Scottish Building Society
Report & Accounts

For the year ended 31 January 2014

SCOTTISH BUILDING SOCIETY

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REPORT AND ACCOUNTS

for the year ended 31 January 2014

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Overview

This has been a busy year for the Scottish Building Society. The integration of the Century Building Society has been successfully achieved, and we welcome all our new members. Gerry Kay, who had served as the Society's Chief Executive for 5½ years, left the Society with our best wishes and thanks for his hard work over those years. He was replaced by Mark Thomson, who came to the Society as Chief Operating Officer and has over 30 years' experience in banking, and lending in particular, most recently with Scottish Widows Bank. He brings a wide knowledge of the savings and mortgage markets, and a strong understanding of the principles of mutuality.

Financial Position

The Society has had a good financial year, despite the ongoing challenging market conditions. We have now seen a period of 5 years with record low Bank Base rates, high, but now falling, inflation, weak wage growth and a resultant squeeze on household incomes. Whilst there are signs of recovery and optimism in the UK economy, the Eurozone was still in recession for much of the year and although the acute issues appear to be over, Europe and the Euro are not entirely out of trouble. There are also reports of increasing house prices and an increase in activity in the housing market, partly attributed to the various Government schemes aimed at supporting this area of the economy.

Whilst governments urge their banks and building societies to increase lending to support the economy, these organisations have little room to move with enhanced capital adequacy rules meaning they need to hold more capital against the loans they write, and such an environment is not compatible with growth in net new lending.

That said the Society's capital ratios remain high by reference to both our peer group and the higher minimum levels of capital expected to be required by the regulators. Profitability has improved and we have high levels of liquidity and capital, which stand us in good stead for continued lending notwithstanding the challenging banking environment.

Although low interest rates have had obvious benefits for mortgage holders, savers are experiencing the pain of this prolonged period of low rates. Most economists suggest that the Bank Base rate is unlikely to increase until 2015 at the earliest. At Scottish Building Society, we are very conscious that the balance of providing competitive mortgage rates and savers rates is something which requires constant attention.

Products

Your management team has spent time this year simplifying our product range. We believe that simplification of both savings and mortgage products is important for our existing members and for attracting new members. We are currently reviewing all of our mortgage and savings products to ensure that the rates are fair and comparable, that we have no 'teaser' rates on savings products which drop to lower rates at a later date, and that any conditions attaching to mortgages or savings products are transparent and easily understandable.

Member Communication

Member communication and feedback is very important to us. We are in the process of redeveloping our regular newsletter and also look forward, at our AGM in Perth in May, to meeting as many members as are able to attend. For those members who cannot be present, we will continue the practice of asking for your questions prior to the AGM, and will endeavour to answer as many of those questions at the meeting as is practical. It has been our practice to take the AGM around Scotland and this year will be our first year in Perth. We hope very much to see a large audience there. In addition to this we would encourage you to raise any questions, issues and concerns that you may have, either as part of the postal or online voting process or by emailing your question to **agmquestion@scotbs.co.uk**.

Regulation

As mentioned above, regulation of the financial services industry has understandably been tightened over recent years with increased capital requirements being simply one of a number of new consequences of the review. An important regulatory development for us is the outcome of the regulator's Mortgage Market Review (MMR) coming in to effect in April 2014. These impose significant additional responsibility on all lenders to ensure borrower "affordability" of mortgage products - in simple terms lenders have a higher burden of responsibility in assessing a mortgage applicant's ability to service a mortgage rather than relying on a borrower undertaking. The Society's underwriting approach, which requires a file-by-file review of applications as opposed to the "credit scoring" process used by many larger lenders, means that we are very well placed to comply with the MMR requirements without having to significantly change the way we conduct our business.

Regulatory compliance continues to take up a great deal of resource for all organisations affected. During 2013, the Financial Services Authority was split into two separate organisations, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Whilst this split makes clear organisational sense in terms of division of responsibilities, there is an inevitable period of duplication in the short term as both the regulatory bodies and those institutions being regulated bed down the new working model. These challenges are of course compounded by the ongoing changing regulatory landscape. However, our members can rest assured that the management team and Board dedicate considerable time to ensuring a close and well-functioning relationship with our regulatory interfaces and compliance with our regulatory obligations.

Management Team

The management team under the new Chief Executive is working hard to continue to provide excellent customer service. I would like to take this opportunity to thank them for their hard work and support and to the Board for their commitment and guidance.

Looking Forward

As I mentioned, there are signs of recovery, and with a financially strong Society and a strong management team under the guidance of Mark Thomson, the Society is well placed to continue to provide the mortgage and savings products which the market requires. The Board is confident that the Society can continue to remain independent, retain its mutual status, and deal with any issues which may arise following the independence vote later this year.

Alexa H Henderson
Chairman

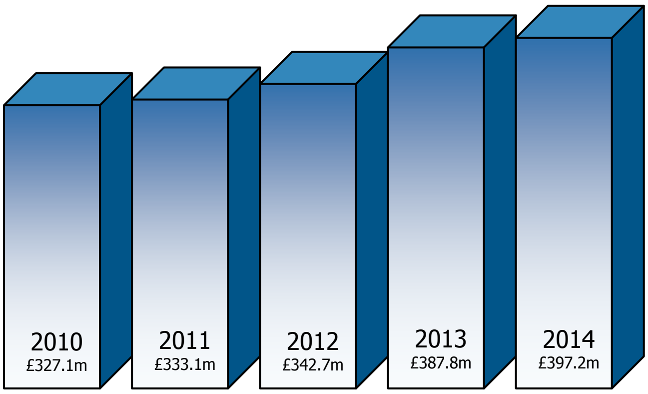
26 March 2014

Total Assets
£397.2million

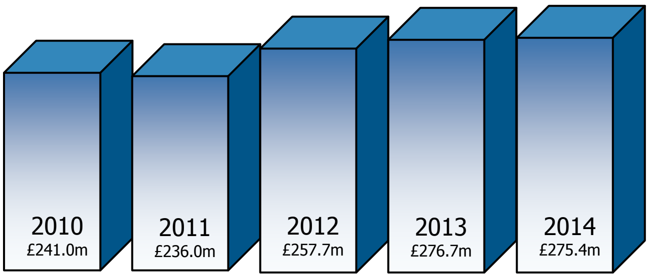
Liquid Assets
£119.2million

Profit Before Tax
(excluding exceptional items)
£1.6million

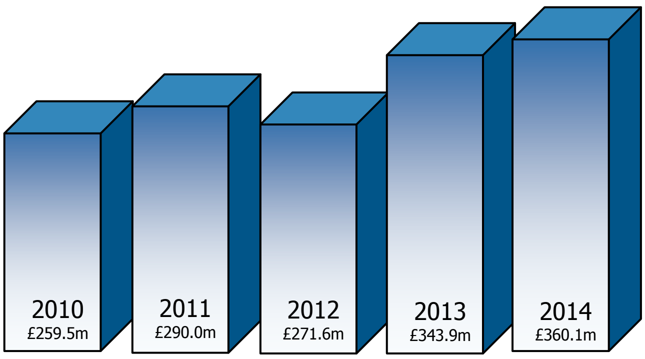
Total Assets



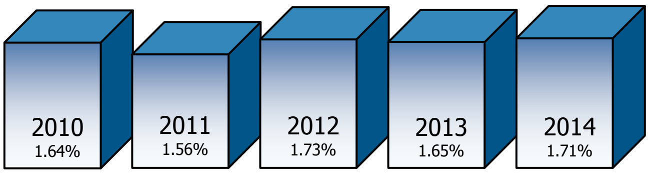
Mortgage Balances



Savings Balances



Net Interest Margin %



Our Performance

I am delighted to report that your Society had another good year, with our profit before tax and exceptional items 60% ahead of the previous year at £1,559,000 (2013: £973,000). Our retained profit, which further strengthens our reserves, was also up on last year.

