative but to do so.

*Auditor's responsibilities*

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

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

*Irregularities – ability to detect*

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

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

Secondly, the society is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the society's licence to operate. We identified the following areas as those most likely to have such an effect: data protection, employment law, regulatory capital and liquidity and certain aspects of building society legislation recognising the financial and regulated nature of the society's activities and its legal form.

Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

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

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

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

**Matthew Rowell**
(Senior Statutory Auditor)

for and on behalf of KPMG LLP,
Statutory Auditor
Chartered Accountants
One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH

20 December 2018

# Statements

# Statement of Comprehensive Income – *for the year ended 31 October 2018*

| | Notes | 2018 £'000 | 2017 £'000 |
|---|---|---|---|
| Interest receivable and similar income | 2 | 6,019 | 5,741 |
| Interest payable and similar charges | 3 | (1,793) | (1,797) |
| Net interest income | | 4,226 | 3,944 |
| Fees and commissions receivable | | 17 | 10 |
| Fees and commissions payable | | (37) | (43) |
| Other operating (charges) / income | | (8) | 30 |
| Total net income | | 4,198 | 3,941 |
| Administrative expenses - recurring | 4 | (3,143) | (2,574) |
| New core IT system migration costs – non-recurring | 4, 5 | - | (473) |
| | | (3,143) | (3,047) |
| Depreciation | 13 | (75) | (60) |
| Operating profit before impairment losses and provisions | | 980 | 834 |

| | Notes | 2018 £'000 | 2017 £'000 |
|---|---|---|---|
| Impairment losses on loans and advances | 12 | (6) | 84 |
| Provisions for liabilities | 19 | 28 | (9) |
| Profit before tax | | 1,002 | 909 |
| Tax expense | 8 | (198) | (181) |
| **Profit for the financial year** | | **804** | **728** |
| **Other comprehensive income** | | | |
| Valuation gains/(losses) on available-for-sale investments taken to equity | | (25) | (28) |
| Realised (gains)/losses on available-for-sale investments transferred to income statement | | 24 | (28) |
| Income tax on other comprehensive income | | - | (8) |
| **Total comprehensive income for the year** | | **803** | **664** |

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

*The notes on pages 46 to 70 form an integral part of these financial statements.*



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# Statement of Financial Position – *at 31 October 2018*

| | Notes | 2018 £'000 | 2017 £'000 |
|---|---|---|---|
| **Assets** | | | |
| Liquid assets | | | |
| Cash in hand | | 82 | 94 |
| Loans and advances to credit institutions | 9 | 43,977 | 17,472 |
| Debt securities | 10 | 36,902 | 74,304 |
| Loans and advances to customers | 11 | 172,228 | 170,598 |
| Tangible fixed assets | 13 | 763 | 560 |
| Deferred tax asset | 18 | - | - |
| Other debtors | 14 | 124 | 110 |
| **Total assets** | | **254,076** | **263,138** |

| | Notes | 2018 £'000 | 2017 £'000 |
|---|---|---|---|
| **Liabilities** | | | |
| Shares | 15 | 218,178 | 226,891 |
| Amounts owed to other customers | 16 | 14,272 | 15,151 |
| Other liabilities | 17 | 177 | 145 |
| Accruals and deferred income | | 435 | 726 |
| Deferred tax liability | 18 | 22 | - |
| Provisions for liabilities | 19 | - | 36 |
| **Total liabilities** | | **233,084** | **242,949** |
| **Reserves** | | | |
| General reserve | | 21,036 | 20,232 |
| Available-for-sale reserve | | (44) | (43) |
| Total reserves attributable to members of the Society | | 20,992 | 20,189 |
| **Total reserves and liabilities** | | **254,076** | **263,138** |

These accounts were approved by the Board of Directors on 20 December 2018 and signed on its behalf:

**James W Dean**
Chairman

**Nicholas H J Sandy**
Vice Chairman

**Michael R Smith**
Chief Executive

*The notes on pages 46 to 70 form an integral part of these financial statements.*



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# Society Statement of Changes in Members' Interests

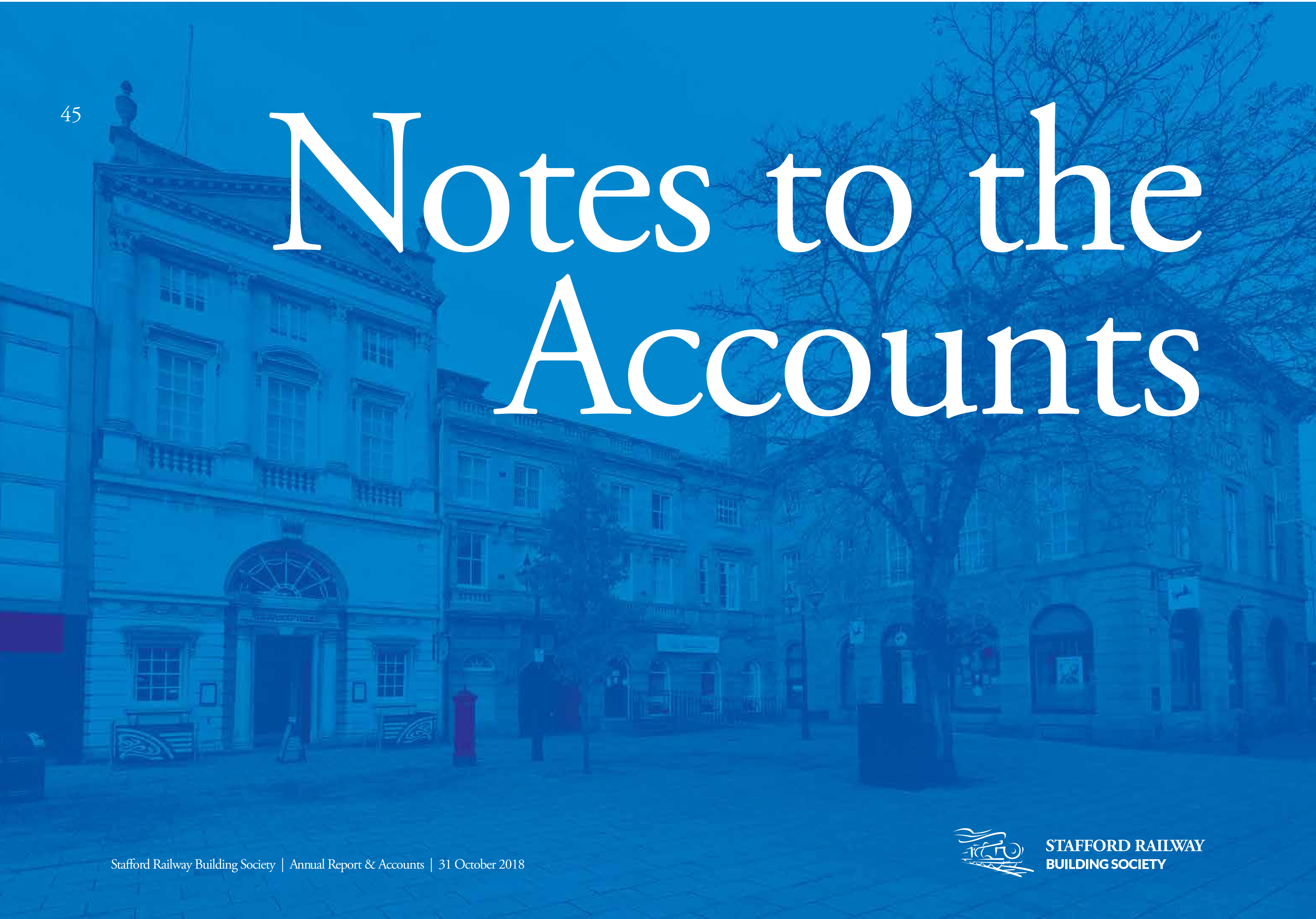
| | General reserve 2018 £'000 | Available -for-sale reserve 2018 £'000 | Total 2018 £'000 | General reserve 2017 £'000 | Available -for-sale reserve 2017 £'000 | Total 2017 £'000 |
|---|---|---|---|---|---|---|
| Balance at 1 November 2017 | 20,232 | (43) | 20,189 | 19,504 | 21 | 19,525 |
| **Total comprehensive income for the period** | | | | | | |
| Profit for the financial year | 804 | - | 804 | 728 | - | 728 |
| Other comprehensive income: | | | | | | |
| Valuation gains/(losses) on available for-sale investments taken to equity | - | (25) | (25) | - | (28) | (28) |
| Realised (gains)/losses on available for-sale investments transferred to income statement | - | 24 | 24 | - | (28) | (28) |
| Income tax on other comprehensive income | - | - | - | - | (8) | (8) |
| Total comprehensive income for the period | 804 | (1) | 803 | 728 | (64) | 664 |
| **Balance at 31 October 2018** | **21,036** | **(44)** | **20,992** | **20,232** | **(43)** | **20,189** |

