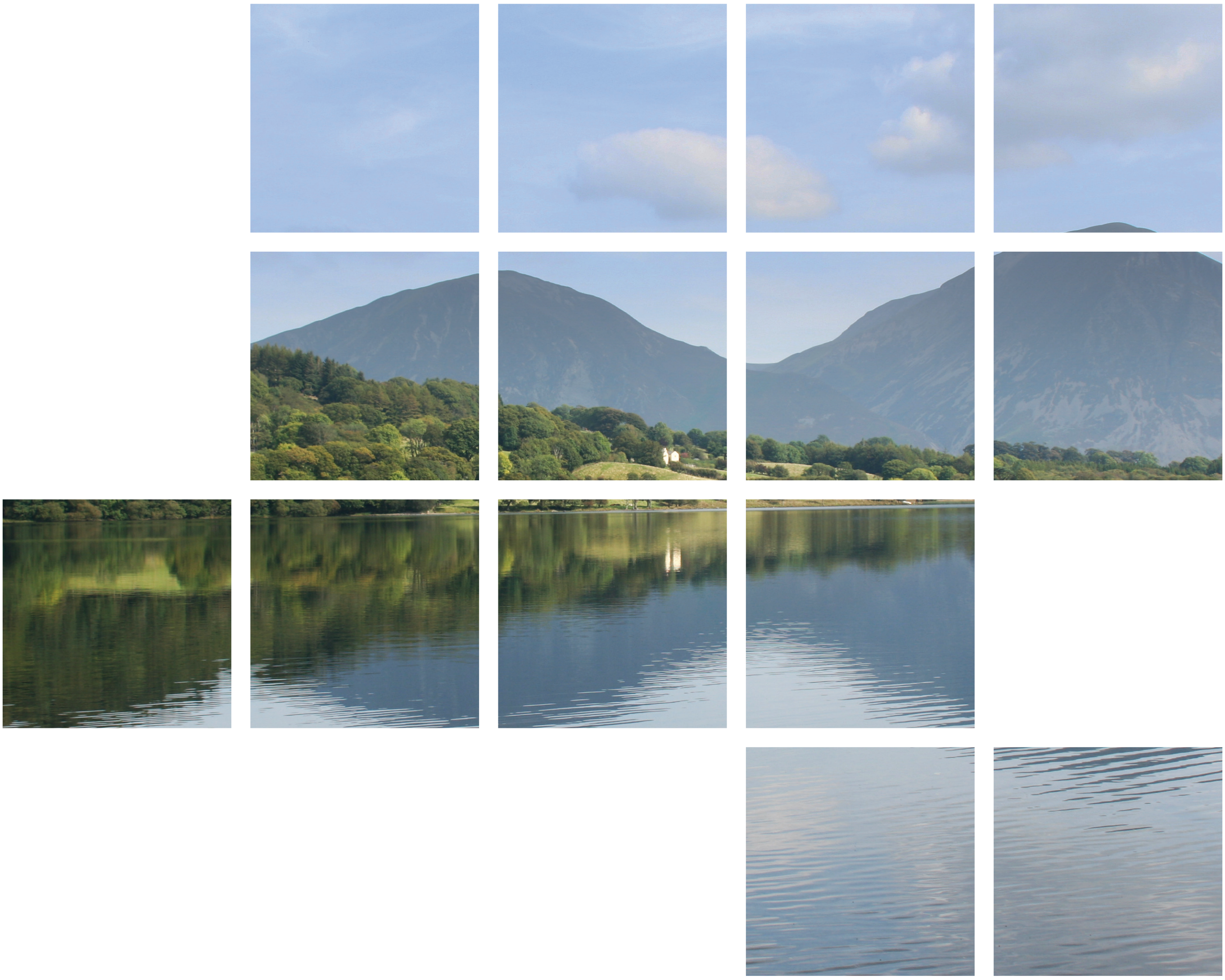
# ANNUAL REPORT and ACCOUNTS

*Year ended 31 March 2015*



Cumberland
Building Society

# ANNUAL REPORT and ACCOUNTS

*Year ended 31 March 2015*

# CHAIRMAN'S STATEMENT

I am delighted to report that the Cumberland has had another very successful year, in terms of its financial and business performance and with respect to the ongoing development of its services to members.

The Group has achieved a record profit after tax of £10.22 million, 0.57% of mean total assets, which continues our well established track record of reporting strong results. Over the last seven years since the financial crisis of 2008 we have maintained levels of profitability which have been amongst the best in the building society sector. This stands as testament to our robust and prudent strategy, our ability to manage our balance sheet and interest margin successfully, the skill and enthusiasm of our staff throughout the Group, and most importantly, reflects the support of our members, which is so much appreciated by us all.

Mortgage balances have increased by over £180 million, 12.9%, in the latest year, and share balances by 6.2%, fuelled by an inflow of funds of over £80 million, the second highest ever. Our total assets now exceed £1.9 billion, and we are the 10th largest building society in the UK. This strong business performance can only be achieved by providing attractive mortgage and savings products, which retain existing members and strengthen our links with them, and appeal to new members. I was delighted by the Society's success in being named the 'Best Regional Building Society' for 2015 at the Mortgage Finance Gazette Awards, for offering the most consistently competitive mortgage rates over the course of a year. This is the third time in six years that the Cumberland has won this award.

Fundamental to our success, is that the Society's strategy, which has been long established and has generally required only tactical alterations in response to conditions as they arise, is underpinned by an unshakeable commitment to put our members first and foremost in everything we do. We are a proudly regional society, seeking to establish direct relationships with our members by helping them with their finances in as many ways as we can, providing them with excellent service whether through the strong branch network, the customer service contact centre in our Head Office in Carlisle, or increasingly, online. Although our internet and mobile services, principally for current account customers, are strong and popular, we are fully aware of the need to develop our digital services further and this is a core part of our strategy for the next few years.

Although mutuality is at the heart of everything we do, we actually aim to operate as a regional bank, by providing the services which one would expect large banks to provide while having the ability to react quickly to changes in the market. At the same time however, to use the key message from our advertising, we strive to enable our members to 'be more than a number'.

Our current account services, so unusual for a building society and indeed, for any financial organisation of our size, continue to develop and attract more members. Moreover, what we can do for personal customers is also replicated by our services for local businesses, both through our commercial lending operations and our business current account, which is unique amongst building societies.

Further details of our performance are contained in the 'Strategic Report' which follows, which also provides information on the Society's strategy, service developments for members and risk management.

Regulation is an essential part of the financial services landscape for the protection of consumers and the raising of standards, whether they be prudential or conduct, and the Society always seeks to achieve compliance smoothly and effectively. Nevertheless, it is important to note that its expansion both in volume and scope comes with ever increasing costs and is significant for every aspect of our business. Having implemented the Mortgage Market Review in April 2014, the process will soon be repeated with the European Mortgage Credit Directive, and regulatory reporting has grown significantly. Our members should also note a further charge of £873,000 payable to the Financial Services Compensation Scheme in respect of the failures of other firms during the financial crisis, bringing the total cost to £5.4 million (before tax relief) since 2009.

It was with regret, that the Board found it necessary to close the Society's defined benefit pension scheme to further accrual in March 2015, but as so many organisations have found over the last few years, the ongoing risks and costs of such a scheme made this inevitable, and the affected staff have transferred into the defined contribution scheme, which was benchmarked to ensure that it was appropriately competitive.

I have been very pleased with the progress of Borderway Finance Limited since its staff transferred into the Group in April 2014, and Cumberland Estate Agents Limited, Cumberland Financial Services Limited and Cumberland Financial Planning Limited also continue to offer excellent service in their fields across our operating area.

With respect to the Board, the year saw the retirement, after many years of service to both the Cumberland and the West Cumbria Building Society prior to our merger in 1996, of our Vice-Chairman Richard Atkinson. Richard has been entirely committed to our local area, the concept of mutuality and the success of the Society, and with his experience, independence of thought and wise counsel has made a huge contribution. Trevor Hebdon has succeeded him as Vice-Chairman.

A new non-executive director, John Davidson, has been appointed during the year, bringing significant financial and general business experience, and is standing for election by the members at the forthcoming AGM.

With respect to executive directors, during the year our Deputy Chief Executive John Leveson left the Society after 17 years as a member of the Board, having played a key role in the development of the Cumberland over that time in several areas of the business. Peter Temple has succeeded him in this role, and Chris McDonald joined the Board as Operations and Human Resources Director, and is also standing for election.

The Cumberland is extremely strong, successful, and most of all, trusted by its members, because of its track record of providing first class service and value for local people. Going forward, we will continue to build on this and do all we can to develop further as we strive to be the natural choice for financial services for the people of our region.

**Michael J. Pratt**
*Chairman*
19 May 2015

# STRATEGIC REPORT

The Directors have pleasure in presenting their 165th Annual Report, together with the Group Accounts and Annual Business Statement, for the year ended 31 March 2015.

## BUSINESS OVERVIEW

Cumberland Building Society aims to be the natural choice for mortgages, current accounts and savings and a leading provider of other retail financial services in its operating area, while continuing to be an independent mutual building society.

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

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

## STRATEGY

The Group's overall strategy is essentially as expressed in the Business Overview section above.

During 2014-15 the Board carried out its annual review of strategy which refined the Group's Corporate Plan. The Group's long term strategy has been consistent for many years, based on the business model set out below, although naturally there are tactical adjustments to this in response to the operating environment of the time. Nevertheless, the strength of the strategy has been amply demonstrated through the economic difficulties of the last few years, with the Group's profitability having remained amongst the strongest and steadiest in the building society sector throughout that time.

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

## BUSINESS MODEL

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

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

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

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

- A full current account service, with cheque book, overdraft facilities, chip and PIN-enabled Visa debit cards for point of sale purchase and ATM transactions, the operation of 20 cash machines connected to the Link network, internet banking for both personal and business customers, mobile banking for personal customers, and an app for payments using mobile telephone numbers. The Cumberland is one of only four building societies which offer a full personal current account service and the only one to provide a current account for business customers;
- a commercial lending operation, focussed primarily on owner-occupied guest houses and hotels, holiday let and buy to let properties, with the majority of its lending located within the branch operating area and in particular, the Lake District;
- an estate agency and lettings and management service, through Cumberland Estate Agents Limited;
- motor vehicle finance, through Borderway Finance Limited;
- financial advice, both on a tied relationship basis through Cumberland Financial Planning Limited in partnership with Legal and General, and independently, through Cumberland Financial Services Limited.

The Board considers that the concentration on relationships with local customers has been a source of strength for many years and is committed to continuing to develop this approach.

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

The Society is very strongly funded by its savings and current account members together with local business customers, with for many years, very little funding having been obtained from the financial markets, although since 2012, drawings have been made from the Government's Funding for Lending Scheme (FLS) to supplement this. With very limited exceptions, the Society does not offer savings and current accounts to those living outside of its branch operating area.

Although the Society has a strong internet and mobile banking offering and is increasingly utilising SMS text messaging, it is very committed to developing digital services further over the next few years, regarding this as vital in ensuring that it provides services that members want.

## THE OPERATING ENVIRONMENT

Interest rates have remained at a low level during the year, with the Bank of England base rate at 0.5%. Although earlier in the year there were expectations that base rate would be increased, this did not materialise and the timing of any rate changes and indeed their direction, are now very uncertain, with the possibility of deflation currently adjudged to have increased. More generally, the FLS since its introduction in 2012, by providing considerable funds to financial institutions at relatively low cost, has had its intended effect of influencing falls in mortgage product rates, and has also depressed rates for savers. The Society has sought to strike a balance between competing strongly in its chosen areas of the mortgage market, while protecting its existing savings customers as far as possible, and will continue to do so.