The financial year 2013/14 was a period that saw a number of changes to your Society, starting in February 2013 with our merger with Century Building Society, when we welcomed around 3,000 members to our enlarged Society; my appointment as Chief Executive in May; and the successful delivery of a major technology project in the autumn to upgrade our IT and telephone infrastructure, which delivers flexibility to our operational model and enhances our 'business continuity' capability.

Despite being a period of change, I am pleased to advise that customer service remains a priority, and was the main driver towards an enhancement in our organisational structure, which now places responsibility for the provision of excellent customer service under one senior manager.

Apart from my own change of role, our Senior Management Team is largely unchanged, except for the addition of Andrew Moses into the role of Head of Operations and Lending. Andrew has over 25 years of highly relevant experience, and is a welcome addition to my Senior Management Team.

Mortgages

Lending on residential property by raising funds from individual savers remains at the heart of your Society's straightforward business model, and our gross lending this year amounted to £23.6m (2013: 52.4m), with overall net lending remaining flat.

Throughout 2013, the residential property market in Scotland was largely subdued, with many lenders generally competing for a limited amount of business. Besides our desire to only lend to credit-worthy individuals, we do not believe it is in your Society's best interests to compete for this business at a price that does not add value. We have, however, been working to simplify our range of mortgage products, and to make the Society easier to deal with, as part of our continuous improvement initiative.

Our competitive strength in mortgages is based upon our traditional approach to lending, where each application is individually assessed by an experienced professional. This means we can often assist applicants whose circumstances do not fit the computerised processing requirements employed by larger lenders.

Individual assessment and prudent lending policies also contribute to the high quality of our mortgage lending and consistently low levels of arrears. At the year-end only 0.41% (2013: 0.61%) of mortgages which were on our books at the beginning of the Financial Year were three months or more in arrears. (This figure, once Century mortgages are included, increases to 1.29%.)

Savings

I fully understand that the current low interest rate environment, which seems likely to continue for a while longer, makes it very difficult for savers to achieve real returns on their investments. It is of course essential for the Society to earn a margin between savings and mortgage lending in order to maintain our strength, and we therefore work hard to achieve a fair balance between the interests of our savers and mortgage borrowers.

While we remain committed to providing our members with the best possible deal, we have, throughout the last year, been working towards an exercise to simplify our product range and to bring our rates across a number of like products into line. This exercise has also been designed to provide our members with a wider range of investment products than we have been able to offer recently, including 'Member-Only' offerings as a reward for your loyalty to the Society.

The Year Ahead

As a Society that wishes to treat its members fairly and consistently throughout their relationship with us, we remain committed to providing our members, whether savers or borrowers, with good value products and an excellent level of customer service. We will continue to seek operating efficiencies through our programme of continuous improvement and technology enhancement, and will be seeking regular feedback on what matters most to our members.

We expect the environment to remain challenging, but firmly believe that your Society and its highly committed staff are well placed to compete and achieve further success.

Mark L Thomson
Chief Executive

26 March 2014

Introduction

The Directors present their 165th Annual Report, together with the Annual Accounts and Annual Business Statement, for the year ended 31 January 2014.

Our Mission, Vision and Values Statements

The Society's Mission Statement is that "we aim to be the Building Society of choice for every stage in life".

Our Vision is "to remain Scottish, Independent and Mutual, providing a first class service and quality products for all members".

The values of the Scottish Building Society are:

- To provide professional and friendly service and to be clear and straightforward in all our communications with our members, who are both our customers and the owners of our business.
- To operate in accordance with the highest standards of integrity and transparency in all relationships with members, business partners and regulators.
- To earn the respect and trust of our members and to be socially responsible in everything we do.
- To maintain the Society's financial strength and stability and aim to be as cost-effective as possible.

Business Review

The Business Review is covered in the Chairman's Report and Chief Executive's Review on pages 1 to 5.

Profit and Capital

Profit for the year before tax excluding the exceptional expenditure of the Financial Services Compensation Scheme (FSCS) levy and merger costs amounted to £1,559,000 compared with £973,000 in 2012-13. This is a strong performance in a difficult market environment, and further strengthens our reserves as a platform for future growth and the provision of member benefit.

Gross capital and free capital as a percentage of shares and borrowings stood at 7.7% and 7.2% respectively at 31 January 2014 (2013: 7.4% and 6.9%). This is comparable with other building societies of a similar size to ourselves.

The Society is required to set out its capital position, risk exposures and risk assessment processes in its Pillar 3 disclosures document which is available on the Society's website or from the Secretary of the Society.

Liquidity

Total cash and investments at 31 January 2014 amounted to £119.2million which represented 32.5% of total shares and borrowings, which compares with £108.7million (30.2%) at 31 January 2013. The Society's continuing aim is to maintain an appropriate level of liquidity at all times, in accordance with prudent management and regulatory requirements.

Interest Rates

The Bank of England base rate fell to an unprecedented 0.50% in March 2009. It has remained at that historical low since that date and there remains (at the time of writing) no firm indication as to when rates might start to rise again. As a result the Society's Standard Variable Rate for mortgages has remained unchanged at 5.29% throughout the financial year and there have also been no global changes to variable savings rates (although there have been some changes to individual mortgage and savings products to reflect market conditions).

The Society's long-term goal continues to be to generate member value through efficient and prudent management and a process to harmonise and simplify savings products has been initiated which will result (when completed) in a clear, simple range of products where all accounts on the same terms will receive the same rate of interest.

Mortgage Arrears and Forbearance

At 31 January 2014 the Group had only eleven mortgage accounts in arrears for 12 months or more (2013: four). The total arrears outstanding on these accounts was £142,748 (2013: £63,393) and the aggregate capital balance was £1,255,221 (2013: £627,737). Five properties had to be taken into possession during the year (2013: two).

The Society uses a number of forbearance measures to assist those borrowers who are, or could be, approaching a point of experiencing financial difficulty. Such measures include agreeing a temporary payment concession in order to reduce the borrowers' financial pressures. We expect borrowers to resume normal payments once they become able to do so. As at 31 January 2014 there were 74 cases benefiting from the Society's forbearance measures with total outstanding capital balances of £5.7million. The Society makes provisions for any expected loss resulting from accounts in arrears in accordance with the Board approved policy.