# Cash Flow Statement

| | Notes | 2018 £'000 | 2017 £'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before tax | | 1,002 | 909 |
| Adjustments for | | | |
| Depreciation | 13 | 75 | 60 |
| Valuation (losses) on available-for-sale investments taken to equity | | (25) | (28) |
| Realised losses/(gains) on available-for-sale investments transferred to income statement | | 24 | (28) |
| Increase / (Decrease) in impairment of loans and advances | | 1 | (84) |
| **Total** | | **1,077** | **829** |
| **Changes in operating assets and liabilities** | | | |
| (Increase) / Decrease in prepayments, accrued income and other assets | | (14) | 632 |
| (Decrease) / Increase in accruals, deferred income and other liabilities | | (327) | 439 |
| (Increase) /Decrease in loans and advances to customers | | (1,631) | 1,455 |

| | Notes | 2018 £'000 | 2017 £'000 |
|---|---|---|---|
| (Decrease) in shares | | (8,713) | (5,513) |
| (Decrease) in amounts owed to other credit institutions and other customers | | (879) | (3,952) |
| Increase in deferred taxation | | 22 | - |
| Taxation paid | | (143) | (181) |
| **Net cash generated by operating activities** | | **(10,608)** | **(6,291)** |
| **Cash flows from investing activities** | | | |
| Purchase of debt securities | | (35,109) | (121,110) |
| Maturity of debt securities | | 72,488 | 137,646 |
| Purchase of tangible fixed assets | 13 | (278) | (156) |
| **Net cash generated by investing activities** | | **37,101** | **16,380** |
| **Net Increase in cash and cash equivalents** | | **26,493** | **10,089** |
| Cash and cash equivalents at 1 November | | 17,566 | 7,477 |
| **Cash and cash equivalents at 31 October** | | **44,059** | **17,566** |

# Notes to the Accounts





STAFFORD RAILWAY
BUILDING SOCIETY

# Notes to the Accounts

## 1. Accounting policies

Stafford Railway Building Society (the "Society") has prepared these Society annual accounts in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 and Financial Reporting Standard 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland ("FRS 102") as issued in August 2014. The Society has also chosen to apply the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement (as adopted for use in the EU). The presentation currency of these annual accounts is sterling. All amounts in the annual accounts have been rounded to the nearest £1,000. There are no foreign currency transactions.

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

Judgements made by the Directors, in the application of these accounting policies that have a significant effect on the annual accounts and estimates with a significant risk of material adjustment in the next year are discussed in note 1.10.

### *1.1 Measurement convention*

The annual accounts are prepared on the historical cost basis with the exception that the Society has elected to adopt IAS 39 Financial Instruments: Recognition and Measurement which requires the Society to measure its debt securities that it has classified as "Available-For-Sale" at fair value with interest and amortisation recognised using the effective interest rate method.

### *1.2 Interest*

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

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Interest income and expense presented in the income statement and other comprehensive income include:

- Interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis; and
- Interest on available-for-sale debt securities calculated on an effective interest basis.

### *1.3 Fees and commission*

Fees, commission income and expenses associated with bringing a mortgage onto the balance sheet are amortised against the expected life of the mortgage on an effective interest rate basis.

Other fees and commission income are recognised on an accruals basis when the service has been provided or on the completion of an act to which the fee relates.

### *1.4 Taxation*

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

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

Deferred tax is provided on timing differences which arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in the Annual Accounts. The following timing differences are not provided for: differences between accumulated depreciation and tax allowances for the cost of a fixed asset if and when all conditions for retaining the tax allowances have been met. Deferred tax is not recognised on permanent differences arising because certain types of income or expense are non-taxable or are disallowable for tax or because certain tax charges or allowances are greater or smaller than the corresponding income or expense.

Deferred tax is measured at the tax rate that is expected to apply to the reversal of the related difference, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax balances are not discounted.

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

*1.5 Financial instruments*

**Recognition**
The Society initially recognises loans and advances to customers, loans and advances to credit institutions and debt securities on the date on which they are originated at fair value. All other financial instruments are recognised on the trade date, which is the date on which the Society becomes a party to the contractual provisions of the instrument.

*Classification*

**Financial assets**
The Society classifies its financial assets into one of the following categories:

- *Loans and receivables*
  Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market and that the Society does not intend to sell immediately or in the near term. Loans and receivables include loans and advances to customers.

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

  The initial value may, if applicable include certain fees which are recognised over the average life of mortgage assets, as noted above.

  Throughout the year and at each year end, the mortgage life assumptions for each scheme are reviewed for appropriateness. Any changes to the expected life assumptions of the mortgage assets are recognised through interest receivable and similar income and reflected in the carrying value of the mortgage assets.

- *Available-for-sale*
  Available-for-sale investments are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments comprise debt securities and are measured at fair value after initial recognition.

  Interest income is recognised in profit or loss using the effective interest method. Impairment losses are recognised in profit or loss.

  Other fair value changes, other than impairment losses, are recognised in Other Comprehensive Income and presented in the available-for-sale reserve within equity. When the investment is sold, the gain or loss accumulated in equity is reclassified to profit or loss.

**Financial liabilities**
The Society classifies its financial liabilities as measured at amortised cost.

*Derecognition*

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

*Measurement*

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

**Identification and measurement of impairment**
At each reporting date, the Society assesses whether there is objective evidence that financial assets not carried at fair value are impaired. A financial asset or a group of financial assets is 'impaired' when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired includes:

- Significant financial difficulty of the borrower or issuer;
- Default or delinquency by a borrower;
- The restructuring of a loan or advance by the Society on terms that the Society would not consider otherwise;
- Indications that a borrower or issuer will enter bankruptcy;
- The disappearance of an active market for a security; or
- Observable data relating to a group of assets such as adverse changes in the payment status of borrowers.

The Society considers evidence of impairment for loans and advances at both a specific asset and a collective level. All individually significant loans and advances are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that are not individually significant are collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

In assessing collective impairment, the Society uses statistical modelling of historical trends of the probability of default, the timing of recoveries and the amount of loss incurred and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than is suggested by historical trends. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

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

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

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

- Moving to an interest only arrangement; and

- Payment plans.

Members requesting a forbearance option will need to provide information to support the request which is likely to include a budget planner, statement of assets and liabilities, bank/credit card statements, payslips etc. in order that the request can be properly assessed.

If the forbearance request is granted the account is monitored in accordance with our policy and procedures. At the appropriate time the forbearance option that has been implemented is cancelled, with the exception of capitalisation of arrears, and the customer's normal contractual payment is restored.

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

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

Impairment losses on available-for-sale investment securities are recognised by reclassifying the losses accumulated in the available for sale reserve in equity to profit or loss. The cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment attributable to application of the effective interest method are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed through profit or loss; otherwise, any increase in fair value is recognised through Other Comprehensive Income. Any subsequent recovery in the fair value of an impaired available-for-sale equity security is always recognised in Other Comprehensive Income.

*1.6 Cash and cash equivalents*

For the purposes of the Statements of Cash Flows, cash comprises cash in hand and unrestricted loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly liquid unrestricted investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months. The Statements of Cash Flows have been prepared using the indirect method.

*1.7 Tangible fixed assets*

Tangible fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses. Where parts of an item of tangible fixed assets have different useful lives, they are accounted for as separate items of tangible fixed assets, for example land is treated separately from buildings.

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

Depreciation is charged to the profit and loss account on a straight-line basis over the estimated useful lives of each part of an item of tangible fixed assets. Land is not depreciated. The estimated useful lives are as follows:

- Buildings 50 years
- Computer equipment 3 years
- Fixtures and fittings 5-10 years

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

*1.8 Employee benefits*

A defined contribution plan is a post-employment benefit plan under which the Society pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the Statement of Comprehensive Income in the periods during which services are rendered by employees.