The Society adapted smoothly to the changed environment which resulted from the rapid falls in base rate during 2008 and 2009 and is confident of its ability to adjust its margins appropriately, while being fully mindful of the interests of members, whenever and in whatever direction rates move next.

Given the very low interest rate environment, over the last few years there has been a pronounced tendency in the market generally for borrowers to prefer fixed rate loans, and savers to prefer variable rate products. The Cumberland has also experienced this, but with respect to fixed rate mortgages, has maintained a policy of hedging these very closely with interest rate swaps, in order to ensure that its position is essentially protected should interest rates rise.

Within the Society's branch operating area both house prices and residential mortgage demand have been steady with at most a very modest improvement. With respect to savings accounts, as market rates have fallen quite sharply the Society's interest rates have become relatively more competitive, particularly for existing members, resulting in a strong inflow of funds during the year. This is also very likely to have limited considerably what for the Society, was the relatively modest impact of the launch of the market-beating over-65's bonds by National Savings and Investments early in 2015.

## PRINCIPAL RISKS AND UNCERTAINTIES

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

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

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

### Liquidity Risk

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

### Market Risk

The primary market risk faced by the Group is interest rate risk. This is the risk of fluctuations in interest rates and changes in the value of derivative contracts impacting upon the value of the Group's assets and liabilities. The ALCO assists management and the Board to manage that risk. The balance sheet is stress tested on a monthly basis to inform the ALCO of the effects on income or costs of interest rates rising or falling. The Treasurer manages the daily position within a framework in accordance with the Treasury Policy Statement. A detailed analysis of the Group's interest rate sensitivity at 31 March 2015 and 2014 can be found in note 25 to the accounts.

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

### Credit Risk

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

In respect of residential mortgages, lending mandates are strictly controlled and all applications are reviewed by a specialist residential mortgage underwriting team. Applications outside individuals' mandates are considered by the Credit Committee, which consists of the executive directors and the General Manager (Operations).

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

The Group Risk Manager attends both the Residential and Commercial Lending Credit Committees to provide independent oversight.

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

### Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal processes or systems, human error or external events. The Group Operational Risk Policy sets out the Group's approach to the management of operational risk.

Line management is responsible for identifying and managing operational risks; this is carried out using an agreed framework and methodology, with the assistance of the Group Risk Manager and with quarterly reporting to the Risk Management Committee. This consists of the executive directors, the General Manager (IT), the General Manager (Operations), the Assistant General Manager (Customer Service Development) and the Group Risk Manager, meets on a quarterly basis and reports to the Audit and Risk Committee, which in turn reports to the Board.

### Conduct Risk

Conduct risk is the risk arising from the Group's conduct in its relationship with customers and concerns the risk of failing to treat customers fairly with resulting detriment to them. The Conduct Risk Committee meets on a quarterly basis to review the Group's performance in this area, considering specific issues that have arisen and management information. It consists of the executive directors, the General Manager (Operations), the Assistant General Manager (Branches), is also attended by one non-executive director and seven other members of the Group's senior management team, and reports to the Board.

## FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES

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

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

## KEY PERFORMANCE INDICATORS

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

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Group Profit After Tax (£ million) | 10.22 | 7.66 | 6.16 |
| Group Profit After Tax as a % of Mean Total Assets | 0.57 | 0.47 | 0.40 |
| Interest Margin for Members (%) | 1.70 | 1.83 | 1.71 |
| Society Administrative Expenses and Depreciation as a % of Mean Total Assets | 0.98 | 1.01 | 0.97 |
| Gross Capital as a % of Shares and Borrowings | 7.42 | 8.02 | 8.18 |
| Loans and Advances to Customers - Balance change % # | 12.90 | 11.90 | 6.95 |
| Lending during the year (£ million) # | 375.86 | 331.92 | 247.13 |
| Inflow of Funds from Customers (£ million) | 80.70 | 74.75 | 9.84 |
| Other Funding as a % of Shares and Borrowings | 13.54 | 8.10 | 4.96 |

# Excludes lending by Borderway Finance Limited

## EXPLANATION OF INDICATORS

### Group Profit After Tax

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

### Group Profit After Tax as a % of Mean Total Assets

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

### Gross Capital as a % of Shares and Borrowings

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

### Interest margin for members

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

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

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

### Loans and Advances to Customers - Balance Change %

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

### Lending during the year

This figure reflects the same factors as mentioned above.

### Inflow of Funds from Customers

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

### Other Funding as a % of Shares and Borrowings

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

## FINANCIAL AND BUSINESS PERFORMANCE

### Income and expenditure

Whilst as a mutual organisation, the maximisation of profit is not a key aim, the Group seeks to make sufficient profit to ensure its ongoing financial strength. The Group achieved a strong profit after tax of £10.22 million in 2014-15, representing 0.57% of mean total assets, up from 0.47% in the previous year. The increase was principally a result of a strengthening of net interest receivable as a result of strong growth in mortgage and retail savings and current account balances, and the reduction in funding costs which resulted from the Government's Funding for Lending Scheme (FLS), both in terms of funds drawn under the Scheme, and as a result of its effect upon market interest rates for retail funding.

The Society monitors the competitiveness of both its mortgage and savings products on an ongoing basis, and during the year there were reductions in fixed rate savings products and variable rate products offered to new customers, albeit that they remained competitive. However, the Society's standard variable rate for residential mortgages and all variable share account rates for existing customers in place at the start of the year, with the exception from March 2015 of variable rate term accounts which paid particularly high levels of interest, remained unchanged during the year. The Society's variable rate term accounts, which are not available to new customers, continue to pay rates which are significantly higher than those available to new customers on comparable products elsewhere.

It is also worth noting that the Society's increase in net interest margin was relatively modest compared with that of several other firms in the latest year, which reflects its approach of protecting existing savers wherever possible. Indeed, the 'net interest margin for members' key performance indicator fell in the latest year, as the fall in the mean interest rate percentage received in relation to residential mortgages was greater than the fall in the mean interest rate percentage paid on savings and current accounts.

In addition, profit was increased by the partial disposal of land at Dalston Road, Carlisle, by Cumberland Property Services Limited.

With respect to the ratio of administrative expenses and depreciation as a proportion of mean total assets, this fell slightly in the year because Society administrative expenses and depreciation rose by 7.3% while mean total assets rose by 10.8%. There was a series of reasons for the increases in costs, including staff and other costs related to a number of initiatives to develop the business.

### Capital

In the latest year the gross capital ratio has reduced because the Group's shares and borrowings increased at a faster rate than its reserves, as a result of the funding of the strong growth in mortgage balances discussed below, and the increase in the defined benefit pension scheme deficit because of the fall in longer term interest rates during the year. Nevertheless, the Society has an extremely strong capital position and in particular, has no capital provided by outside parties which require remuneration.

### Assets – Loans and Liquid Assets

The Society achieved strong mortgage balance growth of 12.9% during the year, with total lending of £375.86 million, 13.2% higher than in the previous year. With respect to owner occupier lending, the Society's products were very competitive throughout the year and were therefore attractive to new borrowers. The Society also performed well in retaining existing customers whose mortgage products had reached the end of their term, by continuing to offer them the same products as those available to new customers.

As well as the strong levels of lending obtained directly through its branches and estate agency offices, the Society continued to develop its lending with a small number of introducer firms, thereby supplementing the growth achieved and assisting with the utilisation of the available FLS funding.

The Society also participated strongly in the buy to let and holiday letting business markets, and in lending on commercial properties, principally in the leisure and hospitality sectors, in line with our approach for many years. Our specialist commercial lending team have had a very successful year and whilst much of this lending is derived from within the branch operating area, many strong applications from all around the country are received.

The quality of both the residential and commercial lending books remains very high, with again, only a modest charge for losses on loans in the profit and loss account this year. The Society has long been and will continue to be a prudent and responsible lender, applying a strong rigour to its underwriting processes in order to ensure that loans are affordable, irrespective of whether an application is received directly or via introducers. All loans are subject to manual underwriting by a specialist team within our Head Office rather than automated credit scoring. In line with the parameters set, many are then considered by the Residential and Commercial Lending Credit Committees, which meet on a frequent basis and involve the four executive directors together with other members of senior management and the Group Risk Manager. The success of this approach is reflected in the facts that at 31 March 2015, only 0.21% of our residential mortgages, well below the industry average, and only 6 of our commercial mortgages, were in arrears of three months or more.

At the start of the financial year we welcomed to the Group the staff and trade of a motor finance business with both an operating area and an approach to lending very much in line with those of the Society, and this has since operated as Borderway Finance Limited. The Borderway team have made great strides in building this business over the last year while meeting increased regulatory requirements under the auspices of the Financial Conduct Authority, lending over £8.2 million across over 900 loans; moreover, there were no loans in arrears at the year end. We regard access to the vehicle finance market as complementary to our existing businesses and very much in line with our strategic objective of offering a wide range of services to our members.

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

### Liabilities – Customer Shares and Deposits and Other Funding

The Society has historically been, and continues to be, very strongly funded by its individual members, virtually all of whom are located within its branch operating area. The Cumberland recorded its second highest inflow of funds ever, at £80.7 million (the highest having been in 2008-09, when many sought a safe place to invest their funds during the financial crisis), with a significant flow of funds into ISAs (particularly as a result of the raising of the annual limit), and also into current accounts for both personal and business customers.

The Cumberland was a founder member in 2013 of the 'Current Account Switch Scheme' and has had far more inbound than outbound switches. This is all the more impressive as the Society has not offered large incentives to achieve this, unlike several other providers. The Society's commitment to excellent customer service, expressed in its advertising slogan of 'be more than a number', appears to continue to resonate with customers.

Funding other than from members has increased considerably over the last year, mainly as a result of further drawings from the FLS, which totalled £189 million at 31 March 2015, of which £69 million remained off balance sheet at the year end, and therefore available for use in the future. The Society intends to draw further amounts prior to the closure of the scheme to drawings in January 2016, but is also actively investigating its options for when the scheme ends completely four years later.

Excluding the FLS funding however, it should be noted that well over half of 'other funding' is from retail customers, principally small and medium sized businesses located within the Society's operating area, and that therefore, the use of 'wholesale' funding from the money markets remains relatively limited. The Cumberland is the only building society which offers a current account service to small businesses and schools. This is managed by the specialist commercial lending team and complements the business lending undertaken as described earlier. As with personal current accounts, this has been very successful in attracting new customers over the last few years.

## DEVELOPMENT OF SERVICES AND SYSTEMS

The development of our services and systems to ensure that they are up to date is essential for us to be able to meet the requirements of our members. The Society's involvement in the current account market is a significant element of this, but is by no means the only field in which it continues to seek improvements, both for customer service and efficiency.

The latest year has been another extremely busy one, with the following new services introduced:

- Participation as a founder member of the national 'Paym' scheme in April 2014, enabling members to send money quickly and securely to a friend or relative's current account using just their mobile phone number, without needing to know account details; the Cumberland was the only building society involved at the scheme's launch;
- At the same time, the frequency of incoming faster payments files was increased from every hour to every 15 minutes in order to transfer such receipts into members' accounts more quickly;
- In July 2014, a mobile friendly version of the Cumberland Estate Agents website was launched in response to the growing use of the internet on mobile devices. Both the Society and Cumberland Estate Agents now have mobile friendly websites;
- In August 2014, the launch of contactless debit cards; these are being issued to new customers as accounts are opened, with existing customers receiving theirs when their cards are renewed, although they can request one at any time;
- In October 2014 a mortgage calculator was added to the Group's website to enable prospective borrowers to work out their possible monthly payments;
- In April 2015 the Society began to provide VISA debit cards for corporate business customers, which will enhance the business current account proposition.

