Report & Accounts 2017

for the year ended 31 August 2017

7
HIGH STREET BRANCHES

40,000
ACCOUNTS

yes yes yes yes yes
yes yes yes yes
To 9 out of 10 first time buyers

£400m
ASSETS

THE
HANLEY
ECONOMIC
Building Society

www.thehanley.co.uk

The Hanley's Board of Directors, from left: Veronica Oak, Steven Jones, Philip Dearing, Mark Selby, Andrew Macdonald, Fionnuala Earley, Simon Woodings and Bob Young.

Annual Report & Accounts Year to 31 August 2017

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Member of the Building Societies Association

Shares and deposits in this Society are trustee investments

Established 1854

Registered Head Office **Granville House, Festival Park, Hanley, Stoke-on-Trent, ST1 5TB**

Telephone: Stoke-on-Trent (01782) 255000

Email: customerservices@thehanley.co.uk

Register No. **248B**

Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority.

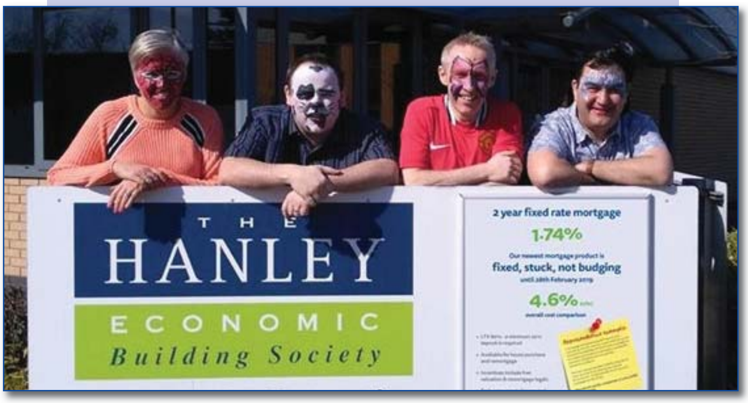
Charmaine Cameron-Reale, our Stone branch manager, represented The Hanley at a Caudwell Children ladies lunch event.

Longton branch assistant Rachel Ecclestone, right, celebrated 15 years' service with The Hanley.

A young customer greets The Hanley's mascot Granville during our Biddulph By The Sea event.

We served cupcakes to customers to celebrate reaching our £100k donation milestone thanks to our Douglas Macmillan Saver account.

Fund raising efforts for Red Nose Day included cakes made by the Underwriting team, while colleagues pictured below, got in on the act with face painting.



We invited children to take part in Granville quizzes during their time in our branches.

Chairman's Statement

The twelve month period 1 September 2016 to 31 August 2017, representing The Hanley's financial year, has been an eventful one in terms of the geopolitical landscape and, more closely to home, our Society. Overseas we've witnessed the election in the US of President Donald Trump and in Europe of President Emmanuel Macron, and in the UK we now have a Parliament with a much-reduced Conservative party majority. These interesting changes, along with the ongoing negotiations with the European Union on Brexit have all indirectly affected The Hanley. Sterling has decreased in value against the dollar by 1.3% and the euro by 7.6%, inflation has risen to 2.9% and economic growth is slowing – but importantly, unemployment levels remain at an all-time low. Meanwhile the Bank of England continues to ensure that rates remain at historic lows, even allowing for some incremental increase, whilst contemporaneously signalling the dangers of consumer indebtedness, principally on auto-finance and credit card balance transfer deals.

The housing market both nationally and locally faces many challenges as a consequence of the points raised above, causing the pace of house price growth across the UK to slow from 5.1% to 2.8% over the year, although it remains more resilient in our heartland where prices rose between 3.5% – 4%. Levels of home buying across the UK are still well below historic levels as home buyers struggle with squeezed budgets, high transaction costs and continued uncertainty as the UK navigates its way through the Brexit negotiations.

Against this landscape of arguably less encouraging news the Group has had a very good year as measured against our Key Performance Indicators – profit before tax is up 39.6% (adding further to our capital base which provides security for Members), gross and net mortgage lending reached all-time highs, retail savings balances increased by 7.3% and we again had an increase in Member numbers by some 400. Those who some years ago were of the view that the small, local mutual Building Society model was doomed are hopefully confounded! With our straightforward, simple, Member-focused strategy your Board consider that we are well placed to engage with whatever challenges the future holds.

> "With our straightforward, simple, Member-focused strategy we are well placed to engage with whatever challenges the future holds."

During the year we co-opted two new Directors. Mark Selby has enjoyed a successful first year as our new CEO, leading a review of the Society's strategy and producing an excellent set of results – you can read a little more about his thoughts on the results and his take on the future in his review of the year on page 4. The Board was also joined by Bob Young, formerly a partner at Begbies Traynor and more latterly as a Partner of local Stoke firm Currie Young. Both Mark and Bob are seeking election at the Annual General Meeting on 18 December and I hope you will support them accordingly.

This will be my final Statement as your Chairman as I plan to step down from the Board in the Spring of 2018. I can say with all sincerity that it has been an immense privilege to play a small part in ensuring that The Hanley continues its 163 year history as a corner-stone financial services provider, initially to the locality of North Staffordshire and these days of course well beyond. Thank you to all the Members I have chatted with during branch visits and Customer Forum meetings, my Board colleagues, business stakeholders, but above all to our amazing staff who continue to provide such a personal, friendly and professional service to you all.

P. R. Dearing
Chairman
31 October 2017

Chief Executive's Business Review

A record year

It has been my privilege to lead The Hanley over the last year – my first as your Chief Executive. It is especially pleasing to record that the Society has achieved its best results for more than ten years and remains in robust financial health.

As a Member of a mutually owned business I hope you will understand the importance of profit to the financial strength of your Society. Profit is the only source of capital available to The Hanley and it is capital that maintains the financial strength of the organisation. It is the Board's first responsibility to keep the Society strong and protect Members' savings. In achieving this strength we sustain the business and the key differences between The Hanley and the large banks with which we compete.

Key financial performance indicators for the Group that demonstrate the year-on-year uplift in overall performance include:

	2017	*2016*	Increase
	£000	*£000*	%
Profit on ordinary activities before tax	1,477	*1,058*	39.60
Profit for the financial year	1,135	*696*	63.07
Liquid assets	96,469	*82,271*	17.26
Mortgage balances	302,760	*291,211*	3.97
Retail savings balances	333,591	*311,013*	7.26
Reserves	26,158	*25,032*	4.50

Strategic review

The Board has completed a full strategic review of the business. We have a clearer understanding of our customers, their needs and the opportunities and challenges we face. As a result we have developed a five year view of the future of the business with a detailed three year plan that we will execute to achieve this future. As a team, we are the custodians of The Hanley and we have a responsibility to ensure it has a strong and relevant future.

Savings

In an extended low interest rate period we have been able to maintain growth in savings balances with net inflows of more than 7%. We have held off reducing interest rates for longer than many of our competitors but have recently had to recognise market pressures and make measured reductions on some accounts. Clearly, we will want to improve rates as and when the market allows. As a small Society we are unable to shape market rates and must therefore remain vigilant to competitor changes

Building society nominated for prestigious awards

THE Hanley Building Society has been nominated for awards that will pitch it against some of the biggest names in the financial services sector.
The Festival Park-based business is one of ten shortlisted in the category for Best First Time Buyer Mortgage Provider and among a similar number in the Best Building Society Mortgage Provider.
The nominations are for the annual Moneyfacts awards organised by the consumer website and in which The Hanley has previously won two trophies and been highly commended on three more occasions

players such as Barclays and Nationwide demonstrates that The Hanley is punching well above its weight and it would be a fantastic accolade for not only The Hanley but the local area if we are successful in either category."
In the past 12 months the society has helped 140 first timers get the keys to their home, a year-on-year rise of 17 per cent. David said: "We underwrite applications rather than credit score which is mainly the process that larger providers use.
"Our criteria is based upon personal affordability including a stress test on interest rates to ensure the

David Lowndes, head of operations - senior manager, at The Hanley.

We succeeded in winning the Moneyfacts Award 2017 for the Best First-Time Buyer Mortgage provider.

The Douglas Macmillan Hospice presented The Hanley with its Corporate Partner 2017 Platinum Award.

and market pressures. Despite this we will continue to offer competitive rates and aim to continue to grow our savings balances over the coming years.

Financial advice

The Society has, for some years, offered financial advice for those Members looking for the potential of higher returns and who are comfortable with exploring different options for growing their savings. This service has been low key for the last few years. As part of our strategic review of the business we have refreshed this area and now offer a new suite of advice and annual reviews. In addition, we are investing in training new advisors from within The Hanley team so we can maintain service in this growing part of the business.

Mortgages

The market for mortgages has been even more challenging than that for savings. Some lenders have been able to use cheaper sources of funding (in part by reducing savings rates) to offer incredibly low-priced mortgages. Without similar low-cost funding, it has been very challenging for The Hanley to compete but despite this we have achieved mortgage growth of 3.97%.

Community

We have continued with our long-standing support of the ‘Dougie Mac’ Hospice. We remain one of their largest corporate partners and this year passed the point where we have donated over £100,000 to this popular local charity.

Our links with local schools and colleges have continued and we are actively looking to extend our program of Apprenticeships for local school leavers. Indeed, some of our most talented colleagues have joined The Hanley through this scheme.

Outlook

Whatever your view of the near-future Bank of England interest rates, it is clear that the current period of historically low rates will continue for some time. The next few years will therefore continue to present challenges for smaller regional societies like The Hanley. The Building Societies Association (our trade body) predicts that the gross lending mortgage market will be flat for the next two years and therefore experience little or no growth. However, with our strategic review and subsequent plan in place, the Board are confident that we can continue to grow and succeed in serving our local community and our Members.

Mark Selby
Chief Executive
31 October 2017

> “As a team, we are the custodians of The Hanley and we have a responsibility to ensure it has a strong and relevant future.”

Moorland Pottery’s money box for the Hanley Economic.

Building society’s duck-shaped box

A BUILDING society has teamed up with a pottery company to produce a selection of duck-shaped ceramic money boxes. The Hanley Economic has commissioned Burslem’s Moorland Pottery to manufacture the exclusive money boxes as part of a campaign to encourage more people to open a savings account.
The ceramic money boxes, which include the words ‘save up at th

Our Moorland Pottery duck moneybox made it into The Sentinel, above.

Once again we were the main sponsor of the Potters ’Arf run. Below, memories of the day in a souvenir book. Right, Potters ’Arf Race Director Ken Rushton. Below right, Underwriter Gio Neglia (left) holding Potters ’Arf winners’ trophies produced by Emma Bridgewater, with Steelite Managing Director Neil Hooper holding finishers’ plates manufactured by his company.

Strategic Business Review

The Directors are pleased to present their Annual Report, together with the Group and Society Accounts and Annual Business Statement, for the year ended 31 August 2017.

Business strategy and objectives

The Board has developed a strategy to deliver its vision to be 'the chosen provider of savings and mortgages within our heartland, built on trusted values and exceptional service'.

We value –
- the support of our Members,
- the commitment, loyalty and continued development of our staff, and
- the diversity that mutuality brings to the financial services market.

We are dedicated to –
- promoting savings and home ownership,
- outstanding customer service,
- fairness in all that we do, and
- making a positive impact in our local community.

The Group's principal business objectives are the provision of mortgage finance for the purchase and improvement of residential property, savings products for private individuals and local businesses, related services and other financial services.

Markets and trends

The Society attracts retail savings primarily from its Staffordshire heartland. In line with its business objective these funds are in turn used to finance local home ownership. The savings market continued to feel the effects of the Government's initiatives such as the Funding for Lending Scheme (FLS) and the introduction of the Term Funding Scheme (TFS), which meant that savings providers lacked the appetite to aggressively compete for savers' cash. FLS and TFS are mechanisms which provide low cost funding for financial institutions to lend to individuals for mortgages and to small and medium-sized enterprises for business purposes. Furthermore, the Bank of England base rate reduced to its lowest historical rate of 0.25% in August 2016. This has meant that competition for retail savings has reduced and the rates offered to savers have fallen as a consequence across the market. The Society must balance returns for savers and excessive retail inflows which can only be lent in the mortgage market if there is sufficient demand. If the mortgage demand is not adequate, then the Society must control savings inflows. However, the Society was able to offer loyalty rates for ISA savers and fixed term bond savers throughout the year which were often amongst the best rates available in the local market.

Financial performance

The Group delivered another strong performance in 2017, with profit after tax of £1.13m (2016: £0.70m). The Society has maintained a consistent record of controlled and sustainable growth in a competitive environment, attracting saving and borrowing Members through a combination of value-for-money products and excellent customer service.

Income statement

Pre-tax profit increased by 39.60% to £1.48m (2016: £1.06m). This resulted from growth in total net income, despite an increase in administration expenses.

An overall profit after tax of £1.13m (2016: £0.70m) was a robust result in the face of strong market competition.

Net interest income

Net interest income of £5.70m was £0.78m higher than the previous year, primarily as a result of an increase in net interest margin which increased by 0.14% to 1.46% (2016: 1.32%), predominantly due to a reduction in the overall cost of funding.

Competition for mortgage business was intense during the year. Our determination to offer our Members competitive deals in line with the market meant that we reduced rates and fees on new lending, and also sought to reward the loyalty of our existing borrowers by reducing the rates we offer to those switching products. Our savings rates continue to be competitively positioned in the market as we try to protect our Members from the full impact of the historically low interest rate environment. During the year, our average savings rate reduced to 0.70% (2016: 1.05%) in line with the wider savings market, and continued to exceed the Bank of England base rate of 0.25%.

Other income and charges

Fees and commission receivable at £0.29m was on a par with the previous year (2016: £0.27m), whereas fees and commission payable at £0.12m increased slightly (2016: £0.10m).

Other fair value movements

The fair value movements are changes in the value of certain assets and liabilities, mainly interest rate swap derivatives to reflect their current market value. These differences will tend to zero as the asset or liability reaches maturity. Fair value changes in 2017 resulted in a net gain of £0.01m (2016: net loss of £0.07m).

Management expenses

The Board is committed to ensuring cost efficiency to sustain a level of profitability to protect Members' interests. During the year administrative expenses increased to £4.16m (2016: £3.93m) due to a combination of general inflationary pressures and business growth, the increased cost of regulatory compliance and an increase in staffing levels across the Society to ensure excellent customer service at all levels of the business.

Overall the management expenses ratio remained constant at 1.10% (2016: 1.10%).

Dividend income and intercompany transfer of mortgage assets

During the year the entire mortgage portfolio held within Hanley Mortgage Services Ltd was transferred to the Society. The book value of the portfolio was £5.26m. In accordance with FRS102 the Board decided to account for the transfer using merger accounting principles whereby the carrying value of the assets were not required to be adjusted to fair value.

Consideration for the transfer of the mortgages was deemed settlement of the intercompany liability Hanley Mortgage Services Ltd had payable to the Society. The difference between the book value of this liability and the book value of mortgage assets transferred represents a dividend in kind. The dividend amount of £1.71m is recognised as dividend income in the income statement of the Society, and as a reduction in equity accounts of Hanley Mortgage Services Ltd.

Provision for FSCS charges

All retail saving institutions regulated by the Financial Conduct Authority (FCA) contribute to the Financial Services Compensation Scheme (FSCS) to fund the structured wind-down of a number of previously failed institutions. The Society's share of this funding during 2017 was £78,000 (2016: £75,000).

Total assets

Total assets have increased by 6.72% from £378.17m at the end of 2016, up to £403.59m at the end of 2017. This was achieved by solid growth in mortgage balances and liquid assets funded primarily through increased retail funding.

Loans and advances to customers

Mortgage balances have increased by £11.55m in the year to £302.76m (2016: £291.21m) with gross lending (the total value of all new mortgage advances) of £69.68m (2016: £65.46m). Redemptions in the year were £45.15m (2016: £42.20m).

The rise in both gross and net lending reflects our strategy of supporting new and existing borrowers with funding from our retail base. Throughout the year we received recognition for a number of our innovative mortgage products including the 2017 Moneyfacts Best First Time Buyer Mortgage Provider accolade in recognition of our commitment in helping aspiring first time buyers to get on to the property ladder. Competitively priced products together with our focus on providing a personal service to our Members helped us to increase our total gross mortgage assets, excluding provisions, to £312.05m (2016: £300.55m). The Society's exposure to residential properties by way of mortgages is 98.16% (2016: 97.92%).

The Board remains committed to the traditional nature of its loan portfolio as residential property is the core market which the Society knows well, enabling prudent and practical lending decisions to continue to be made.

Forbearance and arrears management

The Society applies a prudent lending policy combined with a sympathetic and efficient arrears procedure to ensure that arrears are kept to a minimum. However, despite our prudent and responsible lending policy, individual borrower's circumstances can change which occasionally leads to difficulties in meeting their normal monthly mortgage payments. The Society reviews each case individually where borrowers are experiencing difficulties and offers forbearance measures where it is appropriate for the borrower. The aim of these forbearance measures is to reduce the risk of the borrower ultimately losing their home.

At 31 August 2017 there were no cases (2016: none) where the borrowers were 12 months or more in arrears. In certain circumstances the Society uses forbearance measures to assist those borrowers who are experiencing financial difficulty. In each case an individual assessment is made to ensure forbearance is in the best interests of both the borrower and the Society. It is expected that the borrowers will resume normal payments once they are able. As at 31 August 2017, there were 4 cases (2016: 5) under forbearance measures with total balances of £0.18m (2016: £0.28m) and arrears totalling £7k (2016: £4k). The Board assesses the impact of forbearance measures regularly and considers that if there is a possibility of loss, a provision is made in accordance with the Society's policies.

The main options offered by the Society include: temporary transfer to an interest only mortgage; reduced monthly payment; product review; and the extension of mortgage term.

Impaired mortgages

Included in loans secured on residential property are a total of 12 cases (2016: 13), with a balance outstanding of £13.24m (2016: £13.55m), all of which are either in possession or under management by a Law of Property Act Receiver. Although these cases have experienced previous financial difficulty, each has now been let thereby protecting the fabric of the buildings over which the Society has a charge, as well as generating an income stream which exceeds current funding costs. As at 31 August 2017 total specific impairment provisions of £3.80m (2016: £3.50m) are held against these exposures.

In respect of the portfolio of residential development loans at 31 August 2017, 3 properties (2016: 3) were either in possession or under management by a Law of Property Act Receiver, with a capital balance outstanding of £4.94m (2016: £4.93m). As at 31 August 2017 total specific impairment provisions of £4.15m (2016: £4.06m) are held against these exposures. Each of the three sites over which the Society has a charge are under contractual offer, with the sale of one site having completed in September 2017.

Liquid assets

The Society maintains a prudent level of liquid assets and continues to hold balances well in excess of regulatory requirements, primarily in a Bank of England Reserve Account, which is instantly accessible, and in UK Government Securities, which are readily convertible to cash. This provides a buffer in the event of any major funding issues arising and provides comfort that the Society will be able to meet its financial obligations under both normal and stressed scenarios. Although the Society has not experienced any difficulties in obtaining funding in the challenging market conditions that have existed in recent years, we fully recognise the importance of maintaining a strong liquidity position.

As part of the Capital Requirements Directive IV (CRD IV) package of regulatory reforms, two new measures of liquidity were recently introduced by the Prudential Regulation Authority (PRA). The Liquidity Coverage Ratio (LCR) is a measure of short term liquidity and the Net Stable Funding Ratio (NSFR) is a measure of liquidity over a longer timescale. The Society maintained liquidity quantity and quality well in excess of these regulatory requirements throughout the year.