Key Performance Indicators

The Board and management monitor a range of performance indicators to assess the ongoing health of the Society. The financial indicators are shown in the table below – and some are also shown graphically on page 3. Their significance is explained as:

Total Assets: These have increased by 2.4%, primarily due to the lower levels of lending during the year.

Mortgage Assets: One of the key reasons for the Society's existence is to promote home ownership; this year mortgage assets have remained relatively unchanged due to the subdued market in Scotland.

Share Balances: Another key reason for the Society's existence: to encourage saving and investment. Savings balances have increased by 4.7% this year.

Reserves: The accumulated profits of the Society over more than 165 years of operation, which provide the capital which helps to maintain the Society's financial strength.

Net Interest Margin: The income generated by the Society from its operations, expressed as a percentage of mean total assets.

Liquidity: Total cash and investments held by the Society at the year-end, expressed as a percentage of shares and borrowings.

Gross Capital: This ratio is expressed as a percentage of shares and borrowings and demonstrates the relationship between the Society's capital and its liabilities to investors. It reflects the continuing strength of the Society whilst remaining well within prudent guidelines.

Asset Growth: The annual increase in the Society's assets shown as a percentage.

Group Key Financial Performance Indicators 2010-2014

	2010	2011	2012	2013	2014
Total Assets	£327.1m	£333.1m	£342.7m	£387.8m	£397.2m
Mortgage Assets	£241.0m	£236.0m	£257.7m	£276.7m	£275.4m
Share Balances	£259.5m	£290.0m	£271.6m	£343.9m	£360.1m
Reserves	£24.9m	£25.4m	£26.0m	£26.5m	£28.3m
Net Interest Margin	1.64%	1.56%	1.73%	1.65%	1.71%
Liquidity	27.9%	31.0%	26.3%	30.2%	32.4%
Gross Capital	8.3%	8.3%	8.2%	7.4%	7.7%
Asset Growth	10.6%	1.8%	2.9%	13.2%	2.4%

Non-Financial Key Performance Indicators

The Board also monitors a number of other indicators on a regular basis. Amongst these, it is pleasing to report that:

- 80% of mortgage borrowers reaching the end of their initial incentive period have remained with the Society.
- Customer complaints remain relatively low, with only 44 formal complaints registered during the year, 95% of which were resolved within four weeks of receipt.
- Less than 2% of mortgage accounts have arrears greater than 1.5% of their mortgage balance.
- Overall membership numbers have increased during the year.

Regulation and Compliance

The past year has seen further regulatory changes. In April 2013 the Financial Services Authority (FSA) was replaced by two new regulators, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The Society is now regulated by two separate bodies.

As highlighted last year, the FSA issued revised rules arising from its Mortgage Market Review which will come into force in April 2014. The Society, along with the rest of the mortgage industry, has therefore been working hard to prepare for these new rules and we are well-placed to ensure that our existing and future customers benefit from these changes. The EU Mortgage Credit Directive has recently come into force and this will mean further changes for the mortgage industry over the next two years.

The Society is required to have regard to the principles laid down in the UK Corporate Governance Code. This is covered in more detail in the separate Corporate Governance Report on pages 14 to 17.

Scottish Independence Referendum

The Board takes the view that the Society should remain neutral in the ongoing debate about Scottish Independence, as it will be Scotland's people who will decide the country's future. Whatever the outcome of the September vote, the Society will continue to act in the best interests of our members. The detailed implications for savers and borrowers remain unclear at the present time as – in the event of a 'Yes' vote – much will depend on the outcome of post-referendum negotiations on topics such as currency, financial regulation and EU membership.

Principal Risks and Uncertainties

The Society has a risk-averse strategy and maintains a comprehensive Risk Register reflecting the impact and likelihood of adverse events, which is regularly reviewed by the Board and covers all aspects of the business.

The principal business risks to which the Society is exposed are considered to be:

- **Credit Risk:** This relates to the risk that mortgage customers or treasury counterparties, to whom the Society has lent money, default on their obligation to pay. We seek to mitigate credit risk principally through the careful management of our underwriting policy and process, ensuring that all loans meet the criteria laid down in our Lending policy which is reviewed at least annually. The Society's exposure to counterparties is carefully controlled in accordance with the limits set out in our Liquidity policy.
- **Interest Rate Risk:** This is the risk of the Society's financial position deteriorating as interest rates move over time and the failure to preserve interest rate margins arising from an increase in the cost of funds or a decrease in the earning capacity of assets. We seek to manage interest rate risk by matching the characteristics of mortgage and savings products and through the use of financial instruments within defined parameters.
- **Liquidity Risk:** This relates to the Society's ability to meet its financial obligations as they fall due. The Society has policies in place to ensure it maintains sufficient funds in liquid form at all times and stress tests are carried out regularly to confirm that the Society can withstand normal and abnormal cash outflows.
- **Operational Risk:** This is the risk of a loss arising from inadequate or failed internal processes or systems, human error or external events. Processes and systems are in place to minimise these risks.
- **Strategic and Reputational Risk:** The risk of the Society entering unprofitable markets or offering unprofitable products. The Board has a duty to ensure that the Society makes an adequate amount of profit to maintain capital ratios at a sufficient level to provide long-term financial strength and stability for all members. This also includes risk arising from increased regulation by the financial services regulators.
- **Conduct Risk:** The risk of the Society failing to treat its customers fairly, with resulting detriment to those customers. As noted in the Corporate Governance Report, the Board has established a Conduct Risk Committee to oversee the arrangements already in place to ensure that the Society continues to keep the needs of its members at the heart of everything we do.

A further risk stems from the continuing uncertainty inherent in the current economic environment. There are also additional risks arising from the impact of (a) the outcome of the Scottish Independence Referendum and (b) regulatory changes already mentioned. There remains the potential for further contributions to the FSCS levy which would impact upon the Society's capital and ability to compete over a period of time.

The Society will continue to adopt a cautious approach in the coming financial year, seeking moderate managed growth in order to maintain financial stability, whilst providing suitable mortgage and savings products to customers.

Financial Risk Management Objectives and Policies

The Society has a formal policy for the management of financial risk, including the arrangement of appropriate financial instruments to provide a hedge against identified exposure in fixed-rate lending. Particular risks including credit, liquidity and interest rate risk are considered in Notes 23(e) and 23(f) to the Accounts.

As a key component of the Society's management of financial risk, the Society has established a Management Assets & Liabilities Committee (MALCO) which meets at least monthly to make decisions within Board-prescribed parameters on product pricing, margin policy, hedging strategy and interest rate risk strategy. The MALCO reports to the Board's Assets & Liabilities Committee (ALCO), which in turn reports to the Board.

Capital Requirements

The Board has reviewed its risk assessment to meet the requirements of Basel III and the associated Capital Requirements Regulations and Directive (CRR/CRD). The Society is required to conduct an assessment of the adequacy of its capital and resources, known as the Internal Capital Adequacy Assessment Process (ICAAP), which is regularly reviewed and revised to reflect the prevailing economic climate.