Behind the scenes, the following projects were undertaken:

- A major upgrade to the Society's core customer records, mortgages and savings system;
- The installation of a new mainframe computer;
- The implementation of the Mortgage Market Review.

Projects currently underway include:

- The implementation of a system to provide the ability to apply for current accounts online;
- The implementation of a system which will enable the Society to connect directly with VISA instead of via a third party, which will yield significant cost savings;
- Extending the use of SMS messaging to provide customers with greater protection against fraud;
- The redevelopment of the Group's websites, which will enhance the range of tools and information available to customers and improve their usability and responsiveness on different devices;
- The implementation of a mortgage affordability calculator on the Society's website to enable prospective borrowers to understand how much the Society may be willing to lend to them based on their personal circumstances.

During 2015-16 it is envisaged that the Society's mobile app and internet banking systems will be upgraded, with several new functions being incorporated, including an improvement in their responsiveness to different devices.

## COMMUNITY INVOLVEMENT AND CHARITABLE DONATIONS

The Cumberland is an integral part of its local communities and therefore its involvement with them is regarded as very important. Further information on this can be found within the Annual Review booklet but again, over £100,000 has been donated to charities, clubs and voluntary organisations within our operating area. This includes a donation each year based on 50 pence for each vote recorded at our Annual General Meeting, and last year with over 22% of the eligible membership voting, over £11,000 was raised for the Motor Neurone Disease Association and MND Scotland. This year, the beneficiaries will be seven local hospices.

## STAFF

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

The Cumberland is committed to effective communication with staff, who are kept informed of matters relating to business performance and objectives. Staff involvement in matters affecting them is maintained by regular meetings.

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

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

Once again, it has been an extremely busy year with a wide range of challenges, and the Group's staff, whether they work in its branches or in Head Office, have continued to provide an excellent standard of service to existing members and to attract many new ones, while doing so in a highly professional manner. The directors wish to record their appreciation of the dedication, hard work and enthusiasm of the team during the financial year.

## OUTLOOK

There are conflicting views on the future course of the British economy. Although there are some modest signs of improvement, with unemployment falling and inflation currently at very low levels, pressures on many household budgets remain significant. With ongoing issues in the Eurozone and other geopolitical concerns, it seems rather doubtful that interest rates will move significantly from their current historic lows in the medium term and indeed, there has been recent comment on the risk of deflation which would be likely to slow economic activity and possibly lead to interest rate reductions. The Group's aim is to ensure that it is well positioned to deal with any outcomes, by considering a range of alternative scenarios, and it has certainly been successful in managing its financial and business performance over the last few years, hence its strong record of profitability, growth in mortgage and share balances, and its ability to invest in technological change to enhance services to members. Having achieved strong mortgage growth over the last two years, it is anticipated that this will be at a lower level in 2015-16.

It is envisaged that the Group's fundamental strategy as outlined at the start of this Report will remain in place, with the maintenance of a strong capital position as the new capital requirements regime comes into place over the next few years, being a key focus. Overall however, the Cumberland's hard-earned reputation as a professional, trustworthy and fair organisation underpins its success, and the strong support of our members, whether in the business they do with us or in voting at the AGM, is very much appreciated. We will continue to put our members first and foremost, in everything we do.

On behalf of the Board of Directors

**Michael J. Pratt**
***Chairman***
19 May 2015

# DIRECTORS' REPORT

Information on the Group's strategy and its financial and business performance is provided within the Strategic Report on pages 3 to 7.

## DIRECTORS

The directors at 31 March 2015 and at the date of this report are shown below; further information on them is provided in the Annual Business Statement on page 32, and their attendance (together with those of John Leveson and Richard Atkinson who left the Board on 30 September and 31 December 2014 respectively) at the Board and Board Committees is set out in the Report on Corporate Governance on pages 10 to 12.

David Clarke, Kevin Parr and Michael Pratt retire at the Annual General Meeting and, being eligible, seek re-election. John Davidson and Chris McDonald, who were appointed to the Board during the year, also retire and being eligible, seek election. None of the directors had an interest in shares in, or debentures of, any subsidiary undertaking of the Society at any time during the financial year.

At 31 March 2015 two directors had mortgage loans granted in the ordinary course of business, amounting to £101,000 (2014: two directors, £103,000). A register is maintained at the Principal Office of the Society, containing details of loans, transactions and arrangements between the Society and its directors and connected persons; requisite particulars from it are available for inspection.

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

## MORTGAGE ARREARS AND FORBEARANCE

At 31 March 2015, there were 5 accounts where payments were twelve months or more in arrears. The total amount outstanding on these accounts was £0.46 million, and the amount of arrears was £0.05 million, which represents less than 0.01% of mortgage balances.

In certain circumstances the Society uses forbearance measures to assist those borrowers who are experiencing financial difficulty. Such measures include agreeing a temporary transfer to interest only payments, or a capitalisation of arrears, in order to reduce the borrowers' financial pressures. We expect borrowers to resume normal payments once they are able. During the year, the Society undertook forbearance measures for 40 residential mortgage accounts which had total balances of £2.76 million at 31 March 2015 (2014: 70 accounts, balances of £5.35 million). 6 of these cases had arrears of less than £0.01 million at 31 March 2015 (2014: 21, £0.02 million). Where the Society considers that there is a possibility of a loss, a specific provision is made in accordance with the Society's policies.

## CREDITOR PAYMENT POLICY

The Group policy concerning the payment of trade creditors is to agree terms of payment, to ensure that suppliers fulfil their contractual obligations and to settle invoices for the provision of goods and services within the agreed payment terms. At 31 March 2015 the total amount owed to suppliers was equivalent to 4 days credit (2014: 3 days).

## CHARITABLE AND POLITICAL DONATIONS

During the year, charitable donations of £102,576 were made to a number of organisations within our operating area, of which £25,000 was given to the Cumberland Building Society Charitable Foundation. No contributions were made for political purposes.

## EVENTS SINCE THE YEAR END

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

## GOING CONCERN

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

## AUDITORS

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

On behalf of the Board of Directors

**Michael J. Pratt**
*Chairman*
19 May 2015

Michael Pratt
Chairman

Trevor Hebdon
Vice–Chairman

Kevin Parr
Chief Executive

Peter Temple
Deputy Chief Executive

John Kidd
Finance Director

Chris McDonald
Operations & H.R. Director

Gill Gardner
Non-executive Director

David Clarke
Non-executive Director

Alan Johnston
Non-executive Director

John Davidson,
Non-executive Director

## REPORT ON DIRECTORS' REMUNERATION

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

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

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

The Committee believes that bonus schemes relating to financial and business performance are an appropriate part of a balanced remuneration package, and for the year ended 31 March 2015, agreed a modest bonus scheme based on overall business performance achieved, including customer service, mortgage growth, the increase in current accounts and Group profitability.

Mr. Parr, Mr. Kidd and Mr. Temple were active members of the Society's contributory defined benefit pension scheme until its closure to further accrual on 31 March 2015. Mr. Temple was also a member of a defined contribution scheme in respect of the portion of his salary above a certain amount. Mr. McDonald was a member of a defined contribution scheme before and after his appointment as a director on 13 October 2014 and from 1 April 2015, all of the executive directors are members of this scheme. They are also provided with a car and membership of a private medical insurance scheme. They are employed under contracts terminable by the Society on twelve months' notice and by the individual on six months' notice.

Full details of individual directors' remuneration, including bonus payments, and of their pension benefits in respect of the defined benefit scheme, are contained in note 6 to the accounts. The increase in accrued pension represents the change in the annual pension to which each director is entitled as a result of the changes in pensionable earnings, accrual rate and increases in pensionable service during the year.

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

On behalf of the Remuneration Committee
Gillian Gardner, Chair
19 May 2015

## 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, Strategic Report, Directors' Report and the annual accounts in accordance with applicable law and regulations.

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

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

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

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

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

DIRECTORS' RESPONSIBILITIES FOR ACCOUNTING RECORDS AND INTERNAL CONTROL

The directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act;
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made under the Financial Services and Markets Act 2000.

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

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

# CORPORATE GOVERNANCE

DIRECTORS' REPORT ON CORPORATE GOVERNANCE

Cumberland Building Society is committed to good practice in corporate governance and this report explains how the Society has regard to the principles in the UK Corporate Governance Code (the 'Code') issued by the Financial Reporting Council, including the revisions effective from 1 October 2014.

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

## THE BOARD

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

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

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

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

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

The Board conducts an annual self-assessment exercise to review its effectiveness and highlight any areas which should be improved.

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

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

### AUDIT AND RISK COMMITTEE

This monitors internal controls, financial reporting, risk management and regulatory compliance matters, reviews the work of Internal Audit, Compliance and Risk Management functions, assesses their effectiveness, considers the appointment of the external auditor, and reviews and monitors the external auditor's independence and objectivity and the effectiveness of the audit process. It also has responsibility for ensuring that effective whistle-blowing arrangements are in place, which enables any concerns to be raised by employees in confidence.

The Committee consists of its chairman Trevor Hebdon, and two other non-executive directors, Alan Johnston and John Davidson, who both have recent and relevant financial experience. The four executive directors, the Head of Internal Audit, Group Risk Manager and Group Compliance Manager and representatives from the external auditors also attend Committee meetings by invitation to assist in its deliberations.

### REMUNERATION COMMITTEE

This consists of its chair Gillian Gardner, and all of the other non-executive directors. The Committee's main role is to approve the level of remuneration for the Society's executive and senior management. The Committee is also responsible for determining, on behalf of the Board, the structure of any incentive schemes for staff. Details of the remuneration policy can be found in the Report on Directors' Remuneration on page 9.

### NOMINATION COMMITTEE

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

In addition, the Board receives a monthly report from the Assets and Liabilities Committee.

Set out on page 11 are details of the directors during 2014-15 and their attendance record at Board meetings and relevant Board Committee meetings in the year.

## DIVISION OF RESPONSIBILITIES

**Code Principle A.2: There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.**

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

## THE CHAIRMAN

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

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

## NON-EXECUTIVE DIRECTORS

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

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

Directors' attendance at Board and Board Committee meetings during the year ended 31 March 2015

| Director | Board | Audit and Risk | Remuneration | Nomination |
|---|---|---|---|---|
| Richard Atkinson | 9 (9) | 4 (4) | 8 (8) | 5 (5) |
| David Clarke | 11 (12) | | 10 (11) | 7 (8) |
| John Davidson | 9 (9) | 2 (2) | 8 (8) | 6 (6) |
| Gill Gardner | 11 (12) | | 10 (11) | 7 (8) |
| Trevor Hebdon | 11 (12) | 5 (5) | 11 (11) | 8 (8) |
| Alan Johnston | 12 (12) | 5 (5) | 11 (11) | 8 (8) |
| John Kidd | 12 (12) | | | 8 (8) |
| John Leveson | 6 (6) | | | 4 (4) |
| Chris McDonald | 6 (6) | | | 4 (4) |
| Kevin Parr | 12 (12) | | | 8 (8) |
| Michael Pratt | 11 (12) | | 10 (11) | 7 (8) |
| Peter Temple | 12 (12) | | | 8 (8) |

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

not a member of the committee

## THE COMPOSITION OF THE BOARD

**Code Principle B.1: The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.**

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

Four of the non-executive directors have served for less than the maximum of 9 years recommended by the UK Corporate Governance Code and can be defined as independent under it. Michael Pratt completed 18 years of service on the Board on 29 September 2014 and David Clarke completed 10 years on 14 February 2015.