*1.9 Provisions*

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

*1.10 Assumptions and estimation uncertainties*

Certain 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. The most significant areas where judgements and assumptions are made are as follows:

**Loan impairment**

In determining whether an impairment loss should be recorded, the Society is required to exercise a degree of judgement. Impairments are calculated as the difference between expected future cash flows and the current outstanding balance, using management's best estimate of propensity to default using all available data. Estimates and assumptions are around the probability of any account defaulting, the time taken to complete the sale of properties in possession and the eventual loss incurred in the event of forced sale or write-off. These assumptions are based on observable historical data and updated as the Board consider appropriate to reflect both current and future circumstances.
In exercising its judgement, the Board consider a number of scenarios, incorporating a range of the key variables noted. The scenarios include, for example geographical concentration and borrower age profile.

The probability of default used in the scenarios ranges from 4% to 10%.
A 2.5% increase in the outcome of probability of default would result in an increase in the collective impairment of £59,000. Conversely a 2.5% decrease would result in a decrease in the collective impairment of £52,000. A more aggressive stress based on a 5% increase would result in an increase of £120,000, and a 5% decrease would result in a decrease of £102,000.

**Effective interest rate (EIR)**

The Society recognises interest on loans and advances to customers on the basis of their EIR. This is a constant rate that averages out the effect of incentives and fees across the expected life of the loan account. A critical assumption in the calculation is the expected life, as this determines the assumed period over which customers may be paying various differentiated interest rates. The determination of the estimated life is based on expected redemption data as well as management judgement.

Any changes to the average life will create an adjustment to the loan balance in the balance sheet with a corresponding adjustment to interest receivable in the Statement of Comprehensive Income.

A 3 month increase in the life profile of mortgage assets would result in an increase in the value of loans on the Statement of Financial Position by approximately £4,560 and a corresponding increase in interest receivable.

## 2. Interest receivable and similar income

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| On loans fully secured on residential property | 5,420 | 5,265 |
| On loans and advances to credit institutions | 120 | 125 |
| On debt securities | 479 | 351 |
| | **6,019** | **5,741** |

Included within interest income is £3,021 (2017: £8,375) in respect of interest income accrued on impaired loans two or more months in arrears.

## 3. Interest payable and similar charges

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| On shares held by individuals | 1,770 | 1,782 |
| On deposits and other borrowings | 23 | 15 |
| | **1,793** | **1,797** |

## 4. Administrative expenses

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Wages and salaries | 1,556 | 1,261 |
| Social security costs | 122 | 82 |
| Contributions to defined contribution plans | 81 | 66 |
| | **1,759** | **1,409** |
| Other administrative expenses | 1,384 | 1,638 |
| | **3,143** | **3,047** |

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

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Audit of these annual accounts | 63 | 61 |
| Amounts receivable by the Society's auditor and its associates in respect of: | | |
| Other services | 7 | 5 |
| | **70** | **66** |

## 5. New core IT system migration costs

These represent costs of the implementation of the new software system, overlap and finalisation costs with the previous system supplier, legal fees, project assistance, Board assurance and additional resource to enable staff training and system testing.

## 6. Employee numbers

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

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Full time | 22 | 18 |
| Part time | 15 | 20 |
| | **37** | **38** |

As at 31 October 2018 the Society employed a total of 41 staff (full time 28 and part time 13). The analysis excludes the Society's Non-Executive Directors.

## 7. Directors' remunerations

Total remuneration of the Society's Directors for the year was £616,851 (2017: £450,283). Full details are given in the tables within the Directors' Remuneration Report on pages 28 to 30.

Fees for Directors are not pensionable. Non-Executive Directors do not participate in any incentive scheme or receive any other benefit.

## 8. Tax expense

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

| **Analysis of tax charge in the year** | **2018 £'000** | **2017 £'000** |
|---|---|---|
| *Current tax* | | |
| UK corporation tax on income for the period | 177 | 146 |
| Overprovision of corporation tax in previous period | (2) | - |
| | **175** | **146** |
| *Deferred tax (see note 18)* | | |
| Origination and reversal of timing differences | 23 | 35 |
| Total deferred tax | 23 | 35 |
| **Total tax** | **198** | **181** |

| **Analysis of tax charge in the year** | **2018 £'000** | **2017 £'000** |
|---|---|---|
| Profit on ordinary activities before tax | 1,002 | 909 |
| Tax or profit on ordinary activities at UK standard rate of 19.0% (2017: 19.4%) | 190 | 176 |
| Expenses not deductible for tax purposes | 11 | 1 |
| Overprovision of corporation tax in previous period | (2) | - |
| Accelerated capital allowances and other timing differences | (26) | (13) |
| Movement in collective provision | 2 | (18) |
| **Current tax charge for the year** | **75** | **146** |



STAFFORD RAILWAY
BUILDING SOCIETY

The current tax charge for the period is at the standard rate of corporation tax in the UK which is 19%. Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and to 18% (effective 1 April 2020) were substantively enacted on 26 October 2015. A further reduction to 17% with effect from 1 April 2020 was announced in the UK Budget on 16 March 2016. Accordingly, deferred tax has been measured based on a future effective rate of 17%.

## 9. Loans and advances to credit institutions

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Repayable on demand | 43,977 | 17,472 |
| Total loans and advances to credit institutions | 43,977 | 17,472 |
| **Total included within cash and cash equivalents** | **43,977** | **17,472** |

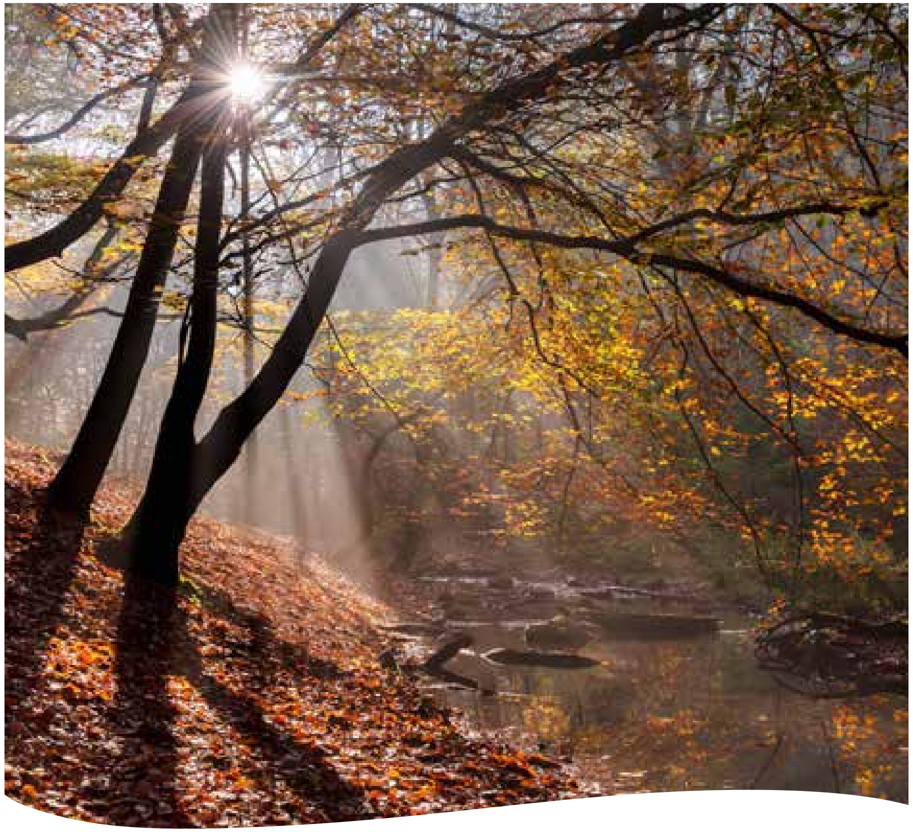
## 10. Debt securities

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Debt securities have remaining maturities as follows: | | |
| In not more than one year | 26,474 | 68,654 |
| In more than one year | 10,428 | 5,650 |
| | **36,902** | **74,304** |
| Transferable debt securities comprise: | | |
| Listed on a recognised investment exchange | 10,187 | 15,425 |
| Unlisted | 26,715 | 58,879 |
| | **36,902** | **74,304** |
| Movements in debt securities during the year are summarised as follows: | | |
| At 1 November | 74,304 | 91,488 |
| Additions | 35,109 | 121,110 |
| Disposals and maturities | (72,463) | (138,230) |
| Movement in premium and accrued interest | (47) | - |
| Valuation (losses) on available-for-sale investments taken to equity | (25) | (28) |
| Realised losses/(gains) on available-for-sale investments transferred to income statement | 24 | (28) |
| Income tax on other comprehensive income | - | (8) |
| **At 31 October** | **36,902** | **74,304** |