Retail savings

The Society continues to be predominantly funded by retail savings, which increased to £333.59m at 31 August 2017 (2016: £311.01m). Savings balances from individuals accounted for 88.61% (2016: 88.42%) of our total funding. The Society experienced retail flows broadly in line with budgets throughout 2017.

Capital

Whilst delivering asset growth, the Society maintained a strong capital position throughout the year with all capital ratios significantly in excess of regulatory requirements. Reserves at 31 August 2017 of £26.16m (2016: £25.03m) grew by 4.50%, sourced solely from retained profits for the year of £1.13m.

Key performance indicators

The Board use a number of key performance indicators to monitor the development, performance and position of the Society on an ongoing basis. These are included to give Members a more comprehensive understanding of the Society's progress.

The Directors are satisfied with the Group's performance, summarised as one of sustained growth in both savings and mortgages, together with a positive contribution to the Group's capital base.

Key Performance Indicators

	2017	2016	2015
Profit after tax as a % of mean total assets	0.29%	0.19%	0.22%
Net interest margin as a % of mean total assets	1.46%	1.32%	1.33%
Gross capital as a % of shares and deposit liabilities	6.95%	7.12%	7.10%
Free capital as a % of shares and deposit liabilities	6.26%	6.35%	6.26%
Management expenses as a % of mean total assets	1.10%	1.10%	1.06%
Cost to income ratio	73.51%	82.25%	78.12%
Liquid assets as a % of shares and deposit liabilities	25.63%	23.39%	24.44%
Retail shares as a % of shares and deposit liabilities	88.61%	88.42%	84.31%
Non-retail shares as a % of shares and deposit liabilities	11.39%	11.58%	15.69%

Profit after tax as a % of mean total assets

Profit after tax is the net amount earned by the Group after taking into account all expenses and tax charges. The profit after tax ratio measures the proportion that these net earnings bear to the simple average of total assets at the beginning and end of the financial year. The Society's profit is its primary source of new capital and is essential in ensuring the long term security of the Society for its Members and meeting the Regulators' capital requirements. The Group's post-tax profit for 2017 increased to £1.13m (2016: £0.70m). The increase in post-tax profit, was driven by an increase in net interest income with only slight uplift in management expenses.

Net interest margin as a % of mean total assets

Net interest margin is interest receivable less interest payable, expressed as a percentage of the simple average of the Group's total assets at the beginning and end of the financial year. Despite increasing market competition, paticularly in respect of mortgages, the Society has increased its interest margin whilst growing both its mortgage and retails savings base.

Gross / free capital as a % of shares and deposit liabilities

Gross capital is defined as general reserves as shown in the Group's balance sheet, and free capital as the aggregate of gross capital and general loss provisions less tangible fixed assets. The Directors ensure that a satisfactory level of capital is maintained to protect the Group against adverse market movements or changes in economic conditions.

At the year end the ratio of gross capital as a percentage of total shares and deposit liabilities was 6.95% (2016: 7.12%) and free capital was 6.26% (2016: 6.35%). The Core Tier 1 (unaudited) ratio stood at 17.78% (2016: 15.47%) and the Leverage ratio (unaudited) stood at 6.20% (2016: 6.30%). Tier 1 Capital was £25.1m (2016: £23.9m) and Tier 2 Capital £0.2m (2016: £0.2m), providing total Capital resources of £25.3m (2016: £24.1m.).

The Board complies with the Basel IV Capital Requirements Directive (CRD) which requires the Society to assess the adequacy of its capital strength through an Internal Capital Adequacy Assessment Process (ICAAP). Through the ICAAP the Board is satisfied that the Society holds a level of capital more than sufficient to satisfy the CRD's Pillar 1 minimum capital requirements and to cover the ratios identified in Pillar 2. The Pillar 3 disclosures required by the CRD can be found on the Society's website, www.thehanley.co.uk.

Management expenses as a % of mean total assets

Management expenses are the Group's administrative expenses and represent the ordinary costs of running the organisation. They comprise mainly the costs of employing staff, maintaining the branch network, ongoing investment in IT and the increasing costs of regulation. The management expenses ratio measures the proportion that these expenses bear to the simple average of total assets at the beginning and end of the financial year. The management expenses ratio is one simple measure of the efficiency with which the Group is run. The Board seek to control this ratio while at the same time ensuring the Group has sufficient resources to operate effectively in a competitive and heavily regulated market.

Cost to income ratio

The cost to income ratio represents the aggregate of administration expenses, depreciation and amortisation expressed as a percentage of total income less other operating charges. In summary the ratio is an indication of the Group's efficiency in ensuring that an increase in its cost base is at least matched, or in this instance, is exceeded by total income generated.

Liquid assets as a % of shares and deposit liabilities

This ratio shows the proportion of the Society's liquid assets to the Society's liabilities to investors. Liquid assets are by their nature realisable, enabling the Society to meet requests by Members for withdrawals, make new mortgage loans and fund general business activities.

Total liquidity of £96.47m (2016: £82.27m) includes £60.01m (2016: £35.21m) deposited with the Bank of England's Reserve Account and £2.00m (2016: £2.00m) in respect of Treasury Bills. All of these investments are highly liquid and qualify towards the Society's liquidity buffer which was significantly in excess of its minimum regulatory requirement.

Retail shares as a % of shares and deposit liabilities

Retail shares balances at 31 August 2017 were £333.59m (2016: £311.01m), an increase of £22.58m (7.26%) on the previous year. This strengthening of our savings base particularly in a period of low interest rates demonstrates our competitive pricing in the market for new and existing Members.

Non-retail funding ratio as a % of shares and deposit liabilities

This ratio shows the level of shares and deposits other than shares held by individuals as a percentage of overall share and deposit liabilities. The Society has a low level of such borrowings and so has a similarly low level of exposure to uncertainties in the money market.

Other indicators

Financial ratios are just one measure of the Group's performance. It is important to the Directors that the Society is also successful in terms of the quality of customer service and Member satisfaction. The Society's Customer Forum is held on a regular basis to seek Member feedback.

Risk management report

Risk management and governance arrangements provide processes for identifying and managing the most significant risks to the Group's objectives. These processes allow the Society to be aware of these risks at an early stage and as far as possible mitigate them. The ability to properly identify, measure, monitor and report risk is vital in ensuring financial strength, appropriate customer outcomes and the ongoing security of Members' funds.

Risk governance and strategy

Risks arise naturally in the course of doing business and especially within the financial services industry. To mitigate these risks to acceptable levels, the Board has put in place a Risk Management Framework which covers all aspects of the Society's operations.

The Board is responsible for all areas of the Society's business. In particular, its role is to focus on the Society's strategy and to ensure that the necessary resources are in place to meet its objectives. The Board is likewise responsible for the design and operational effectiveness of controls within the Society. The Board Risk Committee, which comprises all Non-Executive and Executive Directors, considers all risk matters relating to the ongoing safety and soundness of the Society. Full details of the Group's governance committee structure are included in the Corporate Governance report.

Through its governance structure the Board operates an open and honest culture when identifying and monitoring risks. This culture is underpinned by appropriate risk training for staff, good risk identification and escalation procedures and a robust whistleblowing mechanism.

The Board Risk Committee has clear sight of both current and emerging risks. Underpinning this strategy is a statement of specific risks which the Board will not accept and includes any course of action that will contribute or could reasonably be anticipated to contribute to the following occurrences:

- Irreparable damage to brand and reputation;
- A prolonged loss or disruption to service to a significant number of Members and customers;
- Any significant deviation from the key elements of the Corporate Plan;
- Any breach of law;
- Breach of regulation which could lead to intervention and/or sanction; and
- Physical or mental injury to any employees, Members, customers or stakeholders.

Financial risk management

The Society has a formal structure for managing financial risk which is closely monitored and controlled by the Board, supported by the Audit & Compliance Committee and the Assets & Liabilities Committee. The Society uses financial instruments for risk management purposes, details of which are set out in Note 30.

Stress testing and scenario analysis

Stress tests are an integral part of the annual business planning process and annual review of risk appetite.

Tests are designed to ensure that the Society's financial position, particularly capital adequacy and liquidity together with its risk profile provide sufficient resilience to withstand the impact of severe economic stress on the market ('systemic stress') or Society specific ('idiosyncratic') stress events.

Stress testing also informs early-warning triggers, management actions and contingency and recovery plans to mitigate or avoid potential stresses and vulnerabilities and as such is integral to the risk management framework.

The stress-testing framework also includes reverse stress testing techniques that aim to identify circumstances under which the Society's business model could be rendered unviable, leading to a significant change in business strategy. Stress testing is used to identify, assess and quantify the potential effectiveness of management actions that could be taken to mitigate the impact of a stress.

All stress tests are forward looking, considering both current and future positions.

Risk Management Framework

The Society's Risk Management Framework comprises five elements:

1. **Articulation of the Society's Risk Appetite by the Board of Directors**

   The Board sets an overarching risk appetite statement for the Society. This is supported by a series of risk appetite statements for key risks faced which, together with measurable limits, provide a framework for decision making and to identify and articulate the risks that the Board is willing to take in delivering the Corporate Plan of the Society.

   The Society operates as a prudent organisation in the level of risk it is willing to take in order to achieve strategic goals. This approach has been disseminated by the Board throughout the Society, thereby clearly communicating the risk culture. This culture ensures the tone from the top, set by the Board, is reflected in behaviours and decision-making.

Additionally, the Board has set a boundary condition to be able to withstand a severe but plausible stress and continue to report an accounting profit and meet minimum capital requirements. The Society utilises early warning triggers through a variety of Key Performance Indicators, Board limits and regulatory limits to highlight any area of concern or potential breach of risk appetite.

The Society's performance against Board limits and early warning triggers is reviewed at each Board Risk Committee and on a quarterly basis by the Audit & Compliance Committee.

2. Board Committee Structures overseeing the Risk Management and Internal Control Framework

The Board Risk Committee oversees the Risk Management Framework (including internal controls) within the Society and to support and provide guidance to the Leadership Team, comprising the Executive Directors and Senior Managers, in the execution of their respective roles.

3. Internal Governance Framework

The Society operates an internal governance framework that includes a 'three lines of defence' model, together with structured Non-Executive and Executive Committees with defined authorities, terms of reference and reporting lines as detailed in the Corporate Governance report.

4. Appropriate Management Information

Management information is provided to the Board and relevant committees based on reporting parameters defined between the Board and Leadership Team and it is directly related to the risk appetite and strategic objectives defined by the Board.

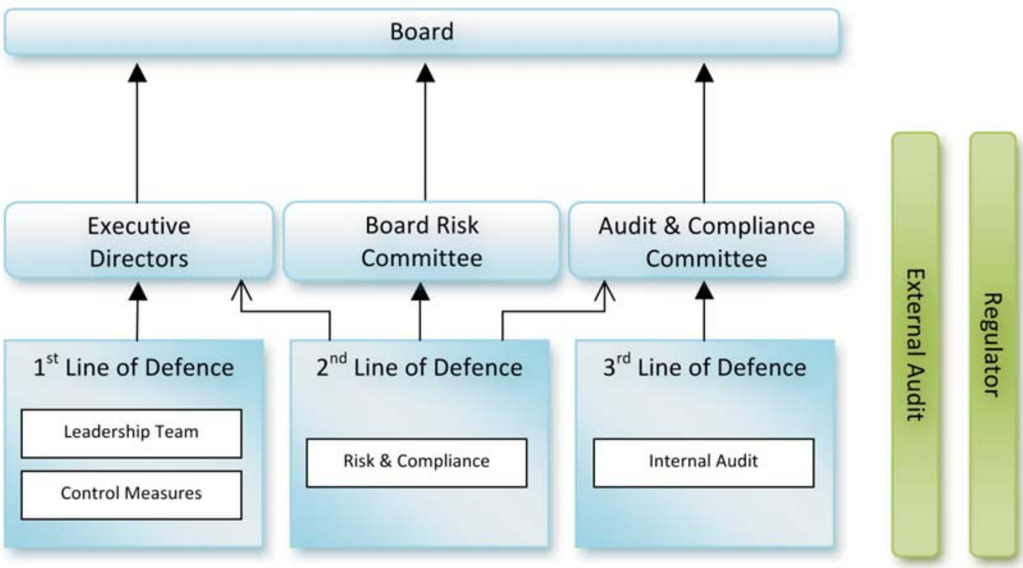
5. Continuous Process of Risk Assessment

It is important that the Society has the ability to respond to changes in the macro-economic environment, new competition and regulatory change and that the Society's Risk Management Framework supports a continuous approach to risk assessment and the determination of risk appetite and strategy. The 'three lines of defence model' ensures that there is an effective assessment of risks within the Society.

The information provided to the Board by the Leadership Team directly and via the relevant Committees continually supports the Board's consideration of the current and future risks attached to the Society's business, the nature and strength of internal controls and the strategic options.

Three Lines of Defence

The Society has a formal structure for managing risks and operates a 'three lines of defence' model which is recognised as an industry standard for risk management. The management of risks is detailed in risk management policies which are set by the Board.



First Line of Defence

The Leadership Team own and manage risks as the first line of defence. They are responsible for identifying, assessing, controlling and mitigating risks by implementing corrective actions to address process and control deficiencies.

Second Line of Defence

The Society's Risk & Compliance function is the second line of defence which monitors and reports on risk and compliance to the relevant Committee. It helps to ensure the Society complies with applicable laws and regulations and that policies and procedures are contemporary and operating as intended.

Third Line of Defence

Internal Audit provide the third line of defence providing the Audit & Compliance Committee and Board with comprehensive assurance based on a level of independence and objectivity which is not available in the second line of defence.

Principal risks and uncertainties

Building societies operate within a highly competitive financial services market, consequently many of the risks arise simply from competing within such a environment. The Hanley, like all businesses, faces a number of risks and uncertainties and seeks to actively manage these risks. The Society has an overall cautious approach to risk, which helps to maintain Member confidence particularly in difficult market conditions. The identification and management of risk is a high priority and is integral to strategy and operations. The principal risks inherent in the Society's business are detailed below.

Credit risk

Credit risk is the risk of a customer or counterparty not meeting their financial obligations to the Society as they fall due. This risk is most likely to arise in the potential inability of a customer to make repayments on their mortgage, and of treasury counterparties to repay loan commitments.

The risk of treasury counterparty default is managed through Board approved Liquidity, Funding and Structural Risk policies. Counterparty credit quality and exposure limits are monitored by the Assets & Liabilities Committee who make recommendations to the Board on changes in any of its related policies.

Mortgage credit risk is managed through the Society's underwriting process which seeks to ensure that customers can afford to repay their debt. All mortgage applications are rigorously assessed with reference to the Society's Lending Policy, changes to policy are approved by the Board and the approval of mortgage applications is mandated. All applications are supported by an independent valuation sourced from the Society's authorised panel of valuers. In the unfortunate event of customers experiencing financial difficulties the Society is highly proactive in providing support which can include working with them to clear arrears, making arrangements, or forbearance.

In respect of residential development loans, the Society additionally has potential exposure in the value of new build properties and development land. This is mitigated by taking a longer term approach to the management of its loans to this sector, which enables the Society to take advantage of any positive cyclical movements in underlying property values. This long term approach similarly applies to the Buy To Let exposures that are either in possession or subject to the Law of Property Act.

However, determining the appropriateness of impairment losses for such long term approaches is judgemental and requires the Society to make a number of assumptions. The preparation of the Society's financial statements in accordance with UK GAAP requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported value of such assets. Due to the inherent uncertainty in making estimates, actual results reported in future periods may differ from current estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. This is further explained in Note 1 to the accounts.

Liquidity risk

Liquidity risk is the risk that the Society is not able to meet its financial obligations as they fall due. The Society's Liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding to maintain full public confidence in the solvency of the Society and to meet its financial obligations. As at 31 August 2017, 64.27% (2016: 45.70%) of the Society's liquid assets were placed with the Bank of England or highly liquid UK Government Securities.

The Society manages this risk through continuous forecasting of cash flow requirements and assessment of retail and wholesale funding risk. The required amount, quality and type of liquid assets required to ensure obligations can be met at all times is maintained in accordance with the Liquidity policy. Regular stress tests are performed to ensure the Society can meet its obligations in both normal and stressed circumstances. The management of the Society's liquidity risk is overseen by the Assets & Liabilities Committee.

The Society undertakes an Internal Liquidity Adequacy Assessment Process (ILAAP) at least annually, which is reviewed by the Board. The ILAAP identifies all the major liquidity risks faced by the Society and ensures adequate liquidity is maintained. The Society also has to adhere to the Liquidity Coverage Ratio (LCR) as defined by the European Capital Requirements Directive IV (CRD IV). This regulatory requirement has been put in place to ensure that all financial institutions have sufficient liquidity to cope with a severe thirty day stressed event. The Society has an LCR far in excess of the regulatory requirements.

Market and interest rate risk

Interest rate risk represents the Society's exposure to movements in interest rates and is managed on a continuous basis, within limits set by the Board, using interest rate swaps. All transactions in such instruments are undertaken to manage the risks arising from underlying business activities. No transactions of a speculative nature are undertaken. The Society utilises hedge accounting under IAS 39 Financial Instruments: Recognition and Measurement to reduce volatility in the Income Statement.

Interest rate sensitivity arises from the potential for different interest rates to move in different ways (e.g. fixed rate mortgages funded by variable rate savings products). This is called basis risk and is reported to and monitored by the Assets & Liabilities Committee on a monthly basis. The Board has also put early warning indicators in place to highlight any potential future basis risk problems and to help ensure the Society can respond appropriately.

The interest rate sensitivity exposure of the Group is set out in Note 30 to the Annual Accounts.

The Society has no direct exposure to foreign currency exchange rates.

Operational risk

Operational risk is the risk of loss through failed or inadequate systems, human error or other external factors. It includes errors, omissions, natural disasters and deliberate acts such as fraud. The Society mitigates this risk through having a robust and effective internal control framework, including internal audit and the Society's compliance function, which are overseen by the Board Risk Committee and the Audit & Compliance Committee.

Concentration risk

The risk of loss due to a large exposure or significant exposures to groups of counterparties who could be affected by common factors for example, geographic location. The Board reviews geographic concentration of mortgage assets and the maximum value of exposures to borrowers and treasury counterparties are monitored by the Assets & Liabilities Committee.

Regulatory and legal risk

Regulatory and legal risk is the risk of fines, public censure, limitation on business, or restitution costs arising from failing to understand, interpret, implement and comply with UK and EU regulatory requirements. The Board monitors these risks and their potential impact through the Board Risk Committee and the Audit & Compliance Committee. In light of the increasing regulatory demands faced by the sector the Board is alert to the potential increase posed by regulatory risk.

Business risk

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

Conduct risk

The Board defines conduct risk as the risk that the Society does not treat its customers fairly and delivers inappropriate consumer outcomes. The Board acknowledges the requirement to fully embrace the Financial Conduct Authority's Principle 6, namely to ensure that the Society pays due regard to the interests of its customers and to treat them fairly at all times. These principles are firmly embedded within the Society's culture and working practices.

The Society recognises that failure to manage conduct risk can lead to unfair treatment of Members or mishandling of Members' accounts and may adversely affect its business operations, threaten its objectives and strategies and the objectives of the Regulator.