In the view of the Board, all the non-executive directors are independent in character and judgement, are free of any relationship or circumstance that could interfere with the exercise of their judgement, and bring wide and varied commercial experience to Board deliberations. In addition, Mr. Pratt and Mr. Clarke stand for re-election by the Society's members at the Annual General Meeting each year.

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

## APPOINTMENTS TO THE BOARD

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

The Nomination Committee leads the process for Board appointments and makes recommendations to the Board. The Board maintains a succession plan and develops a role profile for vacancies arising. Candidates are identified in a number of ways, which includes external search consultants, with appointments to the Board made on merit and against objective criteria and in line with the requirements of the succession plan. All directors must meet and maintain the fitness and propriety standards of the Prudential Regulation Authority and Financial Conduct Authority and must be approved by them in order to hold the controlled function of director. They are also subject to election by members at the AGM following their appointment.

## COMMITMENT

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

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

## DEVELOPMENT

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

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

## INFORMATION AND SUPPORT

**Code Principle B.5: The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.**

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

## PERFORMANCE EVALUATION

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

The Society has a process to evaluate, at least annually, the performance and effectiveness of individual directors, the Chairman, the Board and Board committees. The performance of the Chief Executive and non-executive directors is evaluated annually by the Chairman. The Chairman is evaluated by the Senior Independent Director, after consulting and obtaining the views of the other directors. Those non-executive directors who have served at least 6 years on the Board are subject to a particularly rigorous performance evaluation in line with the Code's requirements. The Board and the Board committees also annually evaluate their overall performance. Annually, the membership and Terms of Reference of the various committees are reviewed and agreed by the Board.

## RE-ELECTION

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

The Board seeks to ensure planned and progressive refreshing of its membership. Directors are subject to election by members at the Annual General Meeting following their appointment and seek re-election every three years thereafter.

The Board has considered the Code provisions relating to re-election of directors and does not feel that it would be appropriate to submit the entire Board for annual re-election by the members. Any non-executive directors serving for over 9 years are, however, subject to annual re-election by the members.

## FINANCIAL AND BUSINESS REPORTING

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

The Statement of Directors' Responsibilities on page 9 sets out the Board's responsibilities in relation to the preparation of the Group's Annual Report and Accounts. Business performance is reviewed in the Chairman's Statement and the Strategic Report and a statement that the Group's business is a going concern is included in the Directors' Report.

The Audit and Risk Committee has advised the Board that in its opinion, the Annual Report and Accounts are fair, balanced and understandable. The primary areas of judgement considered by the Committee in relation to these accounts related to loan loss provisions, the valuation of the defined benefit pension scheme, the FSCS levy position and property revaluations.

## RISK MANAGEMENT AND INTERNAL CONTROL

**Code Principle C.2: The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.**

The Board has delegated responsibility for managing the Society's risk management framework and system of internal control to senior management. The Group Internal Audit function, the Group Compliance Manager and Group Risk Manager provide independent assurance to the Board on the effectiveness of the system of internal control through their reporting to and attendance at the Audit and Risk Committee.

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

## AUDIT COMMITTEE AND AUDITORS

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

The role and membership of the Audit and Risk Committee is set out earlier in this report.

The Committee meets at least five times a year. At least annually, the external auditors meet with the Committee without the executive directors present. Minutes of the Committee's meetings are provided to the subsequent Board Meeting.

The Committee implements the Society's policy on the use of the external auditor for non-audit work, the purpose of which is to ensure the continued independence and objectivity of the external auditor. The external auditor, Deloitte LLP, undertook one non-audit related assignment during the year.

## REMUNERATION

**Code Principle D.1: Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.**

**Code Principle D.2: There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.**

The remuneration policies for executive and non-executive directors are set out in the Report on Directors' Remuneration on page 9. These policies explain the Society's application of the Code principles.

## DIALOGUE WITH SHAREHOLDERS

**Code Principle E.1: There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.**

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

## CONSTRUCTIVE USE OF THE ANNUAL GENERAL MEETING (AGM)

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

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

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

On behalf of the Board of Directors
**Michael J. Pratt** *Chairman*
19 May 2015

# INDEPENDENT AUDITOR'S REPORT

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

We have audited the Group and Society financial statements of Cumberland Building Society for the year ended 31 March 2015 which comprise the Group and Society Income and Expenditure Accounts, the Group and Society Balance Sheets, the Group Statement of Total Recognised Gains and Losses, the Group Cash Flow Statement, the Accounting Policies and the related notes 1 to 26. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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 or the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

### RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

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

### SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### OPINION ON FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the Society's affairs as at 31 March 2015 and of the Group's and the Society's income and expenditure for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986.

### OPINION ON OTHER MATTERS PRESCRIBED BY THE BUILDING SOCIETIES ACT 1986

In our opinion:

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

### MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

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

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

David Heaton (Senior Statutory Auditor)
for and on behalf of Deloitte LLP

*Chartered Accountants and Statutory Auditor*
*Manchester, United Kingdom*

19 May 2015

## GROUP AND SOCIETY INCOME AND EXPENDITURE ACCOUNTS

*For the year ended 31 March 2015*

| | Notes | **Group 2015 £000** | Group 2014 £000 | **Society 2015 £000** | Society 2014 £000 |
|---|---|---|---|---|---|
| Interest receivable and similar income | 2 | **52,095** | 48,611 | **51,554** | 48,615 |
| Interest payable and similar charges | 3 | **(25,254)** | (24,613) | **(25,255)** | (24,614) |
| Net interest receivable | | **26,841** | 23,998 | **26,299** | 24,001 |
| Pension finance income | 26 | **699** | 483 | **699** | 483 |
| Fees and commissions receivable | | **4,903** | 4,678 | **3,142** | 3,078 |
| Fees and commissions payable | | **(2,933)** | (2,626) | **(2,957)** | (2,756) |
| Other operating income | | **3,697** | 3,353 | **3,708** | 3,349 |
| | | **33,207** | 29,886 | **30,891** | 28,155 |
| Administrative expenses | 4 | **(18,447)** | (16,928) | **(16,127)** | (15,138) |
| Depreciation and amortisation | | **(1,635)** | (1,393) | **(1,502)** | (1,292) |
| Gain on disposal of investment property | 14 | **786** | – | **–** | – |
| Operating profit before provisions | | **13,911** | 11,565 | **13,262** | 11,725 |
| Provisions for bad and doubtful debts | 11 | **(218)** | (137) | **(218)** | (137) |
| Provisions for contingent liabilities and commitments – FSCS levy | 22 | **(873)** | (1,162) | **(873)** | (1,162) |
| Profit on ordinary activities before tax | | **12,820** | 10,266 | **12,171** | 10,426 |
| Tax on profit on ordinary activities | 7 | **(2,602)** | (2,609) | **(2,519)** | (2,637) |
| Profit for the financial year | 23 | **10,218** | 7,657 | **9,652** | 7,789 |

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

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

*For the year ended 31 March 2015*

| | Notes | **Group 2015 £000** | Group 2014 £000 | **Society 2015 £000** | Society 2014 £000 |
|---|---|---|---|---|---|
| Profit for the financial year | | **10,218** | 7,657 | **9,652** | 7,789 |
| Actuarial (loss)/gain recognised in pension scheme | 26 | **(5,910)** | 532 | **(5,910)** | 532 |
| Movement in deferred tax relating to pension scheme | 26 | **1,182** | (106) | **1,182** | (106) |
| Unrealised (loss)/gain on revaluation of investment properties | 14 | **(85)** | 515 | **(82)** | 515 |
| Total recognised gains and losses for the year | | **5,405** | 8,598 | **4,842** | 8,730 |

The notes on pages 17 to 31 form part of these accounts.

## GROUP AND SOCIETY BALANCE SHEETS

*As at 31 March 2015*

| Assets | Notes | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|---|
| Liquid assets | | | | | |
| Cash in hand and balances with the Bank of England | | **226,564** | 202,013 | **226,562** | 202,011 |
| Loans and advances to credit institutions | 8 | **69,847** | 71,811 | **69,847** | 71,811 |
| Debt securities | 9 | **1,005** | – | **1,005** | – |
| | | **297,416** | 273,824 | **297,414** | 273,822 |
| Loans and advances to customers | | | | | |
| Loans fully secured on residential property | 10 | **1,428,310** | 1,247,908 | **1,428,310** | 1,247,908 |
| Other loans | 10 | **160,437** | 151,993 | **152,109** | 151,993 |
| | 10 | **1,588,747** | 1,399,901 | **1,580,419** | 1,399,901 |
| Investments | | | | | |
| Investments in subsidiary undertakings | 12 | **–** | – | **9,323** | 2,381 |
| Tangible fixed assets | 13 | **12,539** | 13,492 | **11,121** | 12,049 |
| Investment properties | 14 | **2,952** | 2,725 | **1,492** | 1,075 |
| Other assets | 15 | **1,323** | 1,269 | **2,356** | 2,217 |
| Prepayments and accrued income | 17 | **693** | 1,678 | **493** | 1,673 |
| Total Assets | | **1,903,670** | 1,692,889 | **1,902,618** | 1,693,118 |

| Liabilities | Notes | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|---|
| Shares | 18 | **1,521,694** | 1,433,199 | **1,521,694** | 1,433,199 |
| Amounts owed to credit institutions | 19 | **126,302** | 33,440 | **126,302** | 33,440 |
| Amounts owed to other customers | 20 | **112,058** | 92,920 | **112,953** | 93,260 |
| Other liabilities | 21 | **3,038** | 2,320 | **2,891** | 2,282 |
| Accruals and deferred income | | **3,330** | 2,256 | **2,095** | 2,185 |
| Provisions for liabilities | 22 | **1,471** | 1,640 | **1,471** | 1,640 |
| Net pension liability | 26 | **5,256** | 1,998 | **5,256** | 1,998 |
| Reserves | | | | | |
| General reserves | 23 | **129,790** | 124,300 | **129,523** | 124,599 |
| Investment properties reserve | 23 | **731** | 816 | **433** | 515 |
| Total Liabilities | | **1,903,670** | 1,692,889 | **1,902,618** | 1,693,118 |
| Memorandum items | | | | | |
| Commitments | 24 | **7,416** | 7,343 | **7,416** | 7,343 |

These accounts were approved by the Board of Directors on 19 May 2015
M. J. Pratt, Chairman
T. Hebdon, Vice-Chairman and Chairman of the Audit and Risk Committee
K. Parr, Director and Chief Executive

The notes on pages 17 to 31 form part of these accounts.