## 11. Loans and advances to customers

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Loans fully secured on residential property | 170,373 | 168,526 |
| Loans fully secured on land | 1,855 | 2,072 |
| | **172,228** | **170,598** |
| The remaining maturity of loans and advances to customers from the reporting date is as follows: | | |
| On call and at short notice | 540 | 217 |
| In not more than three months | 223 | 282 |
| In more than three months but not more than one year | 410 | 808 |
| In more than one year but not more than five years | 7,754 | 8,253 |
| In more than five years | 163,494 | 161,230 |
| | **172,421** | **170,790** |
| Less: allowance for impairment (note 12) | (193) | (192) |
| | **172,228** | **170,598** |

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



## 12. Allowance for impairment

| | Loans fully secured on residential property £'000 | Total £'000 |
|---|---|---|
| Individual provision | | |
| At 1 November 2017 | | |
| Individual impairment | 13 | 13 |
| Collective impairment | 179 | 179 |
| | **192** | **192** |
| Utilised in the year | | |
| Individual impairment | (5) | (5) |
| | **(5)** | **(5)** |
| Charge/(credit) for the year | | |
| Individual impairment | (2) | (2) |
| Collective impairment | 8 | 8 |
| | **6** | **6** |
| At 31 October 2018 | | |
| Individual impairment | 6 | 6 |
| Collective impairment | 187 | 187 |
| | **193** | **193** |

| | Loans fully secured on residential property £'000 | Total £'000 |
|---|---|---|
| Individual provision | | |
| At 1 November 2016 | | |
| Individual impairment | 3 | 3 |
| Collective impairment | 273 | 273 |
| | **276** | **276** |
| Charge/(credit) for the year | | |
| Individual impairment | 10 | 10 |
| Collective impairment | (94) | 94) |
| | **(84)** | **(84)** |
| At 31 October 2017 | | |
| Individual impairment | 13 | 13 |
| Collective impairment | 179 | 179 |
| | **192** | **192** |

## 13. Tangible fixed assets

| | Freehold Land and Buildings £'000 | Computer Equipment £'000 | Office Equipment /Fixtures & Fittings £'000 | Total £'000 |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance at 1 November 2017 | 643 | 172 | 497 | 1,312 |
| Additions | - | 66 | 212 | 278 |
| Disposals | - | (60) | (23) | (83) |
| **Balance at 31 October 2018** | **643** | **178** | **686** | **1,507** |
| **Depreciation and impairment** | | | | |
| Balance at 1 November 2017 | 238 | 145 | 369 | 752 |
| Depreciation charge for the year | 15 | 21 | 39 | 75 |
| Disposals | - | (60) | (23) | (83) |
| **Balance at 31 October 2018** | **253** | **106** | **385** | **744** |
| **Net book value** | | | | |
| At 1 November 2017 | 405 | 27 | 128 | 560 |
| **At 31 October 2018** | **390** | **72** | **301** | **763** |

*Land and buildings*

| The net book value of land and buildings comprises: | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Freehold | 390 | 405 |
| **Net book value of land and buildings occupied for own use** | **390** | **405** |

## 14. Other debtors

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Deferred tax assets (see note 18) | - | - |
| Prepayments and accrued income | 124 | 110 |
| | **124** | **110** |

## 15. Shares

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Held by individuals | 218,178 | 226,891 |
| Shares are repayable with remaining maturities from the balance sheet date as follows: | | |
| **Repayable on demand** | **218,178** | **226,891** |

## 16. Amounts owed to other customers

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| **Repayable on demand** | **14,272** | **15,151** |

## 17. Other liabilities

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| **Corporation tax** | **177** | **145** |



STAFFORD RAILWAY BUILDING SOCIETY

## 18. Deferred tax assets and liabities

| | Assets 2018 £'000 | Assets 2017 £'000 | Liabilities 2018 £'000 | Liabilities 2017 £'000 | Net 2018 £'000 | Net 2017 £'000 |
|---|---|---|---|---|---|---|
| Excess of capital allowances over depreciation | - | - | 51 | 25 | 51 | 25 |
| Effective Interest Rate transitional adjustment | - | - | 12 | 13 | 12 | 13 |
| Collective impairment allowance | (32) | (30) | - | - | (32) | (30) |
| Income tax on other comprehensive income | (9) | (8) | - | - | (9) | (8) |
| **Deferred tax (assets) / liabilities** | **(41)** | (38) | **63** | 38 | **22** | - |

No significant reversal of the deferred tax liability in respect of accelerated capital allowances or collective impairment allowance is expected to occur in the year to 31 October 2018. The Corporation Tax impact of the Effective Interest Rate transitional adjustment is spread over ten years and so deferred tax has been recognised accordingly.

## 19. Provisions for liabilities

| | FSCS levy £'000 |
|---|---|
| Balance at 1 November 2017 | 36 |
| Payment during the year | (8) |
| Release of surplus provision | (28) |
| **Balance at 31 October 2018** | **-** |

In March 2018, The Financial Services Compensation Scheme made a final payment to HM Treasury in respect of liabilities arising out of the resolution of Dunfermline Building Society. In May 2018, the capital balance on the Bradford and Bingley loan was fully repaid through the sale of certain Bradford and Bingley mortgage assets. Therefore, the Society has received the last FSCS levy raised in respect of the costs of the 2008/9 failures. This amount of £8k, in respect of the scheme year 2017/18, calculated on protected deposits as at 31 December 2016 was paid on 1 September 2018

## 20. Employee benefits

*Defined contribution plans*

During the year, the Society has contributed to the personal pension plans of its staff. The pension charge in relation to these plans for the year was £80,981 (2017: £65,630). Accrued contributions as at 31 October 2018 were £4,855 (2017: £nil).

## 21. Financial instruments

A financial instrument is a contract that gives rise to a financial asset or financial liability. The Society is a retailer of financial instruments in the form of mortgage and savings products. The Society does not run a trading book.

The Society has a formal structure for managing risk, including established risk limits, reporting lines, mandates, credit risk appetite and other control procedures. The Board delegated Risk Committee is responsible for managing the Society's overall exposure to risk.

The Assets and Liabilities Committee (ALCO) reviews treasury and balance sheet risk related activities and examines market movements to discern changes required to the Society's product range.

Key performance indicators in the form of a dashboard, are provided to the Board on a monthly basis and summary information is reviewed on a weekly basis by Management.

Financial assets and liabilities are measured on an on-going basis either at fair value or at amortised cost. Note 1.5 'Financial instruments' describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The tables below analyse the Society's assets and liabilities by financial classification:

| Carrying values by category 31 October 2018 | Held at amortised cost | | | Held at fair value | |
|---|---|---|---|---|---|
| | Loans and receivables £'000 | Financial liabilities at amortised cost £'000 | Other non -financial assets and liabilities £'000 | Available -for-sale £'000 | Total £'000 |
| **Financial assets** | | | | | |
| Cash in hand | 82 | - | - | - | 82 |
| Loans and advances to credit institutions | 43,977 | - | - | - | 43,977 |
| Debt securities | - | - | - | 36,902 | 36,902 |
| Loans and advances to customers | 172,228 | - | - | - | 172,228 |
| Total financial assets | 216,287 | - | - | 36,902 | 253,189 |
| Non-financial assets | - | - | 887 | - | 887 |
| **Total assets** | **216,287** | **-** | **887** | **36,902** | **254,076** |
| **Financial liabilities** | | | | | |
| Shares | - | 218,178 | - | - | 218,178 |
| Amounts owed to other customers | - | 14,272 | - | - | 14,272 |
| Total financial liabilities | - | 232,450 | - | - | 232,450 |
| Non-financial liabilities | - | - | 634 | - | 634 |
| **Total liabilities** | **-** | **232,450** | **634** | **-** | **233,084** |