A structured approach to the consideration of conduct risk management enables the Leadership Team and the Board to make fully informed conduct decisions without exposing the Society or its Members to unacceptable levels of risk.

The objective of the Society declaring and implementing a Conduct Risk Policy and strategy is to ensure that appropriate actions will be taken by the Leadership Team to identify, and manage effectively, the conduct risks to which the Society and its Members may be exposed.

IT and information security

The Society continues to invest in its technology infrastructure, so that it can maintain and develop services suitable for the evolving needs and expectations of Members in the financial services markets in which it operates.

Whilst there is a strong focus on the development of customer interfaces and services, the Society is also fully aware of external threats, in particular cybercrime attacks designed to deny access to systems and compromise, or misuse, the data and assets held on Society systems. The Society has dedicated first and second line security functions, with specific responsibilities to protect Society and Members' assets.

Independent exercises are undertaken to test the Society's defences and to ensure that cyber controls evolve in line with the ever-changing complexity and unpredictability of cybercrime.

Capital management

The Society continues to comply with the capital adequacy rules of the Prudential Regulation Authority (PRA) by adopting the Standardised Approach to credit risk and the Basic Indicator Approach to operational risk. The Society undertakes an Internal Capital Adequacy Assessment Process (ICAAP) at least annually, which is approved by the Board. The ICAAP identifies all the major risks faced by the Society and allocates capital as appropriate. The ICAAP is reviewed by the PRA in setting the Society's capital requirements as Individual Capital Guidance (ICG). The Society maintains capital in excess of that required by the Regulator.

Charitable and political donations

During the year The Hanley made donations of £39,000 (2016: £37,000) to local charities. No contributions were made for political purposes. In addition, the Society sponsors, and its staff commit their time to, a range of local charitable and community causes.

Executives and staff

The Society maintains an open recruitment and staff development policy, affording equal opportunities regardless of age, gender, race, religion or disability. Staff communication and training continue to remain priorities for the Society.

The Board wish to record their thanks to the staff for the vital contribution they continue to make. Adapting to new methods of operating, particularly using new systems and software is not always easy, but doing so is essential in the rapidly changing financial services marketplace in which the Society competes. The support, co-operation and flexibility of the staff is essential to the ongoing success of The Hanley.

Acknowledgement

We would like to thank our Members for their continued loyalty and acknowledge that the Society's success could not be achieved without their support.

On behalf of the Board
P. R. Dearing
Chairman
31 October 2017

Directors' Report for the year ended 31 August 2017

Directors

The following persons were Directors of the Society during the year and up to the date of signing the Annual Accounts:

Non-Executive Directors

P. R. Dearing BEd (Hons), FCIB (Chairman)
F. B. Earley BSc, MSc
A. S. Macdonald
V. Oak
S. Woodings LLB
R. M. Young MIPA

Executive Directors

M. E. Selby BA, MBA (Chief Executive)
S. Jones BSc (Hons), FCA, MBA (Deputy Chief Executive, Finance Director & Group Secretary)

Mr P. R. Dearing and Mr A. S. Macdonald retire by rotation in accordance with the Society's rule 26(1) and being eligible offer themselves for re-election. Mr M. E. Selby and Mr R. M. Young retire in accordance with rule 25(4) and being eligible offer themselves for election.

Business Review

The Directors are pleased that the Society can report another successful year. A review of the Society's business performance over the last 12 months together with the future outlook is included in the Strategic Business Review on pages 6 to 16, which should be read in conjunction with this report.

Going concern

The Directors have developed a five year view of the business and a three year forecast of the Group's financial position for the period ending 31 August 2020. In doing so they have also considered the effects on the Society's business of operating under stressed but plausible operating conditions. As a result they are satisfied that the Society and the Group have adequate resources to continue in business for the foreseeable future. For this reason, the accounts continue to be prepared on a going concern basis.

Post balance sheet events

The Directors do not consider that there have been any events since the year end that have a material effect on the financial position of the Group or Society.

Auditors

During 2017 in line with best practice the Board tendered for the position of External Auditor and it is our intention to appoint KPMG LLP for the audit of the year ending 31 August 2018. A resolution to appoint KPMG LLP as External Auditor to the Society will be proposed at the Annual General Meeting. The current External Auditor, PricewaterhouseCoopers LLP continue to exhibit independence and objectivity of the audit process, taking into consideration relevant UK professional and regulatory requirements. We wish to thank PricewaterhouseCoopers LLP for the services that they have provided to the Society during their years as External Auditor.

Disclosure of information to auditors

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant information of which the Society's auditors are unaware, and each Director has taken all the steps that they ought to have taken as Directors to make themselves aware of any relevant information and to establish that the Society's auditors are aware of that information.

Directors Indemnity

All Directors have access to independent professional advice if required. Directors and Officers insurance has been put in place by the Society.

On behalf of the Board
P. R. Dearing
Chairman
31 October 2017

Directors' Profiles

Philip Dearing

Philip joined the Board as a Non-Executive Director in October 2009 and was appointed Chairman in October 2014. Philip has enjoyed a career in the retail financial services sector, and in Building Societies particularly. He is also a Non-Executive Director of a large regional social housing provider.

Fionnuala Earley

Fionnuala joined the Board as a Non-Executive Director on 1 September 2013. Fionnuala is Chair of the Remuneration Committee and a member of the Audit & Compliance Committee. Fionnuala has spent her career as a specialist in housing market economics. She has experience of the industry from many perspectives having worked in both the mutual and non-mutual mortgage lending sector, and for the Regulator. She is currently Chief Economist at Countrywide plc.

Andrew Macdonald

Andrew joined the Board as a Non-Executive Director in September 2014. Andrew is Chair of the Audit & Compliance Committee and a member of the Assets & Liabilities Committee. He began his career in branch banking with Barclays in the late 1970's and became a specialist in Treasury and Asset & Liability Risk Management. He later worked for Halifax, Skipton and Nationwide Building Societies, again in Treasury and Asset & Liability management roles, and was as a consequence made a Fellow of the Association of Corporate Treasurers in recognition of his work in this important area.

Veronica Oak

Veronica joined the Board as a Non-Executive Director in March 2015 and is Chair of the Risk Committee. Veronica's career has been within the financial services industry having previously been Marketing Director for a life company and a reinsurer, and spent over 20 years as an independent marketing and business development consultant. She has been a Non-Executive Director for another mutual, Family Investments and is currently on the Board of Chesnara plc and its subsidiary, Countrywide Assured and two companies within the Sanlam group in the UK. She is also on the Board of a trade body which serves the interests of life assurance and investment firms.

Directors’ Profiles *continued*

Steven Jones

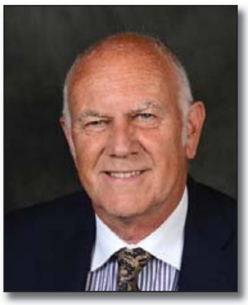
Steven was appointed Finance Director in May 2004, Deputy Chief Executive in June 2012 and Group Secretary in 2016. He is Chair of the Assets & Liabilities Committee and attends the Audit & Compliance Committee as well as the Treasury, Credit and Product Development Management Committees. Steven, who lives locally, is married and has two daughters. Outside of the Society, he is a Governor of Newcastle-under-Lyme College. He is a Fellow of the Institute of Chartered Accountants with a strong background in the financial services sector and is committed to The Hanley’s continued success as a mutual building society within Staffordshire.

Mark Selby

Mark joined The Hanley in November 2016 and has previously been Chief Operating Officer for Virgin Money and worked at Abbey National/Santander and an insurance broker. Before joining Abbey National he completed a Master’s degree at Cranfield School of Management and also has a first degree in Politics and Law. Mark is married to Libby and has two teenage sons.

Simon Woodings

Simon joined the Board as a Non-Executive Director in April 2016 and is a member of the Assets & Liabilities Committee. Simon spent his career in a Stoke-on-Trent based law firm as a corporate/commercial lawyer becoming senior partner until joining his family’s fire protection engineering business in October 2015. Simon remains a consultant to his previous law firm Beswicks Legal. Simon lives near Stone and is married with two children.



Bob Young

Bob was co-opted to the Board in May 2017 and is a member of the Assets & Liabilities Committee. Bob spent his career as an Insolvency and Turnaround Practitioner, for the last 20 years in Stoke-on-Trent, initially as a Director of PwC and later as Senior Partner of the Stoke office of Begbies Traynor. Bob then became a founder member of Currie Young Ltd from which he has now retired. Bob lives in Caverswall and is married with four children.

Directors’ Remuneration Report

Directors’ Remuneration

The purpose of this report is to inform Members of The Hanley about our policy on the remuneration of Executive and Non-Executive Directors. This Policy is reviewed annually by the Board.

The Remuneration Committee

The Committee is responsible for the remuneration policy for all Directors of the Society and it makes recommendations to the Board regarding remuneration and contractual arrangements. The Committee meets at least twice a year. In making its decisions it considers comparative remuneration packages and reviews supporting evidence, including taking external professional advice if appropriate.

Policy for Executive Directors

The Board’s policy is to set remuneration levels which will attract and retain high calibre Executive Directors, and to encourage excellent performance through rewards directly linked to the achievement of The Hanley’s strategic objectives. The main components of the Executive Directors’ remuneration are:

a) ***Basic Salary*** – which takes into account the role and position of individuals including professional experience, responsibilities, job complexity and market conditions. Basic salary is reviewed annually.

b) ***Pensions*** – which involves The Hanley contributing to the personal pension arrangements of its Executive Directors.

The Society does not have a Defined Benefit/Final Salary pension scheme.

c) ***Other Benefits*** – include the provision of a car allowance to each Executive Director, private medical insurance, income protection and a concessionary mortgage rate on loans up to £40,000. Such benefits are reviewed annually by the Remuneration Committee.

Executive Directors have contractual notice periods of up to one year and so any termination payment would not exceed 12 months’ salary and accrued benefits. The performances of both the Chief Executive and the Deputy Chief Executive, Finance Director & Group Secretary are reviewed on an annual basis by the Remuneration Committee.

Policy for Non-Executive Directors

The remuneration of all Non-Executive Directors is reviewed on an annual basis using external benchmarking data for other comparable building societies, and by a performance review process undertaken by the Society’s Board Chairman. The Chairman’s performance review is conducted by the Senior Independent Director and his remuneration is reviewed and set by the Remuneration Committee. There are no bonus schemes for Non-Executive Directors and they do not qualify for pension entitlement or other benefits. Non-Executive Directors do not have employment contracts but serve under letters of appointment following election by the Society’s Membership.

In determining remuneration the Committee considers the guidance provided by the Corporate Governance Code and applies the Financial Conduct Authority (FCA) Remuneration Code.

Directors' Remuneration

	Group and Society	
	2017	*2016*
	£000	*£000*
Directors' emoluments:		
For services as a Non-Executive Director	158	*134*
For executive services	305	*353*
	463	*487*

Emoluments of the Society's Directors are listed below.

Non-Executive Directors:	Fees £000	*Fees £000*
P. R. Dearing (Chairman)	51*	*43*
F. B. Earley	24	*21*
A. S. Macdonald	28	*27*
V. Oak	24	*21*
J. H. Wood (to 30.4.2016)	–	*13*
S. Woodings	23	*9*
R. M. Young (from 5.5.2017)	8	*–*
	158	*134*

*Includes standard Chair's fee of £38k (2016: £37k) for the financial year, plus an additional one-off sum of £13k (2016: £6k) paid in respect of supporting the Leadership Team and providing oversight during the period 1 September 2016 – 31 December 2016 following the departure of the former Chief Executive, Mr D. Webster and the arrival of the current Chief Executive, Mr M. E. Selby.

Executive Directors:	Salary	Benefits	Sub-total	Pension Contribution	Total
2017	£000	£000	£000	£000	£000
M. E. Selby (from 14.11.2016)	136	24	160	12	172
S. Jones	108	12	120	13	133
	244	36	280	25	305
2016	£000	£000	£000	£000	£000
D. Webster (to 31.8.2016)	189	11	200	28	228
S. Jones	105	7	112	13	125
	294	18	312	41	353

F. B. Earley
Chair of the Remuneration Committee
31 October 2017

Corporate Governance

Corporate Governance

The Society is committed to best practice in Corporate Governance. Our approach is based on the principles and provisions of the UK Corporate Governance Code, including the revisions effective for accounting periods beginning on or after 17 June 2016, published by the Financial Reporting Council (FRC) which applies to listed companies. Whilst the Society is not a listed company the Board has regard to the recommendations of the Code and follows those elements that are considered to be appropriate and proportionate to The Hanley. This report sets out how the Society operates and conducts its business in a prudent and efficient manner, thereby maintaining high standards of governance for the benefit of its Members, both current and future.

The Directors are satisfied that the Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for Members to assess the Society's performance, business model and strategy. The Audit & Compliance Committee reviewed and challenged the assumptions, estimates and sensitivities to key accounting estimates and are satisfied that the results are appropriately presented.

The Board

The Society's Rules require that the Board should comprise between five and nine Directors. The Board currently comprises a Chairman, five Non-Executive Directors and two Executive Directors. The Board considers that its current composition is appropriate for the proper direction of the Society's business activities. The Board considers that all its Non-Executive Directors are independent and carry out their duties with complete objectivity. Andrew Macdonald is the Senior Independent Director available to Members to address any concerns or issues they may wish to raise. However, all Directors are happy to make themselves available to Members for such purposes.

There is a formal, rigorous and transparent procedure for the appointment of new Directors. All Non-Executive vacancies are advertised via the Society's website and the local media, using professional external search and recruitment consultants when required. The Nominations Committee makes appointments having considered the balance of skills, experience, availability and core competencies required, having regard for the benefits of diversity so as to offer a depth and breadth of insight, perspective and experience on the Board. New Directors receive formal induction training and all Directors are encouraged to attend industry events, seminars and training courses to maintain an up to date knowledge of the industry and the regulatory framework within which the Society operates. All Directors must meet the test of fitness and propriety as laid down by the Regulator to fulfil their role as Directors. The Board acknowledges that best practice in UK Corporate Governance is continuously evolving and alignment to emerging standards is crucial for The Hanley. The regulatory authorities have published arrangements via Strengthening Accountability in UK Banking for a new senior managers' and certification regime which came into effect in March 2016 and the Board has ensured adherence with this regulatory change.

Performance and evaluation reviews are carried out for each Director on an annual basis by the Chairman with the Senior Independent Director carrying out the review of the Chairman.

The Society's rules require all Directors to submit themselves for election by the Members at the first opportunity after their appointment and for re-election every three years. Where a Director has served six years or more, the Board has agreed that they should put themselves forward for annual re-election by the Members.

Communications

The Board encourages communications with its Members through half-yearly customer forum meetings where the Chief Executive or Deputy Chief Executive speak informally on the main business developments and Members present have the opportunity to raise any questions. The Society holds its Annual General Meeting (AGM) in December and details of the AGM are sent to all eligible voting Members who are encouraged to attend and to use their vote or appoint a proxy to vote if they choose not to, or are unable to, attend the meeting. Voting results are published on the Society's website.

Corporate Governance *continued*

Roles and responsibilities

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose. The Chairman is responsible for the leadership of the Board and ensuring its effectiveness in all aspects of its role. The Chairman is responsible for setting the Board's agenda and promoting a culture of openness and debate and the Board strongly supports the Society's aim to look after its employees to deliver the best service levels possible at all times.

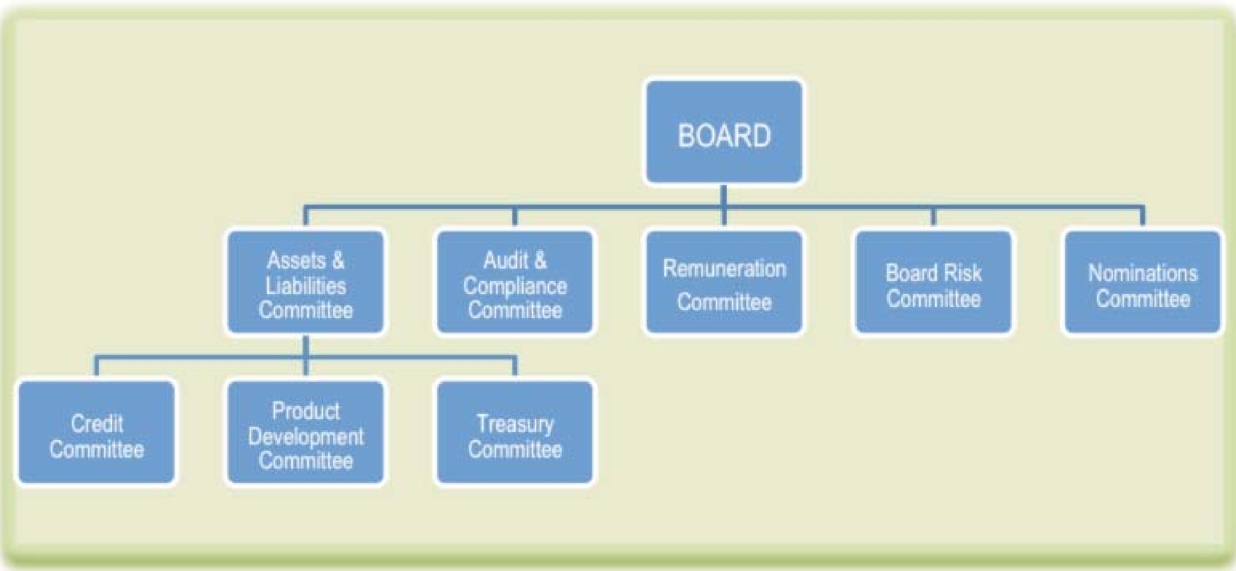
The Board meets at least 8 times per year and convenes a separate strategy meeting where the Society's strategic objectives are agreed together with financial and operational resources to deliver these objectives. For each meeting, comprehensive Board packs are circulated in a timely manner to ensure Board Members can perform their duties effectively.

The principal functions of the Board are to:

- Provide leadership and challenge;
- Set the Society's strategy, policy, internal limits, risk appetite and risk management framework;
- Ensure there are robust systems and controls in place;
- Review business performance against objectives;
- Maintain a strong capital base;
- Provide financial reporting to Regulators and Members;
- Determine remuneration of Non-Executive and Executive Directors;
- Formulate succession plans for Board and Senior Management; and
- Operate in a compliant manner and in accordance with regulatory and legal requirements.

Board Committees

The Board has 5 main sub-committees as follows:



The Credit Committee, Product Development Committee and Treasury Committee are management committees reporting to the Assets & Liabilities Committee.

Board Committees *continued*

1. The Assets & Liabilities Committee convenes monthly and monitors and controls balance sheet risk, funding and liquidity in accordance with the Society's policy. For the year to 31 August 2017 the Committee initially comprised two Non-Executive Directors, Andrew Macdonald and Simon Woodings, and was extended following the appointment of Robert Young in May 2017, and two Executive Directors, Steven Jones (Chair) and Mark Selby following his appointment in November 2016.

2. The Audit & Compliance Committee meets quarterly and reviews the effectiveness of internal controls, the compliance function and the Society's risk management function. It considers and recommends the appointment of the internal and external auditors and monitors their effectiveness and independence. For the year to 31 August 2017 the Committee comprised three Non-Executive Directors, Andrew Macdonald (Chair), Philip Dearing and Fionnuala Earley.