# GROUP CASH FLOW STATEMENT

*For the year ended 31 March 2015*

| | 2015<br>£000 | 2014<br>£000 |
|---|---|---|
| Net cash inflow/(outflow) from operating activities | **18,165** | (2,662) |
| Taxation | **(1,882)** | (2,208) |
| Capital expenditure and financial investment | | |
| Purchase of tangible fixed assets and expenditure on investment property | **(1,239)** | (2,722) |
| Sale of tangible fixed assets and investment property | **1,025** | 43 |
| Purchase of investment securities | **(1,000)** | – |
| Sale and maturity of investment securities | **–** | 6,000 |
| Increase/(decrease) in cash and cash equivalents | **15,069** | (1,549) |

**Reconciliation of operating profit to net cash inflow/(outflow) from operating activities**

| | 2015<br>£000 | 2014<br>£000 |
|---|---|---|
| Operating profit | **12,820** | 10,266 |
| Decrease in prepayments and accrued income | **1,046** | 359 |
| Increase in accruals and deferred income | **1,074** | 482 |
| Provisions for bad and doubtful debts | **218** | 137 |
| Depreciation and amortisation | **1,645** | 1,400 |
| Profit on sale of tangible fixed assets and investment property | **(796)** | (4) |
| Pension contributions | **(2,386)** | (2,214) |
| Pension charges | **548** | 257 |
| Other non-cash movements | **(2,272)** | (47) |
| Net cash inflow from trading activities | **11,897** | 10,636 |
| | | |
| Increase in loans and advances to customers | **(186,791)** | (148,915) |
| Increase in shares | **88,495** | 79,205 |
| Increase in amounts owed to credit institutions and other customers | **112,000** | 55,631 |
| (Increase)/decrease in loans and advances to credit institutions and other liquid assets | **(7,579)** | 3,000 |
| (Increase)/decrease in other assets | **(31)** | 54 |
| Increase/(decrease) in other liabilities and provisions for contingent liabilities and commitments | **174** | (2,273) |
| Net cash inflow/(outflow) from operating activities | **18,165** | (2,662) |

**Analysis of the balances of cash and cash equivalents as shown in the balance sheet**

| | At 1 April 2014<br>£000 | Movement in year<br>£000 | At 31 March 2015<br>£000 |
|---|---|---|---|
| Cash in hand and balances with the Bank of England | 202,013 | 24,551 | 226,564 |
| Loans and advances to credit institutions – repayable on demand (note 8) | 19,141 | (9,482) | 9,659 |
| | 221,154 | 15,069 | 236,223 |

## 1. Accounting Policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

There have been no other significant changes in accounting policies during the year.

(a) **Basis of Preparation**

These accounts have been prepared on the going concern basis as stated in the Directors' Report on page 8, and under the historical cost accounting rules, with the exception of investment properties which are held at open market value, and in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations and applicable UK Accounting Standards.

(b) **Basis of Consolidation**

The consolidated financial statements include the financial statements of the Society and its subsidiary undertakings made up to 31 March 2015.

(c) **Corporation Tax**

Corporation tax is charged in the accounts on the profit for the year as adjusted for taxation purposes.

(d) **Deferred Taxation**

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

(e) **Fixed Assets and Depreciation**

The cost of additions and major alterations to freehold land and buildings and equipment is capitalised. Freehold land and buildings are depreciated at 1% per annum on cost with effect from 1 April 2012 (having been depreciated at 2% per annum since 1 April 1999). In addition, included in freehold land and buildings are amounts in respect of refurbishment and plant which are depreciated over their estimated useful lives on a straight line basis at rates between 5% and 20%.

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

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

(f) **Liquid Assets**

Debt securities intended for use on a continuing basis in the Society's activities are classified as financial fixed assets and are stated at cost. Any permanent diminution in value of such financial fixed assets would result in a write down of the cost of the securities to their recoverable amounts and would be dealt with through the income and expenditure account. Other liquid assets are stated at the lower of cost and net realisable value.

(g) **Pension Costs**

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

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

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

Increases in the present value of scheme liabilities that are expected to arise from employee service in the period (current service costs), and those which have arisen as a result of past service benefit improvements (past service costs), are charged to the income and expenditure account as administrative expenses. The expected return on the scheme's assets less the increase in the scheme's liabilities, arising from the passage of time, is disclosed as a pension finance income or charge.

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

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

(h) **Loans and Advances**

Interest in respect of all loans is credited to the income and expenditure account as it becomes receivable, except in respect of advances where the property has been taken into possession and where the collectability of the interest is subject to significant doubt. Such interest is credited to an interest suspense account.

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

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

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

A general provision is made against other loans and advances to the extent that receipt of these may be doubtful. This provision is based upon the Society's experience and current economic trends and as such may be adjusted in the future as appropriate.

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

(i) **Incentives to Borrowers**

i) Cashbacks

Cashbacks are accounted for on completion of the mortgage and are charged as a reduction of interest receivable.

ii) Interest Discounts

Interest discounts are accounted for within interest receivable over the period of the discount.

(j) **Off Balance Sheet Instruments ('Derivatives')**

The Group enters into derivative financial instruments in order to hedge the risk of interest rate fluctuations and all interest rate related contracts are classified at the balance sheet date as hedging contracts. Income and charges on these instruments are included within the interest caption relevant to the underlying instrument on an accruals basis. If the hedge contract is terminated early, the realised gain or loss is amortised over the residual life of the underlying instrument.

(k) **Investment Properties**

When land and buildings are held for rental purposes or capital appreciation, they are classified as investment properties and held in the balance sheet at their open market valuation and not depreciated. Changes in the market value of such properties are taken to the statement of total recognised gains and losses (being a movement on an investment properties reserve), unless a deficit or its reversal on an investment property is expected to be permanent.

## 2. Interest Receivable and Similar Income

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| On loans fully secured on residential property | **49,716** | 45,654 | **49,716** | 45,654 |
| On other loans | **6,697** | 5,813 | **6,142** | 5,817 |
| On debt securities | | | | |
| Interest and other income | **5** | 42 | **5** | 42 |
| On other liquid assets | | | | |
| Interest and other income | **1,547** | 1,506 | **1,547** | 1,506 |
| Net expense on financial instruments | **(5,870)** | (4,404) | **(5,856)** | (4,404) |
| | **52,095** | 48,611 | **51,554** | 48,615 |

Interest on secured advances, as shown above, has been decreased by £118,000 (2014 - £152,000) being the net effect of interest suspended on non-performing loans in accordance with the Society's accounting policy, and the recovery of interest written off in prior years. Movements in the suspended interest account were as follows:

| | Group and Society 2015 £000 | Group and Society 2014 £000 |
|---|---|---|
| At 1 April | **247** | 107 |
| Interest suspended during the year | **118** | 152 |
| Interest written off during the year | **(300)** | (12) |
| At 31 March | **65** | 247 |

## 3. Interest Payable and Similar Charges

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| On shares held by individuals | **23,390** | 23,603 | **23,390** | 23,603 |
| On deposits and other borrowings | **2,064** | 1,333 | **2,065** | 1,334 |
| Net income on financial instruments | **(200)** | (323) | **(200)** | (323) |
| | **25,254** | 24,613 | **25,255** | 24,614 |

## 4. Administrative Expenses

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| Staff costs (note 5) | **11,638** | 10,209 | **10,108** | 9,117 |
| Remuneration of auditor (excluding VAT) | | | | |
| – Audit of annual accounts | **66** | 67 | **50** | 60 |
| – Other services | **18** | 24 | **18** | 24 |
| Other expenses | **6,725** | 6,628 | **5,951** | 5,937 |
| | **18,447** | 16,928 | **16,127** | 15,138 |

## 5. Staff Numbers and Costs

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

| | Full time 2015 | Full time 2014 | Part time 2015 | Part time 2014 |
|---|---|---|---|---|
| Society's principal office | **154** | 150 | **57** | 52 |
| Society's branches | **118** | 116 | **104** | 104 |
| Subsidiaries | **40** | 27 | **22** | 19 |
| | **312** | 293 | **183** | 175 |

| The aggregate costs of these persons were as follows: | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| Wages and salaries | **9,639** | 8,778 | **8,321** | 7,828 |
| Social security costs | **752** | 691 | **639** | 617 |
| Other pension costs (note 26) | **1,247** | 740 | **1,148** | 672 |
| | **11,638** | 10,209 | **10,108** | 9,117 |

The Group operates a salary sacrifice scheme whereby the employee agrees to a reduction in salary in return for the Group making the pension contributions that were previously paid by the employee. The amounts shown above under wages and salaries include the headline salary (i.e. before the salary sacrifice deduction) and other pension costs exclude the additional contributions made by the Group as a result of the salary sacrifice scheme. This also applies to the executive directors' remuneration disclosures in note 6.

## 6. Directors' Emoluments and Transactions

| | 2015 £000 | 2014 £000 |
|---|---|---|
| **Total directors' remuneration** | **912** | 853 |
| **Non-executive directors' remuneration** | | |
| Michael Pratt (Chairman) | **44** | 43 |
| Richard Atkinson (Vice-Chairman, retired 31 December 2014) | **21** | 26 |
| Trevor Hebdon (Chairman of the Audit and Risk Committee and from 1 January 2015, Vice-Chairman) | **29** | 28 |
| David Clarke | **24** | 24 |
| John Davidson (appointed 8 July 2014) | **18** | – |
| Gill Gardner | **24** | 24 |
| Alan Johnston | **25** | 24 |
| | **185** | 169 |

| **Executive directors' remuneration** **2015** | **Salary £000** | **Bonus £000** | **Taxable benefits £000** | **Total £000** |
|---|---|---|---|---|
| Kevin Parr | **203** | **20** | **6** | **229** |
| John Leveson (resigned 30 September 2014) | **103** | **–** | **3** | **106** |
| John Kidd | **136** | **14** | **7** | **157** |
| Peter Temple | **130** | **14** | **5** | **149** |
| Chris McDonald (appointed 13 October 2014) | **54** | **12** | **3** | **69** |
| | **626** | **60** | **24** | **710** |

Included within Mr Leveson's salary is a payment of £25,000 in respect of loss of office as a director.

| 2014 | | | | |
|---|---|---|---|---|
| Kevin Parr | 198 | 15 | 6 | 219 |
| John Leveson | 144 | 11 | 6 | 161 |
| John Kidd | 133 | 10 | 7 | 150 |
| Peter Temple | 121 | 9 | 5 | 135 |
| | 596 | 45 | 24 | 665 |

| **Defined Benefit Pension Scheme** Pension benefits earned by directors: | **Accumulated total accrued pension at 31 March 2015 £000** | **Increase in accrued pension in year to 31 March 2015 £000** | Increase in accrued pension in year to 31 March 2014 £000 |
|---|---|---|---|
| Kevin Parr | **71** | **4** | 6 |
| John Kidd | **45** | **2** | 3 |
| Peter Temple | **54** | **2** | 4 |

The Society paid £3,000 (2014 - £3,000) of contributions into a defined contribution scheme for Mr. Temple relating to a portion of his salary, and £6,000 for Mr. McDonald relating to his salary from 13 October 2014.

Pensions paid to former directors were £nil (2014 - £5,000).