STAFFORD RAILWAY BUILDING SOCIETY

| Carrying values by category 31 October 2017 | Held at amortised cost | | | Held at fair value | |
|---|---|---|---|---|---|
| | Loans and receivables £'000 | Financial liabilities at amortised cost £'000 | Other non -financial assets and liabilities £'000 | Available -for-sale £'000 | Total £'000 |
| **Financial assets** | | | | | |
| Cash in hand | 94 | - | - | - | 94 |
| Loans and advances to credit institutions | 17,472 | - | - | - | 17,472 |
| Debt securities | - | - | - | 74,304 | 74,304 |
| Loans and advances to customers | 170,598 | - | - | - | 170,598 |
| Total financial assets | 188,164 | - | - | 74,304 | 262,468 |
| Non-financial assets | - | - | 670 | | 670 |
| **Total assets** | **188,164** | **-** | **670** | **74,304** | **263,138** |
| **Financial liabilities** | | | | | |
| Shares | - | 226,891 | - | - | 226,891 |
| Amounts owed to other customers | - | 15,151 | - | - | 15,151 |
| Total financial liabilities | - | 242,042 | - | - | 242,042 |
| Non-financial liabilities | - | - | 907 | - | 907 |
| **Total liabilities** | **-** | **242,042** | **907** | **-** | **242,949** |

*Valuation of financial instruments carried at fair value*

The Society holds certain financial assets and liabilities at fair value, grouped into Levels 1 to 3 of the fair value hierarchy (see below).

Valuation techniques

Fair values are determined using the following fair value hierarchy that reflects the significance of the inputs in measuring fair value:

- Level 1 – The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 – Inputs other than quoted prices included within level 1 that are observable (that is, developed using market data) for the asset or liability, either directly or indirectly; and
- Level 3 – Inputs are unobservable (that is, for which market data is unavailable) for the asset or liability.

The table below summarises the fair values of the Society's financial assets and liabilities that are accounted for at fair value, analysed by the valuation methodology used by the Society to derive the financial instruments fair value:

| **31 October 2018** | **Level 1 £'000** | **Level 2 £'000** | **Level 3 £'000** | **Total £'000** |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Available for sale | | | | |
| Debt securities | 36,902 | - | - | 36,902 |
| | | | | |
| **31 October 2017** | | | | |
| **Financial assets** | | | | |
| Available for sale | | | | |
| Debt securities | 74,304 | - | - | 74,304 |

Valuation techniques

The main valuation technique employed by the Society to establish fair value of the financial instruments disclosed above are set out below:

Debt securities – Level 1: Market prices have been used to determine the fair value of listed debt securities.

*Credit risk*

Credit risk is the risk of loss or delay if a customer or counterparty fails to perform their obligations, such as the timely repayment of a loan or other credit arrangement. The Society has no appetite for material credit losses. This is controlled through credit quality standards, underwriting rules, as well as limits by exposure to counterparty, sector, country and instrument. The Society's maximum credit risk exposure is detailed in the table below:

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Loans and advances to credit institutions | 43,977 | 17,472 |
| Debt securities | 36,902 | 74,304 |
| Loans and advances to customers | 172,228 | 170,598 |
| Total statement of financial position exposure | 253,107 | 262,374 |
| Off balance sheet exposure – mortgage commitments | 17,240 | 8,415 |
| | **270,347** | **270,789** |

The Society does not use credit derivatives, or similar instruments, to manage its credit risk.

**Loans and advances to credit institutions and debt securities**

The Assets and Liabilities Committee (ALCO) is responsible for approving treasury counterparties for investment purposes. The credit risk appetite for liquid assets is defined by: the minimum counterparty credit rating; the permissible instruments; the maximum percentage of total liquid assets held at each credit risk level; and the investment term. This is monitored daily by the Society's Executive and Management and reviewed monthly by the Assets and Liabilities Committee (ALCO).

An analysis of the Society's treasury asset concentration is shown in the table below:

| | 2018 £'000 | 2018 % | 2017 £'000 | 2017 % |
|---|---|---|---|---|
| **Industry sector** | | | | |
| Banks | 17,970 | 22.2 | 25,533 | 27.8 |
| Bank of England | 39,688 | 49.0 | 10,002 | 10.9 |
| Building Societies | 6,379 | 7.9 | 8,019 | 8.7 |
| Central Government | 16,924 | 20.9 | 48,316 | 52.6 |
| **Total** | **80,961** | **100.0** | **91,870** | **100.0** |



STAFFORD RAILWAY
BUILDING SOCIETY

| Geographic region | 2018 £'000 | AA % | A % | BBB % | Other % | 2017 £'000 |
|---|---|---|---|---|---|---|
| United Kingdom | 80,863 | 75.20 | 24.68 | - | - | 91,870 |
| USA | 98 | 0.12 | - | - | - | - |
| | **80,961** | **75.32** | **24.68** | **-** | **-** | **91,870** |

The Society has no exposure to foreign exchange risk. All instruments are denominated in sterling.

There are no impairment charges against any of the Society's treasury assets at 31 October 2018.

Loans and advances to customers
All mortgage loan applications are assessed with reference to the Society's risk appetite and Board approved lending policy.

The Board's risk appetite is based on:

1. The maximum proportion of the total mortgage portfolio that certain loans types can represent;

2. Loan-to-value (LTV) ratios; and

3. The arrears level.

LTV and arrears levels are key drivers of the Pillar 1 credit risk capital calculation. All mortgage products are priced to ensure that the margin appropriately reflects the credit risk involved and the carrying cost of the incremental risk capital.

The Board believes in a stepwise approach to product development. New products should typically be introduced via a limited number of channels, such as well-established and highly reputable specialist brokers. Capital will be committed in a staged manner, with regular product performance reviews being performed.

For the Society as a whole, mortgages on prime owner occupied residential properties will be a minimum of 80% of mortgage assets and arrears rates will be kept below the national average reported by UK Finance.

The lending portfolio is monitored by the Operational Management Committee to ensure that it remains in line with the stated risk appetite of the Society. All mortgage applications are underwritten individually on a case-by-case basis ensuring that they meet the Lending Policy rules which support the risk appetite of the Society. All mortgage applications will be overseen by the Head of Mortgages and Underwriting who ensures that all lending criteria have been applied and that all information submitted within the application is validated.

| | 2018 £'000 | 2018 % | 2017 £'000 | 2017 % |
|---|---|---|---|---|
| **Industry sector** | | | | |
| Residential mortgages | | | | |
| Owner occupied | 140,975 | 81.7 | 142,867 | 83.7 |
| Buy-to-let | 29,074 | 16.9 | 25,360 | 14.8 |
| Commercial mortgages | 2,372 | 1.4 | 2,563 | 1.5 |
| **Total Gross Mortgages** | **172,421** | **100.0** | **170,790** | **100.0** |

The Society operates throughout England and Wales.

An analysis of the Society's geographical concentration is shown in the table below:

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Stafford ST16-ST18 | 37,190 | 44,141 |
| Rest of Staffordshire | 26,390 | 28,564 |
| Rest of UK | 108,841 | 98,085 |
| **Total Gross Mortgages** | **172,421** | **170,790** |

The tables below stratify credit exposures from mortgage loans and advances to retail customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral. The gross amounts exclude any impairment allowance. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination updated based on changes in house price indices.