3. The Remuneration Committee meets half yearly and independently reviews and recommends changes to the terms and conditions of employment of the Directors and Senior Managers. For the year to 31 August 2017 the Committee comprised three Non-Executive Directors, Fionnuala Earley (Chair), Veronica Oak, and Philip Dearing.

4. The Board Risk Committee, chaired by Veronica Oak, meets at least 6 times per year and reviews and monitors risk tolerance in accordance with the Board's stated risk appetite and Risk Management Framework. The Society's risk management function is based on three lines of defence to ensure appropriate responsibility is allocated to the Leadership Team for the reporting and escalation of risks. The business areas provide the first line of defence which includes ensuring the Society complies with policies, risk appetite and limits, stress testing, self-assessment and development of risk registers. The Risk and Compliance functions comprise the second line of defence, developing the risk framework and undertaking risk monitoring, challenge and oversight. Internal Audit act as the third line of defence, providing an independent challenge to the overall management of the framework and also providing assurance to the Board and Audit & Compliance Committee on the adequacy of both the first and second lines of defence. It ensures that risks are appropriately managed in accordance with policy and within the limits of the Board's stated risk appetite and provides assurance that the Society is adhering to regulatory risk requirements by monitoring actions taken to resolve any risk control weaknesses or failings in the Society's strategy, operations and performance. All Directors of the Society are members of the Board Risk Committee and members of the Leadership Team attend by invitation.

5. The Nominations Committee meets as required to consider Board appointments and to ensure that it comprises sufficient Directors who are fit and proper, independent and who can meet the collective and individual responsibilities of Board members. All Directors of the Society are members of the Nominations Committee.

Attendance at Board and Committee meetings for the year to 31 August 2017 has been recorded as follows:-

	Board	Assets & Liabilities	Audit & Compliance	Remuneration	Risk	Nominations
P. R. Dearing	8 (8)	-	4 (4)	3 (3)	7 (7)	4 (4)
F. B. Earley	8 (8)	-	2 (4)	3 (3)	7 (7)	4 (4)
S. Jones	8 (8)	11 (11)	-	-	7 (7)	4 (4)
A. S. Macdonald	8 (8)	10 (11)	4 (4)	-	7 (7)	4 (4)
V. Oak	8 (8)	-	-	2 (3)	6 (7)	3 (4)
M. E. Selby (from 14.11.2016)	6 (6)	8 (10)	-	-	6 (6)	3 (3)
S. Woodings	8 (8)	11 (11)	-	-	7 (7)	4 (4)
R. M. Young (from 5.5.2017)	3 (3)	5 (5)	-	-	3 (3)	2 (2)

( ) = number of meetings eligible to attend

P. R. Dearing
Chairman
31 October 2017

Audit & Compliance Committee Report

The Audit & Compliance Committee is an essential part of the Society's governance framework to which the Board has delegated oversight of financial reporting, internal controls, internal audit and external audit. This report provides an overview of the Committee's work and details of how it has discharged its responsibilities during the year.

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

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

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

The composition of the Committee is detailed on page 24. The Chief Executive, the Deputy Chief Executive & Finance Director and the Head of Risk & Compliance attend the meeting by invitation. Both the Internal and External Auditors are also invited to each meeting, which commences with a discussion without the Executive Directors being present.

Key areas reviewed during 2017

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

1. Financial Reporting

The primary role of the Committee in relation to financial reporting is to review and assess with the Leadership Team and the external auditor the integrity and appropriateness of the annual financial statements concentrating on amongst other matters:

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

The primary areas of judgement considered by the Committee in relation to the 2017 accounts were:

- Loan loss provisions: Review of judgements used to determine timing of recognition and valuation of loan loss provisions in line with FRS102 and IAS39;
- Revenue recognition: Review of the design, implementation and effectiveness of controls around the calculation of interest income and charges, including the timing of fees and commission recognition under effective interest rate methodologies;
- Hedge accounting: Review of systems and processes used to calculate effectiveness of hedges and impact on Income Statements and Statement of Financial Position under IAS39; and
- Mortgage asset transfer: Review of the appropriate accounting treatment in line with FRS102 of the transfer of the mortgage assets from Hanley Mortgage Services Ltd to the Society.

The Committee considered whether the 2017 Annual Report and Accounts were fair, balanced and understandable. The Committee did this by satisfying itself that there was a robust process of review and challenge to ensure balance and consistency.

The Committee fully discharged its responsibilities in relation to financial reporting of the Annual Report and Accounts 2017.

2. Internal Audit

The Committee is responsible for monitoring internal audit activities and effectiveness and ensuring that sufficient resources are in place. In order to provide the scalability and flexibility of specialist resources required within internal audit, the Society continues to outsource this role to RSM.

Key reviews were completed through their agreed work programme during the year including areas of internal control significance, specifically, online functionality project control, information security and cyber-crime, lending and underwriting processes, complaints, financial promotions and financial crime, compliance monitoring and training and competency scheme.

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

The Committee considers guidance from the Chartered Institute of Internal Auditors entitled 'Effective Internal Audit in the Financial Services Sector' when ensuring that the internal auditors and the Committee were fulfilling their obligations in a robust manner.

The Committee also approved the fee for the programme of internal audit work for the year having reviewed the scope of the work programme in detail.

3. System of Internal Controls

The Board recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of Members' and Society assets. Internal control also facilitates the effectiveness and efficiency of operations, helps to ensure the reliability of internal and external reporting and assists in compliance with applicable laws and regulations.

The Society operates in a dynamic business environment and, as a result, the risks it faces are continually changing. The internal control framework has been designed to ensure thorough and regular evaluation of the nature and extent of risk and the Society's ability to mitigate or react accordingly. It is the role of the Leadership Team to implement the Board's policies on risk and control. It is also recognised that all employees have responsibility for internal control as part of their accountability for achieving objectives. Staff training and induction is designed to ensure that they are clear on their accountabilities in this area and are competent to operate and monitor the internal control framework.

The Internal Auditor provided independent assurance to the Board on the effectiveness of the internal control framework through the Committee.

The Committee review the internal control framework through regular reporting from the Leadership Team, Internal and External Auditors. The main internal control matters which were reviewed by the Committee in 2017 were:

- Prudential and conduct related;
- Internal audit plans;
- Control reports from the Internal Auditor;
- The status of any issues raised in control reports to ensure a timely resolution; and
- Whistleblowing arrangements.

The information received and considered by the Committee provided 'adequate and effective' assurance that during 2017 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate internal control framework.

4. External Audit

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

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

The Committee approved the fees for audit services for 2017 after a review of the level and nature of the work to be performed and being satisfied that the fees were appropriate for the scope of the work required.

The Committee considers the reappointment of the External Auditor, including rotation of the Audit Partner, each year and also assesses their independence on an ongoing basis.

During 2017, in line with best practice, the Committee oversaw the tender process for the position of External Auditor for the year ending 31 August 2018. Following a structured and objective assessment of the tenders received the Committee recommended to the Board the appointment of KPMG LLP. A resolution to appoint KPMG LLP as External Auditor to the Society will be proposed at the Annual General Meeting. The Committee wishes to thank PricewaterhouseCoopers LLP for the services that they have provided to the Society during their years as External Auditor.

5. Audit & Compliance Committee effectiveness

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

A. S. Macdonald
Chair of the Audit & Compliance Committee
31 October 2017

Directors’ Responsibilities

Directors’ responsibilities for preparing the Annual Accounts

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

The Directors are required by the Building Societies Act 1986 (The Act) to prepare, for each financial year, Annual Accounts which give a true and fair view:

- of the state of the affairs of the Society and of the Group as at the end of the financial year;
- of the income and expenditure of the Society and of the Group for the financial year;
- of the cash flows of the Society and of the Group for the financial year.

In preparing those accounts, the Directors are required to:

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

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

The Directors are responsible for the maintenance and integrity of the Society’s website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors’ responsibilities for accounting records and internal control

The Directors are responsible for ensuring that the Society and Group:

- keeps accounting records in accordance with the Building Societies Act 1986;
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Conduct Authority and Prudential Regulation Authority under the Financial Services and Markets Act 2000.

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

On behalf of the Board
P. R. Dearing
Chairman
31 October 2017

Independent Auditors’ Report

Independent auditors’ report to the Members of The Hanley Economic Building Society

Report on the audit of the annual accounts

Our Opinion

In our opinion, The Hanley Economic Building Society’s Group annual accounts and Society annual accounts (the “annual accounts”):

- give a true and fair view of the state of the Group’s and of the Society’s affairs as at 31 August 2017 and of the Group’s and the Society’s income and expenditure and the Group’s and the Society’s cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 “The Financial Reporting Standard applicable in the UK and Republic of Ireland”, and applicable law); and
- have been prepared in accordance with the requirements of the Building Societies Act 1986.

We have audited the annual accounts, included within the Report & Accounts (the “Annual Report”), which comprise the Group and Society statements of financial position as at 31 August 2017; the Group and Society income statements; the Group and Society statements of comprehensive income; the Group and Society statements of cash flows; the Group and Society statement of changes in members’ interests for the year then ended; the accounting policies; and the notes to the annual accounts.

Our opinion is consistent with our reporting to the Audit & Compliance Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (“ISAs (UK)”) and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditor’s responsibilities for the audit of the annual accounts section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group and Society in accordance with the ethical requirements that are relevant to our audit of the annual accounts in the UK, which includes the FRC’s Ethical Standard applicable to public interest entities and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC’s Ethical Standard were not provided to the Group and Society.

The non-audit services that we have provided to the Group and its subsidiaries, in the period from 1 September 2016 to 31 August 2017, are disclosed in the Annual Report within note 7 to the annual accounts.

Our audit approach

Overview

Materiality

- £260,000 – Group annual accounts

  Based on 1% of Group net assets
- £234,000 – Society annual accounts

  Based on 1% of Society net assets

Audit scope

- We conducted all of our audit work from Stoke-on-Trent using one audit team.
- Audit procedures were performed over all material account balances and financial information in the Society due to its significance to the Group’s financial performance and position.
- Audit procedures were performed over specific account balances and financial information in two other Group undertakings that materially contributed to the Group’s financial performance and/or position.

Key audit matters

- Loan loss provisioning
- Hedge accounting
- Effective interest rate accounting
- Asset transfer from Hanley Mortgage Services Limited to the Society

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the annual accounts. In particular, we considered where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the annual accounts of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in our audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Loan loss provisioning (Group and Society) See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates and note 9 for detailed disclosures. The Group and Society has recognised an impairment charge on loans and advances to customers of Nil (2016: gain of £245,000) in the year. A specific provision of £9,141,000 (2016: £9,196,000) and a collective provision of £150,000 (2016: £150,000) is held at year end. The specific provision covers individually significant loans and advances where the customer is experiencing a specific case of difficulty, the property is in possession by the Society, or in arrears. The Society is currently engaged in disposing of this portfolio under a managed disposal plan. The value of the portfolio remains significant in the context of the results in current and previous years. Significant judgement needs to be applied by the directors to estimate the potential loss on loans where an impairment event has occurred. Judgement is required in respect of identifying an impairment trigger event on loans and, once impaired, the estimate of loss on a loan is calculated by use of models to discount the future cash flows expected to be received on the loan. The calculation is impacted by a number of assumptions which we focused on, including, but not limited to: • The value of the underlying security at the time of planned disposal; • Likelihood of continuing to receive cash flows between the year end date and the date of planned disposal; and	We have discussed the basis of the loan loss provision policy extensively with both management and the Audit & Compliance Committee throughout the year and in prior years. We have tested impairment models and independently tested or corroborated key inputs and assumptions. We tested the significant inputs in the models to underlying evidence from loan documentation, for example by agreeing property values to latest valuations provided by external third parties (indexing where required) and other details to tenancy agreements. To test the key assumptions within impairment calculations, we reviewed supporting data used by the directors' to form their assumptions. We tested this data back to historic transactions where appropriate. We also undertook sensitivity analysis on all significant assumptions (including time to disposal, house price forecasts, redemption cash flows and probabilities of default) to assess the degree of change required in those assumptions to result in material movement in the loan loss provisions, and assessed the likelihood of such changes arising individually and in aggregate. Where the directors relied on third party property valuations, we engaged valuations experts to review the appropriateness of a sample of these valuations and to check they were in line with industry standard requirements. This includes assessing the appropriateness of the surveyors used and their competencies. We evaluated the outcome of specifically impaired loans that redeemed in the year by comparing the losses arising to previously calculated impairment provisions in order to assess management's

Key audit matter	How our audit addressed the key audit matter
• The exit strategy of the Society, which determines the date at which proceeds from the loan will be realised. The above are subject to significant estimation uncertainty and as a result there is an increased risk that actual losses may be materially different to impairment allowances.	ability to accurately calculate loan loss provisions. Where specifically impaired loans have been redeemed post year end, we compared post year end sale proceeds to the year end provisions. In evaluating the completeness of the loan loss provisions we reviewed a sample of the controls relied upon by the directors to ensure accurate capture of arrears, forbearance and loan to value information, including the allocation of cash receipts from borrowers to the correct loan accounts. We reviewed the "watch lists" representing borrowers being monitored by the Credit Committee, to identify any loans of higher risk and investigated the past performance of these loans to assess if an impairment event had occurred. We also re-performed management's process for identifying specifically impaired loans based on the year end loan book data. This included assessing whether any loan accounts that are recognised as not impaired displayed impairment indicators that were not captured by management's impairment policy. Based on the evidence we obtained, we determined that the assumptions used within the loan loss provisions and the data used within models were reasonable and the accounting estimate is within an acceptable range calculated in accordance with accounting standards.
Hedge accounting (Group and Society) See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates and note 6 for the detailed disclosures. The Society's operations expose the Group to significant interest rate risk as a result of a mismatch between fixed and floating interest cash inflows and outflows. The directors have sought to mitigate the risk of future movements in market interest rates affecting profitability through the use of derivative financial instruments, in the form of interest rate swap contracts. The directors designated these under hedge accounting arrangements, to reduce the effect of future movements in interest rates on the amounts recorded in the financial statements. The Society uses valuation models to determine the fair value of both interest rate swaps and the fixed interest rate mortgages that they are hedged against at the balance sheet date. The Society also uses models to assess hedge effectiveness for the accounting hedges as required by accounting standards. The directors manually track hedge ineffectiveness that arises as a result of limitations in the models used. We focused on this area as the hedge accounting rules are complex. Combined with the number of both fixed interest mortgages and interest rate swaps held on balance sheet, this gives rise to an increase in the risk of error in application.	We discussed the risks associated with hedge accounting due to the complexity of the application of accounting standards, with the Audit & Compliance Committee throughout the year and in the prior year. We also discussed the importance of, and the risks associated with, reliance on manual processes to calculate hedge ineffectiveness arising throughout the year and on the year end balance sheet. We updated our understanding of management's calculations and tested the process for the designation and monitoring of hedge relationships, in addition to management's performance of hedge effectiveness testing. The underlying calculations are system driven, but the process for monitoring hedge ineffectiveness is manual. We validated system driven calculations and manual calculations and agreed them to the financial statements. We obtained and read the Society's latest hedge accounting documentation to evaluate whether this documentation was compliant with accounting requirements for applying hedge accounting. We obtained a sample of derivative contracts and undertook independent valuations of these instruments at the balance sheet date using our own models. We also independently re-calculated fixed interest mortgage fair values at the balance sheet date using independent models. Within our models we used externally available sources for interest rate yield curves to arrive at our independent estimate.

Key audit matter	How our audit addressed the key audit matter
In particular, we focussed on: • system driven fair value calculations performed over interest rate swaps and fixed rate mortgage contracts; • results of system driven hedge effectiveness tests performed throughout the year; and • the Society's hedge documentation and calculation spreadsheets used to calculate ineffectiveness in hedge relationships.	Management's fair value calculations rely on the accurate loading of internal balance sheet date and independent market data into their hedge accounting software. We performed a combination of controls and substantive testing over the accurate loading of data into this hedge accounting software during the year and as at the balance sheet date. We obtained and re-performed the hedge effectiveness calculations undertaken by management in assessing the effectiveness of the Society's hedge relationships. In performing this work we also recalculated the ineffectiveness recorded within the income statement. We performed testing procedures over the completeness and accuracy of management's manual tracking of hedge ineffectiveness, back to source data relating to derivatives and fixed interest mortgages. We also recalculated the manual calculations performed by management and found them to be mathematically accurate. Our testing did not identify any material discrepancies in hedge documentation, or material errors in the application of accounting rules or calculations of fair values on the year end balance sheet.
Effective interest rate accounting (Group and Society) See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates. Loans and advances to customers are held at amortised cost and interest receivable is recognised using the effective interest rate method. The recognition of interest receivable using the effective interest rate method requires judgement by management regarding the expected life of mortgage assets. This is because accounting standards require that interest income is recognised using a constant yield over the estimated life of loans, which requires incorporating fee income charged to customers over the life of a mortgage product into the effective interest rate. Loans and advances to customers presented in the statement of financial position are adjusted for fees charged to customers at inception which are recognised over the assumed expected behavioural life of these assets. We focused our work on the appropriateness of management's assumptions in light of historic redemption experience, mathematical accuracy of the underlying calculations and consistent of management's calculations with accounting standards.	We understood the basis of management's process for recognising interest income using the effective interest rate method, and identified the key data inputs and assumptions within management's calculation. We reviewed the approach to management's interest income recognition to determine whether it is consistent with applicable accounting standards. This included assessing whether the fees included within management's model should be included within the effective interest rate. We agreed loan book standing data to management's calculations for the effective interest rate asset, including fees charged, contractual interest rates, mortgage promotional periods, and contractual cash flows. We tested the supporting data set behind management's assumption regarding the behavioural life of loans and advances to customers for completeness and accuracy. We performed sensitivity analysis over this assumption to consider how the Group's interest income recognition would change in the event of management using a different assumption. We identified that the assumption used by management reflected their historical redemption experience. Based on the evidence we obtained, we determined that interest income recognition is consistent with management's loan book experience and accounting standards.

Key audit matter	How our audit addressed the key audit matter
Asset transfer from Hanley Mortgage Services Limited to the Society (Society only) See note 16 to the annual accounts for management's disclosures relating to the transaction. On 1 March 2017 Hanley Mortgage Services Limited transferred its entire mortgage portfolio to the Society in exchange for settlement of the intercompany liability that Hanley Mortgage Services Limited owed to the Society. As the value of the mortgage portfolio was greater than the value of the intercompany liability, this transaction represents in a 'dividend in kind', resulting the Society recognising a dividend in its stand-alone income statement. We focused our work on assessing whether the transfer satisfied the criteria for de-recognition from the subsidiary balance sheet and at what value the assets should be recognised on the Society balance sheet. We also focused on the legality of the dividend payment and its accounting treatment, as well as how this is disclosed and discussed within the Annual Report.	We reviewed management's evidence for the operational transfer of administration of the mortgage assets from Hanley Mortgage Services Limited to the Society and concluded that this transfer gave rise to accounting de-recognition within the books and records of the company. We considered the value at which the mortgage assets should be recognised on the Society balance sheet and determined that it was appropriate for the assets to be recognised at book value at the date of transfer. We considered that the transfer should be treated as a distribution from Hanley Mortgage Services Limited to the Society, where the consideration for the distribution is the settlement of the intercompany balance between the two entities. We agreed the accounting adjustments posted by management to reflect the transfer and agreed that they had been accurately recorded within the financial statements. We recalculated the value of dividend income recognised in the income statement of the Society. Based on the evidence we obtained, we determined that the transfer has been recorded and disclosed in accordance with accounting standards.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the annual accounts as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

All of the Group's activities are in the United Kingdom and it reports its operating results along a single business line, being the provision of mortgage finance for the purchase and improvement of residential property, savings products for private individuals and local businesses and related services. The Group is formed of the Society and two subsidiaries, Hanley Financial Services Limited and Hanley Mortgage Services Limited, both of which are material to the Group. A significant proportion (97%) of the Group's operating profit for the year is driven by the Society, along with (100%) of the Group's total assets. Significant activity in other Group entities includes:

- The provision of financial advice to customers, undertaken by the subsidiary Hanley Financial Services Limited; and
- The provision of back book mortgage administration services, undertaken by the subsidiary Hanley Mortgage Services Limited, which has been transferred to the Society during the year.