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

| 7. Taxation | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| (a) Analysis of charge in year: | | | | |
| Current tax | | | | |
| Corporation tax at 21% (2014 - 23%) | **2,316** | 1,956 | **2,231** | 1,993 |
| Over provision of corporation tax in prior years | **(59)** | – | **(64)** | – |
| Total current tax | **2,257** | 1,956 | **2,167** | 1,993 |
| Deferred tax at 20% (2014 - 20%) | | | | |
| Origination and reversal of timing differences | **345** | 653 | **352** | 644 |
| Tax on profit on ordinary activities | **2,602** | 2,609 | **2,519** | 2,637 |
| (b) Factors affecting current tax charge in year: | | | | |
| Profit on ordinary activities before tax | **12,820** | 10,266 | **12,171** | 10,426 |
| Tax on profit on ordinary activities at UK standard rate of 21% (2014 - 23%) | **2,692** | 2,361 | **2,556** | 2,398 |
| Effects of: | | | | |
| Depreciation in excess of capital allowances | **35** | 32 | **23** | 23 |
| Other timing differences | **–** | – | **(1)** | – |
| Adjustments on disposal of investment property | **(52)** | – | **–** | – |
| Expenses not deductible for tax purposes | **27** | 15 | **39** | 22 |
| Adjustments to tax charge for payments basis (pensions) | **(386)** | (450) | **(386)** | (450) |
| Small companies rate | **–** | (2) | **–** | – |
| Over provision of corporation tax in prior years | **(59)** | – | **(64)** | – |
| Current tax charge for year | **2,257** | 1,956 | **2,167** | 1,993 |

| 8. Loans and Advances to Credit Institutions | Group and Society 2015 £000 | Group and Society 2014 £000 |
|---|---|---|
| Loans and advances to credit institutions are repayable from the date of the balance sheet in the ordinary course of business as follows: | | |
| On demand | **9,659** | 19,141 |
| In not more than three months | **14,000** | 2,500 |
| In more than three months but not more than one year | **37,000** | 50,000 |
| In more than one year but not more than five years | **9,079** | – |
| | **69,738** | 71,641 |
| Accrued interest | **109** | 170 |
| | **69,847** | 71,811 |

## 9. Debt Securities

| | Group and Society 2015 £000 | Group and Society 2014 £000 |
|---|---|---|
| (a) Debt securities comprise: | | |
| Issued by other financial institutions, unlisted | **1,005** | – |

| | Group and Society 2015 £000 | Group and Society 2014 £000 |
|---|---|---|
| (b) Debt securities are repayable from the date of the balance sheet in the ordinary course of business as follows: | | |
| In not more than one year | **1,000** | – |
| Accrued interest | **5** | – |
| | **1,005** | – |

In addition, at 31 March 2015 the Society had drawn £189 million (2014 - £100 million) of Treasury Bills under the Bank of England's Funding for Lending Scheme, of which £69 million (2014 - £70 million) were held off balance sheet.

## 10. Loans and Advances to Customers

| | **Group 2015 £000** | Group 2014 £000 | **Society 2015 £000** | Society 2014 £000 |
|---|---|---|---|---|
| (a) Loans and advances to customers comprise: | | | | |
| Loans fully secured on residential property | **1,428,310** | 1,247,908 | **1,428,310** | 1,247,908 |
| Other loans | | | | |
| Loans fully secured on land | **150,625** | 150,305 | **150,625** | 150,305 |
| Other loans | **9,812** | 1,688 | **1,484** | 1,688 |
| | **1,588,747** | 1,399,901 | **1,580,419** | 1,399,901 |

| | **Group 2015 £000** | Group 2014 £000 | **Society 2015 £000** | Society 2014 £000 |
|---|---|---|---|---|
| (b) The maturity of loans and advances to customers from the date of the balance sheet is as follows: | | | | |
| On call and at short notice | **3,025** | 5,264 | **3,025** | 5,264 |
| In not more than three months | **17,236** | 14,025 | **17,235** | 14,025 |
| In more than three months but not more than one year | **56,081** | 52,649 | **55,984** | 52,649 |
| In more than one year but not more than five years | **306,126** | 284,516 | **297,896** | 284,516 |
| In more than five years | **1,210,831** | 1,050,054 | **1,210,831** | 1,050,054 |
| | **1,593,299** | 1,406,508 | **1,584,971** | 1,406,508 |
| Less: Provisions (note 11) | **(4,552)** | (6,607) | **(4,552)** | (6,607) |
| | **1,588,747** | 1,399,901 | **1,580,419** | 1,399,901 |

The actual experience of repayments may differ from the above since many loans and advances are repaid early. At 31 March 2015 £373.0 million (2014 - £211.5 million) of loans had been pledged as collateral to the Bank of England under the Funding for Lending Scheme.

| 11. Provisions for Bad and Doubtful Debts | Loans fully secured on residential property £000 | Loans fully secured on land £000 | Other loans £000 | Total £000 |
|---|---|---|---|---|
| | | | | Group and Society |
| Provisions against loans and advances to customers have been made as follows: | | | | |
| At 1 April 2014 | | | | |
| General provision | 1,619 | 1,748 | 40 | 3,407 |
| Specific provision | 200 | 2,965 | 35 | 3,200 |
| | 1,819 | 4,713 | 75 | 6,607 |
| Amounts written off during year | | | | |
| Specific provision | (177) | (2,200) | (5) | (2,382) |
| | (177) | (2,200) | (5) | (2,382) |
| Income and expenditure account | | | | |
| Provisions for bad and doubtful debts | | | | |
| General provision | 60 | – | – | 60 |
| Specific provision | 49 | 213 | 5 | 267 |
| | 109 | 213 | 5 | 327 |
| At 31 March 2015 | | | | |
| General provision | 1,679 | 1,748 | 40 | 3,467 |
| Specific provision | 72 | 978 | 35 | 1,085 |
| | 1,751 | 2,726 | 75 | 4,552 |

The total charge of £218,000 in the income and expenditure account consists of the charge of £327,000 shown above, a credit of £97,000 in relation to a loan written off during the year, and a net credit of £12,000 in respect of additional costs and recoveries against loans which had been written off in prior years.

| 12. Investments in Subsidiary Undertakings (Society) | Shares £000 | Loans £000 | Total £000 |
|---|---|---|---|
| Cost at 1 April 2014 | 1,390 | 991 | 2,381 |
| Advances | – | 7,000 | 7,000 |
| Repayments | – | (558) | (558) |
| Investments | 500 | – | 500 |
| Cost at 31 March 2015 | 1,890 | 7,433 | 9,323 |

**Subsidiary undertakings carrying on a business**
At 31 March 2015 the Society held an interest in the following principal subsidiary undertakings all limited by shares under the Companies Act 2006:

| | Country of Registration | Principal Activity | Class of Shares | Interest of Society |
|---|---|---|---|---|
| Direct | | | | |
| Cumberland Holdings Ltd | England | Holding Company | Ordinary | 100% |
| Indirect | | | | |
| Borderway Finance Ltd | England | Motor Vehicle Finance | Ordinary | 100% |
| Cumberland Estate Agents Ltd | England | Estate Agents | Ordinary | 100% |
| Cumberland Financial Services Ltd | England | Independent Financial Adviser | Ordinary | 100% |
| Cumberland Financial Planning Ltd | England | Financial Adviser | Ordinary | 100% |
| Cumberland Homes Ltd | England | Development Company | Ordinary | 100% |
| Cumberland Property Services Ltd | England | Property Company | Ordinary | 100% |

## 13. Tangible Fixed Assets (Group)

| | Freehold Land and Buildings £000 | Equipment, Fixtures and Fittings and Vehicles £000 | Total £000 |
|---|---|---|---|
| Cost | | | |
| At 1 April 2014 | 19,668 | 8,036 | 27,704 |
| Additions | 366 | 873 | 1,239 |
| Disposals | (4) | (328) | (332) |
| Properties transferred to 'investment properties' (note 14) | (1,196) | – | (1,196) |
| At 31 March 2015 | 18,834 | 8,581 | 27,415 |
| Depreciation | | | |
| At 1 April 2014 | 9,735 | 4,477 | 14,212 |
| Charge for year | 350 | 1,295 | 1,645 |
| Disposals | (4) | (285) | (289) |
| Properties transferred to 'investment properties' (note 14) | (692) | – | (692) |
| At 31 March 2015 | 9,389 | 5,487 | 14,876 |
| Net book value | | | |
| At 31 March 2015 | 9,445 | 3,094 | 12,539 |
| At 31 March 2014 | 9,933 | 3,559 | 13,492 |

### Tangible Fixed Assets (Society)

| | Freehold Land and Buildings £000 | Equipment, Fixtures and Fittings and Vehicles £000 | Total £000 |
|---|---|---|---|
| Cost | | | |
| At 1 April 2014 | 17,596 | 7,677 | 25,273 |
| Additions | 367 | 749 | 1,116 |
| Disposals | (4) | (295) | (299) |
| Properties transferred to 'investment properties' (note 14) | (1,196) | – | (1,196) |
| At 31 March 2015 | 16,763 | 8,131 | 24,894 |
| Depreciation | | | |
| At 1 April 2014 | 8,888 | 4,336 | 13,224 |
| Charge for year | 310 | 1,199 | 1,509 |
| Disposals | (4) | (264) | (268) |
| Properties transferred to 'investment properties' (note 14) | (692) | – | (692) |
| At 31 March 2015 | 8,502 | 5,271 | 13,773 |
| Net book value | | | |
| At 31 March 2015 | 8,261 | 2,860 | 11,121 |
| At 31 March 2014 | 8,708 | 3,341 | 12,049 |

The net book value of land and buildings occupied by the Group for its own activities at 31 March 2015 was £8,777,000 (Society £7,387,000) (2014 - Group £9,122,000, Society £7,770,000).

## 14. Investment Properties

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| At 1 April | **2,725** | 1,650 | **1,075** | – |
| Properties transferred from 'tangible fixed assets' (note 13) | **504** | 1,075 | **504** | 1,075 |
| Disposals | **(356)** | – | **–** | – |
| Revaluation | **79** | – | **(87)** | – |
| At 31 March | **2,952** | 2,725 | **1,492** | 1,075 |

Part of the Society's former Principal Office which was previously held by the Society within tangible fixed assets, has now been reclassified as an investment property. Valuations of all investment properties were carried out on an open market value basis by an independent valuer, T.M. Hargraves BSc FRICS, Director of Hyde Harrington Ltd, as at 31 March 2015.
The Group made a gain before tax of £786,000 on the disposal of part of an investment property at Dalston Road, Carlisle.

## 15. Other Assets

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| Deferred taxation asset (note 16) | **906** | 883 | **892** | 876 |
| Other | **417** | 386 | **1,464** | 1,341 |
| | **1,323** | 1,269 | **2,356** | 2,217 |

## 16. Deferred Taxation

The elements of deferred taxation at 20% (2014 - 20%) are as follows:

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| Difference between accumulated depreciation and amortisation and capital allowances | **212** | 202 | **198** | 195 |
| General mortgage loss provisions | **694** | 681 | **694** | 681 |
| Deferred taxation asset (note 15) | **906** | 883 | **892** | 876 |

The deferred taxation movement for the year is as follows:

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| At 1 April | **883** | 995 | **876** | 979 |
| Charge for the year (note 7) | **(345)** | (653) | **(352)** | (644) |
| Offset against pension deficit | **368** | 541 | **368** | 541 |
| At 31 March | **906** | 883 | **892** | 876 |

## 17. Prepayments and Accrued Income

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| Accrued income relating to off balance sheet instruments | **159** | 1,432 | **159** | 1,432 |
| Other | **534** | 246 | **334** | 241 |
| | **693** | 1,678 | **493** | 1,673 |

## 18. Shares

| | Group and Society 2015 £000 | Group and Society 2014 £000 |
|---|---|---|
| (a) Shares comprise: | | |
| Held by individuals | **1,521,687** | 1,433,192 |
| Other | **7** | 7 |
| | **1,521,694** | 1,433,199 |
| (b) Repayable from the date of the balance sheet in the ordinary course of business as follows: | | |
| On demand | **918,981** | 802,638 |
| In not more than three months | **191,951** | 189,059 |
| In more than three months but not more than one year | **306,698** | 312,881 |
| In more than one year but not more than five years | **96,744** | 120,555 |
| | **1,514,374** | 1,425,133 |
| Accrued interest | **7,320** | 8,066 |
| | **1,521,694** | 1,433,199 |