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| **LTV ratio** | | |
| Less than 50% | 110,997 | 84,116 |
| 51 – 70% | 50,782 | 56,578 |
| 71 – 90% | 10,642 | 28,607 |
| 91 – 100% | - | 919 |
| More than 100% | - | 570 |
| **Total Gross Mortgages** | **172,421** | **170,790** |
| **Average LTV** | **32.2%** | **34.8%** |



STAFFORD RAILWAY BUILDING SOCIETY

*Credit risk*

*Credit quality analysis of loans and advances to customers*

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

| | Loans fully secured on residential property 2018 £'000 | Loans fully secured on land 2018 £'000 | Total loans 2018 £'000 | Loans fully secured on residential property 2017 £'000 | Loans fully secured on land 2017 £'000 | Total loans 2017 £'000 |
|---|---|---|---|---|---|---|
| **Neither past due nor impaired** | **167,288** | **1,855** | **169,143** | **165,067** | **2,072** | **167,139** |
| **Past due but not impaired** | | | | | | |
| 0 – 60 days | 2,989 | - | 2,989 | 2,787 | - | 2,787 |
| 60 – 90 days | 27 | - | 27 | 478 | - | 478 |
| 90 – 180 days | 53 | - | 53 | 113 | - | 113 |
| 180 days+ | 56 | - | 56 | - | - | - |
| | **3,125** | **-** | **3,125** | **3,378** | **-** | **3,378** |
| **Individually impaired** | | | | | | |
| Not past due | - | - | - | - | - | - |
| 30 – 60 days | 153 | - | 153 | 108 | - | 108 |
| 60 – 90 days | - | - | - | 66 | - | 66 |
| 90 – 180 days | - | - | - | - | - | - |
| 180 days+ | - | - | - | - | - | - |
| Possession | - | - | - | 99 | - | 99 |
| | **153** | **-** | **153** | **273** | **-** | **273** |

| | Loans fully secured on residential property 2018 £'000 | Loans fully secured on land 2018 £'000 | Total loans 2018 £'000 | Loans fully secured on residential property 2017 £'000 | Loans fully secured on land 2017 £'000 | Total loans 2017 £'000 |
|---|---|---|---|---|---|---|
| **Allowance for impairment** | | | | | | |
| Individual | (6) | - | (6) | (13) | - | (13) |
| Collective | (187) | - | (187) | (179) | - | (179) |
| **Total allowance for impairment** | **(193)** | **-** | **(193)** | **(192)** | **-** | **(192)** |

Individual assessments are made of all mortgage loans where objective evidence indicates that losses are likely (for example when loans are past due) or the property is in possession, or where fraud or negligence has been identified. Further consideration is given in accounting policy 1.5 to the accounts.

The status "past due but not impaired" includes any asset where a payment due is received late or missed but no individual provision has been allocated. The amount included is the entire loan amount rather than just the overdue amount. The status also includes cases in forbearance measures, which as at 31 October 2018 totalled £0.88m (2017: £1.51m).

Possession balances would represent those loans where the Society has taken ownership of the underlying security pending its sale. Repossessed properties are made available-for-sale in accordance with statutory guidelines with proceeds used to reduce or repay the outstanding loan. Any collateral surplus on the sale of repossessed properties, after a deduction for costs incurred in relation to the sale, would be returned to the borrower.

*Forbearance*

The Society has various forbearance options to support members who may find themselves in financial difficulty. These include payment plans, capitalisations, term extensions, temporary transfer to interest only and reduced payment concessions.

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

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

The table below analyses residential mortgage balances under forbearance arrangements at the year-end:

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| Payment plan | 159 | 763 |
| Transfers to interest only | 717 | 748 |
| | **876** | **1,511** |

These represent a total of 13 accounts in forbearance at 31 October 2018 (2017: 19). These accounts are shown above as impaired.

No individual impairments in respect of cases in forbearance (2017: nil).

*Liquidity risk*

Liquidity Risk is the risk that the Society, although solvent, has insufficient financial resources available to meet its obligations as they fall due, or can only secure those resources at excessive cost.

The Society must at all times have sufficient liquidity to meet its liabilities over all reasonable market-wide and Society-specific stress scenarios (both short-term and long-term) over the economic cycle, expressed in terms of a survival period.

The Society has a conservative approach to managing liquidity risk and requires sufficient liquid assets to be maintained in order to:

- Meet day-to-day business needs;
- Cater for an unexpected funding stress scenario; and
- Ensure maturity mismatches are provided for.

Balance sheet and liquidity risk limits (including counterparty limits) are set to support this risk appetite within the Society's suite of treasury and liquidity policies.

The monitoring of liquidity, in line with the Society's policy framework, is performed daily by the Executive and Management.

The Society's liquidity policy is designed to ensure that the Society has sufficient liquid resources to withstand a range of stressed scenarios. A series of liquidity stress tests have been developed as part of the Society's Individual Liquidity Adequacy Assessment Process (ILAAP). They include scenarios that fulfil the specific requirements of the Prudential Regulation Authority (PRA), the idiosyncratic, market-wide and combination stress tests and scenarios identified by the Society which are specific to its business model.

The stress tests are performed periodically and reported to Assets and Liabilities Committee (ALCO) to confirm that the Liquidity Policy remains appropriate. The Society's liquid resources comprise high quality liquid assets, including gilts and treasury bills. At the end of year, the ratio of liquid assets to shares and deposits was 34.83% compared to 37.96% at 31 October 2017.

The Society maintains a contingency funding plan to ensure that it has so far as possible, sufficient liquid financial resources to meet liabilities as they fall due under each of the scenarios.

All Society liquid assets are unencumbered as at the balance sheet date.

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

| **31 October 2018** | **On demand £'000** | **Not more than three months £'000** | **More than three months but not more than one year £'000** | **More than one year but not more than five years £'000** | **More than five years £'000** | **Total £'000** |
|---|---|---|---|---|---|---|
| **Financial Liabilities** | | | | | | |
| Shares | 218,178 | - | - | - | - | 218,178 |
| Amounts owed to other customers | 14,272 | - | - | - | - | 14,272 |
| | **232,450** | **-** | **-** | **-** | **-** | **232,450** |
| Other liabilities | - | 634 | - | - | - | 634 |
| **Total financial liabilities** | **232,450** | **634** | **-** | **-** | **-** | **233,084** |

| **31 October 2018** | **On demand £'000** | **Not more than three months £'000** | **More than three months but not more than one year £'000** | **More than one year but not more than five years £'000** | **More than five years £'000** | **Total £'000** |
|---|---|---|---|---|---|---|
| **Financial Liabilities** | | | | | | |
| Shares | 226,891 | - | - | - | - | 226,891 |
| Amounts owed to other customers | 15,151 | - | - | - | - | 15,151 |
| | **242,042** | **-** | **-** | **-** | **-** | **242,042** |
| Other liabilities | - | 907 | - | - | - | 907 |
| **Total financial liabilities** | **242,042** | **907** | **-** | **-** | **-** | **242,949** |

*Market risk*

Market risk is the risk that the value of, or income arising from, the Society's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk, foreign currency risk and equity risk.

The Society only deals with products in sterling so is not directly affected by currency risk. The Society's products are also only interest orientated products so are not exposed to other pricing risks. The Society's Interest rate risk arises from the impact changes in interest rates have on the Society's cash flows. The Society does not have any fixed rate savings or mortgage products, only variable, and therefore the Interest Rate Risk for the Society is significantly less than for other similar institutions. The Society's main exposure to interest rates arises from its investment in Government Gilts and Certificates of Deposit with other financial institutions. The Society uses specialist external treasury advisers for investing surplus funds and has a good spread of maturity of its invested monies to manage this risk effectively.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Society's financial assets and financial liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a monthly basis include a 100-basis point (bp) parallel fall or rise in the LIBOR yield curve and a 50bp rise or fall in the greater than 12-month portion of the LIBOR yield curve. The following is an analysis of the Society's sensitivity to an increase or decrease in market interest rates, assuming no asymmetrical movement in yield curves and a constant financial position. The impact to profit would be the same to equity.

| | 100bp parallel increase £'000 | 100bp parallel decrease £'000 | 50bp increase after 1 year £'000 | 50bp decrease after 1 year £'000 |
|---|---|---|---|---|
| **Sensitivity of projected net interest income** | | | | |
| **At 31 October 2018** | | | | |
| Average for the period | 780 | 260 | 597 | 443 |
| Maximum for the period | 805 | 262 | 612 | 451 |
| Minimum for the period | 754 | 257 | 581 | 435 |
| **At 31 October 2017** | | | | |
| Average for the period | 1,047 | 349 | 762 | 634 |
| Maximum for the period | 1,083 | 353 | 782 | 646 |
| Minimum for the period | 1,011 | 345 | 741 | 621 |

The Society is exposed to movements in interest rates and manages this exposure on a continuous basis, within limits set by the Board, using only instruments recoded on the balance sheet. The results are reported to Assets and Liabilities Committee (ALCO) and the Board on a monthly basis.

