

**The Loughborough**  
where people make the difference

**Annual Report  
& Accounts  
2006**

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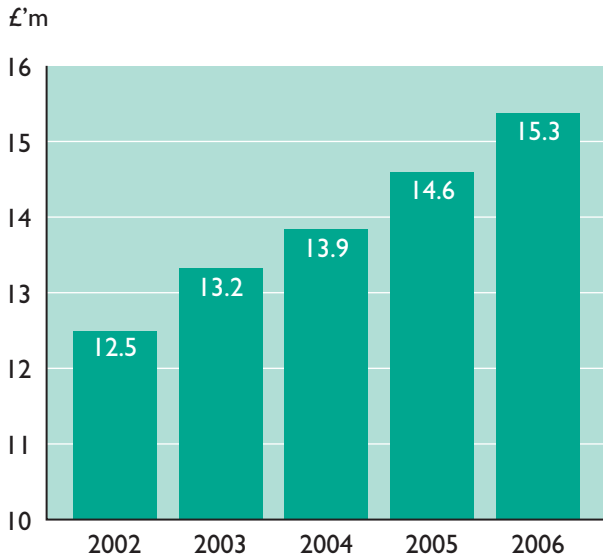
# Society Performance over the past 5 years

## Key Performance Indicators (KPIs)

The Board uses a number of KPIs to measure and monitor progress and performance. Over the past 5 years the Society has planned to grow in a controlled manner, ensuring that the interests of borrowers and savers are safeguarded. Some of the KPIs are illustrated below to show the progress the Society has made with the help of members and staff.

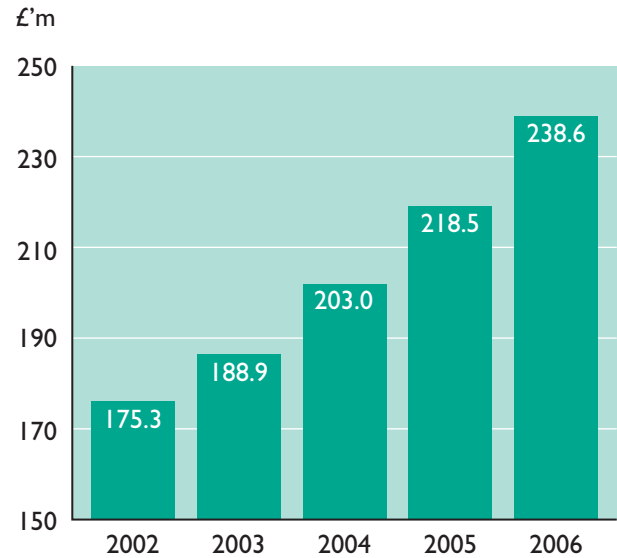
### General Reserves

The Directors remain committed to maintaining a strong capital position. The level of capital at October 2006 underlines the financial strength of the balance sheet.



### Total Assets

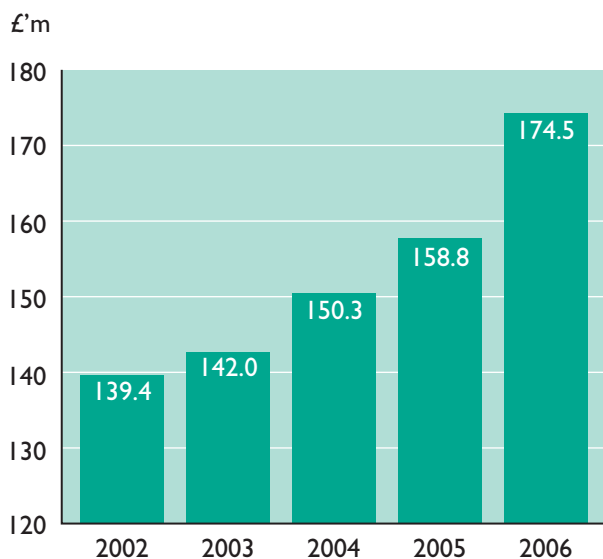
The high quality of our products and services is reflected in sustained asset growth, in our core markets of mortgages and savings, over a five-year period.



### Share Balances

(excluding accrued interest)

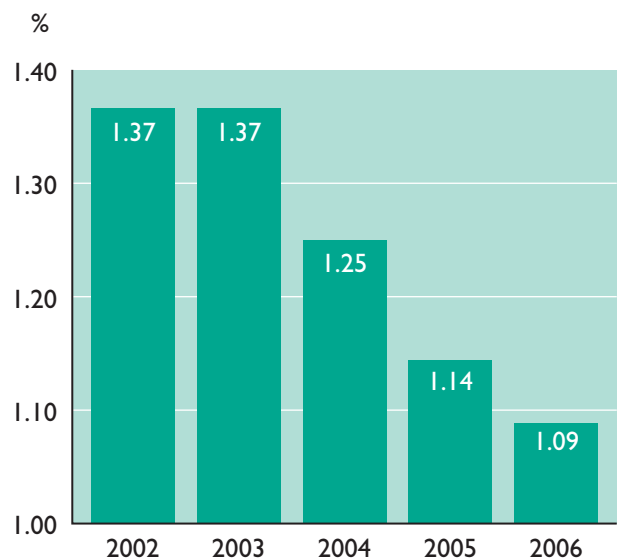
The Society continues to offer competitive products to new and existing members, resulting in continued growth in share balances.



### Management Expenses % of Mean Assets

(excluding exceptional items)

We aim to reduce our cost base each year. Lower costs allow us to maintain the branch network and offer competitive products for the benefit of all our members.



The Directors are pleased to present their 139th Annual Report, together with the Annual Accounts and Annual Business Statement of the Society for the year ended 31 October 2006.

## Business Objectives and Activities

The principal business of the Society is that of raising, primarily by the subscription of members, a stock or fund for making to them advances secured on land for their residential use.

The business objectives are to promote savings and home ownership, primarily in the East Midlands, through a competitive interest rate structure on a variety of straightforward products combined with high levels of personal service to all of our members.

## Principal Risks and Uncertainties

The Society has a risk aware culture which helps to protect members' interests and reduce exposure to the principal risks and uncertainties facing the business.

Building Societies operate in a highly competitive and regulated market with significant uncertainties arising from the general economic environment, which in turn will affect the UK Housing market and levels of unemployment.

The management of risk and strategic direction are key activities, vital for the success of the business. The Board of Directors, aided by a number of committees, are responsible for ensuring that an up to date risk management structure is in place covering all aspects of the business.

The Board is currently reviewing its risk assessment to meet the requirements of Basel II and the associated Capital Requirements Directive. Progress is being made and this risk based approach to capital will be incorporated into policies and procedures before the final implementation date of January 2008.

## Review of the Year

We are very pleased to be able to report that despite a number of major challenges, 2005/2006 has been another impressive year for the Loughborough. Assets rose in the year

by 9.18% to a new record of £238.6 million. The growth in mortgage assets was 9.50% to a new record of £196.3 million.

Despite concerns that were expressed at the start of the year, the U.K. economy has proved remarkably resilient. House prices have continued to move ahead encouraged by a stable interest rate environment. The Bank of England became more concerned about inflation as the year progressed and in August bank base rate was increased by 0.25% to 4.75%. In response the Loughborough raised its' Standard Variable Rate to 6.4% but not until October 1. The major proportion of the Society's lending was done in the first half of the year in anticipation of the move to a new I.T. system. The final figure of £54.1 million was in line with the target set at the beginning of the year. The quality of the Society's mortgage portfolio remains good with only 1 case in possession and no cases more than 12 months in arrear, at year end. Overall levels of arrears have also reduced during the year.