## 19. Amounts owed to Credit Institutions

| | Group and Society 2015 £000 | Group and Society 2014 £000 |
|---|---|---|
| Repayable from the date of the balance sheet in the ordinary course of business as follows: | | |
| In not more than three months | **6,500** | 1,500 |
| In more than three months but not more than one year | **–** | 2,000 |
| In more than one year but not more than five years | **119,721** | 29,912 |
| | **126,221** | 33,412 |
| Accrued interest | **81** | 28 |
| | **126,302** | 33,440 |

## 20. Amounts owed to Other Customers

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| Repayable from the date of the balance sheet in the ordinary course of business as follows: | | | | |
| On demand | **38,585** | 28,688 | **39,480** | 29,028 |
| In not more than three months | **52,893** | 21,875 | **52,893** | 21,875 |
| In more than three months but not more than one year | **16,721** | 37,255 | **16,721** | 37,255 |
| In more than one year but not more than five years | **3,369** | 4,659 | **3,369** | 4,659 |
| | **111,568** | 92,477 | **112,463** | 92,817 |
| Accrued interest | **490** | 443 | **490** | 443 |
| | **112,058** | 92,920 | **112,953** | 93,260 |

## 21. Other Liabilities

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| Falling due within one year: | | | | |
| Corporation tax | **980** | 605 | **857** | 593 |
| Income tax | **684** | 614 | **684** | 614 |
| Other creditors | **1,374** | 1,101 | **1,350** | 1,075 |
| | **3,038** | 2,320 | **2,891** | 2,282 |

## 22. Provisions for Liabilities

| | Group and Society 2015 £000 | Group and Society 2014 £000 |
|---|---|---|
| Financial Services Compensation Scheme Levy: | | |
| At 1 April | **1,640** | 1,470 |
| Paid | **(1,042)** | (992) |
| Charged to income and expenditure account | **873** | 1,162 |
| At 31 March | **1,471** | 1,640 |

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

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

Interest is charged on each outstanding loan at the higher of 12 months LIBOR plus 100 basis points and the relevant gilt rate published by the Debt Management Office, on which the management expenses levies for scheme years 2013-14 and 2014-15 have been based.

In the current year, the Society paid £1,042,000 in respect of the levy for 2013-14.

The charge of £873,000 in the latest year reflects, based on the Society's share of UK protected deposits:
a) the management expenses levies for 2014-15 and 2015-16, and
b) the last of three tranches in relation to the current estimated shortfall on the capital loans outstanding.

## 23. Reserves

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| **General Reserves** | | | | |
| At 1 April | **124,300** | 116,217 | **124,599** | 116,384 |
| Profit for the financial year | **10,218** | 7,657 | **9,652** | 7,789 |
| Actuarial (loss)/gain net of deferred tax in the STRGL | **(4,728)** | 426 | **(4,728)** | 426 |
| At 31 March | **129,790** | 124,300 | **129,523** | 124,599 |
| **Investment Properties** | | | | |
| At 31 March | **731** | 816 | **433** | 515 |
| Reserves excluding net pension liability | **135,777** | 127,114 | **135,212** | 127,112 |
| Net pension liability | **(5,256)** | (1,998) | **(5,256)** | (1,998) |
| Reserves including net pension liability | **130,521** | 125,116 | **129,956** | 125,114 |

## 24. Guarantees and other Financial Commitments

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

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

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

| | Group 2015 £000 | Group 2014 £000 | Society 2015 £000 | Society 2014 £000 |
|---|---|---|---|---|
| Contracted but not provided for | **340** | 265 | **325** | 265 |
| (d) Memorandum items | | | | |
| Irrevocable mortgage commitments | **7,416** | 7,343 | **7,416** | 7,343 |

## 25. Financial Instruments

A financial instrument is a contract which gives rise to a financial asset of one entity and a financial liability of another entity. The Group is a retailer of financial instruments in the form of mortgage and savings products, and also uses wholesale financial instruments to invest liquid asset balances, raise wholesale funding and manage the risks arising from its operations.

The Group has a formal structure for managing risk, including established risk limits, reporting lines, mandates and other control procedures. This is set out in the Treasury Policy Statement, approved by the Board. This structure is reviewed regularly by the Assets and Liabilities Committee (ALCO), which is charged with the responsibility for managing and controlling the balance sheet exposures and the use of financial instruments for risk management purposes.

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

Derivatives are only used by the Group in accordance with the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors specified in the legislation. Derivatives are not used in trading activity or for speculative purposes.

**Types of derivatives**

The principal derivatives used in balance sheet risk management are interest rate swaps which are used to hedge Group balance sheet exposures arising from fixed rate mortgage lending and savings products.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. Such risks may alternatively be managed using on balance sheet instruments as part of an integrated approach to risk management.

| Activity | Risk | Type of hedge |
|---|---|---|
| Fixed rate savings products | Sensitivity to falls in interest rates | Receive fixed interest rate swaps |
| Fixed rate mortgage lending | Sensitivity to increases in interest rates | Pay fixed interest rate swaps |

The table below shows the nominal principal amounts, credit risk weighted amounts and replacement costs of derivatives, analysed by maturity. Nominal principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The replacement cost represents the cost of replacing contracts with positive values, calculated at market rates current at the balance sheet date, reflecting the Group's maximum exposure should the counterparties default. The credit risk weighted amount, which is calculated according to rules specified by the Prudential Regulation Authority, is based on the replacement cost, but also takes into account measures of the extent of potential future exposure and the nature of the counterparty.

| | **Nominal principal amount 2015 £000** | **Credit risk weighted amount 2015 £000** | **Replacement cost 2015 £000** | Nominal principal amount 2014 £000 | Credit risk weighted amount 2014 £000 | Replacement cost 2014 £000 |
|---|---|---|---|---|---|---|
| Interest rate contracts | | | | | | |
| – under one year | **167,800** | **–** | **–** | 230,900 | – | – |
| – between one and five years | **690,150** | **2,226** | **–** | 575,700 | 1,823 | – |

The accounting policy for derivatives is described in note 1 to the accounts.

**Liquidity risk**

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

**Market risk**

The primary market risk faced by the Group is interest rate risk. The potential impact of changes in interest rates on the Group's financial position is monitored against policy limits approved by the Board on a continuous basis, and managed using a combination of on and off balance sheet instruments.

The table below shows the allocation of assets and liabilities at the balance sheet date to time bands by reference to the earlier of the next interest repricing date and the maturity date. The interest rate sensitivity gap represents the asset/liability mis–match within the balance sheet after taking into account off balance sheet derivatives and quantifies the net value of assets or liabilities which will give rise to earnings variations when interest rates change.

| **Group At 31 March 2015:** | **Not more than three months £000** | **More than three months but not more than six months £000** | **More than six months but not more than one year £000** | **More than one year but not more than five years £000** | **Non interest bearing £000** | **Total £000** |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Liquid assets | 255,140 | 13,000 | 20,000 | 9,078 | 198 | 297,416 |
| Loans fully secured on residential property and other loans | 792,798 | 26,185 | 73,123 | 701,193 | (4,552) | 1,588,747 |
| Tangible fixed assets | – | – | – | – | 12,539 | 12,539 |
| Other assets | – | – | – | – | 4,968 | 4,968 |
| Total assets | 1,047,938 | 39,185 | 93,123 | 710,271 | 13,153 | 1,903,670 |
| **Liabilities** | | | | | | |
| Shares | 1,288,217 | 64,052 | 81,360 | 80,745 | 7,320 | 1,521,694 |
| Amounts owed to credit institutions and other customers | 218,700 | 9,893 | 5,827 | 3,369 | 571 | 238,360 |
| Other liabilities | – | – | – | – | 13,095 | 13,095 |
| Reserves | – | – | – | – | 130,521 | 130,521 |
| Total liabilities | 1,506,917 | 73,945 | 87,187 | 84,114 | 151,507 | 1,903,670 |
| Net assets / (liabilities) | (458,979) | (34,760) | 5,936 | 626,157 | (138,354) | – |
| Off balance sheet items | 711,650 | (23,600) | (40,600) | (647,450) | – | – |
| Interest rate sensitivity gap | 252,671 | (58,360) | (34,664) | (21,293) | (138,354) | – |
| Cumulative gap | 252,671 | 194,311 | 159,647 | 138,354 | – | – |

| Group<br>At 31 March 2014: | Not more than three months £000 | More than three months but not more than six months £000 | More than six months but not more than one year £000 | More than one year but not more than five years £000 | Non interest bearing £000 | Total £000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Liquid assets | 223,582 | 26,000 | 24,000 | – | 242 | 273,824 |
| Loans fully secured on residential property and other loans | 795,588 | 33,794 | 51,635 | 525,491 | (6,607) | 1,399,901 |
| Tangible fixed assets | – | – | – | – | 13,492 | 13,492 |
| Other assets | – | – | – | – | 5,672 | 5,672 |
| Total assets | 1,019,170 | 59,794 | 75,635 | 525,491 | 12,799 | 1,692,889 |
| **Liabilities** | | | | | | |
| Shares | 1,147,339 | 72,295 | 91,404 | 114,095 | 8,066 | 1,433,199 |
| Amounts owed to credit institutions and other customers | 101,389 | 2,000 | 22,500 | – | 471 | 126,360 |
| Other liabilities | – | – | – | – | 8,214 | 8,214 |
| Reserves | – | – | – | – | 125,116 | 125,116 |
| Total liabilities | 1,248,728 | 74,295 | 113,904 | 114,095 | 141,867 | 1,692,889 |
| Net assets / (liabilities) | (229,558) | (14,501) | (38,269) | 411,396 | (129,068) | – |
| Off balance sheet items | 429,850 | 24,800 | 1,350 | (456,000) | – | – |
| Interest rate sensitivity gap | 200,292 | 10,299 | (36,919) | (44,604) | (129,068) | – |
| Cumulative gap | 200,292 | 210,591 | 173,672 | 129,068 | – | – |

**Fair values of financial instruments**
Set out below is a comparison of book and fair values of some of the Group's financial instruments by category. Where available, market values have been used to calculate fair values. Where market values are not available, fair values have been calculated by discounting cash flows at prevailing interest rates. Interest rate options have been valued using current replacement cost for comparable instruments.
The table excludes certain financial assets and liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. Thus it excludes mortgages, retail savings accounts and other balance sheet items whose book and fair values may differ at the balance sheet date.

| Assets | **Book value 2015 £000** | **Fair value 2015 £000** | Book value 2014 £000 | Fair value 2014 £000 |
|---|---|---|---|---|
| On balance sheet instruments | | | | |
| Liquid assets | **1,005** | **1,007** | – | – |
| Off balance sheet instruments | | | | |
| Interest rate contracts | **159** | **(6,513)** | 1,431 | 6,550 |

Liquid assets as stated above excludes non-marketable instruments.