Going Concern

As part of the Society's forward planning process, the Directors have considered forecasts showing the Society's capital, liquidity and financial position for the coming financial year under normal operating conditions. They have also considered the effect on the Society's business, financial position, capital and liquidity under stressed operating conditions.

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.

Corporate Social Responsibility (CSR)

The Society recognises that CSR is concerned with how businesses take account of the social, environmental and economic impacts of their operations. We seek to be a good corporate citizen in all aspects of our operations and activities and aim to be recognised as a socially responsible business by our members, our staff and the communities in which we operate. This is articulated in our Corporate Social Responsibility Policy.

Customer Service and Conduct of Business

The Society is committed to treating its members fairly and to acting with honesty and integrity in its relationships with members, regulators and the wider community. Continuous review and improvement is used to build on the high level of service throughout the Society and the many positive aspects already in place, as outlined in the Chief Executive's Review.

Donations and Community Support

The Society continues to provide support for local events in areas around its branches, and is looking to further develop its community involvement during the coming years.

Charitable donations are made to reflect and encourage members' participation in the Society's Annual General Meetings each year. The 2013 AGM was held at the Scottish National Gallery in Edinburgh and £500 was donated to the Scottish Wildlife Trust for members attending in person and £1,600 was donated to Carers Scotland for postal and online votes received.

The 2014 AGM will be held at the Royal George Hotel in Perth on 28 May and a donation will be made to Diabetes UK Scotland for every voting member attending and for every postal and online vote received.

There were no donations for political purposes.

Environmental Issues

The Society aims to minimise the environmental impacts of all our operations by striving to reduce unnecessary consumption, to re-use and recycle where possible, to manage energy usage wisely and to promote the control of environmental issues at all levels. We continue to use paper from sources approved by the Forestry Stewardship Council wherever possible, to recycle waste paper and other materials and to encourage our staff to be environmentally aware at all times.

Following the successful introduction of online voting facilities, we also intend to reduce our impact on the environment in the future by allowing members to opt to receive future AGM packs electronically.

Employee Policies

The Society aims to create an environment in which all staff feel valued, where discriminatory behaviour is not tolerated and all employees are encouraged to enhance their skills through personal development and training programmes linked closely to their specific role and annual performance review.

Merger with Century Building Society

The merger with Century Building Society took effect on 1 February 2013. The customer and accounts data from Century was successfully integrated into the Society's main computer systems very quickly and changes have been made to interest capitalisation and charging dates during this year to bring Century heritage accounts into line with the Society's operating processes.

The Directors are pleased to welcome former Century members as members of the enlarged Society.

Technology

The Society has completed an extensive upgrade to its computer and telephone systems during the year. These changes provide a firm foundation for greater flexibility and other improvements in working processes and also help to ensure better business continuity provision.

Staff and Agents

The Directors recognise the contribution that staff at all levels make to the continuing success of the Society and would once again like to record their appreciation for the efforts made by everyone, particularly in what has been another very busy and challenging year.

The Directors also wish to acknowledge the assistance provided by our agency network that enables the Society to offer a counter service to members throughout Scotland, particularly in rural areas.

Directors

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

Non-Executive Directors

Alexa H Henderson BSc CA	Chairman
Robert Golbourn MBA FCIBS	Vice-Chairman & Senior Independent Director Chairman of Credit Committee Chairman of Nomination & Remuneration Committee
Moira R Sibbald LLB	Chairman of Audit Committee
David Peebles MSc DipM MCIM FCIBS MCT	Chairman of Assets & Liabilities Committee
David W P Chalmers OBE	Retired 28 May 2013
George B Clark LLB LLM WS	Retired 28 May 2013
Raymond J Abbott CA	Appointed 1 June 2013
John C Ogston FCIBS	Appointed 1 July 2013

Executive Directors

Gerard J Kay CA	Chief Executive (resigned 30 April 2013)
Mark L Thomson FCIBS	Chief Operating Officer (until 30 April 2013) Chief Executive (from 1 May 2013) Chairman of Conduct Risk Committee

Biographies of all current Directors appear on pages 12 & 13.

None of the Directors had any beneficial interest in the Society's subsidiary undertaking, SBS Mortgages Limited, as at the year end. The Society maintains liability insurance cover for Directors and Officers as permitted by the Building Societies Act 1986.

Election of Directors

Raymond Abbott and John Ogston were co-opted to the Board during the year and are retiring in accordance with Rule 25(4).

Where an individual has been a Director for more than nine years, the Society's policy is that they should seek re-election by the members at least every two years, after having been assessed by the Board as continuing to be independent in character and judgement. Alexa Henderson was first appointed to the Board in 2001 and last stood for re-election in 2012.

Under Rule 26 any Director who has not been elected or re-elected at either of the last two Annual General Meetings must retire from office and seek re-election. This year Moira Sibbald is retiring under Rule 26, having last been re-elected in 2011.

Being eligible under the Rules, all of the above offer themselves for election/re-election.

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 Society.

Supplier Payment Policy

The Society's continuing policy concerning the payment of its trade creditors is to pay within the agreed terms of credit, once the supplier has discharged their contractual obligations. The average number of days' credit taken to pay suppliers during the year ended 31 January 2014 was ten (2013: ten).

Auditor

Following a review of their corporate structure, our auditor, KPMG Audit Plc, has instigated an orderly wind down of its business, with future audit work being undertaken by KPMG LLP. The Board has decided to put KPMG LLP forward to be appointed as auditors and a resolution for their appointment will be proposed for consideration at the Annual General Meeting to be held on 28 May 2014.

There is no difference in liability terms between KPMG Audit Plc and KPMG LLP.

By order of the Board

Andrew J W Tristram
Secretary

26 March 2014

Alexa Henderson qualified as a Chartered Accountant and worked with KPMG and Arthur Andersen in Edinburgh and Melbourne, primarily in financial services audit. On returning to Edinburgh she joined the WM Company, provider of information services to investment funds. As a past Director of the WM Company, previously a Bankers Trust then Deutsche Bank subsidiary, and as Trustee of their company pension scheme, Alexa has experience in investment, compliance, financial and general management which she brings to the board of Scottish Building Society. She is also involved in the Stewart Ivory Financial Education initiative to raise financial awareness amongst young people. Alexa was appointed to the Board of Adam & Company during 2012 and chairs their Audit Committee. Alexa joined the Society's Board in 2001 and has chaired the Audit Committee, the Assets, Liabilities & Planning Committee and has also been Vice-Chair of the ALCO and the Board itself. She was appointed as Society Chairman in June 2011.

Robert Golbourn joined the Board in 2006 and is currently Vice-Chairman, Senior Independent Director and Chairman of the Credit Committee, having previously been Chairman of the Audit Committee from 2007 to 2011. He is a Fellow and former Member of Council of the Chartered Institute of Bankers in Scotland. He spent 30 years with Clydesdale Bank, in various management positions and later in senior roles including Regional Manager, Treasurer and Head of Credit. In 1994 he joined Scottish Widows, then an independent mutual, to set up a new banking subsidiary which grew to become a well-established operator in the direct and intermediary markets. He retired as Managing Director of Scottish Widows Bank in 2003. Rob keeps well up to date with financial sector issues through a wide network of contacts established throughout his career.