Competition for retail funds has intensified during the year with a wide variety of new entrants into the U.K. market. We are pleased to report that the Loughborough has been successful both in attracting a retail inflow of more than £9.7 million during the year and in increasing the number of investor members. The Society has continued to offer a range of variable and fixed rate products, with the Classic Account for the over-50's and the Penguin Account for young savers proving to be the most popular accounts. Investors' balances have increased by £16.0 million and at the end of the year stood at £178.0 million, another new record. The Society has continued to play an active role in the wholesale money markets in order to smooth out fluctuations between savings inflows and mortgage demand.

Pre tax profit amounted to £1,048,000 in 2005/2006, with profit after tax at £749,000. The Society's Board continues to target a level of profit that is in line with the Society's mutual status and which allows the Society's members to benefit as much as possible. The credit for bad and doubtful debts amounted to £32,000. The Society has maintained its' financial strength with the capital ratios remaining more than adequate to satisfy foreseeable requirements.

# Directors' Report

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## Information Technology

On August 21, the Society completed the successful implementation of a new I.T. system, provided by Bailey Computer Services, a wholly owned subsidiary of the Skipton Building Society. The project was delivered on time and under budget and the Board would like to thank all the staff for their support and dedication on this project. The move to a managed service will, in the Board's view, both mitigate risk to the business and reduce costs over the medium-term.

## Regulation

The Society is regulated by the Financial Services Authority (FSA) for all aspects of mortgage lending and administration, as well as for deposit taking and the provision of financial services. In addition the Society subscribes to the Banking Code and is a member of the Financial Ombudsman Scheme. The Board is concerned about the pressure caused by the constant flow of new regulatory requirements, including the new Capital Requirements Directive and introduction of International Accounting Standards which will undoubtedly add to the Society's costs over the next few years.

## Costs

The Society has again been successful in reducing its' management expenses ratio. The core figure for 2005/2006 fell to £1.09, a reduction of 5p from the previous year and a reduction of 28p over the last three years. The Board views the control of costs as playing an integral part in the Society's success and has continued to seek ways of reducing costs without compromising the level of service provided by the Loughborough, to all members.

## Post Balance Sheet Events

The Board considers that there have been no events since the year end that have a material effect on the financial position of the Society.

## Creditor Payment Policy

The Society's continuing policy concerning the payment of its trade creditors is to pay invoices within the agreed terms

of credit, once the supplier's contractual obligations have been discharged. Amounts due to relevant creditors of the Society as at 31 October 2006 represented 23 days.

## Liquid Assets

Liquid assets in the form of cash and investments were £40.8m at the year-end representing 18.47% of total shares and borrowings.

## Loans and Advances

The total number of mortgages executed during the year was 385 plus 182 further advances on existing accounts, the amount advanced being £54.1m, this figure includes £10.0m of sub participation lending arranged through a major mutual organisation.

## Mortgage Arrears

At the end of the year, there were no cases where mortgage repayments were twelve months or more in arrears.

## Financial Risk Management Objectives and Policies

The Society has a formal structure for managing risk including establishing risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Society's Assets and Liabilities Committee as detailed on page 8.

Full details of the Society's approach to financial risk management and the key risks faced are given in Note 21 to the Accounts.

## Capital Ratios

Profit after tax transferred to general reserve was £749,000. At 31 October 2006 Free capital amounted to £15.56m or 7.04% of total shares and borrowings. Gross capital amounted to £16.07m or 7.27% of total shares and borrowings.

## Directors

The following persons served as Directors during the year:-

### Non Executive Directors

P. R. Blakemore BA, FCA	(Chairman)
S. P. Mellors FRICS	(Deputy Chairman)
J. B. Gibbins FCA	(Chairman of Audit and Compliance)
Mrs C. D. Clifford BA, FCIPD	(Appointed 31 October 2006)
P. M. Jackson FIMI	(Resigned 31 October 2006)
A. Roberts LL.B	(Senior Independent Director)

### Executive Directors

S. R. Peete BA, FCIB	(Chief Executive)
Mrs C. Joyce BA, ACIB	(Operations Director)
C. G. Bradley BSc, ACA, ACIB	(Finance Director)

The Directors would like to thank Peter Jackson, who resigned as a Director in October, for his contribution during his term of service on the Board. Peter brought his experience of running a small business to the Board and he played an important role on the Development and Marketing Committee. Mrs Cheryl Clifford joined the Board at the year end and brings wide experience as a Human Resources Consultant and as a non executive in the Insurance industry.

The Directors retiring in accordance with the Rules are Mr S. R. Peete and Mrs C. D. Clifford who, being eligible, offer themselves for re-election and election respectively. Mr J. B. Gibbins will not be standing for election at the February 2007 Annual General Meeting as he is leaving the Board before that date.

## Auditors

The auditors, KPMG Audit Plc have signified their willingness to continue in office and a resolution will, therefore, be proposed at the Annual General Meeting that they should be re-appointed as auditors of the Society.

## Management and Staff

The Directors would like to record their appreciation for the dedication and enthusiasm of the management and staff at the end of what has been a very successful year for the Society.

Thanks are also due to all our members and professional contacts for their continued support.

On behalf of the Board

**Paul R. Blakemore**  
Chairman

13 December 2006

# Corporate Governance Report

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## Corporate Governance

The Society's Board views good corporate governance as playing an essential role in discharging the Board's responsibilities to the Society's members. The Board believes that the Society complies fully with the Code of Governance contained in Chapter 3 of the Interim Prudential Sourcebook for Building Societies issued by the Financial Services Authority.

The Combined Code of Corporate Governance ("the Combined Code") issued in 2003 applies to UK listed companies and it is not compulsory for Building Societies. The Board does however have regard to the Combined Code when reviewing corporate governance arrangements.

## The Board of Directors

The Board's principal functions are to focus on strategic issues, to provide guidelines and parameters within which the business is managed, to review business performance on a regular basis and ultimately to safeguard the interests of members. The Board operates through regular meetings and via a series of Committees, all of which have written terms of reference and established reporting procedures. The major Committees are those relating to Audit and Compliance, Nominations, Staff and Remuneration, Assets and Liabilities and Development and Marketing.

At the end of October 2006 the Board was made up of 5 non-executive directors, including the Chairman and Deputy Chairman, and 3 executive directors. The Board views all the non-executive directors as being independent in character. Mr Scott Mellors is the managing partner of John German Estate Agents who operate as managers of the Society's valuation services. The size and composition of the Board is subject to regular review to ensure both adequate succession and that the Board has the necessary skills and experience to direct the Society's activities. Independent Directors are not expected to serve more than three full 3 year terms. Any total term lasting for more than 9 years will be approved only in

exceptional circumstances, and then only on the basis of annual re-election. The maximum age for any Director is 70 at which point retirement is mandatory.

The Board has elected Mr. Alan Roberts as the Society's Senior Independent Director. Mr. Roberts is available to members if they have concerns regarding their membership of the Society which contact through the normal channels of Chairman, Chief Executive or Finance Director has failed to resolve or for which is considered inappropriate.

All Directors are Approved Persons as defined by the Society's regulator, the Financial Services Authority (FSA) and must continue to maintain the 'fit and proper' requirements of the FSA and comply with the FSA Principles for Approved Persons and its Code of Practice.