The accounting records and functions for all entities within the Group are located at the Society's principal office in Stoke-on-Trent, with consolidation of the Group annual accounts being performed from this location.

Our audit procedures on the Society and its subsidiary undertakings provided us with sufficient audit evidence as a basis for our opinion on the Group annual accounts as a whole.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the annual accounts as a whole.

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

	Group annual accounts	Society annual accounts
Overall materiality	£260,000 (2016: £190,000)	£234,000 (2016: £187,000)
How we determined it	1% of net assets (2016: 2% of interest income)	
Rationale for benchmark applied	Following a re-assessment in the year, net assets has been considered the most appropriate benchmark to use in the current environment for the Society and Group, given their strategy is not one purely of profit maximisation but instead to provide a secure place for customer investments, in a mutual environment. Regulatory capital is the key benchmark for management and regulators, but is not a statutory accounts measure. Hence the materiality calculation is based on net assets, as this approximates to regulatory capital resources given the simple funding structure of the Society and Group.	

We agreed with the Audit & Compliance Committee that we would report to them misstatements identified during our audit above £13,000 (Group audit) (2016: £9,500) and £11,700 (Society audit) (2016: £9,250), as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the annual accounts is not appropriate; or
- the directors have not disclosed in the annual accounts any identified material uncertainties that may cast significant doubt about the Group's and Society's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the annual accounts are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Society's ability to continue as a going concern.

Reporting on other information

The other information comprises all the information in the Annual Report other than the annual accounts and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the annual accounts does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the annual accounts, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the annual accounts or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the annual accounts or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Annual Business Statement and Directors' Report we also considered whether the disclosures required by the Building Societies Act 1986 have been included.

Building Society Act 1986 – Opinion on Annual Business Statement and Directors' Report

In our opinion, based on our work undertaken in the course of the audit:

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the year ended 31 August 2017 is consistent with the accounting records and the annual accounts; and

- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given

Responsibilities for the annual accounts and the audit

Responsibilities of the directors for the annual accounts

As explained more fully in the Directors' Responsibilities Statement set out on page 28, the directors are responsible for the preparation of the annual accounts in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the directors are responsible for assessing the Group's and the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the annual accounts

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

A further description of our responsibilities for the audit of the annual accounts is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Building Societies Act 1986 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit & Compliance Committee, we were appointed by the members on 5 December 2016 to audit the annual accounts for the year ended 31 August 2017. The total period of uninterrupted engagement is 13 years, covering the years ended 31 August 2005 to 2017.

Andrew Batty (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
East Midlands
31 October 2017

Income Statements

For the year ended 31 August 2017	Notes	Group 2017 £000	*Group 2016 £000*	Society 2017 £000	*Society 2016 £000*
Interest receivable and similar income	2	8,742	*9,087*	8,656	*8,897*
Interest payable and similar charges	3	(3,043)	*(4,166)*	(3,043)	*(4,166)*
Net interest income		5,699	*4,921*	5,613	*4,731*
Fees and commissions receivable	4	294	*274*	162	*157*
Fees and commissions payable	5	(115)	*(103)*	(85)	*(78)*
Net gains / (losses) from derivative financial instruments	6	11	*(71)*	11	*(71)*
Dividend income	16	–	*–*	1,714	*–*
Total net income		5,889	*5,021*	7,415	*4,739*
Administrative expenses	7	(4,159)	*(3,927)*	(4,017)	*(3,776)*
Depreciation and amortisation	17/18	(157)	*(188)*	(157)	*(188)*
Other operating charges		(18)	*(18)*	(18)	*(18)*
Operating profit before impairment losses and provisions		1,555	*888*	3,223	*757*
Impairment gains / (losses) on loans and advances	9	–	*245*	(50)	*245*
Provision for contingent liabilities and commitments – FSCS levy	25	(78)	*(75)*	(78)	*(75)*
Profit on ordinary activities before tax		1,477	*1,058*	3,095	*927*
Tax on profit on ordinary activities	10	(342)	*(362)*	(324)	*(334)*
Profit for the financial year	27	1,135	*696*	2,771	*593*

The notes on pages 41 to 74 form part of these accounts.

The above results are all derived from continuing operations. The profit for the financial year is attributable to the Members of the Society.

Statements of Comprehensive Income

For the year ended 31 August 2017

	Notes	Group 2017 £000	*Group 2016 £000*	Society 2017 £000	*Society 2016 £000*
Profit for the financial year		1,135	*696*	2,771	*593*
Items that may be subsequently reclassified to the Income Statement					
Available for Sale Reserve	28	(8)	*41*	(8)	*41*
Tax on items that may be reclassified to the Income Statement	28	(1)	*(9)*	(1)	*(9)*
Other Comprehensive Income for the year net of tax		(9)	*32*	(9)	*32*
Total Comprehensive Income for the financial year		1,126	*728*	2,762	*625*

Statements of Financial Position

As at 31 August 2017

	Notes	Group 2017 £000	*Group 2016 £000*	Society 2017 £000	*Society 2016 £000*
ASSETS					
Liquid assets					
Cash in hand and balances with the Bank of England	11	60,354	*35,583*	60,354	*35,583*
Loans and advances to credit institutions	12	8,018	*6,956*	7,763	*6,829*
Debt securities	13	28,097	*39,732*	28,097	*39,732*
		96,469	*82,271*	96,214	*82,144*
Derivative financial instruments	14	7	*–*	7	*–*
Loans and advances to customers	9/15	302,760	*291,211*	302,760	*285,624*
Investments in subsidiary undertakings	16	–	*–*	–	*3,838*
Tangible fixed assets	17	2,649	*2,739*	2,649	*2,739*
Intangible fixed assets	18	96	*118*	96	*118*
Other assets - deferred taxation	26	913	*1,107*	913	*1,098*
Prepayments and accrued income	19	697	*721*	697	*721*
Total assets		403,591	*378,167*	403,336	*376,282*
LIABILITIES					
Shares	20	333,591	*311,013*	333,591	*311,013*
Amounts owed to credit institutions	21	10,523	*6,535*	10,523	*6,535*
Amounts owed to other customers	22	32,339	*34,183*	32,339	*34,183*
Derivative financial instruments	14	214	*569*	214	*569*
Other liabilities	23	56	*34*	812	*797*
Accruals and deferred income	24	534	*621*	534	*620*
Provisions for liabilities – FSCS Levy	25	176	*180*	176	*180*
Total liabilities		377,433	*353,135*	378,189	*353,897*
Reserves					
General reserves	27	26,162	*25,027*	25,151	*22,380*
Available for sale reserves	28	(4)	*5*	(4)	*5*
Total reserves attributable to Members of the Society		26,158	*25,032*	25,147	*22,385*
Total liabilities		403,591	*378,167*	403,336	*376,282*

The notes on pages 41 to 74 form part of these accounts.

Approved by the Board of Directors
on 31 October 2017

P. R. DEARING
Chairman

A. S. MACDONALD
Vice Chairman

S. JONES
Deputy Chief Executive, Finance Director & Group Secretary

Statement of Changes in Members' Interests

For the year ended 31 August 2017

GROUP	Notes	General Reserve £000	Available for Sale Reserve £000	Total £000
At 1 September 2015		24,331	(27)	24,304
Profit for the year		696	–	696
Net gains from changes in financial assets		–	32	32
At 31 August 2016	27/28	25,027	5	25,032
Profit for the year		1,135	–	1,135
Net losses from changes in financial assets		–	(9)	(9)
At 31 August 2017	27/28	26,162	(4)	26,158

SOCIETY	Notes	General Reserve £000	Available for Sale Reserve £000	Total £000
At 1 September 2015		21,787	(27)	21,760
Profit for the year		593	–	593
Net gains from changes in financial assets		–	32	32
At 31 August 2016	27/28	22,380	5	22,385
Profit for the year		2,771	–	2,771
Net losses from changes in financial assets		–	(9)	(9)
At 31 August 2017	27/28	25,151	(4)	25,147

Statements of Cash Flow

For the year ended 31 August 2017	Group 2017 £000	*Group 2016 £000*	Society 2017 £000	*Society 2016 £000*
Cash flows from operating activities				
Profit before tax	1,477	*1,058*	3,095	*927*
Depreciation and amortisation of fixed assets	157	*188*	157	*188*
(Increase) / decrease in fair value of derivative financial instruments and hedged items	(11)	*71*	(11)	*71*
(Increase) in effective interest rate adjustment	(7)	*(4)*	(7)	*(4)*
(Decrease) in impairment on loans and advances to customers	(55)	*(414)*	(5)	*(414)*
Net losses / (gains) on disposal and amortisation of debt securities	116	*(107)*	116	*(107)*
Total cashflow from operating activities	1,677	*792*	3,345	*661*
Changes in operating assets and liabilities				
(Increase) in loans and advances to customers	(11,838)	*(11,012)*	(17,475)	*(11,827)*
Decrease in intercompany indebtedness	–	*–*	3,838	*870*
(Decrease) / increase in accruals and deferred income	(87)	*19*	(86)	*19*
Decrease / (increase) in prepayments and accrued income	24	*(59)*	24	*(60)*
Increase / (decrease) in amounts owed to credit institutions	3,988	*(8,001)*	3,988	*(8,001)*
(Decrease) in amounts owed to other customers	(1,844)	*(5,012)*	(1,844)	*(5,012)*
(Increase) / decrease in loans and advances to credit institutions	(1,001)	*2,000*	(1,001)	*2,000*
(Decrease) in other liabilities	–	*(187)*	(24)	*(234)*
Increase in shares	22,578	*22,302*	22,578	*22,302*
(Decrease) in FSCS Provision	(4)	*(103)*	(4)	*(103)*
Taxation paid	(126)	*(279)*	(100)	*(238)*
Net cash generated from operating activities	13,367	*460*	13,239	*377*
Cash flows from investing activities				
Proceeds from sale of tangible fixed assets	12	*32*	12	*32*
Purchase of tangible fixed assets	(32)	*(5)*	(32)	*(5)*
Proceeds from sale of intangible fixed assets	–	*–*	–	*–*
Purchase of intangible fixed assets	(25)	*(42)*	(25)	*(42)*
Purchase of investment securities	(40,997)	*(56,477)*	(40,997)	*(56,477)*
Maturities and disposal of investment securities	52,507	*58,179*	52,507	*58,179*
Net cash used in investing activities	11,465	*1,687*	11,465	*1,687*
Net increase in cash and cash equivalents	24,832	*2,147*	24,704	*2,064*
Cash and cash equivalents at 1 September	42,539	*40,392*	42,412	*40,348*
Cash and cash equivalents at 31 August	67,371	*42,539*	67,116	*42,412*
Net cash generated from operating activities	24,832	*2,147*	24,704	*2,064*

Notes to the Accounts

1. Accounting policies

Basis of preparation

The annual accounts have been prepared in compliance with Financial Reporting Standard 102 (FRS102), IAS 39 Financial Instruments: Recognition and Measurement (IAS39) and the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended).

Basis of accounting

The annual accounts have been prepared on a going concern basis under the historical cost convention with the exception of the following:

- Available for sale assets are held at fair value;
- Derivatives and underlying hedged items are held at fair value.

The financial statements are presented in Sterling (£). There are no foreign currency transactions.

Basis of consolidation

The Group accounts consolidate the accounts of the Society and all its subsidiary undertakings, and exclude any profits or losses on intra Group transactions. These accounts are made up to 31 August 2017. Unless otherwise stated, the acquisition method of accounting has been adopted. In the Society's accounts, investments in subsidiary undertakings are stated at the lower of cost and recoverable amount. Uniform accounting policies are applied throughout the Group.

Exemptions

The Group has taken exemption as provided in Section 33.1A of FRS102 and does not disclose transactions with Members of the same group that are wholly owned.

Investments in subsidiary undertakings

Investments in subsidiary undertakings are stated at cost less any provision for impairment.

Interest income and expense

Interest income and expense in respect of all financial assets is credited to the Income Statement as it becomes receivable with the exception of certain fees and cost that are recognised on an effective interest rate basis. These include cashback, application fees, valuation fees, broker fees and higher lending fees. The effect of the policy is to spread the impact of relevant costs and fees directly attributable and incremental to setting up the loan, over the effective life of the mortgage, which broadly equates to the incentive period of the mortgage.

Interest payable on shares and amounts owed to credit institutions and other customers is accrued on a daily interest basis.

Fees and commissions

Fees payable and receivable other than relating to mortgage loans (which are recognised in accordance with effective interest rate), including sales commission, are recognised when the relevant service is provided.

Financial assets

The Group and Society have chosen to adopt the recognition and measurement provisions of IAS39, and disclosure requirements of section 11 and 12 of FRS102 in respect of Financial Instruments.

a) Loans and receivables

Loans and receivables are predominantly mortgage loans to customers and money market advances held for liquidity purposes. They are recorded at amortised cost, including any effective interest rate adjustment, less any impairment losses other than where an adjustment is made as part of a fair value hedging arrangement.

b) Financial asset at fair value through profit and loss

The Group uses derivatives only for interest rate risk management purposes. It does not use derivatives for trading purposes. A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate mortgages.

1. Accounting policies (continued)

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently re-measured at their fair value. Fair values of derivative financial instruments are calculated by discounted cash flow models using yield curves that are based on observable market data. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk within net gain/(losses) from derivative financial instruments.

All derivatives entered into by the Group are for the purposes of providing an economic hedge. Hedge accounting is an optional treatment but the specific rules and conditions in IAS39 have to be complied with before it can be applied. When transactions meet the criteria specified in IAS39, the Group applies fair value hedge accounting so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the Income Statement to offset the fair value movement of the related derivative. The Group has classified all of its derivatives as fair value hedges. To qualify for hedge accounting at inception the hedge relationship must be clearly documented. At inception the derivative must be expected to be highly effective in offsetting the hedged risk, and effectiveness must be tested throughout the life of the hedge relationship.

If the hedging derivative expires or is sold, terminated, or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, hedge accounting is discontinued prospectively. If the underlying instrument is sold or repaid, the unamortised fair value adjustment is immediately recognised in the Income Statement and therefore as a consequence within the statement of changes in Members' Interests. A summary of the effects of hedging and the associated fair value adjustments can be found in Notes 14 and 30.

c) Available for sale assets – debt securities

Available for sale assets are non-derivative assets that are intended to be held for an indefinite period of time. They may be sold in response to needs for changes in liquidity or changes in interest rates. The Group's debt securities are classified as available-for-sale assets. The Group measures debt securities at fair value, with subsequent changes in fair value being recognised through the Statement of Comprehensive Income, except for impairment losses which are recognised in profit or loss.

Further information regarding how fair values are determined can be found in Note 30 to the accounts. Upon sale or maturity of the asset, the cumulative gains and losses recognised in other comprehensive income are removed from available-for-sale reserves and recycled to the Income Statement.

d) Offsetting

Financial assets and liabilities are offset and the net amounts presented in the financial statements when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously. No such assets or liabilities are offset in the Statement of Financial Position.

e) Financial liabilities

Financial liabilities are measured at amortised cost, and are recognised on the Statement of Financial Position when the Society becomes a party to the contractual provision of the instrument. Financial liabilities are derecognised when the liability is extinguished which is when the contractual obligation is discharged or expires.

Taxation

Current tax is the amount of income tax payable in respect of the taxable profit for the year or prior years. Tax is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the period end.

The Finance Team periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax is recognised providing for temporary differences between the carrying amount of certain assets and liabilities for accounting purposes and for taxation purposes. Deferred tax is provided using tax rates enacted or substantively enacted at the Statement of Financial Position date, depending on the date at which they are expected to reverse.

1. Accounting policies (continued)

Deferred tax has been recognised in respect of all timing differences at the reporting date, with the exception of the following:

- Difference relating to investments in subsidiaries, to the extent that the parent is able to control reversal of the timing differences and it is probable they will not reverse in the foreseeable future;
- Permanent differences, other than those arising on business combinations.

FRS102 prohibits discounting of deferred tax.

Tangible fixed assets

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

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

Depreciation is provided to write off the cost, less the estimated residual value, of tangible fixed assets over their estimated useful economic lives as follows:

• Freehold buildings and leasehold properties (long)	–	50 years on a straight line basis
• Leasehold land and leasehold properties (short)	–	Life of lease on a straight line basis
• Equipment, fixtures and fittings	–	5 to 10 years on a straight line basis
• Vehicles	–	25% on the reducing balance

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

Intangible assets

The costs of computer software acquired where the Group will derive future economic benefit are capitalised at the acquisition date. Amortisation is charged to the Income Statement on a straight line basis over the estimated useful lives. Computer software is amortised from the date it is available for use. The estimated useful lives are within a range of 1 to 10 years based on historical experience.

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

Cash and cash equivalents

For the purposes of the Statements of Cash Flow, cash and cash equivalents comprise balances with less than 3 months to maturity at the Statements of Financial Position date, including cash in hand and balances with the Bank of England and loans and advances to credit institutions.

Dividend income

Dividend income is recognised when the right to receive payment is established. Where the substance of the dividend is a return of capital, that element of the dividend is offset against the carrying value of the investment. In all other cases, dividend income is taken to the income statement.

1. Accounting policies (continued)

Leases

Operating lease rentals are charged to the Income Statement account on a straight line basis over the period of the lease. The Group has no finance lease agreements.

Impairment of loans and advances to customers and forbearance

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

Objective evidence that financial assets are impaired includes:

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

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

In assessing collective impairment, the Group uses statistical modelling of historical trends such as forced sale discounts, house price movements, the timing of expected recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than is suggested by historical trends.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cashflows discounted at the asset's original effective interest rate basis. A range of forbearance options are available to support customers who are in financial difficulty. The purpose of forbearance is to support customers who have temporary financial difficulties and help them get back on track. The main options offered by the Group include:

- Temporary transfer to an interest only mortgage;
- Reduced monthly payment;
- Product review;
- Capitalisation of arrears; and
- Extension of mortgage term.

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

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

1. Accounting policies (continued)

Impairment losses on debt securities

At each Statements of Financial Position date the Group assesses whether or not there is objective evidence that individual debt instruments are impaired. In determining whether there is any objective evidence of impairment the Group takes into account a number of factors including:

- Significant financial difficulties of the issuer or obligor;
- Any breach of contract or covenants;
- The granting of any concession or rearrangement of terms;
- The disappearance of an active market;
- Any significant downgrade of ratings of the issuer or obligor;
- Any significant reduction in market value of the instrument.

In some cases a significant adverse change in one of the above factors will cause the Group to determine that there is objective evidence of impairment. In other cases it may not be possible to identify a single event that identifies impairment. The Group may additionally determine that there is impairment where there are a number of factors contributing to that view.