Moira Sibbald has been the Legal Counsel & Group Company Secretary of the CALA Group Ltd, a residential property developer with operations in Scotland and England, since 2001. Prior to that her career had developed from private practice in Edinburgh as a solicitor specialising in commercial property to her appointment as a General Manager within a building society having responsibility at various times for mortgage and investment administration, compliance, governance, HR and customer service. Previously Moira has been a non-executive director of an arts charity and of a large Scottish based Housing Association. She also has experience as a pension trustee. Her wide experience in property and financial services strengthens the Board's expertise in the property market, customer service, risk, corporate governance and legal and compliance matters. Moira joined the Board in 2008 and currently chairs the Audit Committee.

David Peebles joined the Board in 2006 and is currently Chairman of the Assets & Liabilities Committee. He is a Fellow of the Chartered Institute of Bankers in Scotland and a Chartered Banker. He has a Postgraduate Diploma and a Masters Degree in Marketing and is also a member of the Association of Corporate Treasurers. As a former bank Treasurer he has an in-depth knowledge of Risk and Balance Sheet management. David is a Managing Partner of XM International Associates Ltd which provides consultancy advice to a diverse group of financial services organisations worldwide. He also has Directorships in companies in the property and asset management-related fields.

Raymond Abbott is a chartered accountant by profession and has worked in private equity and investment for over twenty years. As the former managing director of Alliance Trust Equity Partners he was responsible for strategic development. Previously he founded the UK venture investor Albany Ventures and prior to that was Director of Investment at British Linen Bank. Raymond also serves as a non-executive director of Foresight 4 plc, Galleria Holdings Limited and Essex Services Group plc. He therefore brings a wealth of financial experience to the Board, having been appointed in June 2013.

Jack Ogston is a Fellow of the Chartered Institute of Bankers in Scotland, having spent 36 years in management positions with Clydesdale Bank, latterly as Head of Corporate & Structured Finance in Scotland. He has significant board and lending experience and is currently an advisor to Davidson Chalmers Solicitors, Maven Capital Partners and Kingdom Taverns. Jack was appointed to the Board in July 2013.

Mark Thomson was appointed as Chief Executive on 1 May 2013, having joined the Society in April 2012 in the role of Chief Operating Officer and been appointed to the Board in October 2012. He is a Fellow of the Chartered Institute of Bankers in Scotland and a Chartered Banker. During his 30-year career Mark has worked in a variety of roles in retail banking, including 16 years at Scottish Widows Bank, where his responsibilities included credit risk management and compliance, as well as a wide range of operational activities. Mark was appointed to the Board of Scottish Widows Bank in January 2006 as Credit Director – a position he held until joining the Society.

The Board of Directors is responsible for the governance of the Society, on behalf of the members, and is committed to good practice in Corporate Governance. The Financial Reporting Council issued the latest version of the UK Corporate Governance Code for listed companies ('the Code') in September 2012 and, although the Code does not directly apply to mutual organisations, the Board has regard to its principles as outlined in the report below, in accordance with the expectation of the regulators.

The Role of the Board

The principal functions of the Board are to set the Society's strategy, as articulated in the Corporate Plan and annual business plans agreed by the Board, to ensure that the necessary financial and human resources are in place for the Society to meet its objectives, and to review management performance. The Board is responsible for succession planning for both Executive and Non-Executive Director positions. As part of its annual evaluation process, the Board considers the balance of skills and experience it requires, the requirements of the business, and recommends change where appropriate.

The full Board normally meets on a monthly basis with additional meetings as required. In 2013-14 there were twelve Board meetings and a specific meeting to consider strategy and the Corporate Plan. A table showing details of Directors' attendance during the year in relation to Board and Committee meetings forms part of this report and appears on page 16.

There is a schedule of matters reserved for Board decision and the Board has delegated certain responsibilities to the committees described below, all of which report to the Board. Minutes of each committee's meetings are distributed to all Board members and the Chairman of each committee provides a report at the Board meeting following any meeting of that committee. The terms of reference for all committees are available on the Society's website. The Society maintains liability insurance cover for Directors and Officers.

Audit Committee: This Committee met on six occasions during the year and is chaired by an independent Director. Executive Directors, other members of management and internal and external auditors attend by invitation only. The Committee considers regulatory compliance matters and adequacy of internal controls. It also reviews audit reports, monitors the effectiveness of the internal audit function and agrees the annual internal audit plan. It considers and recommends to the Board (for approval by the members) the appointment or re-appointment of the external auditors, and the policy on the engagement of the external auditors for non-audit services and approval of their fees. The Committee also monitors the external auditors' independence, objectivity, competence and effectiveness. It also ensures that the systems of accounting, business control and management of information are adequate for the Society's needs. At least annually the Committee meets with the external auditors without the Executive Directors being present. As required by the Code, the Committee provides advice to the Board confirming that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Society's performance, business model and strategy.

The Committee comprises three Non-Executive Directors who all have relevant financial experience. Moira Sibbald chairs the Committee, with members during the year being Robert Golbourn, David Chalmers (until 28 May 2013) and Raymond Abbott (from 26 June 2013). The Society Chairman and members of senior management attend by invitation, together with representatives from the internal and external auditors.

Assets & Liabilities Committee (ALCO): This Committee held ten meetings during the year and its remit includes monitoring capital and liquidity, balance sheet structure, financial risk management, pricing of new and existing products, and monitoring of treasury activities – including counterparties, interest rate risk and basis risk.

The Committee comprises three Non-Executive Directors, together with the Chief Executive and Head of Finance. The Committee is chaired by David Peebles and Non-Executive members during the year were Alexa Henderson, David Chalmers (until 28 May 2013) and Raymond Abbott (from 26 June 2013). Other members of senior management and the Finance team attend by invitation.

Credit Committee: This Committee provides Board oversight of credit risk, under the chairmanship of Robert Golbourn. Membership consists of two Non-Executive Directors, currently David Peebles and Jack Ogston, and the Chief Executive, and meetings are attended by the Head of Operations & Lending together with other relevant staff as necessary.

The Committee held ten meetings during the year and its remit includes reviewing lending policies, monitoring of mortgage market conditions from a credit risk perspective, reviewing the credit quality and risk profile of the mortgage book, assessing credit risks associated with new and existing mortgage products, overviewing lending decisions, monitoring arrears and reviewing specific and general loss provisions. Any recommendations for changes to policies etc are referred to the Board for approval.

Nomination & Remuneration Committee: This Committee reviews Board constitution, skills, performance, succession plans and Director elections and is responsible for remuneration policy for all Directors and for making recommendations to the Board regarding general remuneration and contractual arrangements. It also supervises the process for appointment of new Directors. The Committee comprises all Non-Executive Directors and is chaired by the Senior Independent Director (George Clark until 28 May 2013 and Robert Golbourn thereafter). The Chief Executive attends by invitation but takes no part in any discussion of his own remuneration. There were three meetings during the year.