All Directors are provided with clear, timely and accurate information for the effective conduct of business, including an established list of items for review and regular financial updates.

All Directors are given appropriate training following their appointment and 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 are entitled to seek independent professional advice at the Society's expense.

Each year all of the Directors are subject to a formal appraisal. The Chief Executive carries out an appraisal of both the Finance Director and the Operations Director based on a range of business and personal objectives agreed at the beginning of each year. The Chairman carries out the Chief Executive's appraisal, with performance also being measured against a range of business and personal objectives. The Staff and Remuneration Committee then discuss these appraisals with the other non-executive Directors, prior to agreeing any increase in remuneration.

The Chairman carries out an appraisal of the non-executive Directors, basing his assessment on each Directors contribution to the Board's performance, using criteria such as attendance, performance at meetings and additional training and development. The Chairman's performance is assessed by the Senior Independent Director, and pays special attention to the way in which the Chairman leads the Board and the effectiveness of the Board in formulating the Society's strategy.

Different people carry out the roles of Chairman and Chief Executive. The main role of the Chairman is to lead the Board and to ensure that it operates effectively. The Chief Executive's role is to put into effect the strategies agreed by the Board and the general operational management of the Society.

The effectiveness of the Board and of the Board Committees is reviewed annually, with a formal discussion at the first Board Meeting after the Society's Annual General

Meeting. The discussion considers the Society's performance against its peers, the views of both internal and external audit and the results of any reviews or themed visits carried out by the FSA.

## Appointments to the Board

The Society has a recruitment policy, agreed by the Board, which details the process by which new Directors are appointed. All new Directors are then subject to election by the members at the Annual General Meeting, held in the next financial year following the Directors' appointment, in accordance with the Rules of the Society. The Rules also provide that all Directors must put themselves forward for re-election at least once every three years. On 31 October 2006 the Society appointed Mrs Cheryl Clifford to the Board. Mrs Clifford's appointment was made by means of an executive search company, working to criteria defined by the Nominations Committee. The company created a short list of candidates who were interviewed by the Nominations Committee, which then made the final choice.

## Attendance at Board and Committee Meetings

The number of Board and Committee meetings attended by each Director during the year is shown below:

	Board	Audit and Compliance	Assets and Liabilities	Nominations	Staff and Remuneration	Development and Marketing
P. R. Blakemore (Chairman)	12	*	4	1	1	*
S. P. Mellors (Deputy Chairman)	12	4	4	*	1	4
C. G. Bradley	12	*	4	*	*	4
J. B. Gibbins	12	4	*	*	*	*
P. M. Jackson (resigned 31 October)	12	*	*	*	1	4
C. Joyce	11	*	4	*	*	4
S. R. Peete	11	*	4	*	*	4
A. Roberts	12	4	*	1	1	*
<b>Number of Meetings</b>	<b>12</b>	<b>4</b>	<b>4</b>	<b>1</b>	<b>1</b>	<b>4</b>

\*not a member of the Committee

# Corporate Governance Report

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## Audit and Compliance Committee

The Committee considers regulatory compliance matters, the adequacy of internal controls and evaluation of risks. It also reviews both internal and external audit reports, monitors the effectiveness of internal and external auditors and agrees the annual internal audit plan.

The following non-executive directors served during the year: J. B. Gibbins (Chairman), S. P. Mellors and A. Roberts.

The Chief Executive and Finance Director, together with representatives from both internal and external auditors, also attend the quarterly meetings of the Committee, by invitation. Part of each meeting takes place without the Executives being present. Other members of the Society's management team attend the Committee as required.

## Assets and Liabilities Committee

The remit of this Committee is to monitor risks on both sides of the balance sheet, including the use of derivatives for fixed rate products. The Committee also reviews the structure of interest rates and the treasury activities of the Society.

The following directors served during the year: S. R. Peete (Chairman), P. R. Blakemore, C. G. Bradley, C. Joyce and S. P. Mellors.

## Nominations Committee

The Nominations Committee is responsible for making recommendations on appointments to the Board, 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 efficiently and effectively. The Committee also reviews Board succession planning in the light of the challenges and opportunities facing the Society, and audits the skills and expertise the Board will require in future.

The following non-executive directors served during the year: P. R. Blakemore (Chairman) and A. Roberts.

## Staff and Remuneration Committee

The Staff and Remuneration Committee is responsible for determining the remuneration of the executive directors within a framework agreed with the full Board. The Committee also considers the recommendations of the Executive Directors relating to the remuneration of all Society staff, before approving any overall increase in the level of staff remuneration. The Directors' Remuneration Report is set out on pages 9 and 10.

The Combined Code states that the Committee should set the remuneration of the Chairman. However the Board believes that the remuneration of all non-executive Directors should be determined in the manner described in the Directors' Remuneration Report.

Meetings of the Committee are held as required and are normally attended by the Chief Executive, who withdraws from the meeting when his own remuneration is under discussion.

The following non-executive directors served during the year: P. R. Blakemore (Chairman), P. M. Jackson, S. P. Mellors and A. Roberts.

## Development and Marketing Committee

The Committee meets on a regular basis to assess development and marketing strategy and opportunities to promote the Society's activities and products.

The following directors served during the year: S. P. Mellors (Chairman), C. G. Bradley, P. M. Jackson, C. Joyce and S. R. Peete.

**Paul R. Blakemore**  
Chairman

13 December 2006

# Directors' Remuneration Report

The purpose of this report is to inform members, in line with good corporate practice, of the policy for the remuneration of the Society's Executive Management Team and its Non-Executive Directors. It provides details of the elements of Directors' remuneration and explains the process for setting them.

An advisory resolution will be put to this year's Annual General Meeting, inviting members to vote on the Directors' Remuneration Report.

## Policy

The Board Staff and Remuneration Committee reviews and recommends to the Board the policy and practice on the remuneration of Executive Directors. The Committee takes into account relevant factors from both the FSA code of governance for Building Societies and the Combined Code.

The policy is designed to ensure that senior executive remuneration reflects performance and allows the Society to attract, motivate and retain high calibre, qualified executives, with the skills and experience needed to lead a business of this nature and complexity and develop it for the long term benefit of our members, in an increasingly regulated and competitive market.

In order to achieve this, the Committee seeks to ensure that remuneration levels are fair and competitive, reflecting market comparatives from similar financial institutions, and each individual's personal development and contribution to the Society's performance.

The Staff and Remuneration Committee comprises four Non-Executive Directors, as detailed on page 8. Meetings of the Committee are also attended by the Chief Executive, as appropriate. The Chief Executive withdraws from the meeting when his own remuneration is being considered.

The Chief Executive assesses individual performance of the other Executives against specific corporate and individual objectives and makes recommendations to the Staff and Remuneration Committee.

## Executive Directors' Remuneration

Remuneration of the Society's Executive Management Team comprises a number of elements: basic salary, annual and medium term incentive schemes, contributions to pension schemes and other benefits.

## Basic Salary

Basic salaries are paid at an appropriate level to take account of job content and responsibilities, external market competitiveness and individual performance in the role.

## Annual Bonus

The Annual Bonus is an incentive scheme that provides non-pensionable rewards directly linked to the achievement of key performance targets of both the Society and the individuals themselves. Performance targets are reviewed annually, by the Society's Board, to ensure they are aligned to business priorities. The overall objective is to improve Society performance whilst maintaining the financial strength of the Society for the benefit of its members. The maximum figure payable is 10% of basic salary, the amount payable for 2005/06 was 6%.