**Gains and losses arising from derivatives used to hedge financial risks**
Gains and losses arising from derivatives used to hedge financial risks are not recognised within interest receivable until the exposure that is being hedged is itself recognised. Unrecognised gains and losses arising from derivatives and the movements therein are shown in the table below.

| | Unrecognised gains £000 | Unrecognised losses £000 | Net Unrecognised gain/(loss) £000 |
|---|---|---|---|
| Unrecognised at the start of the year | 7,289 | (2,170) | 5,119 |
| Recognised in the year | (1,265) | 388 | (877) |
| Carried forward to future periods | 6,024 | (1,782) | 4,242 |
| Gains and losses arising in the year but not recognised in the year | (4,603) | (6,311) | (10,914) |
| Unrecognised at the end of the year | 1,421 | (8,093) | (6,672) |
| Of which: | | | |
| Expected to be realised in the year ending 31 March 2016 | 522 | (722) | (200) |
| Expected to be realised after 31 March 2016 | 899 | (7,371) | (6,472) |
| | 1,421 | (8,093) | (6,672) |

## 26. Pensions

The Group operates a defined benefit pension scheme and three defined contribution schemes, funded by contributions from the Group and its staff.

**Defined contribution schemes**

The Group's contributions in the year to the defined contribution schemes totalled £334,000 (2014 - £203,000). This excludes the additional contributions made by the Group as a result of the operation of the salary sacrifice scheme outlined in note 5. The assets of the schemes are externally managed. One of the schemes is open to all new employees.

**Defined benefit scheme**

The defined benefit scheme is externally managed and was closed to new entrants in April 2000, and to further accrual at 31 March 2015. All of the following details relate solely to the defined benefit scheme. The valuation used for FRS 17 disclosures has been prepared by a qualified independent actuary to take account of the requirements of FRS 17 in order to assess the liabilities of the scheme at 31 March 2015 using the projected unit method with a suitable control period which reflects the expected ageing of the scheme. Scheme assets are stated at their market value at 31 March 2015.

The most recent full actuarial valuation was as at 27 August 2012 and showed a deficit of £9,180,000.

| Principal assumptions used to calculate the scheme's liabilities under FRS 17 | **2015 %** | 2014 % |
|---|---|---|
| Rate of increase in salaries | **2.70** | 3.25 |
| Rate of increase in pensions in payment | **2.30 - 3.10** | 2.40 - 3.50 |
| Discount rate | **3.30** | 4.40 |
| Inflation assumptions - RPI | **3.20** | 3.50 |
| - CPI | **2.20** | 2.75 |

Post-retirement mortality is based on 95% of the 2014 S1PxA year of birth tables, projected assuming medium cohort improvements with a minimum improvement of 1.25% per annum. No allowance is made for pre-retirement mortality.

| The number of years' life expectancy, retiring at 62, is as follows: | **2015** | 2014 |
|---|---|---|
| Retiring today: | | |
| Males | **87.3** | 87.4 |
| Females | **89.8** | 89.8 |
| Retiring in 20 years: | | |
| Males | **89.2** | 89.3 |
| Females | **91.8** | 91.8 |

The Group contributed at the rate of 20.3% (2014 - 20.3%) of pensionable salaries for the year. It also made an additional contribution of £1,500,000 in June 2014.

**Amounts recognised in the balance sheet**

| | **2015 £000** | 2014 £000 | 2013 £000 | 2012 £000 | 2011 £000 |
|---|---|---|---|---|---|
| Present value of scheme liabilities | **(61,232)** | (49,741) | (48,888) | (44,060) | (38,607) |
| Fair value of scheme assets | **54,662** | 47,243 | 43,901 | 39,064 | 38,558 |
| Net pension liability | **(6,570)** | (2,498) | (4,987) | (4,996) | (49) |
| Net pension liability after deferred tax | **(5,256)** | (1,998) | (3,840) | (3,797) | (36) |

**Reconciliation of the present value of scheme liabilities**

| | **2015 £000** | 2014 £000 |
|---|---|---|
| At 1 April | **49,741** | 48,888 |
| Interest cost | **2,167** | 2,144 |
| Current service cost | **445** | 491 |
| Past service cost | **360** | – |
| Contributions from scheme members | **161** | 163 |
| Charges paid | **–** | (11) |
| Benefits paid | **(1,598)** | (961) |
| Actuarial loss/(gain) | **9,956** | (973) |
| At 31 March | **61,232** | 49,741 |

| Reconciliation of the fair value of scheme assets | **2015 £000** | 2014 £000 |
|---|---|---|
| At 1 April | **47,243** | 43,901 |
| Expected return on assets | **2,866** | 2,627 |
| Contributions from employers and scheme members | **2,214** | 2,225 |
| Charges paid | **–** | (11) |
| Benefits paid | **(1,598)** | (961) |
| Expenses paid | **(109)** | (97) |
| Actuarial gain/(loss) | **4,046** | (441) |
| At 31 March | **54,662** | 47,243 |

**Fair value of the scheme's assets and the expected rates of return at 31 March**

| | **Expected long term rate of return 2015 %** | **Value 2015 £000** | Expected long term rate of return 2014 % | Value 2014 £000 |
|---|---|---|---|---|
| Equities and other growth-type assets | **6.80** | **34,644** | 7.00 | 30,275 |
| Corporate Bonds | **3.10** | **17,277** | 4.30 | 14,297 |
| Cash | **3.80** | **336** | 4.00 | 391 |
| Annuities | **3.30** | **2,405** | 4.40 | 2,280 |
| Total market value of assets | | **54,662** | | 47,243 |

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

**Amounts recognised in the performance statements under the requirements of FRS 17**

| **a) Administrative expenses** | **2015 £000** | 2014 £000 |
|---|---|---|
| Current service cost | **445** | 491 |
| Past service cost | **360** | – |
| Total operating charge | **805** | 491 |

The past service cost has arisen as a result of the closure of the scheme to further accrual as at 31 March 2015, as members who were active immediately prior to closure, now have a guarantee that their benefit at retirement will be the greater of their benefit with salary linking continuing to apply until they leave Society employment, and their deferred benefit revalued from closure in the usual way.

The operating charge of £805,000 (2014 - £491,000), plus the Group's contributions to the defined contribution schemes of £334,000 (2014 - £203,000), and life assurance premiums of £108,000, comprise the Group's 'other pension costs' total of £1,247,000 (2014 - £740,000) shown in note 5.

| **b) Pension finance income** | | |
|---|---|---|
| Expected return on pension scheme assets | **2,866** | 2,627 |
| Interest on pension scheme liabilities | **(2,167)** | (2,144) |
| Net income | **699** | 483 |

| **c) Statement of Total Recognised Gains and Losses (STRGL)** | | |
|---|---|---|
| Actual return less expected return on pension scheme assets | **4,046** | (441) |
| Experience gains arising on scheme liabilities | **4** | 180 |
| Changes in assumptions underlying the present value of the scheme's liabilities | **(9,960)** | 793 |
| Actuarial (loss)/gain | **(5,910)** | 532 |
| Movement in deferred taxation relating to pension scheme | **1,182** | (106) |
| Actuarial (loss)/gain recognised in the STRGL | **(4,728)** | 426 |

| **d) Movement in the deficit in the scheme during the year** | | |
|---|---|---|
| Deficit in scheme at beginning of year | **(2,498)** | (4,987) |
| Movement in year: | | |
| Current and past service costs | **(805)** | (491) |
| Contributions | **1,944** | 1,965 |
| Other finance income | **699** | 483 |
| Actuarial (loss)/gain | **(5,910)** | 532 |
| Deficit in scheme at end of year | **(6,570)** | (2,498) |

| History of experience gains and losses | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Actual return less expected return on pension scheme assets (£000) | **4,046** | (441) | 2,664 | 1,565 | 103 |
| Percentage of scheme assets | **7.4** | 0.9 | 6.1 | 4.0 | 0.3 |
| Experience gains/(losses) arising on the scheme liabilities (£000) | **4** | 180 | (273) | 304 | 380 |
| Percentage of scheme liabilities | **0.0** | 0.4 | 0.6 | 0.7 | 1.0 |
| Actuarial (loss)/gain recognised in the STRGL (£000) | **(5,910)** | 532 | (466) | (5,150) | (75) |
| Percentage of scheme liabilities | **9.7** | 1.1 | 1.0 | 11.7 | 0.2 |

## ANNUAL BUSINESS STATEMENT

*For the year ended 31 March 2015*

| 1. Statutory Percentages | 31 March 2015 % | Statutory Limit % |
|---|---|---|
| Lending Limit | **10.52** | 25 |
| Funding Limit | **13.54** | 50 |

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

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

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

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

| 2. Other Percentages | Group 31 March 2015 % | Group 31 March 2014 % |
|---|---|---|
| As percentage of shares and borrowings: | | |
| Gross capital | **7.42** | 8.02 |
| Free capital | **6.90** | 7.38 |
| Liquid assets | **16.90** | 17.56 |
| Profit for the financial year as a percentage of mean total assets | **0.57** | 0.47 |
| Management expenses as a percentage of mean total assets | **1.12** | 1.13 |

| | Society 31 March 2015 % | Society 31 March 2014 % |
|---|---|---|
| Management expenses as a percentage of mean total assets | **0.98** | 1.01 |

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

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

## 3. Information relating to the Directors and Chief Executive as at 31 March 2015

| Name | Occupation | Date of Birth | Date of Appointment | Other Directorships (excluding dormant companies) |
|---|---|---|---|---|
| **DIRECTORS** | | | | |
| M. J. Pratt, BA, FCA | Company Director | 26.1.56 | 29.9.96 | ASW Properties Ltd<br>Carleton Properties (Cumbria) Ltd<br>Brigrove Ltd<br>Brigrove (Two) Ltd<br>Brigrove (Three) Ltd<br>Brigrove (Four) Ltd<br>Brigrove (Five) Ltd<br>Brigrove (Six) Ltd<br>Gibbons Properties Ltd<br>MEP Enterprises Ltd<br>The Old Ginn House Ltd<br>The Veterinary Defence Society Ltd |
| T. Hebdon, ACIB | Business Consultant | 21.3.54 | 11.12.09 | Carlisle Cathedral Development Trust |
| D. M. Clarke, BSc, FCIM, FCIMC | Company Director | 22.5.48 | 14.2.05 | Fellside Management Services Ltd<br>The Pensions Advisory Service Ltd |
| J. S. Davidson | Business Advisor | 1.9.54 | 8.7.14 | |
| G. F. Gardner, MA (Cantab) | Solicitor | 28.9.64 | 17.9.12 | Member of Brabners LLP |
| A. J. Johnston, BA, FCA | Chartered Accountant | 13.2.60 | 15.2.11 | Armstrong Watson Financial Planning Ltd<br>Future Money Ltd<br>Armstrong Watson Accountants<br>Armstrong Watson General Partner Ltd<br>Armstrong Watson Audit Ltd<br>Carlisle Cathedral Development Trust |
| J. C. N. Kidd, BA, ACA | Building Society Finance Director | 10.6.65 | 28.3.02 | Cumberland Homes Ltd<br>Cumberland Property Services Ltd |
| C. McDonald, BSc | Building Society Operations and Human Resources Director | 6.11.62 | 13.10.14 | Mobile Payments Service Company Ltd |
| K. Parr, BA, FCCA | Building Society Chief Executive | 27.5.60 | 26.7.94 | Cumberland Holdings Ltd<br>Cumberland Financial Services Ltd<br>Cumberland Property Services Ltd<br>Cumberland Estate Agents Ltd<br>Cumberland Homes Ltd<br>Cumberland Financial Planning Ltd<br>Borderway Finance Ltd |
| P. R. Temple, BSc, MBA | Building Society Deputy Chief Executive | 9.3.61 | 1.9.07 | Cumberland Estate Agents Ltd<br>Cumberland Financial Services Ltd<br>Cumberland Holdings Ltd<br>Cumberland Financial Planning Ltd<br>Borderway Finance Ltd |

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

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

Cumberland
Building Society

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