Where the Group determines that there is objective evidence of impairment or that trigger events exist at the statement of financial position date, then, in the case of available for sale instruments, the cumulative loss that had been recognised directly in reserves is removed from reserves and recognised in the Income Statement. In the case of held to maturity instruments an appropriate charge is made to the Income Statement.

If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be related to an event occurring after the impairment loss was recognised through the Income Statement, the impairment loss is reversed, with the amount of the reversal recognised through the Income Statement.

Pension costs

The Group contributes to personal pension plans of its staff. The Group's contributions are charged against profits in the year to which they relate. The charge to the Income Statements for the year is shown in Note 7 to the accounts.

Critical accounting estimates and judgements

As a part of the preparation of the Annual Report and Accounts the Group makes estimates and judgements that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on many factors including historical experience and expectations of future events that are believed to be reasonable under the circumstances.

These estimates and judgements are described below:

a) Impairment losses and advances

The Group reviews its mortgage portfolio to assess the adequacy of its impairment provisions at least on a quarterly basis. In undertaking this review, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before such decrease in an individual loan can be identified. This evidence may include observable data indicating that there has been an adverse change in the payments status or borrower's local economic conditions, including forbearance measures such as a transfer to interest only payment and term extensions that correlate with defaults on assets in the Group.

The Group also assesses the loss on loans and advances as a result of expected movements in house prices and the forced sale discount on properties in possession as well as the likely time taken to recover a loan through the sale of collateral. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to minimise any differences between loss estimates and actual loss experience.

1. Accounting policies (continued)

The expected date of disposal of the individual mortgage asset is an important assumption in determining the level of impairment provision. If the date of disposal was within 1 year of the Statement of Financial Position date, it would result in the impairment provision being increased from £9.1m to £11.6m. Alternatively an assumed 15 year disposal plan would result in the impairment provision being reduced from £9.1m to £8.2m.

Forecast movements in house price indices is a second important assumption in determining the level of impairment provision required. Currently the impairment provisioning models include HPI assumptions drawn from a variety of external sources. Assuming no rise in HPI over the 5 years to the planned disposal date, would result in the impairment provisioning model being increased from £9.1m to £10.6m. Conversely assuming annual growth in HPI of 5% over the 5 years to the planned disposal date would result in the impairment provisioning model being decreased from £9.1m to £8.5m.

b) Effective Interest Rate

FRS102 requires that all of the cash flows directly associated with financial instruments must be recognised in the Income Statement using the effective interest rate method. When this approach is applied to a mortgage portfolio, judgements must be made to estimate the average life of each mortgage where a product fee is attached. These judgements are applied taking into account factors including the terms of the particular products, historic repayment data and economic conditions. These estimates are updated in each reporting period to reflect the portfolio's actual performance.

c) Deferred taxation

A deferred tax asset is recognised to the extent that it is considered probable that future taxable profits will be available to utilise its carrying value. In preparing future budgets for the Group the Board consider past performance, the Group and Society's current financial position and an expectation of future growth and development. These budgets show that the Group will remain sufficiently profitable to allow for the full recognition of the deferred tax asset. In the event of future changes to UK Corporation Tax, currently at 17%, or the level of budgeted profits, may result in a change to the recognised assets.

d) Fair values of derivatives and financial assets

The Group employs the following techniques in determining the fair value of its derivatives and financial assets:

- Available for sale – measured at fair value using market prices. The Group holds a portfolio of high quality liquid assets and certificates of deposit in its management of liquidity risk; and
- Derivative financial instruments – calculated by discounted cash flow models using yield curves that are based on observable market data. These assets are held by the Group in its management of interest rate risk.

	Group		Society	
	2017	*2016*	2017	*2016*
2. Interest receivable and similar income	£000	*£000*	£000	*£000*
On loans fully secured on residential property	8,272	*8,334*	8,173	*8,098*
On other loans	146	*156*	146	*156*
On debt securities – interest and other income	202	*387*	202	*387*
On other liquid assets – interest and other income	122	*210*	122	*210*
Interest receivable from subsidiary undertaking	–	*–*	13	*46*
	8,742	*9,087*	8,656	*8,897*

		Group		Society	
		2017	*2016*	2017	*2016*
3.	**Interest payable and similar charges**	£000	*£000*	£000	*£000*
	On shares held by individuals	2,248	*3,160*	2,248	*3,160*
	On deposits and other borrowings	413	*622*	413	*622*
	Net interest expense on derivative financial instruments	382	*384*	382	*384*
		3,043	*4,166*	3,043	*4,166*

		Group		Society	
		2017	*2016*	2017	*2016*
4.	**Fees and commissions receivable**	£000	*£000*	£000	*£000*
	Insurance commissions	82	*81*	82	*81*
	Fees receivable	77	*63*	77	*62*
	Rentals and sundry income	3	*14*	3	*14*
	Fees receivable by subsidiary	132	*116*	–	*–*
		294	*274*	162	*157*

		Group		Society	
		2017	*2016*	2017	*2016*
5.	**Fees and commissions payable**	£000	*£000*	£000	*£000*
	Bank charges	45	*32*	45	*32*
	Other fees payable	70	*71*	40	*46*
		115	*103*	85	*78*

		Group		Society	
		2017	*2016*	2017	*2016*
6.	**Net gains / (losses) from derivative financial instruments**	£000	*£000*	£000	*£000*
	Derivatives in designated fair value hedge relationships	376	*(314)*	376	*(314)*
	Adjustment to hedging items in fair value hedged accounting relationships	(351)	*220*	(351)	*220*
	Derivatives not in designated fair value hedge relationships	(14)	*23*	(14)	*23*
		11	*(71)*	11	*(71)*

The net gains / (losses) from derivative financial instruments represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting is not achievable on certain items. The movement is primarily due to timing differences in income recognition between derivative instruments and the hedged assets. This gain or loss will tend to zero over time and this is taken into account by the Board when considering the Group's underlying performance.

	Group		Society	
7. Administrative expenses and staff numbers	2017	*2016*	2017	*2016*
Administrative expenses	£000	*£000*	£000	*£000*
Directors' emoluments:				
(i) Fees	158	*134*	158	*134*
(ii) For executive services	305	*353*	305	*353*
Remuneration and expenses of staff:				
(i) Salaries and wages	1,632	*1,440*	1,520	*1,314*
(ii) Social security costs	191	*178*	183	*171*
(iii) Other pension costs	134	*166*	134	*166*
Remuneration of auditors*:				
For audit work	142	*116*	142	*116*
For non-audit assurance services	19	*–*	19	*–*
Operating leases – land and buildings	58	*57*	58	*57*
Other administrative expenses	1,520	*1,483*	1,498	*1,465*
	4,159	*3,927*	4,017	*3,776*

* Remuneration of the auditors disclosed above includes VAT. The audit fee of £142,000 comprises £115,000 for the current year and £27,000 additional fees in relation to the prior year audit. The audit fee in 2017 includes £5,000 (2016: £3,000) which relates to the audit of the subsidiary financial statements.

Staff numbers	2017		*2016*	
The average monthly number of persons employed during the year was:	Full Time	Part Time	*Full Time*	*Part Time*
At head office	27	11	*24*	*10*
At branch offices	21	8	*20*	*9*
Society	48	19	*44*	*19*
Subsidiary undertakings	2	1	*1*	*2*
Group	50	20	*45*	*21*

8. Directors' and Key Managers' Remuneration

Total remuneration of the Society's Directors for the year was £463,000 (2016: £487,000). Full details are given in the Directors' Remuneration Report on page 20. Remuneration of the Leadership Team, excluding the Executive Directors, for the year was £253,000 (2016: £205,000).

The Society does not contribute to Non-Executive Directors' pensions.

Directors' loans and transactions

At 31 August 2017 there was 1 (2016: 2) outstanding mortgage loan granted in the ordinary course of business to Directors and connected persons, amounting in aggregate to £165,645 (2016: £194,986). A register is maintained at the Head Office of the Society which shows details of all loans, transactions and arrangements with Directors and connected persons. A statement, for the current financial year, of the appropriate details contained in the register will be available for inspection at the Head Office for a period of 15 days up to and including the Annual General Meeting.

9. Provision for impairment losses on loans and advances to customers

	Group			Society		
	Loans fully secured on residential property	Other loans fully secured on land	Total	Loans fully secured on residential property	Other loans fully secured on land	Total
	£000	£000	£000	£000	£000	£000
Individual provision						
At 1 September 2016	9,196	–	9,196	9,196	–	9,196
Amounts utilised	(55)	–	(55)	(55)	–	(55)
Released in the year	–	–	–	–	–	–
At 31 August 2017	9,141	–	9,141	9,141	–	9,141
Collective provision						
At 1 September 2016	138	12	150	88	12	100
Movement in the year	–	–	–	50	–	50
At 31 August 2017	138	12	150	138	12	150
Individual provision						
At 1 September 2015	9,610	–	9,610	9,610	–	9,610
Amounts utilised	(169)	–	(169)	(169)	–	(169)
Released in the year	(245)	–	(245)	(245)	–	(245)
At 31 August 2016	9,196	–	9,196	9,196	–	9,196
Collective provision						
At 1 September 2015	138	12	150	88	12	100
At 31 August 2016	138	12	150	88	12	100
Total provision:						
31 August 2017	9,279	12	9,291	9,279	12	9,291
31 August 2016	9,334	12	9,346	9,284	12	9,296

The Provisions as at 31 August 2017 and 2016 have been deducted from loans fully secured on residential property and loans fully secured on land in the balance sheet. Full details are included in Note 15, 'Loans and advances to customers'. During the year the Society disposed of 2 properties (2016: 1) utilising specific provisions of £55k (2016: £169k) previously allocated to the exposure. Furthermore the provision has been maintained for the year (2016: release of £245k).

		Group		Society	
10	**Tax on profit on ordinary activities**	2017	*2016*	2017	*2016*
		£000	*£000*	£000	*£000*
	a) Analysis of charge in year:				
	Current tax	149	*76*	140	*49*
	Under provision of tax in prior years	–	*2*	–	*2*
	Total current tax (see Note (b) below)	149	*78*	140	*51*
	Deferred tax (see Note 26):				
	Origination and reversal of timing differences	193	*284*	184	*283*
	Tax on profit on ordinary activities	342	*362*	324	*334*
	b) Factors affecting current tax charge in year:				
	Profit on ordinary activities before tax	1,477	*1,058*	3,095	*927*
	Tax on profit on ordinary activities	289	*211*	606	*184*
	Effects of:				
	Capital allowances in excess of depreciation	8	*(12)*	8	*(12)*
	Expenses not deductible for tax purposes	2	*19*	12	*19*
	Prior year adjustments	–	*2*	–	*2*
	Tax adjustments and other timing differences	(150)	*(142)*	(150)	*(142)*
	Exempt dividend in kind income	–	*–*	(336)	*–*
	Current tax charge for year	149	*78*	140	*51*

The standard rate of Corporation Tax in the UK was 19% with effect from 1 April 2017 and accordingly the Society's profits have been taxed at an effective rate of 19.58% (2016: 20%). Deferred tax has been measured based on the substantively enacted rate of 17% (2016: 18%). Further details on deferred tax are included in Note 26.

		Group and Society	
		2017	*2016*
11.	**Cash in hand and balances with the Bank of England**	£000	*£000*
	Cash in hand	342	*376*
	Bank of England Reserve Account	60,012	*35,207*
		60,354	*35,583*

Cash and cash equivalents on the Statements of Cash Flow constitutes cash in hand and balances with the Bank of England and loans and advances to credit institutions with maturities of less than three months. This totals £67,371k (2016: £42,539k) for the Group and £67,116k (2016: £42,412k) for the Society.

		Group		Society	
12.	**Loans and advances to credit institutions**	2017	*2016*	2017	*2016*
	Loans and advances to credit institutions have remaining maturities as follows:	£000	*£000*	£000	*£000*
	Accrued interest	–	*1*	–	*1*
	Repayable on demand	7,017	*6,955*	6,762	*6,828*
	In more than three months but not more than one year	1,001	*–*	1,001	*–*
		8,018	*6,956*	7,763	*6,829*

The Society has three Credit Support Annexes (CSA) for its derivative instruments which typically provides for the exchange of collateral on a daily basis to mitigate net mark to market credit exposure. As at 31 August 2017 a total exchange of collateral of £521k (2016: £541k) has taken place in accordance with the trigger points within the respective CSA. These are included within loans and advances to credit institutions and are repayable on demand.

	Group and Society	
	2017	*2016*
13. Debt securities	£000	*£000*
Treasury bills issued by UK Government	2,000	*2,000*
Certificates of deposits	26,097	*37,732*
	28,097	*39,732*

The Board consider the primary purpose of holding securities is prudential. The securities held as liquid assets are held with the intention of use on a continuing basis in the Society's activities.

	Group and Society	
	2017	*2016*
Movements in debt securities during the year are summarised as follows:	£000	*£000*
At 1 September	39,732	*41,286*
Additions	40,997	*56,477*
Disposals and maturities	(52,493)	*(58,167)*
Movement in premium and accrued interest	(131)	*95*
Gains in fair value recognised in other comprehensive income	(8)	*41*
At 31 August	28,097	*39,732*

	Group and Society		
14. Derivative financial instruments	Contract Notional Amount £000	Fair Value Assets £000	Fair Value Liabilities £000
At 31 August 2017			
Unmatched derivatives - Interest rate swaps	14,250	–	16
Derivatives designated as fair value hedges interest rate swaps	49,200	7	198
	63,450	7	214
At 31 August 2016			
Unmatched derivatives - Interest rate swaps	4,500	–	2
Derivatives designated as fair value hedges interest rate swaps	67,250	–	567
	71,750	–	569

Unmatched derivatives related to swaps which had not been matched against mortgages for hedge accounting purposes as at the relevant balance sheet date.

	Group		Society	
15. Loans and advances to customers	2017	*2016*	2017	*2016*
	£000	*£000*	£000	*£000*
Loans and advances to customers comprise:				
Loans fully secured on residential property	298,488	*286,288*	298,488	*280,701*
Loans fully secured on land	4,141	*4,441*	4,141	*4,441*
Fair value adjustment for hedged risk	131	*482*	131	*482*
	302,760	*291,211*	302,760	*285,624*

Loans and advances to customers are held at amortised cost (with the exception of loans in a hedging relationship), with interest and the associated costs being recognised in the interest receivable and similar income line of the Income Statement on an effective interest rate basis.

Fair value hedging adjustments of £131k (2016: £482k) have been made to certain fixed rate mortgages that are in fair value hedging relationships.

The maturity of loans fully secured on residential property and loans fully secured on land from the balance sheet date is as follows:

	Group		Society	
	2017	*2016*	2017	*2016*
	£000	*£000*	£000	*£000*
Repayable on demand	12,674	*10,513*	12,674	*10,513*
In not more than three months	4,616	*2,395*	4,616	*2,395*
In more than three months but not more than one year	12,759	*12,197*	12,759	*12,197*
In more than one year but not more than five years	57,807	*57,970*	57,807	*57,970*
In more than five years	223,994	*216,937*	223,994	*211,300*
	311,850	*300,012*	311,850	*294,375*
Provisions for bad and doubtful debts (See Note 9)	(9,291)	*(9,346)*	(9,291)	*(9,296)*
Fair value adjustment for hedged risk	131	*482*	131	*482*
Effective Interest Rate Adjustment	70	*63*	70	*63*
	302,760	*291,211*	302,760	*285,624*

This analysis assumes that each mortgage account will continue under its current terms and, in particular, that it will not be redeemed before the contractual maturity date. However, the Society's mortgage conditions give the Society the right to demand repayment of the mortgage debt in full after three months written notice to the borrower. When the borrower is in default repayment is due immediately.

Included in loans secured on residential property are a total of 12 cases (2016: 13), with a balance outstanding of £13.2m (2016: £13.5m), all of which are either in possession or under management by a Law of Property Act Receiver. Although these cases have experienced previous financial difficulty, each has now been let thereby protecting the fabric of the buildings over which the Society has a charge, as well as generating an income stream which exceeds current funding costs. As at 31 August 2017 total specific impairment provisions of £3.8m (2016: £3.5m) are held against these exposures.

In respect of the portfolio of residential development loans at 31 August 2017, 3 properties (2016: 3) were either in possession or under management by a Law of Property Act Receiver, with a capital balance outstanding of £4.9m (2016: £4.9m). As at 31 August 2017 total specific impairment provisions of £4.1m (2016: £4.1m) are held against these exposures. Each of the three sites over which the Society has a charge are under contractual offer, with the sale of one site having completed in September 2017.

16. Investments in subsidiary undertakings	Society Shares in subsidiary undertakings £000	Loans to subsidiary undertakings £000	Total £000
At 1 September 2016	–	3,838	3,838
Advances	–	85	85
Repayments	–	(380)	(380)
Return of capital	–	(3,543)	(3,543)
At 31 August 2017	–	–	–

The Society directly holds 100% of the issued ordinary share capital of the following companies which are registered in England and Wales:

	Principal Activity	**Registered Address**
Hanley Mortgage Services Limited	Mortgage lender	Granville House, Festival Park, Stoke on Trent ST1 5TB
Hanley Financial Services Limited	Financial advisory services	Granville House, Festival Park, Stoke on Trent ST1 5TB

Both subsidiary undertakings operate within the United Kingdom and are included in the Group's accounts.

Hanley Mortgage Services Limited is a wholly owned direct subsidiary undertaking of the Society. The Society holds 100% of the issued shares in the subsidiary. The company is registered in England and Wales. All shares are £1 ordinary shares. The principal activity of the subsidiary is the purchase and administration of mortgage portfolios. No Director had a beneficial interest in any shares or debentures of the subsidiary undertaking.

During the year the entire mortgage portfolio held within the subsidiary was transferred to the Society. The book value of the portfolio was £5.26m. In accordance with FRS102 the Board decided to account for the transfer using merger accounting principles whereby the carrying value of the assets were not required to be adjusted to fair value.

Consideration for the transfer of the mortgages was deemed settlement of the intercompany liability that Hanley Mortgage Services Ltd had with the Society. The reduction of the intercompany liability to Nil has therefore been accounted for by the Society as a return of capital. The difference between the value of the mortgages transferred and the intercompany liability has been accounted for as a dividend in kind. The dividend amount of £1.71m is recognised as dividend income in the accounts of the Society, and a reduction in equity in the accounts of the subsidiary.

Hanley Financial Services Limited is a wholly owned direct subsidiary undertaking of the Society. The Society holds 100% of the issued shares in the subsidiary. The company is registered in England and Wales. All shares are £1 ordinary shares. The principal activity of the subsidiary is providing customers with professional financial advice and services. No Director had a beneficial interest in any shares or debentures of the subsidiary undertaking.

As at 31 August 2017 amounts due to Hanley Financial Services Limited from the Society of £765k (2016: £789k) are included in Other Liabilities, see Note 23.