## Medium Term Bonus

This was introduced in the 2003/04 financial year and is based on the achievement of specific key targets over a three year period to October 2006. The selected targets over this period were asset growth, reduction of core costs and the successful completion of annual projects. The maximum payment achievable under the scheme was set at 10% of basic salary at October 2006, and this is the percentage that is payable. Payments are non-pensionable. A new scheme is under consideration for the period commencing 2006/07.

## Pension Benefits

The Society operates a contributory money purchase scheme and makes contributions for all qualifying staff, including the executive directors. The Society also operates a death in service scheme for all members of the pension scheme. The scheme provides a lump sum of four times basic salary in the event of death in service.

# Directors' Remuneration Report

## Other Benefits

The Society provides other taxable benefits to Executive Directors comprising a car, health care provision and concessionary mortgage.

## Service Contracts

All executive directors are employed on service contracts, which can be terminated by the Society on one year's notice and by the individual executives on 6 months notice. The contracts terminate at age 65.

## Non-Executive Directors' Remuneration

Non-Executive Directors are remunerated solely by fees. The Board's policy is to increase the fees annually in line with the general percentage rise in staff salaries. They do not have service contracts and they do not receive any salary, pension, bonus incentives or other taxable benefits. The fees paid reflect time spent on Society affairs including membership of Board committees.

## Directors' Remuneration (audited information)

Executive Directors (£ '000)						
2006	Salary	Annual Bonus	Medium Term Bonus	Pension Contributions	Benefits	TOTAL
S. R. Peete	92	5	9	11	11	128
C. Joyce	65	4	7	7	8	91
C. G. Bradley	65	4	7	9	8	93
<b>TOTALS</b>	<b>222</b>	<b>13</b>	<b>23</b>	<b>27</b>	<b>27</b>	<b>312</b>

2005	Salary	Annual Bonus	Pension Contributions	Benefits	TOTAL
S. R. Peete	87	7	10	11	115
C. Joyce	63	5	6	7	81
C. G. Bradley	62	5	8	8	83
<b>TOTALS</b>	<b>212</b>	<b>17</b>	<b>24</b>	<b>26</b>	<b>279</b>

Non-Executive Directors (£ '000)	
	Fees
	2006
P. R. Blakemore (Chairman)	29
S. P. Mellors (Deputy Chairman)	22
J. B. Gibbins (Chairman of Audit and Compliance)	21
P. M. Jackson (Resigned 31 October 2006)	18
A. Roberts	18
<b>TOTALS</b>	<b>108</b>

Fees
2005
28
21
20
17
17
<b>103</b>

# Directors' Responsibilities Statement

## Directors' responsibilities for Preparing the Annual Accounts

The following statement, which should be read in conjunction with the statement of the Auditors' responsibilities on page 12, 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 as at the end of the financial year
- of the income and expenditure of the Society 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 U.K. 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 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.

## Directors' responsibilities for Accounting Records and Internal Control

The Directors are responsible for ensuring that the Society -

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

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

## Going Concern

The Directors are satisfied that the Society has adequate resources to continue in business for the foreseeable future.

For this reason, the accounts continue to be prepared on the going concern basis.

**Paul R. Blakemore**  
Chairman

13 December 2006

# Independent Auditors' Report to the Members of Loughborough Building Society

We have audited the annual accounts of Loughborough Building Society for the year ended 31 October 2006 which comprise the Income and Expenditure Account, the Statement of Total Recognised Gains and Losses, the Balance Sheet, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out herein.

We have examined the Annual Business Statement (other than the details of directors upon which we are not required to report) and the Directors' Report.

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

## Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and Accounts, including the directors' report, the annual business statement and the annual accounts in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 11.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). We are also responsible for examining the Annual Business Statement (other than the details of directors) and for reading the information in the Directors' Report and assessing whether it is consistent with the accounting records and the annual accounts.

We report to you our opinion as to whether the annual accounts give a true and fair view and are properly prepared in accordance with the Building Societies Act 1986 and regulations made under it. In addition, we report to you our opinion as to whether certain information in the annual business statement gives a true representation of the matters in respect of which it is given, whether the information in the directors' report is consistent with the accounting records and the annual accounts and whether the annual business statement and the directors' report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it.

We also report to you if, in our opinion, the annual accounts are not in agreement with the accounting records or if we

have not received all the information and explanations that we require for our audit.

We read the other information contained in the Annual Report and Accounts and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the annual accounts, annual business statement and directors' report. Our responsibilities do not extend to any other information.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the annual accounts and the annual business statement. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the annual accounts, and of whether the accounting policies are appropriate to the society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the annual accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the annual accounts.

## Opinion

In our opinion:

- a) the annual accounts give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of affairs of the society as at 31 October 2006 and of the income and expenditure of the society for the year then ended;
- b) 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;
- c) the information given in the directors' report is consistent with the accounting records and the annual accounts; and
- d) the annual accounts, the annual business statement and the directors' report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it.

## KPMG Audit Plc

Chartered Accountants  
Registered Auditor

Birmingham  
13 December 2006

## Income and Expenditure Account for the year ended 31 October 2006

	Note	2006 £'000	2005 £'000
Interest receivable and similar income	2	12,743	11,919
Interest payable and similar charges	3	(9,331)	(8,585)
Net interest receivable		3,412	3,334
Fees and commissions receivable		162	165
Fees and commissions payable		(83)	(119)
Other operating income		175	261
Total income		3,666	3,641
Administrative expenses - on-going	4	(2,414)	(2,246)
Administrative expenses - exceptional	4	(101)	(179)
Depreciation and amortisation		(77)	(164)
Other operating charges		(58)	(83)
Operating profit before provisions		1,016	969
Provisions for bad and doubtful debts	11	32	3
Operating profit and profit on ordinary activities before tax		1,048	972
Tax on profit on ordinary activities	8	(299)	(279)
<b>PROFIT FOR THE FINANCIAL YEAR</b>		<b>749</b>	<b>693</b>

The notes on pages 16 to 30 form part of these accounts.

The above results are all derived from continuing operations.

### Statement of Total Recognised Gains and Losses for the year ended 31 October 2006

Profit for the financial year	749	693
Unrealised surplus on revaluation of properties	-	232
Total recognised gains and losses relating to the year	749	925
Total recognised gains and losses since last annual report	749	925

There is no material difference between the profit on ordinary activities before tax and the profit for the financial year stated above and their historical cost equivalents.

# Balance Sheet

as at 31 October 2006

	Note	2006 £'000	2005 £'000
<b>ASSETS</b>			
<b>Liquid assets</b>			
Cash in hand		115	47
Loans and advances to credit institutions	9	18,964	17,336
Debt Securities	10	21,739	20,356
		<b>40,818</b>	<b>37,739</b>
<b>Loans and advances to customers</b>			
Loans fully secured on residential property	12	180,395	162,732
Other loans	12	15,911	16,537
		<b>196,306</b>	<b>179,269</b>
Tangible fixed assets	13	1,065	1,086
Other assets	14	244	320
Prepayments and accrued income		155	110
<b>TOTAL ASSETS</b>		<b>238,588</b>	<b>218,524</b>
<b>LIABILITIES</b>			
Shares	15	178,008	162,044
Amounts owed to credit institutions	16	25,389	19,304
Amounts owed to other customers	17	17,611	20,277
Other liabilities	18	1,510	1,578
		<b>222,518</b>	<b>203,203</b>
<b>Revaluation Reserve</b>	19	<b>736</b>	<b>742</b>
<b>Reserves</b>			
General Reserves	19	15,334	14,579
<b>TOTAL LIABILITIES</b>		<b>238,588</b>	<b>218,524</b>

The notes on pages 16 to 30 form part of these accounts.