Conduct Risk Committee: This Committee has been established by the Board to provide assurance that members (or potential members) are being treated fairly and consistently and that Conduct Risks are being appropriately managed by monitoring performance against the Society's Conduct Risk Appetite. The Committee is chaired by the Chief Executive, and consists of one Non-Executive Director (Alexa Henderson), the Head of Operations & Lending and the Secretary & Head of Compliance. Other members of the management team attend as required. The Committee met for the first time in January 2014.

Division of Responsibilities: Chairman and Chief Executive

The offices of Chief Executive and Chairman are distinct and held by different people. The Chief Executive is responsible for managing the Society's business within the parameters set by the Board. The Chairman sets the direction and culture of the Board, facilitating effective contribution from Directors, maintaining constructive relations between Executive and Non-Executive Directors and ensuring that Directors receive accurate, timely and clear advice and information. The current Chairman (Alexa Henderson) was considered independent on her appointment in June 2011, having demonstrated clear commitment, experience, and capability since joining the Board in March 2001.

Non-Executive Directors

Non-Executive Directors are required to have a full understanding of the risks in the business; to show commercial leadership within a framework of prudent and effective risk management controls; to provide an independent perspective, monitoring performance and resources; and to constructively challenge strategic proposals, whilst supporting the Executive management. The Non-Executive Directors meet regularly without the Chief Executive present. The Board has appointed a Senior Independent Director (George Clark until 28 May 2013 and Robert Golbourn thereafter), to provide support for the Chairman and an alternative route for communication from members and staff. His main responsibilities are to chair the Nomination & Remuneration Committee and to carry out the appraisal of the Chairman, taking into account the views of the other Directors.

The Composition of the Board

The Board currently consists of six Non-Executive and one Executive Director, providing a balance of skills and experience appropriate for the requirements of the business. The Board is satisfied that in terms of independence of character, judgement and robustness of challenge to the Society's Management, each Non-Executive Director is considered independent. Factors taken into account when assessing independence include length of service, material business relationships and whether the Director has recently been an employee of the Society.

Although Alexa Henderson has been a Non-Executive Director for more than nine years, the Board is satisfied that her length of service does not impair her independence and that she continues to bring valuable knowledge and experience to the Society.

Business relationships between the Society and firms connected with Directors were specifically considered by the Board. It was not considered that these relationships are material or that they in any way compromise the independence of the Directors concerned. No ex-employees are or have been Non-Executive Directors.

The membership of committees is reviewed annually.

Appointments to the Board

The Society values all aspects of diversity, including gender, and ensures that Non-Executive Director appointments are made on merit, based on the specific skills and experience required. Vacancies are advertised within the Society's membership and more widely where appropriate. Members have the right under the Society's Rules to nominate candidates for election to the Board. The Nomination & Remuneration Committee leads the recruitment process, although the final decision rests with the Board as a whole.

All Directors must meet the requirements of fitness and propriety laid down by the regulators and all Directors must be approved by the regulators in order to fulfil their controlled function as a Director. This process is likely to include an interview by a Panel at the regulators' offices in London.

Commitment

The Nomination & Remuneration Committee evaluates the ability of Non-Executive Directors to commit the time required for their role, prior to appointment. The letter of appointment sets out the expected time commitment and Directors undertake that they have sufficient time to meet those expectations. The formal appraisal process carried out by the Chairman each year also assesses whether Directors have demonstrated this ability during the year.

The attendance record of Board and Committee members during the year is set out below. This table does not reflect Directors' attendance at additional ad hoc meetings, seminars, conferences and courses during the year or time spent on preparation for meetings etc. Generally each Non-Executive Director spends a minimum of 2-3 days each month on Society business and the Chairman's time commitment is considerably more.

Directors' Attendance 2013-14

The table below shows the number of formal Board meetings attended by each Director and, in relation to Committees, the number of meetings and attendance by individuals as members of those Committees.

The figures in brackets denote the number of meetings each Director was eligible to attend.

	Board	Audit Committee	Assets & Liabilities Committee	Credit Committee	Nomination & Remuneration Committee	Conduct Risk Committee
R J Abbott	8(8)	3(3)	5(5)	-	2(2)	-
D W P Chalmers	5(5)	2(2)	5(5)	-	1(1)	-
G B Clark	5(5)	-	-	-	1(1)	-
R Golbourn	13(13)	6(6)	-	10(10)	3(3)	-
A H Henderson	13(13)	-	10(10)	1(1)	3(3)	1(1)
J C Ogston	6(7)	-	-	5(5)	1(2)	-
D Peebles	12(13)	-	10(10)	6(10)	3(3)	-
M R Sibbald	12(13)	6(6)	-	-	3(3)	-
G J Kay	1(3)	-	1(2)	2(3)	-	-
M L Thomson	13(13)	-	10(10)	7(7)	-	1(1)

Development

All new Directors receive induction training, and ongoing training is provided by attendance at courses and seminars organised by outside bodies, in particular the Building Societies Association. Training and development needs are identified as part of the annual appraisal of the Board's and individual Director's performance and effectiveness. The Secretary has specific responsibility for ensuring that Directors are provided with appropriate information and training.

Information and Support

The Chairman ensures that the Board receives sufficient information to enable it to discharge its responsibilities. The quality and content of management information provided to the Board and Committees is constantly reviewed by Directors and management. The Secretary provides support on corporate governance matters and the Board has access to independent professional advice if required.

Evaluation

The Chairman & Vice-Chairman review the performance of the Chief Executive annually. Non-Executive Directors are evaluated by the Chairman using questions based on the FRC guidance on Board Effectiveness issued in March 2011. The Chairman is evaluated by the Senior Independent Director, taking into account the views of the other Directors. The Board evaluates its overall performance and that of each Committee. This process is used to improve the effectiveness of Directors and the Board collectively.

Re-election

The Society's Rules require that Directors are submitted for election at the Annual General Meeting (AGM) following their appointment to the Board. All Directors are required by the Society's Rules to seek re-election if they have not been elected at either of the two previous AGMs. Directors may also submit themselves for re-election voluntarily. The Nomination & Remuneration Committee considers and makes a recommendation to the Board whether each Non-Executive Director should be submitted for re-election, bearing in mind that Director's continued independence and contribution to Board deliberations. The UK Corporate Governance Code specifies that any Director serving for longer than nine years should be subject to annual re-election by the members. The Board considers that annual re-election is not appropriate for the Society, as compliance with the requirements under the Society's Rules has tended to mean Directors standing for re-election every two years.

Financial and Business Reporting

The Statement of Directors' Responsibilities on page 20 sets out the Board's responsibilities in relation to the Society's Annual Report and Accounts and a statement that the Society's business is a going concern is included in the Directors' Report on page 9.

Risk Management and Internal Control

The Board is collectively responsible for determining strategies for risk management and control. Senior management are responsible for designing, operating and monitoring risk management and internal control processes through the Risk Management Committee that reports directly to the Board each month. The Board reviews the adequacy of these processes and the Internal Audit function provides independent and objective assurance that the processes are appropriate and effectively applied. The Society has a strong compliance culture and the Board is satisfied that the Society's systems are effective and appropriate to the scale and complexity of the Society's business.