17. Tangible fixed assets

Group and Society

2017	Land and Buildings Freehold £000	Land and Buildings Long Lease £000	Land and Buildings Short Lease £000	Equipment, Fixtures, Fittings & Vehicles £000	Total £000
Cost at 1 September 2016	1,012	2,124	249	796	4,181
Additions during the year	–	–	–	32	32
Disposals during the year	–	–	–	(36)	(36)
Cost at 31 August 2017	1,012	2,124	249	792	4,177
Depreciation at 1 September 2016	268	277	236	661	1,442
Charge for the year	20	39	7	44	110
Disposals during the year	–	–	–	(24)	(24)
Depreciation at 31 August 2017	288	316	243	681	1,528
Net book value:					
at 31 August 2016	744	1,847	13	135	2,739
at 31 August 2017	724	1,808	6	111	2,649

Group and Society

2016	Land and Buildings Freehold £000	Land and Buildings Long Lease £000	Land and Buildings Short Lease £000	Equipment, Fixtures, Fittings & Vehicles £000	Total £000
Cost at 1 September 2015	1,012	2,124	249	849	4,234
Additions during the year	–	–	–	5	5
Disposals during the year	–	–	–	(58)	(58)
Cost at 31 August 2016	1,012	2,124	249	796	4,181
Depreciation at 1 September 2015	248	238	217	626	1,329
Charge for the year	20	39	19	61	139
Disposals during the year	–	–	–	(26)	(26)
Depreciation at 31 August 2016	268	277	236	661	1,442
Net book value:					
at 31 August 2015	764	1,886	32	223	2,905
at 31 August 2016	744	1,847	13	135	2,739

All land and buildings are occupied by the Group and the Society.

	Group and Society	
	2017	*2016*
18. Intangible fixed assets	£000	*£000*
Cost as at 1 September 2016	686	*644*
Additions during the year	25	*42*
Disposals during the year	–	*–*
Cost as at 31 August 2017	711	*686*
Amortisation as at 1 September 2016	568	*519*
Charge for the year	47	*49*
Disposals during the year	–	*–*
Amortisation as at 31 August 2017	615	*568*
Net Book Value		
at 31 August 2016	118	*125*
at 31 August 2017	96	*118*

	Group		Society	
	2017	*2016*	2017	*2016*
19. Prepayments and accrued income	£000	*£000*	£000	*£000*
Prepayments and accrued income	697	*721*	697	*721*
	697	*721*	697	*721*

	Group and Society	
	2017	*2016*
20. Shares	£000	*£000*
Held by individuals	333,591	*311,013*
	333,591	*311,013*
Repayable from the date of the balance sheet in the ordinary course of business as follows:		
Accrued interest	681	*939*
Repayable on demand	230,134	*209,344*
In not more than three months	98,940	*96,198*
In more than three months but not more than one year	3,225	*3,982*
In more than one year	611	*550*
	333,591	*311,013*

		Group and Society	
		2017	*2016*
21.	**Amounts owed to credit institutions**	£000	*£000*
	Repayable from the date of the balance sheet in the ordinary course of business as follows:		
	Accrued interest	23	*35*
	In not more than three months	3,500	*1,000*
	In more than three months but not more than one year	7,000	*5,500*
		10,523	*6,535*

		Group and Society	
		2017	*2016*
22.	**Amounts owed to other customers**	£000	*£000*
	Repayable from the date of the balance sheet in the ordinary course of business as follows:		
	Accrued interest	20	*24*
	Repayable on demand	22,830	*25,682*
	In not more than three months	636	*627*
	In more than three months but not more than five years	8,853	*7,850*
		32,339	*34,183*

		Group		Society	
		2017	*2016*	2017	*2016*
23.	**Other liabilities**	£000	*£000*	£000	*£000*
	Corporation tax due within one year	56	*34*	47	*8*
	Amounts due to Group undertakings (See Note 16)	–	*–*	765	*789*
		56	*34*	812	*797*

		Group		Society	
		2017	*2016*	2017	*2016*
24.	**Accruals and deferred income**	£000	*£000*	£000	*£000*
	Accruals	446	*522*	446	*521*
	Deferred income	88	*99*	88	*99*
		534	*621*	534	*620*

	Group 2017	Group *2016*	Society 2017	Society *2016*
25. Provision for liabilities – FSCS Levy	£000	*£000*	£000	*£000*
Provision for FSCS Levy	176	*180*	176	*180*
	176	*180*	176	*180*

As a result of notifications it has received from the Financial Services Compensation Scheme, the Society has recognised in this year's accounts a charge for a levy of £78,000 (2016: £75,000) which gives a total levy provision, as at 31 August 2017, of £176,000. This provision is in respect of the scheme year 2016/17, which is calculated with reference to the protected deposits at 31 December 2015, and the scheme year 2017/18, which has been estimated based on the protected deposits held at 31 December 2016. The levy amounts have been calculated with reference to the level of the Society's protected deposits and expected compensation levies.

The FSCS may have a further liability if there are insufficient funds available from the realisation of the assets of Bradford & Bingley Plc to fully repay the respective HM Treasury loan.

	Group 2017	Group *2016*	Society 2017	Society *2016*
26. Deferred taxation	£000	*£000*	£000	*£000*
Deferred tax asset	913	*1,107*	913	*1,098*
Elements of deferred taxation are as follows:				
Differences between accumulated depreciation and capital allowances	(123)	*(127)*	(123)	*(126)*
Other short term timing differences	1,036	*1,234*	1,036	*1,224*
	913	*1,107*	913	*1,098*
Deferred taxation at 1 September	1,107	*1,393*	1,098	*1,383*
Deferred tax charge				
Items in relation to statement of comprehensive income	(193)	*(284)*	(184)	*(283)*
Movements in relation to debt securities	(1)	*(2)*	(1)	*(2)*
At 31 August	913	*1,107*	913	*1,098*

The deferred tax asset is recognised at the substantively enacted UK Corporation Tax rate of 17% (2016: 18%). Recognition of deferred tax assets depends on the availability of future taxable trading profits. Further details are included in Note 1.

27. General reserves	Group 2017 £000	*Group 2016 £000*	Society 2017 £000	*Society 2016 £000*
At 1 September	25,027	*24,331*	22,380	*21,787*
Profit for the financial year	1,135	*696*	2,771	*593*
At 31 August	26,162	*25,027*	25,151	*22,380*

28. Available for sale reserves	Group and Society 2017 £000	*2016 £000*
At 1 September	5	*(27)*
Net (loss) / gain from change in fair value	(8)	*41*
	(3)	*14*
Corporation Tax on Available for Sale Reserve	–	*(7)*
Deferred Tax on Available for Sale Reserve	(1)	*(2)*
	(4)	*5*

29. Guarantees and other financial commitments

Annual commitments under non-cancellable operating leases, excluding VAT, are as follows:

	Group and Society 2017 Land and buildings £000	*2016 Land and buildings £000*
Within one year	47	*47*
Within two to five years	97	*144*
	144	*191*

30. 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 Society 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 Society has a formal structure for managing risk, including established risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Assets & Liabilities Committee.

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 Society in accordance with the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates. Derivatives are not used in trading activity or for speculative purposes.

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

The Society applies fair value hedging techniques to reduce its interest rate risk as follows:

Activity	**Risk**	**Fair value interest rate hedge**
Fixed rate mortgages	Increase in interest rates	Group pays fixed, receives variable
Fixed rate savings	Decrease in interest rates	Group receives fixed, pays variable

The fair value of these hedges at 31 August 2017 and 31 August 2016 are shown in Note 14.

The following table sets out a summary of terms and conditions and accounting policies for financial instruments.

Financial instrument	Terms and Conditions	Accounting Policy
Loans and advances to credit institutions	Fixed interest rates Fixed term Short to medium term maturity	Loans and receivables at amortised cost Accounted for at settlement date
Debt securities	Fixed interest rates Fixed term Short to medium term maturity	Available for sale at fair value Accounted for at settlement date
Loans and advances to customers	Secured on residential property or land Standard contractual term Fixed or variable interest rate	Loans and receivables at amortised cost if not in a hedging relationship Loans and advances held at fair value where in a hedging relationship accounted for at settlement date
Shares	Variable term Fixed or variable interest rates	Amortised cost Accounted for at settlement date
Amounts owed to credit institutions	Fixed interest rates Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date
Amounts owed to other customers	Fixed interest rates Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date
Derivative financial instruments	Fixed interest received/paid converted to variable interest paid/received Based on notional value of derivative	Fair value through profit and loss Accounted for at trade date

30. Financial instruments continued

Financial assets and liabilities are measured on an ongoing basis either at fair value or amortised cost. Note 1 describes how the classes of financial instruments are measured, and how income and expenses, including fair value and gains and losses, are recognised. The tables below analyse the Group's assets and liabilities by financial classification.

Carrying values by category 31 August 2017	Group					
	Held at amortised cost		Held at fair value			
	Loans and receivables	Cash and financial assets and liabilities at amortised cost	Available-for-sale	Derivatives designated as fair value hedges	Unmatched derivatives	Total
Financial assets	£000	£000	£000	£000	£000	£000
Cash in hand and balances with Bank of England	–	60,354	–	–	–	60,354
Loans and advances to credit institutions	8,018	–	–	–	–	8,018
Debt securities	–	–	28,097	–	–	28,097
Derivative financial instruments	–	–	–	7	–	7
Loans and advances to customers	302,760	–	–	–	–	302,760
Total financial assets	310,778	60,354	28,097	7	–	399,236
Total non-financial assets						4,355
Total Group assets						403,591
Financial liabilities						
Shares	–	333,591	–	–	–	333,591
Amounts owed to credit institutions	–	10,523	–	–	–	10,523
Amounts owed to other customers	–	32,339	–	–	–	32,339
Derivative financial instruments	–	–	–	16	198	214
Total financial liabilities	–	376,453	–	16	198	376,667
Total non-financial liabilities						766
General and other reserves						26,158
Total Group liabilities						403,591

30. Financial instruments continued

Carrying values by category 31 August 2016	Group					
	Held at amortised cost		Held at fair value			
	Loans and receivables	Cash and financial assets and liabilities at amortised cost	Available-for-sale	Derivatives designated as fair value hedges	Unmatched derivatives	Total
Financial assets	£000	£000	£000	£000	£000	£000
Cash in hand and balances with Bank of England	–	35,583	–	–	–	35,583
Loans and advances to credit institutions	6,956	–	–	–	–	6,956
Debt securities	–	–	39,732	–	–	39,732
Derivative financial instruments	–	–	–	–	–	–
Loans and advances to customers	291,211	–	–	–	–	291,211
Total financial assets	298,167	35,583	39,732	–	–	373,482
Total non-financial assets						4,685
Total Group assets						378,167
Financial liabilities						
Shares	–	311,013	–	–	–	311,013
Amounts owed to credit institutions	–	6,535	–	–	–	6,535
Amounts owed to other customers	–	34,183	–	–	–	34,183
Derivative financial instruments	–	–	–	567	2	569
Total financial liabilities	–	351,731	–	567	2	352,300
Total non-financial liabilities						835
General and other reserves						25,032
Total Group liabilities						378,167

Fair values of financial assets and liabilities

Fair value is the value for which an asset or liability could be exchanged or settled between knowledgeable willing parties in an arm's length transaction. The estimated fair value of the financial assets and liabilities above has been calculated using a hierachy valuation methodology which is split into three levels as follows:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

30. Financial instruments continued

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

		Group			
31 August 2017	Notes	Level 1	Level 2	Level 3	Total
Financial assets		£000	£000	£000	£000
Available-for-sale					
Debt securities	13	28,097	–	–	28,097
Derivative financial instruments					
Interest rate swaps	14	–	7		7
		28,097	7	–	28,104
Financial liabilities					
Derivative financial instruments					
Interest rate swaps	14	–	214	–	214
		–	214	–	214
31 August 2016					
Financial assets					
Available-for-sale					
Debt securities	13	39,732	–	–	39,732
Derivative financial instruments					
Interest rate swaps	14	–	–	–	–
		39,732	–	–	39,732
Financial liabilities					
Derivative financial instruments					
Interest rate swaps	14	–	569	–	569
		–	569	–	569

Valuation techniques

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

Debt securities – Level 1

Market prices have been used to determine the fair value of listed debt securities.

Interest rate swaps – Level 2

The valuation of interest rate swaps is based on the 'present value' method. Expected interest cash flows are discounted using the prevailing yield curves. The yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments.

30. Financial instruments continued

Credit risk

Credit risk is the risk that the Group incurs a financial loss arising from the failure of a customer or counterparty to meet their contractual obligations. The Group structures the level of credit risk it undertakes, by maintaining a governance framework involving delegated approval authority levels and credit procedures, the objective of which is to build and maintain asset portfolios of high quality.

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

	Group 2017	*Group 2016*	Society 2017	*Society 2016*
Credit risk exposure	£000	*£000*	£000	*£000*
Cash in hand and balances with Bank of England	60,354	*35,583*	60,354	*35,583*
Loans and advances to credit institutions	8,018	*6,956*	7,763	*6,829*
Debt securities	28,097	*39,732*	28,097	*39,732*
Derivative financial instruments	7	*–*	7	*–*
Loans and advances to customers	302,760	*291,211*	302,760	*285,624*
Total statement of financial exposure	399,236	*373,482*	398,981	*367,768*
Off balance sheet exposure - mortgage commitments	12,751	*16,096*	12,751	*16,096*
Total	411,987	*389,578*	411,732	*383,864*

a) Loans and advances to credit institutions, debt securities and derivative financial instruments

The Assets & Liabilities Committee is responsible for approving treasury counterparties for both derivatives and investment purposes. Limits are placed on the amount of risk accepted in relation to a single counterparty, or group of counterparties, and to industry sectors. This is monitored daily by the Society's Finance Director and reviewed monthly by the Assets & Liabilities Committee.

The Society's Liquidity Policy only permits lending to central government (which includes the Bank of England), banks with a high credit rating and building societies. The Finance Director performs regular analysis of counterparty credit risk and monitoring of publicly available information to highlight possible indirect exposures.

30. Financial instruments continued

An analysis of the Group's treasury asset concentration is shown in the tables below:

Industry sector	Group 2017 £000	2017 %	*2016 £000*	*2016 %*
Banks	25,064	25.98	*33,585*	*40.82*
Building Societies	9,051	9.38	*11,103*	*13.50*
Central Bank	60,354	62.56	*35,583*	*43.25*
Central Government	2,000	2.08	*2,000*	*2.43*
	96,469	100.00	*82,271*	*100.00*

Geographic region	2017 £000	AAA %	AA %	Group A %	BBB %	Other %	*2016 £000*
United Kingdom	87,939	0.00	71.10	24.02	2.60	2.28	*82,271*
Europe	4,012	0.00	100.00	0.00	0.00	0.00	*–*
Australia	4,518	0.00	100.00	0.00	0.00	0.00	*–*

The Group has no exposure to foreign exchange risk. All instruments are denominated in Sterling.

The Group's derivative financial instruments are analysed in the table below:

Geographic region	2017 £000	AAA %	Group AA %	A %	BBB %	*2016 £000*
United Kingdom	63,450	0.00	1.58	62.96	35.46	*71,750*

There are no impairment charges against any of the Group's treasury assets at 31 August 2017.

30. Financial instruments continued

b) Loans and advances to customers

All mortgage loan applications are assessed with reference to the Group's Credit Risk Appetite statement and Lending Policy, which includes assessing applicants for potential fraud risk, and which is approved by the Board. When deciding on the overall risk appetite that the Group wishes to adopt, both numerical and non-numerical considerations are taken into account, along with data on the current UK economic climate and competitor activity. The Lending Policy must comply with all the prevailing regulatory policy and framework.

The lending portfolio as originated is monitored by the Board to ensure that it remains in line with the stated risk appetite of the Group, including adherence to the lending principles, policies and lending limits.

Credit risk management information is comprehensive and is circulated to respective Board committees on a regular basis to ensure that the portfolio remains within the Group's risk appetite.

The Group operates throughout England & Wales and an analysis of the Group's geographical concentration is shown in the table below:

	Group and Society	
	2017	*2016*
Geographical analysis	%	*%*
East Anglia	3	*3*
East Midlands	6	*6*
London and South East	23	*23*
North East	2	*2*
North West	19	*19*
South West	7	*7*
Wales	4	*4*
West Midlands	30	*30*
Yorkshire and Humberside	6	*6*
	100	*100*

30. Financial instruments continued

The average loan to value (LTV) is the mean LTV for the portfolio. Each individual LTV is calculated by comparing the value of the gross mortgage loan to the value of collateral held and adjusted by a house price index for loans which are on residential property.

The average LTV of mortgage loans is 53% (2016: 52%). All residential loans with an initial LTV of greater than 80% are insured for a seven year period from inception with a Lloyds of London insurance firm.

Further LTV information on the Group's mortgage portfolio is shown below:

	Group and Society	
LTV analysis	2017	*2016*
	%	*%*
>0% – 50%	27	*29*
>50% – 60%	14	*14*
>60% – 70%	17	*16*
>70% – 80%	19	*21*
>80% – 90%	9	*7*
>90% – 100%	6	*5*
>100%	8	*8*
	100	*100*
Average loans to value of mortgage loans (%)	53	*52*

All loans with a LTV exceeding 100% are regularly monitored by the Credit Committee. Further, all loans with a LTV exceeding 100% are included in the individual impairment provisioning model used to determine the adequacy of the Group's overall impairment provision. See Note 1.

30. Financial instruments continued

The table below provides information on loans by payment due status net of provisions:

	Group and Society			
Arrears analysis	2017	2017	*2016*	*2016*
Not impaired:	£000	%	*£000*	*%*
Neither past due or impaired	284,728	91.30	*271,771*	*90.58*
Past due up to 3 months	842	0.27	*2,164*	*0.72*
Past due 3 – 6 months	780	0.25	*337*	*0.11*
Past due 6 – 12 months	115	0.04	*114*	*0.04*
Past due over 12 months	–	–	*–*	*–*
Impaired:				
Not past due	7,089	2.27	*7,146*	*2.40*
Past due up to 3 months	117	0.04	*183*	*0.06*
Past due 3 – 6 months	–	–	*45*	*0.01*
Past due 6 – 12 months	–	–	*–*	*–*
Past due over 12 months	–	–	*–*	*–*
Possessions and LPA receiverships	18,179	5.83	*18,252*	*6.08*
Total as per Note 15	311,850	100.00	*300,012*	*100.00*

	Indexed	Unindexed	*Indexed*	*Unindexed*
Value of collateral held:	£000	£000	*£000*	*£000*
Neither past due or impaired	624,718	521,865	*620,748*	*514,346*
Past due but not impaired	5,418	3,373	*7,317*	*5,201*
Impaired	14,062	12,707	*14,155*	*13,228*
	644,198	537,945	*642,220*	*532,775*

The Group uses HPI indexing to update the property values of its mortgage portfolio on a monthly basis. Collateral values are adjusted by the Nationwide price index to derive the indexed valuation at 31 August. The collateral consists of UK property and land.

The quality of the Group's mortgage book is reflected in the value of mortgage accounts in arrears as a percentage of the overall portfolio of 0.60% (2016: 0.94%).

With collateral capped to the amount of outstanding debt, the value of collateral held against impaired assets at 31 August 2017 is £14,062k (2016: £14,155k) against outstanding debt of £25,385k (2016: £25,626k). Any shortfall in collateral on impaired mortgage exposures is a key consideration in the assessment of the adequacy of individual impairment provisions. See Note 1.

Mortgage indemnity insurance acts as additional security. It is taken out for all residential loans where the borrowing exceeds 80% of the value of the total security at the point of origination.

The status 'past due up to three months but not impaired' and 'past due over three months but not impaired' includes any asset where a payment due is received late or missed but no individual provision has been allocated. The amount included is the entire loan amount rather than just the overdue amount.