These accounts were approved by the Board of Directors on 13 December 2006 and were signed on its behalf by:

<b>Paul R. Blakemore</b>	Chairman
<b>Scott P. Mellors</b>	Deputy Chairman
<b>Stephen R. Peete</b>	Director and Chief Executive

## Cash Flow Statement

### for the year ended 31 October 2006

	2006 £'000	2005 £'000
<b>Net cash inflow from operating activities</b>	<b>2,991</b>	<b>1,211</b>
<b>Taxation paid</b>	<b>(311)</b>	<b>(257)</b>
<b>Capital expenditure and financial investment</b>		
Purchase of debt securities	(32,789)	(25,078)
Sale and maturity of debt securities	31,524	25,056
Purchase of tangible fixed assets	(64)	(26)
Sale of tangible fixed assets	8	-
<b>Increase in cash</b>	<b>1,359</b>	<b>906</b>
<b>Reconciliation of operating profit to net cash inflow from operating activities</b>		
Operating profit and profit on ordinary activities before tax	1,048	972
Increase in prepayments and accrued income	(200)	(19)
Increase in accruals and deferred income	369	594
(Decrease) / increase in provisions for bad and doubtful debts	(32)	36
Depreciation and amortisation	77	164
Amortisation of mortgage portfolio acquisition premium	39	77
<b>Net cash inflow from trading activities</b>	<b>1,301</b>	<b>1,824</b>
Net increase in loans and advances to customers	(17,005)	(14,380)
Net increase in shares	15,655	8,521
Net increase in deposits and other borrowings	3,359	5,126
Net increase in loans and advances to credit institutions	(300)	(200)
Net decrease in other liquid assets	-	25
Net (decrease) / increase in other liabilities	(19)	295
<b>Net cash inflow from operating activities</b>	<b>2,991</b>	<b>1,211</b>

<b>Analysis of increase in cash</b>	<b>At 1 Nov 2005</b>	<b>Net increase</b>	<b>At 31 Oct 2006</b>
Cash in hand	47	68	115
Loans and advances to credit institutions repayable on demand	7,498	1,291	8,789
	<b>7,545</b>	<b>1,359</b>	<b>8,904</b>

	<b>At 1 Nov 2004</b>	<b>Net increase/(decrease)</b>	<b>At 31 Oct 2005</b>
Cash in hand	140	(93)	47
Loans and advances to credit institutions repayable on demand	6,499	999	7,498
	<b>6,639</b>	<b>906</b>	<b>7,545</b>

# Notes to the Accounts

## I. Accounting Policies.

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Society's accounts.

### Basis of preparation

These accounts have been prepared under the historical cost convention, as modified by the revaluation of the freehold premises, and in accordance with applicable accounting standards and the Building Societies (Accounts and Related Provisions) Regulations 1998.

### Taxation

The charge for taxation is based upon the profit for the year and takes into account taxation which is deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen, but not reversed, by the balance sheet date, except as otherwise required by Financial Reporting Standard 19, Deferred Taxation.

### Fixed Assets and Depreciation

Depreciation is provided on a straight line basis to write off the cost, or valuation, of fixed assets, other than freehold land, over their estimated useful economic lives as follows:

Freehold Premises	50 years
Improvements to Leasehold Premises	5 years
Motor Vehicles	4 years
Office Equipment, fixtures and fittings	3 to 5 years
Computer Equipment	2 years

Freehold properties are revalued every 5 years, on an existing use basis, by an independent external valuer. An interim internal valuation is carried out in the third year after full revaluation. The surplus or deficit on revaluation is taken to revaluation reserve.

### Liquid Assets

Liquid assets are shown at cost including debt securities which are intended for use on a continuing basis. Premiums and discounts arising from the purchase of debt securities held as financial fixed assets are amortised on a straight line

basis over the period to maturity. Any amounts so amortised are charged or credited to the income and expenditure account for the relevant financial years. Where there is a permanent diminution in the value of a financial fixed asset, a provision is made so as to write down the cost of the security to its recoverable amount.

### Pension Costs

Pension costs are charged to the income and expenditure account in the year in which contributions are payable.

### Provision for loans and advances

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

Throughout the year, and at the year end, individual assessments are made of all loans and advances on properties which are in possession, or in arrears by three months or more. Specific provision is made against those loans and advances which are considered to be impaired. In considering the specific provision for impaired loans, account is taken of any discount which may be needed against the value of the property at the balance sheet date to agree a sale within three months of that date, the amounts recoverable under mortgage indemnity policies and anticipated realisation costs.

A general provision is made against those advances which have not been specifically identified as impaired, but where the Society's experience and the general economic climate would indicate that losses may ultimately be realised.

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

Loans and advances in the balance sheet are shown net of provisions, specific and general. The charge to the income and expenditure account comprises the movements in the provisions together with the losses written off in the year, less any recoveries of amounts of amounts previously written off.

## I. Accounting Policies (continued)

### Off balance sheet instruments

The Society uses interest rate contracts solely for hedging purposes. All interest related contracts are classified at the balance sheet date as hedging contracts and are valued, and income and expenditure recognised, on an equivalent basis to the assets and liabilities being hedged.

### Incentives to borrowers

Cashbacks and other incentives to borrowers are written off in the year in which they are incurred and charged against interest receivable and similar income.

### Operating leases

Rental charges arising from operating leases are charged to the income and expenditure account on a straight line basis over the life of the lease.

### Loans and Advances Acquired

Loans and advances acquired are included at their fair value. When the fair value of the assets acquired exceeds the acquired book value, the resulting premium is included in other assets and is amortised over the estimated economic life of the assets as an adjustment to interest receivable.

## Notes to the Accounts

	2006 £'000	2005 £'000
<b>2. Interest receivable and similar income</b>		
On loans fully secured on residential property	9,730	8,975
On other loans	1,104	1,080
On debt securities		
interest	974	988
(loss) / profit on disposals	(54)	10
On other liquid assets		
interest and other income	1,027	854
Net (expense) / income on financial instruments	(38)	12
	<b>12,743</b>	<b>11,919</b>

Total income on fixed income debt securities amounted to £596,480 (2005 : £740,226)

Interest on secured advances as shown above has been reduced by £14,353 (2005 : £11,912) representing interest suspended on non- performing loans in accordance with the Society's accounting policy.

Movements in the suspended interest account are as follows:

At 1 November 2005	10	-
Interest written off during year net of recoveries	(24)	(2)
Interest suspended in the year	14	12
At 31 October 2006	-	10

The amount of interest suspended as at the year end has been deducted from the appropriate assets in the balance sheet.

### 3. Interest payable and similar charges

On shares held by individuals	7,067	6,625
On deposits and other borrowings	2,264	1,961
Net income on financial instruments	-	(1)
	<b>9,331</b>	<b>8,585</b>

	<b>2006</b>	2005
	<b>£'000</b>	£'000
<b>4. Administrative expenses</b>		
Staff costs		
Wages and salaries	<b>1,049</b>	943
Social security costs	<b>105</b>	92
Other pension costs	<b>59</b>	53
	<b>1,213</b>	1,088
Other Administrative expenses		
On-going	<b>1,201</b>	1,158
Exceptional	<b>101</b>	179
	<b>2,515</b>	2,425

The exceptional costs are non-recurring IT and redundancy costs in connection with the IT systems replacement completed in 2006.