*Capital*

The Society's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain future development of the business. The formal Internal Capital Adequacy Assessment Process (ICAAP) assists the Society with its management of capital. The Board monitors the Society's capital position on a monthly basis to assess whether adequate capital is held to mitigate the risks it faces in the course of its business activities. The Society's actual and expected capital position is reviewed against stated risk appetite which aims to maintain capital at a level that equates to or exceeds its Internal Capital Guidance (ICG).

The Board manages the Society's capital and risk exposures to maintain capital in line with regulatory requirements which includes monitoring of:

- Lending decisions – The Society maintains a comprehensive set of sectoral limits in its lending policy in order to manage credit risk appetite. Individual property valuations are monitored against House Price Index (HPI) data;
- Concentration risk – The design of lending products takes into account the overall mix of the loan portfolio to manage exposure to risks arising from the property market and other markets the Society is active in; and
- Counterparty risk – Wholesale lending is only carried out with approved counterparties in line with the Society's lending criteria and is subject to a range of limits that reflect the risk appetite of the Society.

Stress tests are used as part of the process of managing capital requirements.

The Society's capital requirements are set and monitored by the PRA. During 2018 the Society has continued to comply with the European Union (EU) Capital Requirements Regulation and Directive (Basel III) as amended by the PRA.

Regulatory capital is analysed into two tiers:

- Tier 1 capital – which comprised retained earnings, revaluation reserve less intangibles (where applicable); and
- Tier 2 capital – which includes collective provisions.

The level of capital is matched against risk-weighted assets which are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets. There were no reported breaches of capital requirements during the year. There have been no material changes in the Society's management of capital during the year. The Society's regulatory position as at 31 October 2018 under the standardised approach was as follows:

| | 2018 £'000 | 2017 £'000 |
|---|---|---|
| **Tier 1 Capital** | | |
| General reserves | 20,992 | 20,189 |
| **Tier 2 Capital** | | |
| Collective provision | 187 | 179 |
| **Total Regulatory Capital** | **21,179** | **20,368** |

This is also referred to in the Society's Pillar 3 document held on the Society's website.

## 22. Commitments

*Capital commitments*

Contractual commitments to purchase tangible fixed assets at the year-end were £41k (2017: nil) for the Society.

## 23. Related parties

Related parties are identified as key management personnel, being the Executive Directors and Non-Executive Directors who are responsible for ensuring that the Society meets its strategic and operational objectives. In the normal course of business, key management personnel, and their close family members, transacted with the Society. The balances of transactions with key management personnel and their close family members are disclosed below.

As required under section 68 of the Building Societies Act 1986, a register is maintained at the Head Office of the Society which shows details of all loans, transactions and arrangements between the Society and its Directors and connected persons. A statement, for the current financial year, of the appropriate details contained in the register will be available for inspection at the Head Office for a period of 15 days up to and including the day of the Annual General Meeting.

Susan Whiting and Jeremy Hodgkiss are Directors and shareholders of Deans (Staffordshire) Limited. As detailed in The Directors' Remuneration Report, the Society engaged Deans (Staffordshire) Limited in the provision of Executive services. The contract ended on 30 June 2018.

During the 8 months to 30 June 2018 Deans (Staffordshire) Limited paid the Society rent for office accommodation amounting to £nil (2017: £25,703). In addition to the amounts disclosed in the Directors' Remuneration Report, the Society made payments to Deans (Staffordshire) Limited for some staff services and some office accommodation and facilities amounting to £nil (2017: £48,000). Amounts in respect of additional services are not included in Directors' emoluments.

At 31 October 2018 there were outstanding mortgage loans granted in the ordinary course of business at the Society's standard variable mortgage rate to 1 Director in aggregate to £162,829 (2017: one Director in aggregate to £173,285).

Directors' and connected parties hold savings balances with the Society; all accounts have the same terms and conditions as available to members of the Society. The savings balances are not detailed in the register unlike loans and transactions above, due to their sensitive nature. The aggregate amount of all savings balances at 31 October 2018 was £136,736 (2017: £162,581).

## 24. Subsequent events

The Directors consider that there has been no event since the end of the financial year that has a significant effect on the position of the Society.

## 25. Country by Country Reporting

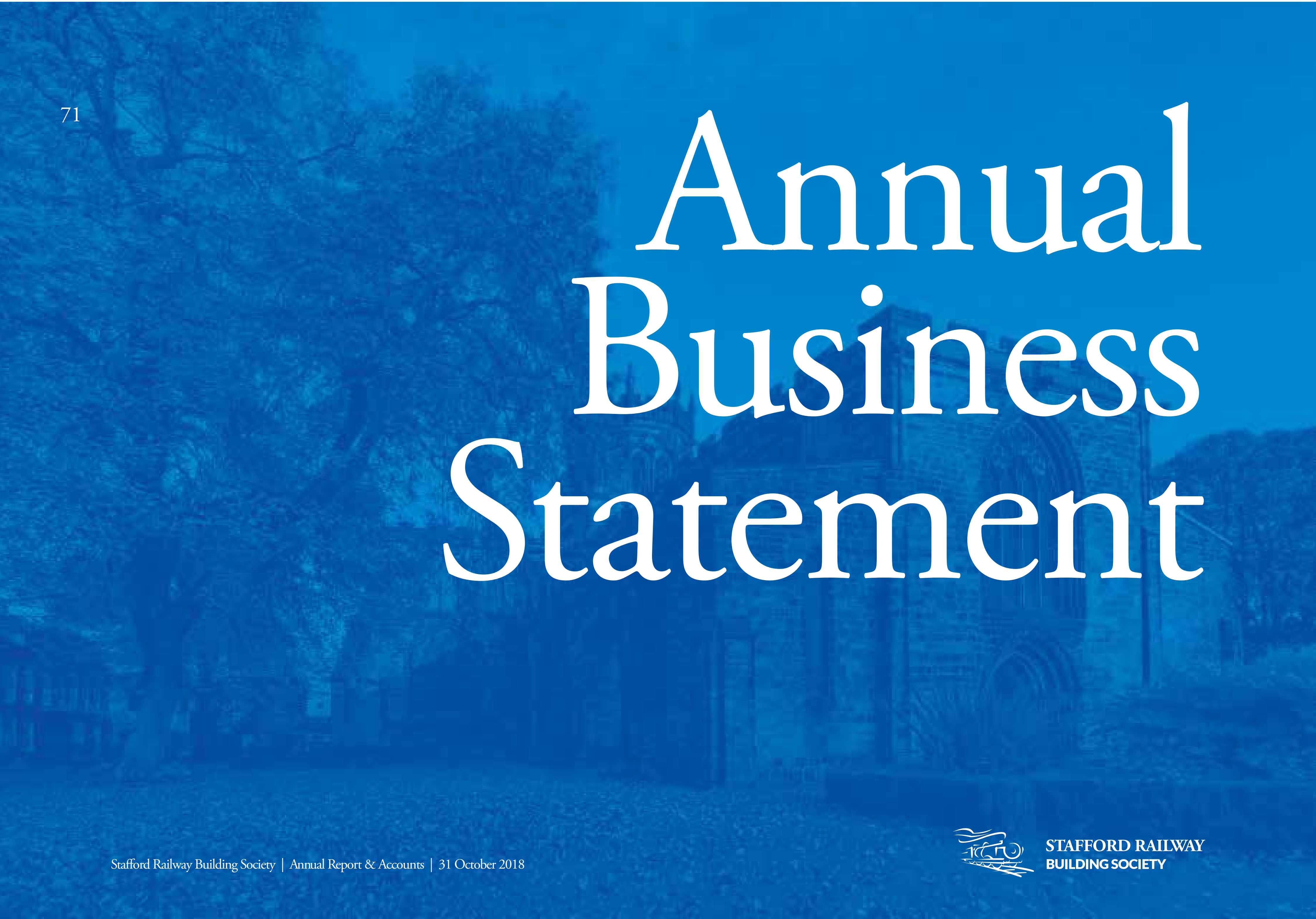
The reporting obligations set out in Article 89 of the European Union's Capital Requirements Directive IV (CRD IV) have been implemented in the UK by the Capital Requirements (Country-by-Country Reporting) Regulations. As a mutual organisation, the Society's primary focus is its members and it aims to provide mortgage and savings products supported by excellent customer service.

Details of the principal activities are detailed in note 1 to the Annual Report and Accounts.