Remuneration

The Directors' Remuneration Report on pages 18 & 19 sets out the remuneration policies for Executive and Non-Executive Directors and explains how this meets the requirements of the UK Corporate Governance Code.

Dialogue with Shareholders

As a mutual organisation the Society does not have 'shareholders' as referred to in the Code, and the Society's saving and borrowing customers are also its members. The Society seeks the views of its members through membership surveys, members' forums, the Society newsletter and the AGM.

Constructive Use of the Annual General Meeting (AGM)

Each year the Society sends details of the AGM to those members who are eligible to vote. The AGM is held in a different location each year to encourage member attendance and participation. Resolutions include the election of Directors and a separate advisory vote on the Directors' Remuneration Report.

Members are encouraged to exercise their right to vote and a donation to charity is made for each vote cast either in person or by proxy. Members are provided with forms and prepaid envelopes which enable them to appoint a proxy to vote on their behalf if they are unable to attend in person. Proxy voting can also be conducted via a secure website. The proxy form and website provide the opportunity to formally abstain in respect of any resolutions, should the member so wish. The receipt and counting of proxy votes is conducted by independent scrutineers.

At the AGM a poll is called in relation to each resolution and the proxy votes cast are included in the result. The results are subsequently disclosed on the Society's website. Members who cannot attend the meeting are encouraged to submit questions in writing.

Alexa H Henderson
Chairman

26 March 2014

The purpose of this report is to inform members of the Society, in line with the relevant provisions of the UK Corporate Governance Code, of the policy for determining the remuneration of Executive and Non-Executive Directors. The Society has adopted a Remuneration Policy which meets the applicable requirements of the Remuneration Code issued by the Financial Conduct Authority.

A statement of all Directors' Remuneration is included within this report and also appears in the Summary Financial Statement issued annually to all members. An advisory vote on Directors' Remuneration is included in the AGM agenda.

As a mutual organisation, the Society has no share option scheme and none of the Directors has any beneficial interest in, or any rights to subscribe for, shares in or debentures of any connected undertaking of the Society.

Procedure for Developing Policy on Executive and Individual Director Remuneration

The Board has overall responsibility for overseeing arrangements for remuneration. This is done through the Nomination & Remuneration Committee, which is chaired by the Senior Independent Director. All Non-Executive Directors are members of the Committee and the Chief Executive attends meetings and acts as secretary of the Committee but takes no part in discussions on his own remuneration.

The Committee reviews remuneration for Directors and staff annually, using data from comparable organisations and taking advice from external consultants when appropriate.

Non-Executive Directors

The level of fees payable to Non-Executive Directors is assessed annually using market information and data from comparable organisations. The fees payable to the Chairman and Vice-Chairman reflect the additional responsibilities of these positions.

Fees for Non-Executive Directors are non-pensionable and Non-Executive Directors do not participate in any bonus or incentive schemes or receive any other benefits other than reimbursement of expenses incurred in the execution of their duties as Directors.

Executive Director

The Chief Executive’s basic salary is reviewed annually by reference to jobs carrying similar responsibilities in comparable organisations and by reference to market conditions and personal performance.

His contract with the Society includes a non-pensionable executive bonus scheme which is payable dependant on the Society's performance and the individual's personal performance measured against pre-agreed objectives. For Society performance there are a number of key measures set by the Board – including membership numbers, net lending and savings targets, arrears management, risk management and compliance with regulations – all of which are to be achieved within a specified set of financial ratios. The Board also sets four or five individual objectives against which the individual is assessed for personal performance. No single factor can therefore unduly influence the amount of bonus payable.

Bonus payments to the Chief Executive are not guaranteed and are reviewed each year.

The Society makes a minimum contribution of 20% of salary to the Chief Executive’s private pension arrangements and he also receive a further taxable benefit comprising a Society car.

Service Contracts

The Chief Executive has a service contract with the Society which can be terminated by either side giving six months’ notice.

Non-Executive Directors do not have service contracts but serve under letters of appointment subject to election by the Society's members.

Non-Executive Directors

	Fees only	
	To 31 January 2014	**To 31 January 2013**
R J Abbott (appointed 1 June 2013)	£13,333	-
D W P Chalmers (retired 28 May 2013)	£6,087	£17,900
G B Clark (retired 28 May 2013)	£6,087	£17,900
R Golbourn	£23,157	£21,050
A H Henderson	£31,567	£28,150
J C Ogston (appointed 1 July 2013)	£11,667	-
D Peebles	£19,420	£17,900
M R Sibbald	£19,420	£17,900
Total	**£130,738**	**£120,800**

The fees shown for Mr Ogston were paid through a third-party service company.

Executive Directors

To 31 January 2014					
	Salary	Bonus	Pension Contributions	Taxable Benefits	Total
G J Kay (resigned 30/4/2013)	£25,950	-	£5,839	£2,122	£33,911
M L Thomson	£97,400	£11,500	£19,080	£6,367	£134,347
Total 2014	**£123,350**	**£11,500**	**£24,919**	**£8,489**	**£168,258**

Mr Kay also received a final contractual payment on his resignation as Chief Executive amounting to £122,393.

To 31 January 2013					
G J Kay	£101,800	£17,095	£22,905	£8,232	£150,032
M L Thomson (appointed Director 12/10/2012)	£68,750	-	£14,000	-	£82,750
J B Dunn (resigned 2/3/2012)	£5,596	-	£1,119	£1,784	£8,499
Total 2013	**£176,146**	**£17,095**	**£38,024**	**£10,016**	**£241,281**

All pension contributions paid by the Society were in respect of money-purchase pension schemes.

Robert Golbourn
Chairman, Nomination & Remuneration Committee
26 March 2014

Directors' responsibilities for preparing the Annual Report, the Annual Business Statement, the Directors' Report and the Annual Accounts

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

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

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

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

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

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for ensuring that the Group:

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

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

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

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

We have audited the Group and Society Annual Accounts of Scottish Building Society for the year ended 31 January 2014 set out on pages 22 to 40. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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

As explained more fully in the Directors' Responsibilities Statement set out on page 20, the Directors are responsible for the preparation of Annual Accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the Annual Accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Annual Accounts

A description of the scope of an audit of annual accounts is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on Annual Accounts

In our opinion the Annual Accounts:

- give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of affairs of the Group and of the Society as at 31 January 2014 and of the income and expenditure of the Group and of the Society for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

- the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations thereunder;
- the information given in the Directors' Report for the financial year for which the Annual Accounts are prepared 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.

Matters on which we are required to report by exception

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

- proper accounting records have not been kept by the Society; or
- the 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.