The Society makes a contribution of between 4% and 14.5% (2005: 4% and 13.5%) of individuals' basic gross pay into employees' Personal Pension schemes. There were no outstanding or prepaid contributions at either the beginning or the end of the financial year.

Other Administrative expenses include:

Amounts charged under other operating leases	<b>45</b>	45
Remuneration of Auditors and their associates (including VAT)		
audit fees	<b>32</b>	31
non audit fees	<b>1</b>	2

# Notes to the Accounts

## 5. Employees

The average number of persons employed by the Society during the year was :

	<b>2006</b>	<b>2006</b>	<b>2005</b>	<b>2005</b>
	<b>Full time</b>	<b>Part time</b>	<b>Full time</b>	<b>Part time</b>
Head office	<b>31</b>	<b>3</b>	29	2
Branch offices	<b>14</b>	<b>4</b>	14	6
Total	<b>45</b>	<b>7</b>	43	8

## 6. Remuneration of Directors

	<b>2006</b>	<b>2005</b>
	<b>£'000</b>	<b>£'000</b>
For services as Non executive Directors	<b>108</b>	103
For Executive services	<b>312</b>	279
	<b>420</b>	382

Full details are given in the Directors' Remuneration Report on pages 9 and 10.

## 7. Loans to Directors and Connected Parties

At 31 October 2006 there were outstanding mortgage loans granted in the ordinary course of business to 6 (2005:5) Directors and connected persons, amounting in aggregate to £759,305 (2005 : £690,660).

A register is maintained at the Head Office of the Society, in accordance with the requirements of Section 68 of the Building Societies Act 1986, which shows details of all loans, transactions and arrangements with Directors and their connected persons. A statement of the appropriate details contained in the register, for the financial year ended 31 October 2006, will be available for inspection at the Society's Head Office for a period of 15 days up to and including the Annual General Meeting.

### 8. Tax on profit on ordinary activities

	2006 £'000	2005 £'000
<b>Analysis of charge in year</b>		
Current tax		
Corporation tax at 30% (2005 : 30%)	262	311
<b>Total Current Tax</b>	<b>262</b>	<b>311</b>
Deferred Tax		
Origination and reversal of timing differences	37	(27)
Adjustment in respect of prior year	-	(5)
<b>Total Deferred Tax (Note 14)</b>	<b>37</b>	<b>(32)</b>
<b>Tax on profit on ordinary activities</b>	<b>299</b>	<b>279</b>
<b>Factors affecting the tax charge for the current period</b>		
Profit on ordinary activities before tax	1,048	972
Current tax at 30% (2005 : 30%)	314	292
Effects of:		
Difference between depreciation and capital allowances	(29)	9
Expenses not deductible for tax purposes	2	3
Other timing differences	(8)	18
Marginal relief	(17)	(11)
<b>Current tax charge for year</b>	<b>262</b>	<b>311</b>
<b>9. Loans and advances to credit institutions</b>		
Accrued interest	175	138
Repayable on demand	8,789	7,498
Other loans and advances by remaining maturity of:		
In not more than three months	6,000	6,200
In more than three months but not more than one year	4,000	3,500
<b>Total</b>	<b>18,964</b>	<b>17,336</b>

## Notes to the Accounts

<b>10. Debt securities</b>	<b>2006</b>	<b>2005</b>
	<b>£'000</b>	<b>£'000</b>
Issued by other borrowers	<b>21,739</b>	20,356
	<b>21,739</b>	20,356
Debt securities have remaining maturities as follows:		
Accrued interest	<b>454</b>	336
In not more than one year	<b>16,210</b>	16,600
In more than one year	<b>5,075</b>	3,420
	<b>21,739</b>	20,356
Transferable debt securities (excluding accrued interest) comprise:		
Listed	<b>6,095</b>	5,420
Unlisted	<b>15,190</b>	14,600
	<b>21,285</b>	20,020
Market value of listed transferable debt securities	<b>6,118</b>	5,423
Included in debt securities are:		
Unamortised discounts	-	1

The Directors of the Society consider that the primary purpose of holding debt securities is prudential. The securities are held as financial fixed assets with the intention of use on a continuing basis in the Society's activities and are therefore classified as financial fixed assets.

Movements during the year of debt securities held as financial fixed assets are as follows:

<b>Cost (excluding accrued interest)</b>	<b>£'000</b>
At 1 November 2005	<b>20,020</b>
Additions	<b>32,789</b>
Disposals	<b>(31,524)</b>
At 31 October 2006	<b>21,285</b>
<b>Provision for amortisation</b>	
At 1 November 2005	-
Written back in the year	-
At 31 October 2006	-
<b>Net book value at 31 October 2006</b>	<b>21,285</b>
Net book value at 31 October 2005	<b>20,020</b>

### 11. Provisions for bad and doubtful debts

	Loans fully secured on residential property £'000	Loans fully secured on land £'000	TOTAL £'000
At 1 November 2005			
General provision	358	209	567
Specific provision	31	-	31
	<b>389</b>	<b>209</b>	<b>598</b>
Income and expenditure account			
General provision	(2)	(8)	(10)
Specific provision	(22)	-	(22)
Net (credit)/charge to income and expenditure account	<b>(24)</b>	<b>(8)</b>	<b>(32)</b>
At 31 October 2006			
General provision	356	201	557
Specific provision	9	-	9
	<b>365</b>	<b>201</b>	<b>566</b>

### 12. Loans and advances to customers

	2006 £'000	2005 £'000
Loans fully secured on residential property	180,395	162,732
Loans fully secured on land	15,911	16,537
	<b>196,306</b>	<b>179,269</b>
The remaining maturity of loans and advances to customers from the date of the balance sheet is as follows:		
On call and at short notice	351	571
In not more than three months	254	35
In more than three months but not more than one year	222	400
In more than one year but not more than five years	5,519	4,555
In more than five years	190,526	174,306
	<b>196,872</b>	<b>179,867</b>
Less: provisions for bad and doubtful debts (note 11)	<b>(566)</b>	<b>(598)</b>
	<b>196,306</b>	<b>179,269</b>

## Notes to the Accounts

<b>13. Tangible fixed assets</b>	Freehold Land and Buildings £'000	Improvements to Leasehold Property £'000	Equipment, Fixtures Fittings & vehicles £'000	Total £'000
<b>Cost or Valuation</b>				
At 1 November 2005	<b>1,005</b>	<b>356</b>	<b>1,385</b>	<b>2,746</b>
Additions during year	-	-	<b>64</b>	<b>64</b>
Disposals during year	-	-	<b>(867)</b>	<b>(867)</b>
At 31 October 2006	<b>1,005</b>	<b>356</b>	<b>582</b>	<b>1,943</b>
<b>Depreciation</b>				
At 1 November 2005	-	<b>356</b>	<b>1,304</b>	<b>1,660</b>
Charged in year	<b>10</b>	-	<b>67</b>	<b>77</b>
Disposals during year	-	-	<b>(859)</b>	<b>(859)</b>
At 31 October 2006	<b>10</b>	<b>356</b>	<b>512</b>	<b>878</b>
<b>Net Book Value</b>				
At 31 October 2006	<b>995</b>	-	<b>70</b>	<b>1,065</b>
At 31 October 2005	1,005	-	81	1,086

The revaluation of the Society's freehold land and buildings was carried out on 31 October 2005 by Messrs Robert Ellis, Chartered Surveyors, on an existing use basis.