**For the year ended 31 October 2018**

The Society's Annual Accounts report:

- Total operating income was £4.2m (2017: £3.9m). Total operating income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable);
- Profit before tax was £1.0m (2017: £0.9m) all of which arising from UK based activity;
- The average number of Society full time equivalent employees was 30 (2017: 28) all of which were employed in the UK;
- Corporation tax of £0.1m was paid in the year and is all within the UK tax jurisdiction; and.
- No public subsidies were received in the year.



# Annual Business Statement

# Annual Business Statement *– for the year ended 31 October 2018*

## 1. Statutory Percentages

| | Percentage as at 31 Oct 2018 % | Statutory Limit |
|---|---|---|
| Proportion of business assets not in the form of loans fully secured on residential property (the "Lending limit") | 1.15 | 25 |
| Proportion of shares and deposits not in the form of shares held by individuals (the "Funding limit") | 6.14 | 50 |
| The percentages are calculated in accordance with, and the statutory limits are those prescribed by, sections 6 and 7 of the Building Societies Act 1986 as amended by the Building Societies Act 1997. | | |
| Business assets are the total assets of the Society as shown in the balance sheet plus collective loan loss impairment less fixed assets and liquid assets. | | |
| Loans fully secured on residential property are the amount of the principal owing by borrowers and interest accrued not yet payable. This is the amount shown in the balance sheet plus collective loan loss impairment. | | |

## 2. Other Percentages

| | 31 Oct 2018 % | 31 Oct 2017 % |
|---|---|---|
| Gross capital as a percentage of share and deposit liabilities | 9.03 | 8.34 |
| Free capital as a percentage of share and deposit liabilities | 8.78 | 8.18 |
| Liquid assets as a percentage of share and deposit liabilities | 34.83 | 37.96 |
| Cost income ratio represents the aggregate of administration expenses and deprecation expressed as a percentage of total income less other operating charges | 76.66 | 78.84 |
| As a percentage of mean assets | | |
| Profit after taxation | 0.31 | 0.27 |
| Management expenses – statutory basis | 1.24 | 1.16 |
| Management expenses – excluding IT system migration costs | 1.24 | 0.99 |

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

- Shares and deposits' represent the total of shares, amounts owed to credit institutions and amounts owed to other customers.
- Gross capital' represents the general reserves including the available-for-sale reserve.
- Free capital' represents the aggregate of gross capital and collective loan loss impairment less tangible fixed assets.
- Mean total assets' represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- Liquid assets' represent the total cash in hand, treasury bills, loans and advances to credit institutions and debt securities.
- Management expenses' represent the aggregate of recurring administrative expenses, depreciation and amortisation. The ratios above are expressed including and excluding non-recurring Core IT System migration costs.

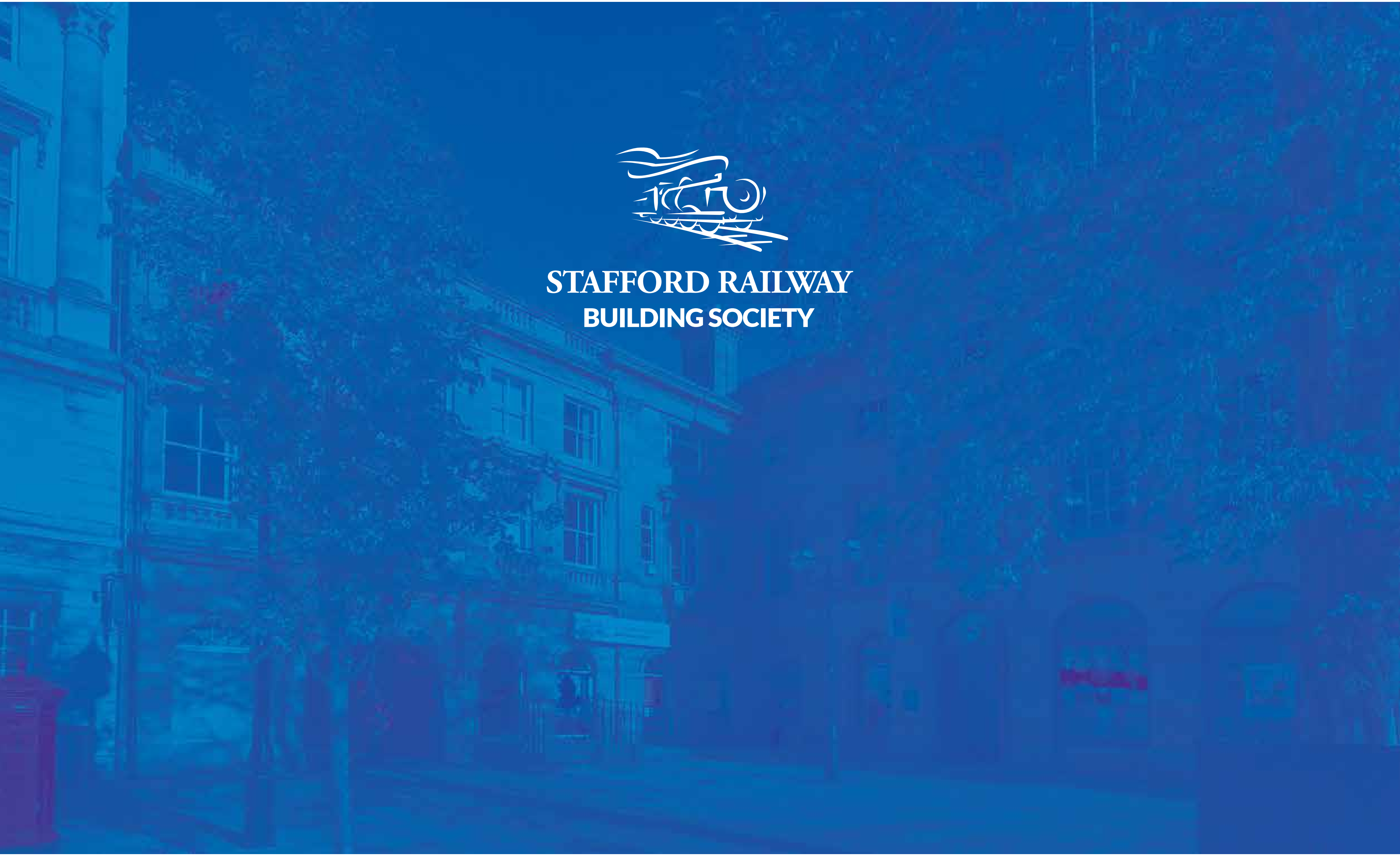


STAFFORD RAILWAY
BUILDING SOCIETY

### 3. Information relating to the Directors at 31 October 2018

| Name | Occupation and Date of Appointment | Other Directorships |
|---|---|---|
| James W Dean<br>Chairman | Chartered Accountant<br>20.08.12 | Notemega Limited<br>Seale Hill Management Company<br>Rathbone Brothers PLC<br>Rathbone Investment Management Limited<br>School Governor (Reigate Grammar School – limited by guarantee)<br>RJ Young Properties Limited |
| Nicholas H J Sandy<br>Vice Chairman | Chartered Surveyor (Retired)<br>20.12.10 | Grey Geese Properties Limited |
| Gary CD Crowe | Management Consultant<br>20.07.15 | University Hospitals of North Midlands NHS Trust<br>Professor at Keele University |
| David J Grant | Company Director and Consultant<br>22.05.17 | BLAKK Limited |
| Colin C Lloyd | Principal Consultant<br>21.07.14 | Community Sports Trust<br>Aquabox |
| Steven Jones | Deputy Chief Executive and Finance Director<br>06.06.18 | Newcastle and Stafford Colleges Group |
| Karen E McCormick | Consultant / Independent Director<br>20.07.15 | Mottram Hall Farm Management Company Limited<br>Karen McCormick Associates Limited<br>Currency Matters Limited<br>Bank and Clients PLC |
| Michael R Smith | Chief Executive<br>09.10.17 | - |

Documents may be served on the above Directors care of KPMG LLP (UK), 1 Sovereign Square, Sovereign Street, Leeds LS1 4DA. Service Contracts: None of the Non-Executive Directors has a service contract. Michael Smith and Steven Jones are employed under a contract that is terminable by either the Society or the Director on twelve months' and six months' notice respectively.



STAFFORD RAILWAY
BUILDING SOCIETY

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