Possession balances represent those buy to let or development land loans where the Group has taken action to realise the underlying security. The Group has various forbearance options to support customers who may find themselves in financial difficulty.

30. Financial instruments continued

Forbearance

This is where reduced monthly payment concessions allow a customer to make an agreed underpayment for a specific period of time. Forbearance is offered to customers who are experiencing specific cases of difficulty.

The concession, which is a reduced payment, is usually a temporary transfer to interest only which allows the customer to pay only the interest of the loan without reducing the capital. At the end of the concessionary period the Society works constructively with the customer to identify the most suitable payment plan to manage their monthly mortgage payments going forward.

Examples of these payment plans include increasing their normal monthly payment, subject to affordability, or extending the term of the mortgage again in order to reduce the mortgage payment to an affordable level for the customer based on their current financial circumstances.

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

Regular monitoring of the forbearance activity is reported to the Board at regular intervals. In addition all forbearance arrangements are reviewed and discussed with the customer on a regular basis to assess the ongoing potential risk to the Society and suitability of the arrangement for the customer.

At 31 August 2017 the Society had 4 cases (2016: 5) subject to forbearance measures. In each instance the loans were not impaired and were subject to interest only concessions at the year end.

30. Financial instruments continued

Liquidity risk

Liquidity risk is the risk that the Society will not have sufficient financial resources available to meet its obligations as they fall due, under either normal business conditions or a stressed environment. The Society's Liquidity Policy requires that a significant amount of its total assets are carried in the form of cash and other readily realisable assets in order to:

• meet day-to-day business needs;
• meet any unexpected cash needs;
• maintain public confidence; and
• ensure maturity mismatches are provided for.

Monitoring of liquidity, in line with the Society's Liquidity Policy, is performed daily. Compliance with the policy is reported monthly to both Assets & Liabilities Committee and to the Board.

The Society's Liquidity Policy is designed to ensure the Society has sufficient liquid resources to withstand a range of stressed scenarios. A series of liquidity stress tests have been developed as part of the liquidity risk assessment process. They include scenarios that fulfil the specific requirements of the Prudential Regulation Authority (the idiosyncratic, market-wide and combination stress tests). The stress tests are performed monthly and reported to Assets & Liabilities Committee to allow them to confirm the Liquidity Policy remains appropriate.

The Society's liquid resources comprise high quality liquid assets, including a Bank of England Reserve Account, certificates of deposit and term deposits, supplemented by an amount of UK Government Treasury Bills purchased by the Society. At the end of the year the ratio of liquid assets to shares and deposit liabilities was 25.63% (2016: 23.39%).

The following tables on pages 70 and 71 analyse the Society's assets and liabilities into residual maturity groupings, based on the remaining period to contractual maturity at the Statement of Financial Position date. This is not representative of the Society's management of liquidity. Loans and advances to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis. For example most mortgages have a contractual maturity of around 25 years but are generally repaid much sooner. Conversely, retail deposits repayable on demand generally remain on balance sheet much longer.

Notes to the Accounts *continued*

30. Financial instruments continued

Residual maturity as at 31 August 2017	Group						
Financial assets	On demand £000	Not more than three months £000	More than three months but not more than one year £000	More than one year but not more than five years £000	More than five years £000	Non-cash £000	Total £000
Liquid assets							
Cash in hand and balances with Bank of England	60,354	–	–	–	–	–	60,354
Loans and advances to credit institutions	7,017	–	1,001	–	–	–	8,018
Debt securities	–	14,073	14,024	–	–	–	28,097
Total liquid assets	67,371	14,073	15,025	–	–	–	96,469
Derivative financial instruments	–	–	–	–	–	7	7
Loans and advances to customers	12,674	4,616	12,759	57,807	223,994	(9,090)	302,760
Tangible assets	–	–	–	–	–	2,649	2,649
Intangible assets	–	–	–	–	–	96	96
Other assets	–	–	–	–	–	1,610	1,610
Total assets	80,045	18,689	27,784	57,807	223,994	(4,728)	403,591
Financial liabilities and reserves							
Shares	230,536	99,214	3,225	616	–	–	333,591
Amounts owed to credit institutions and other customers	22,830	4,144	15,888	–	–	–	42,862
Derivative financial instruments	–	–	–	–	–	214	214
Other liabilities	–	–	–	–	–	590	590
Provisions for liabilities - FSCS Levy	–	–	–	–	–	176	176
Reserves	–	–	–	–	–	26,158	26,158
Total liabilities and reserves	253,366	103,358	19,113	616	–	27,138	403,591
Net liquidity gap	(173,321)	(84,669)	8,671	57,191	223,994	(31,866)	–

There is no material difference between the maturity profile for the Group and that for the Society. All Group liquid assets are unencumbered as at the balance sheet date.

30. Financial instruments continued

Residual maturity as at 31 August 2016	Group						
Financial assets	On demand £000	Not more than three months £000	More than three months but not more than one year £000	More than one year but not more than five years £000	More than five years £000	Non-cash £000	Total £000
Liquid assets							
Cash in hand and balances with Bank of England	35,583	–	–	–	–	–	35,583
Loans and advances to credit institutions	6,956	–	–	–	–	–	6,956
Debt securities	–	21,184	18,548	–	–	–	39,732
Total liquid assets	42,539	21,184	18,548	–	–	–	82,271
Derivative financial instruments	–	–	–	–	–	–	–
Loans and advances to customers	10,513	2,395	12,197	57,970	217,078	(8,942)	291,211
Tangible assets	–	–	–	–	–	2,739	2,739
Intangible assets	–	–	–	–	–	118	118
Other assets	–	–	–	–	–	1,828	1,828
Total assets	53,052	23,579	30,745	57,970	217,078	(4,257)	378,167
Financial liabilities and reserves							
Shares	209,823	96,652	3,982	556	–	–	311,013
Amounts owed to credit institutions and other customers	25,683	1,632	13,403	–	–	–	40,718
Derivative financial instruments	–	–	–	–	–	569	569
Other liabilities	–	–	–	–	–	655	655
Provisions for liabilities - FSCS Levy	–	–	–	–	–	180	180
Reserves	–	–	–	–	–	25,032	25,032
Total liabilities and reserves	235,506	98,284	17,385	556	–	26,436	378,167
Net liquidity gap	(182,454)	(74,705)	13,360	57,414	217,078	(30,693)	–

There is no material difference between the maturity profile for the Group and that for the Society. All Group liquid assets are unencumbered as at the balance sheet date.

30. Financial instruments continued

The following is an analysis of gross cash flows payable under financial liabilities.

31 August 2017	Group						
Financial liabilities	On demand £000	Not more than three months £000	More than three months but not more than one year £000	More than one year but not more than five years £000	More than five years £000	Non-cash £000	Total £000
Shares	230,540	99,215	3,225	616	–	–	333,596
Amounts owed to credit institutions and other customers	22,831	4,136	15,853	–	–	–	42,820
Derivative financial instruments	–	–	–	–	–	214	214
Total liabilities	253,371	103,351	19,078	616	–	214	376,630

31 August 2016	Group						
Financial liabilities	On demand £000	Not more than three months £000	More than three months but not more than one year £000	More than one year but not more than five years £000	More than five years £000	Non-cash £000	Total £000
Shares	209,823	96,797	4,014	686	–	–	311,320
Amounts owed to credit institutions and other customers	25,683	1,636	13,476	–	–	–	40,795
Derivative financial instruments	–	–	–	–	–	569	569
Total liabilities	235,506	98,433	17,490	686	–	569	352,684

The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates, for the average period until maturity on the amounts outstanding at the Statement of Financial Position date. The derivative financial instrument cash flows include the payable leg of all interest rate swap derivatives held by the Group and Society at the Statement of Financial Position date.

30. Financial instruments continued

Market risk

Market risk is the risk of changes to the Society's financial condition caused by market interest rates. The Society is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk).

The Society has adopted the 'Matched' approach to interest rate risk, as defined by the Prudential Regulation Authority. Societies adopting the Matched approach should have a balance sheet where assets and liabilities are entirely in Sterling and use hedging contracts (or internal matching of assets and liabilities with similar interest rate and maturity features) to neutralise the risk arising from loans or funding other than at administered rates, on a tranche by tranche, product by product basis. By adopting this approach the Society does not take an interest rate view for the purposes of determining a hedging strategy.

The management of interest rate risk is based on a full Statement of Financial Position gap analysis. The Statement of Financial Position is subjected to a stress test of a 2% rise in interest rates on a monthly basis and the results are reported to the Assets & Liabilities Committee monthly. In addition interest rate basis risk sensitivity is similarly reported to the Assets & Liabilities Committee monthly. Both sets of results are measured against the risk appetite for market risk which is currently set as a percentage of capital.

The table below summarises the Group's exposure to interest rate risk. Included in the table are Group assets and liabilities, including derivative financial instruments which are used solely to reduce exposure to interest rate risk, categorised by repricing date.

Interest reset date At 31 August 2017	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Non-interest bearing	Total
Financial Assets	£000	£000	£000	£000	£000	£000	£000
Cash in hand and balances with the Bank of England	60,342	–	–	–	–	12	60,354
Loans and advances to credit institutions	7,017	1,001	–	–	–	–	8,018
Debt securities	14,000	7,000	7,000	–	–	97	28,097
Derivative financial instruments	–	–	–	–	–	7	7
Loans and advances to customers	239,365	1,903	23,365	47,418	–	(9,291)	302,760
Tangible and intangible fixed assets	–	–	–	–	–	2,745	2,745
Other assets	–	–	–	–	–	1,610	1,610
Total assets	320,724	9,904	30,365	47,418	–	(4,820)	403,591
Shares	302,328	5,830	16,308	8,444	–	681	333,591
Amounts owed to credit institutions	3,500	5,500	1,500	–	–	23	10,523
Amounts owed to other customers	23,296	2,023	7,000	–	–	20	32,339
Other liabilities	–	–	–	–	–	980	980
Reserves	–	–	–	–	–	26,158	26,158
Total liabilities	329,124	13,353	24,808	8,444	–	27,862	403,591
Net assets/(liabilities)	(8,400)	(3,449)	5,557	38,974	–	(32,682)	–
Off balance sheet items	63,450	(10,250)	(24,200)	(29,000)	–	–	–
Interest rate sensitivity gap	55,050	(13,699)	(18,643)	9,974	–	(32,682)	–
Cumulative gap	55,050	41,351	22,708	32,682	32,682	–	–

30. Financial instruments continued

The interest rate sensitivity of the Group at 31 August 2016 was:

Interest reset date At 31 August 2016 **Financial Assets**	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	More than five years £000	Non-interest bearing £000	Total £000
Cash in hand and balances with the Bank of England	35,576	–	–	–	–	7	35,583
Loans and advances to credit institutions	6,955	–	–	–	–	1	6,956
Debt securities	20,002	4,505	14,997	–	–	228	39,732
Derivative financial instruments	–	–	–	–	–	–	–
Loans and advances to customers	217,795	4,001	35,113	43,648	–	(9,346)	291,211
Tangible and intangible fixed assets	–	–	–	–	–	2,857	2,857
Other assets	–	–	–	–	–	1,828	1,828
Total assets	280,328	8,506	50,110	43,648	–	(4,425)	378,167
Shares	285,291	5,691	18,694	398	–	939	311,013
Amounts owed to credit institutions	1,000	4,000	1,500	–	–	35	6,535
Amounts owed to other customers	26,140	3,023	4,996	–	–	24	34,183
Other liabilities	–	–	–	–	–	1,404	1,404
Reserves	–	–	–	–	–	25,032	25,032
Total liabilities	312,431	12,714	25,190	398	–	27,434	378,167
Net assets/(liabilities)	(32,103)	(4,208)	24,920	43,250	–	(31,859)	–
Off balance sheet items	70,750	(3,500)	(32,500)	(34,750)	–	–	–
Interest rate sensitivity gap	38,647	(7,708)	(7,580)	8,500	–	(31,859)	–
Cumulative gap	38,647	30,939	23,359	31,859	31,859	–	–

There is no material difference between the interest rate risk profile for the Group and that for the Society. The Group is not exposed to foreign currency risk.

The Society does not have any financial assets or liabilities that are offset with the net amount presented in the Statement of Financial Position as FRS102 Section 11.38A requires both an enforceable right to set off and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Society. All financial assets and liabilities are presented on a gross basis in the Statement of Financial Position.

The Society has three Credit Support Annexes (CSA) for its derivative instruments which typically provide for the exchange of collateral on a daily basis to mitigate net mark-to-market credit exposure. As at 31 August 2017 a total exchange of collateral of £521k (2016: £541k) has taken place in accordance with the trigger points within the respective CSA. These are included within loans and advances to credit institutions.

Annual Business Statement

For the year ended 31 August 2017

1. STATUTORY PERCENTAGES

	Percentages at	Statutory Limit
	%	%
Proportion of business assets not in the form of loans fully secured on residential property (the 'lending limit')	1.84	25
Proportion of shares and deposits not in the form of shares held by individuals (the 'funding limit')	11.39	50

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, sections 6 and 7 of the Building Societies Act 1986 as amended by the Buildings Societies Act 1997.

Business assets are the total assets of the Group as shown in the balance sheet plus provisions for bad and doubtful debts, less fixed assets and liquid assets.

Loans fully secured on residential property are the amount of principal owing by borrowers and interest accrued not yet payable. This is the amount shown in the balance sheet plus provisions for bad and doubtful debts.

2. OTHER PERCENTAGES

	Ratio at	
	31 August 2017	*31 August 2016*
	%	*%*
Gross capital as a percentage of shares and borrowings	6.95	*7.12*
Free capital as a percentage of shares and borrowings	6.26	*6.35*
Liquid assets as a percentage of shares and borrowings	25.63	*23.39*
As a percentage of mean assets:		
Profit after taxation	0.29	*0.19*
Management expenses	1.10	*1.10*
Cost/income	73.51	*82.25*

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

- 'Shares and borrowings' represent the total of shares, amounts owed to credit institutions and amounts owed to other customers.
- 'Gross capital' represents general reserves.
- '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.
- 'Cost/income' represents the aggregate of administration expenses, depreciation and amortisation expressed as a percentage of total income less other operating charges.

3. INFORMATION RELATING TO THE DIRECTORS AT 31 AUGUST 2017

Name	Occupation	Date of Birth	Date of Appointment	Directorships
P. R. Dearing BEd (Hons), FCIB	Consultant	18.2.1950	1.10.2009	Hanley Financial Services Ltd Hanley Mortgage Services Ltd Waterloo Housing Group Dales Housing Ltd Seven Locks Housing Ltd The Dynamic Boardroom Ltd
F. B. Earley BSc, MSc	Economist	12.10.1964	1.9.2013	–
S. Jones BSc (Hons), FCA, MBA	Society's Deputy Chief Executive, Finance Director & Group Secretary	6.12.1962	1.5.2004	Newcastle under Lyme College Hanley Financial Services Ltd Hanley Mortgage Services Ltd
A. S. Macdonald	Consultant	20.10.1954	1.9.2014	Sempre Ski Ltd Non-Newtonian Hospitality Ltd
V. Oak	Director	13.11.1961	1.3.2015	Chesnara plc Countrywide Assured Ltd Investment and Life Assurance Group Ltd Sanlam UK Ltd Sanlam Investment Holdings UK Ltd Hanley Financial Services Ltd Hanley Mortgage Services Ltd
M. E. Selby BA, MBA	Society's Chief Executive	30.8.1969	14.11.2016	Hanley Financial Services Ltd Hanley Mortgage Services Ltd
S. Woodings LLB	Company Director and Consultant Solicitor	15.9.1966	1.4.2016	Argus Fire Protection Company Ltd Slademain Ltd Beswicks Solicitors LLP
R. M. Young MIPA	Company Director and Consultant	20.12.1953	5.5.2017	Caverswall Park Management Company Ltd Caverswall Park Developments Ltd

Documents may be served on the above named Directors c/o PricewaterhouseCoopers LLP, Donington Court, Pegasus Business Park, Castle Donington, Herald Way, East Midlands, DE74 2UZ

SERVICE CONTRACTS

Mr M. E. Selby is employed under a contract that is terminable by either the Society or the Director on six months' notice.

Mr S. Jones is employed under a contract that is terminable by the Society on one year's notice or the Director on six months' notice.

4. OFFICERS

Name	Occupation	Directorships
L. Barlow ACMA, CGMA	Head of Finance	–
R. Hassall BSc (Hons)	Head of Operations	Birchwood Academy Trust
D. Henry PG Dip HRM	Head of Human Resources	–
D. Lownds BSc (Hons)	Head of Sales, Marketing & Business Development	–
T. A. Ratcliffe	Head of Branches	–
V. Thackstone	Head of Risk & Compliance	–

The Officers of the Society are referred to as Senior Managers and, along with the Executive Directors, constitute the Leadership Team.

Country by Country Reporting

The reporting obligations set out in Article 89 of the European Union's Capital Requirements Directive IV (CRD IV) have been implemented in the UK by Capital Requirements (Country-by-Country Reporting) Regulations 2013. The regulations require the Society to disclose information regarding the source of its income and location of operations.

As a mutual organisation, The Hanley Economic Building Society's primary focus is its Members and it aims to provide mortgage, savings and insurance products supported by excellent customer service. Additionally, The Hanley offers financial advice through its subsidiary Hanley Financial Services Limited. The consolidated financial statements of the Group include the audited results of the Society and its subsidiary undertakings.

Details of the consolidated entities and their principal activities are detailed in Note 16 to the Annual Report and Accounts. All of the consolidated entities were incorporated in the United Kingdom.

For the year ended 31 August 2017:

The Hanley Economic Building Society's annual accounts report:

- Group total operating income was £5.9m (2016: £5.1m). Total operating income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable).
- Profit before tax was £1.5m (2016: £1.1m), all of which arising from UK-based activity.
- The average number of Group full time equivalent employees was 60 (2016: 56), all of which were employed in the UK.
- Corporation tax of £0.1m (2016: £0.2m) was paid in the year and is all within the UK tax jurisdiction.
- No public subsidies were received in the year.

Independent auditors' report to the Directors of The Hanley Economic Building Society

We have audited the accompanying schedule above of The Hanley Economic Building Society for the year ended 31 August 2017 (the schedule). The schedule has been prepared by the Directors based on the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Directors' Responsibility for the schedule

The Directors are responsible for the preparation of the schedule in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013, for the appropriateness of the basis of preparation and the interpretation of the Regulations as they affect the preparation of the schedule, and for such internal control as the Directors determine is necessary to enable the preparation of the schedule that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the schedule based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the schedule.

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

Opinion

In our opinion, the Country-by-Country information in the schedule as at 31 August 2017 is prepared, in all material respects, in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Basis of Preparation and Restriction on Distribution

Without modifying our opinion, we draw attention to the schedule, which describes the basis of preparation. The schedule is prepared to assist the Directors to meet the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013. As a result, the schedule may not be suitable for another purpose.

Our report is intended solely for the benefit of the Directors of The Hanley Economic Building Society. We do not accept or assume any responsibility or liability to any other party save where terms are agreed between us in writing.

PricewaterhouseCoopers LLP
Chartered Accountants, East Midlands
31 October 2017

Staff

The Board would like to thank all the staff for their continued hard work and dedication to The Hanley.

Branches

Biddulph	Deborah Ward, Emma Dawson, Sarah Donally
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