The historical cost of the revalued assets is £ 419,956 (2005 : £ 419,956). The accumulated historical cost depreciation on those revalued assets would be £105,713 (2005: £101,621). Included in the total net book value of freehold land and buildings is £495,000 (2005: £495,000) in respect of land on which no depreciation is provided.

The net book value of land and buildings occupied by the Society for its own activities is £750,466 (2005 : £758,333).

	2006 £'000	2005 £'000
<b>14. Other Assets</b>		
Unamortised mortgage portfolio acquisition premium	20	59
Deferred Taxation	224	261
	<b>244</b>	<b>320</b>
Deferred taxation comprises:		
Capital allowances	60	89
Timing differences related to general mortgage loss provision	162	160
Other timing differences	2	12
	<b>224</b>	<b>261</b>
Movement in deferred taxation		
At 1 November 2005	261	229
(Charge) / Credit to income and expenditure account	(37)	32
At 31 October 2006	<b>224</b>	<b>261</b>

In accordance with Financial Reporting Standard 19, the deferred tax liability of £63,177 (2005: £66,459) arising on the revaluation of freehold premises has not been recognised.

### 15. Shares

Held by individuals	<b>178,008</b>	162,044
Shares are repayable from the balance sheet date in the ordinary course of business as follows :		
Accrued interest	3,503	3,194
Repayable on demand	<b>153,706</b>	147,533
In not more than three months	3,412	139
In more than three months but not more than one year	4,242	3,465
In more than one year but not more than five years	13,145	7,713
	<b>178,008</b>	<b>162,044</b>

### 16. Amounts owed to credit institutions

Amounts owed to credit institutions are repayable from the balance sheet date in the ordinary course of business as follows:

Accrued interest	539	404
In not more than three months	13,000	8,200
In more than three months but not more than one year	11,850	10,700
	<b>25,389</b>	<b>19,304</b>

## Notes to the Accounts

	<b>2006</b>	2005
	<b>£'000</b>	£'000
<b>17. Amounts owed to other customers</b>		
Amounts owed to other customers are repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	<b>262</b>	337
Repayable on demand	<b>5,117</b>	5,191
In not more than three months	<b>5,881</b>	8,737
In more than three months but not more than one year	<b>6,351</b>	6,012
	<b>17,611</b>	20,277

### 18. Other Liabilities

Amounts falling due within one year

Corporation tax	<b>282</b>	331
Income tax	<b>469</b>	412
Other creditors	<b>759</b>	835
	<b>1,510</b>	1,578

### 19. Reserves

	<b>General Reserves</b>	<b>Revaluation Reserve</b>
	<b>£'000</b>	<b>£'000</b>
At 1 November 2005	<b>14,579</b>	<b>742</b>
Profit for the financial year	<b>749</b>	-
Depreciation transfer	<b>6</b>	<b>(6)</b>
At 31 October 2006	<b>15,334</b>	<b>736</b>

## 20. Guarantees and other financial commitments

### a. Contingent liabilities

The Society has a contingent liability in respect of contributions to the Financial Services Compensation Scheme.

### b. Annual commitments

At 31 October 2006 the Society had annual commitments for operating leases relating to land and buildings as follows:

	2006 £'000	2005 £'000
Operating leases which expire:		
After five years	45	45

### c. Capital commitments

There were £nil capital commitments at 31 October 2006 contracted not provided for (2005: £nil).

## 21. Financial Instruments

A financial instrument is a contract that 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. The Society also uses wholesale financial instruments to invest liquid asset balances, raise wholesale funds 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. The policy statement is reviewed regularly by the Board.

Instruments used for risk management purposes include derivative financial instruments ('derivatives'), which are contracts or agreements whose value is derived from one or more of underlying price, rate or index inherent in the contract or agreement, such as interest rates or stock market indices. All transactions in derivatives are undertaken to manage the risks arising from underlying business activities.

These derivatives are only used by the Society in accordance with the Building Societies Act 1986 to limit the extent to which the Society will be affected by changes in interest rates or other factors specified in the legislation. Derivatives are not used in trading activity or for speculative purposes, and consequently all such instruments are classified as hedging contracts.

The derivative instruments used by the Society in managing its balance sheet exposures are interest rate swaps. These are used to protect the Society from exposures arising principally from fixed rate mortgage lending, fixed rate savings products and fixed rate deposit funding. The duration of the off balance sheet contract is generally short to medium term and their maturity profile reflects the nature of the exposures arising from the underlying business activities.

# Notes to the Accounts

## 21. Financial Instruments (continued)

### Outstanding Derivative Contracts

The table below shows the notional principal amounts, credit risk weighted amounts and replacement costs of derivatives. Notional principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The credit risk weighted amount is calculated according to rules specified by the Financial Services Authority, and is based on the replacement cost, but also takes into account measures of the extent of potential future exposure and nature of the counterparty. The replacement cost represents the cost of replacing contracts with a positive value, calculated at market rates current at the balance sheet date, and reflects the Society's maximum exposure should all counterparties default.

	2006 £'000	2005 £'000
<b>Unmatured interest rate swaps</b>		
Notional principal amount	38,100	28,900
Credit risk weighted amount	49	30
Replacement cost	121	29

### Risk Management

The main financial risks arising from the Society's activities are liquidity risk, credit risk and interest rate risk. The Board reviews and agrees policies for managing each of these risks, as summarised below.

#### Liquidity Risk

Liquidity Risk is the risk of failing to meet demands and commitments to provide funds to customers and other third parties. The Society's policy is to maintain sufficient liquid funds at all times to ensure that liabilities can be met as they fall due. The objective of liquidity is to help smooth mismatches between maturing assets and liabilities thereby maintaining public confidence in the solvency of the Society. In addition it is the Society's policy to maintain committed borrowing facilities in order to provide additional flexibility in the management of the Society's liquidity. At the year end the Society had undrawn committed facilities of £8.0 m. (2005: £11.0 m.)

#### Credit Risk

Credit Risk is the risk that counterparties will not be able to meet their obligations as they fall due. The Society is exposed to both retail credit risk, through mortgage lending, and wholesale credit risk, via treasury operations. All loan applications are assessed with reference to the Society's lending policy. Changes to the policy are approved by the Board, and the approval of loan applications is mandated. The Assets and Liabilities Board Committee is responsible for approving treasury counterparties.

#### Interest Rate Risk

Interest Rate Risk is the risk that income arising from the Society's assets and/or liabilities varies as a result of changes in interest rates. The Society is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates, or, if earlier, the dates on which the instruments mature. The Society manages this exposure continually by using both on and off- balance sheet instruments.

## 21. Financial Instruments (continued)

After taking into account the derivatives entered into by the Society, the interest rate sensitivity exposure was:

<b>As at 31 October 2006</b>	Not more than three months £'000	More than three months but not more than six months £'000	More than six months but not more than one year £'000	More than one year but not more than five years £'000	Non interest bearing £'000	TOTAL £'000
<b>Assets</b>						
Liquid assets	29,199	4,700	6,175	-	744	40,818
Loans and advances to customers	176,243	1,468	4,561	14,600	(566)	196,306
Tangible fixed assets	-	-	-	-	1,065	1,065
Other assets	-	-	-	-	399	399
<b>Total assets</b>	<b>205,442</b>	<b>6,168</b>	<b>10,736</b>	<b>14,600</b>	<b>1,642</b>	<b>238,588</b>
<b>Liabilities</b>						
Shares	159,897	2,515	1,188	10,905	3,503	178,008
Amounts owed to credit institutions and other customers	24,998	11,296	5,905	-	801	43,000
Other liabilities	-	-	-	-	1,510	1,510
Reserves	-	-	-	-	16,070	16,070
<b>Total liabilities</b>	<b>184,895</b>	<b>13,811</b>	<b>7,093</b>	<b>10,905</b>	<b>21,884</b>	<b>238,588</b>
Off balance sheet items	6,000	(1,700)	(1,000)	(3,300)	-	-
Interest rate sensitivity gap	26,547	(9,343)	2,643	395	(20,242)	-

### Comparative position at 31 October 2005

Total assets	188,642	6,495	3,544	18,404	1,439	218,524
Total liabilities	172,700	10,657	8,016	6,317	20,834	218,524
Off balance sheet items	10,950	(1,250)	2,000	(11,700)	-	-
Interest rate sensitivity gap	26,892	(5,412)	(2,472)	387	(19,395)	-

Liquid assets include cash in hand and balances to credit institutions and debt securities.

Other assets include prepayments, other assets and accrued income.

# Notes to the Accounts

## 21. Financial Instruments (continued)

### Fair values of financial instruments

Set out below is a comparison of book and fair values of some of the Society's financial instruments by category as at 31 October 2006. Market values have been used to determine fair values. The table excludes certain financial assets and liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. It therefore excludes such items as mortgages, share accounts and deposits with other credit institutions.

	<b>2006</b>	<b>2006</b>	<b>2005</b>	<b>2005</b>
	<b>Book Value</b>	<b>Fair Value</b>	<b>Book Value</b>	<b>Fair Value</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
On balance sheet instruments				
Debt securities	<b>21,739</b>	<b>21,748</b>	<b>20,356</b>	<b>20,361</b>
Off balance sheet instruments				
Interest rate swaps	-	<b>4</b>	-	<b>(72)</b>

### Hedges

Hedges which comprise the 'Derivatives' referred to above are used to reduce the risk of loss arising from changes in interest rates. Gains and losses on instruments used for hedging are recognised in line with the item being hedged and are only recognised in the event of the underlying exposure itself being unwound. The following table sets out the movements in unrecognised and recognised gains and losses in the year to 31 October 2006.

	<b>2006</b>	<b>2006</b>	<b>2006</b>
	<b>Unrecognised gains</b>	<b>Unrecognised losses</b>	<b>Net gain/ (loss)</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Gains and losses			
Unrecognised at the start of financial year	<b>29</b>	<b>(101)</b>	<b>(72)</b>
Items unrecognised at the start of the year recognised in the year	<b>(19)</b>	<b>58</b>	<b>39</b>
Items unrecognised at the start of year and unrecognised at the year end	<b>10</b>	<b>(43)</b>	<b>(33)</b>
Gains and losses arising in the year unrecognised in the year	<b>111</b>	<b>(74)</b>	<b>37</b>
Unrecognised at the end of the financial year	<b>121</b>	<b>(117)</b>	<b>4</b>
Of which:			
Expected to be realised in the year to 31 October 2007	<b>74</b>	<b>(91)</b>	<b>(17)</b>
Expected to be realised after 31 October 2007	<b>47</b>	<b>(26)</b>	<b>21</b>
	<b>121</b>	<b>(117)</b>	<b>4</b>

# Annual Business Statement

## for the year ended 31 October 2006

### 1. Statutory Percentages

	2006 %	Statutory Limit %
Lending Limit	8.37	25.00
Funding Limit	19.46	50.00

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

The Lending Limit measures the proportion of business assets not in the form of loans fully secured on residential property. Business assets are the total assets of the Society as shown on 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.

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

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

### 2. Other Percentages

	2006 %	2005 %
<b>As a percentage of shares and borrowings :</b>		
Gross capital	7.27	7.60
Free capital	7.04	7.34
Liquid assets	18.47	18.72
<b>As a percentage of mean total assets:</b>		
Profit for the financial year	0.33	0.33
Management expenses	1.13	1.23
Management expenses less exceptional items	1.09	1.14

The above percentages have been prepared from the Society'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 the aggregate of the general reserves and the revaluation reserve.

'**Free capital**' represents the aggregate of gross capital and general loss provisions for bad and doubtful debts, less tangible fixed assets.

'**Mean total assets**' represents the average of total assets at the beginning and end of the 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.

# Annual Business Statement

for the year ended 31 October 2006

## 3. Information relating to the Directors at 31 October 2006

<b>Name</b> <b>Date of Birth</b>	<b>Date of</b> <b>Appointment</b>	<b>Business</b> <b>Occupation</b>	<b>Other Directorships</b>
P. R. Blakemore Chairman (6.12.51)	01.10.90	Chartered Accountant	B.B.M. Services Ltd Charnwood Accounting Solutions Ltd Godkin & Co Ltd KDB Bookkeeping Ltd
S. P. Mellors Deputy Chairman (7.6.51)	08.11.99	Chartered Surveyor	Bradgate Mews (Ratby) Management Co Ltd CPG Developments Ltd CPG Homes Ltd IM4U Ltd Linkfield Court Management Co Ltd
C. G. Bradley (10.11.52)	01.09.93	Building Society Finance Director	None
Mrs C. D. Clifford (29.12.57)	31.10.06	Human Resources Consultant	Budget Group Ltd Gilling Consulting Ltd
J. B. Gibbins (15.8.37)	14.03.94	Chartered Accountant	Hempland Close Management Co. Ltd
Mrs C. Joyce (21.5.63)	10.11.03	Building Society Operations Director	None
S. R. Peete (19.1.58)	08.04.98	Building Society Chief Executive	None
A.Roberts (24.1.47)	09.11.98	Solicitor	None

Documents may be served on the above named Directors c/o KPMG Audit Plc at the following address:

2 Cornwall Street, Birmingham B3 2DL

The three Executive Directors are employed on contracts requiring a notice period of 12 months by the Society and 6 months by the individual. The contracts were entered into on 19 October 2004.

# **The Loughborough**

where people make the difference

## ***Head Office***

6 High Street, Loughborough, LE11 2QB.

Tel: (01509) 610707 Fax: (01509) 231058

Email: [enquiries@theloughborough.co.uk](mailto:enquiries@theloughborough.co.uk)

## ***Branch Offices***

4 High Street, Loughborough, LE11 2PY.

Tel: (01509) 610600 Fax: (01509) 610200

Email: [lboro@theloughborough.co.uk](mailto:lboro@theloughborough.co.uk)

1/2 Babington Lane, Derby, DE1 1SU.

Tel: (01332) 290818 Fax: (01332) 293228

Email: [derby@theloughborough.co.uk](mailto:derby@theloughborough.co.uk)

5 Market Place, Long Eaton, Nottingham, NG10 1JL.

Tel: (0115) 9728088 Fax: (0115) 9469624

Email: [longeaton@theloughborough.co.uk](mailto:longeaton@theloughborough.co.uk)

**website: “[www.theloughborough.co.uk](http://www.theloughborough.co.uk)”**

**The Society is authorised and regulated by the Financial Services Authority and is entered in the FSA Register under number 157258.**

Established 1867