Catherine Burnet (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
20 Castle Terrace
Edinburgh

26 March 2014

INCOME AND EXPENDITURE ACCOUNT
for the year ended 31 January 2014

SCOTTISH BUILDING SOCIETY

	Notes	Group 2014 £000	Group 2013 £000	Society 2014 £000	Society 2013 £000
Interest receivable and similar income	*2*	**13,157**	12,802	**13,095**	12,731
Interest payable and similar charges	*3*	**6,435**	6,792	**6,435**	6,792
Net interest receivable		**6,722**	6,010	**6,660**	5,939
Fees and commissions receivable		**32**	40	**32**	40
Fees and commissions payable		**540**	571	**540**	571
Other operating income		**402**	526	**402**	526
Total Income		**6,616**	6,005	**6,554**	5,934
Administrative expenses	*5*	**4,725**	4,684	**4,665**	4,613
Depreciation and amortisation	*15*	**245**	178	**245**	178
Other operating charges	*4*	**44**	120	**44**	120
Provisions for bad and doubtful debts	*12*	**43**	50	**43**	50
Movements in values of acquired assets	*13*	**-**	-	**-**	-
Profit before FSCS levy and merger costs		**1,559**	973	**1,557**	973
Provision for FSCS levy	*21*	**258**	187	**258**	187
Merger costs	*25*	**235**	-	**235**	-
Profit on ordinary activities before tax		**1,066**	786	**1,064**	786
Tax on profit on ordinary activities	*8*	**47**	204	**47**	204
Profit for the financial year	*22*	**1,019**	582	**1,017**	582

The Notes on pages 25 to 40 form part of these accounts.

The above results are all derived from continuing operations.

"Profit on ordinary activities before tax" represents the FRS3 caption "Operating profit".

There are no recognised gains or losses other than the profits above and therefore no separate statement of recognised gains or losses has been presented.

BALANCE SHEET
as at 31 January 2014

SCOTTISH BUILDING SOCIETY

	Notes	Group 2014 £000	Group 2013 £000	Society 2014 £000	Society 2013 £000
ASSETS					
Liquid Assets:					
Cash in hand and balances with the Bank of England		**54,153**	34,655	**54,153**	34,655
Treasury bills	*10*	**-**	-	**-**	-
Loans and advances to credit institutions	*9*	**31,841**	45,257	**31,841**	45,257
Debt securities	*10*	**33,169**	28,741	**33,169**	28,741
		119,163	108,653	**119,163**	108,653
Loans and Advances to Customers:	*11, 12*				
Loans Fully Secured on Residential Property		**257,716**	257,754	**256,598**	256,564
Loans Fully Secured on Land		**17,668**	18,908	**17,668**	18,908
		275,384	276,662	**274,266**	275,472
Investments:					
Investment in subsidiary undertaking	*14*	**-**	-	**10**	10
Tangible Fixed Assets	*15*	**2,000**	1,909	**2,000**	1,909
Other Assets		**273**	64	**273**	64
Prepayments and Accrued Income		**412**	507	**412**	507
TOTAL ASSETS		**397,232**	387,795	**396,124**	386,615
LIABILITIES					
Shares	*16*	**360,085**	343,877	**360,085**	343,877
Amounts owed to Credit Institutions	*17*	**-**	3,570	**-**	3,570
Amounts owed to Other Customers	*18*	**7,098**	12,023	**7,098**	12,023
Other Liabilities	*19*	**689**	764	**1,137**	1,138
Accruals and Deferred Income		**646**	643	**646**	643
Provisions for Liabilities	*21*	**425**	382	**425**	382
Reserves:					
General Reserves	*22*	**28,289**	26,536	**26,733**	24,982
TOTAL LIABILITIES		**397,232**	387,795	**396,124**	386,615

The Notes on pages 25 to 40 form part of these accounts.

These accounts were approved by the Board of Directors on 26 March 2014 and were signed on its behalf by:

Alexa H Henderson
Chairman

Robert Golbourn
Vice Chairman

Mark L Thomson
Chief Executive

GROUP CASH FLOW STATEMENT
for the year ended 31 January 2014

SCOTTISH BUILDING SOCIETY

	2014 £000	2013 £000
Net cash inflow from operating activities	**4,984**	21,457
Taxation	**(328)**	(207)
Capital expenditure and financial investment		
Purchase of debt securities	**(33,519)**	(44,028)
Purchase of treasury bills	**-**	(79,380)
Sale and maturity of debt securities	**30,561**	37,020
Sale and maturity of treasury bills	**-**	96,360
Purchase of tangible fixed assets	**(361)**	(251)
Proceeds from disposal of tangible fixed assets	**714**	4
Acquired on transfer of engagements	**3,597**	-
Increase in cash	**5,648**	30,975

Reconciliation of operating profit to net cash inflow from operating activities

	2014 £000	2013 £000
Operating profit	**1,066**	786
Decrease/(Increase) in prepayments and accrued income	**265**	(575)
(Decrease)/Increase in accruals and deferred income	**(1,015)**	1,177
Provisions for bad and doubtful debts	**(121)**	50
Provision for FSCS levy	**14**	71
Depreciation and amortisation	**245**	178
(Profit) on sale of tangible fixed assets	**(7)**	(4)
Net cash inflow from trading activities	**447**	1,683
Loans and advances made to customers	**(23,579)**	(52,375)
Loans and advances repaid by customers	**40,899**	33,381
Net (decrease)/increase in shares	**(3,873)**	71,033
Net (decrease) in amounts owed to credit institutions and other customers	**(8,407)**	(27,988)
Net (increase) in loans and advances to credit institutions	**(500)**	(4,499)
Net (increase) in other assets	**(9)**	(7)
Net increase in other liabilities	**6**	229
Net cash inflow from operating activities	**4,984**	21,457

Reconciliation of cash balances	**2013 £000**	**Cash Flow**	**2014 £000**
Cash in hand and balances with the Bank of England	**34,655**	**19,498**	**54,153**
Loans and advances to credit institutions - repayable on demand	**21,603**	**(13,850)**	**7,753**
	56,258	**5,648**	**61,906**

	2012 £000	Cash Flow	2013 £000
Cash in hand	82	34,573	34,655
Loans and advances to credit institutions - repayable on demand	25,201	(3,598)	21,603
	25,283	30,975	56,258

1. PRINCIPAL ACCOUNTING POLICIES

Accounting convention
The Accounts are drawn up under the historical cost convention.

Format of accounts
The Accounts have been prepared in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 and applicable accounting standards.

Basis of consolidation
The Group Accounts comprise the accounts of the Society and its subsidiary undertaking made up to 31 January each year.

Deferred taxation
Provision is made, using the liability method, on a non-discounted basis for taxation at the relevant rate in respect of all items where there is a timing difference between their treatment for accounts and taxation purposes except where, in the opinion of the Directors, it is likely that tax assets would not be recoverable in the foreseeable future.

Tangible fixed assets and depreciation
i) The cost of additions and major alterations to office premises, equipment and fixtures and fittings is capitalised.

ii) The cost of freehold premises is written off over 50 years on a straight-line basis. No depreciation is provided on freehold land.

The cost of other fixed assets is written off over their estimated useful lives as follows:

The cost of tenant's improvements to leasehold premises is written off over 5 years on a straight-line basis.

Office equipment and motor vehicles are depreciated over 4 to 10 years on a straight-line basis.

Liquid assets
Liquid assets are stated at the lower of cost and net realisable value, including debt securities and treasury bills intended for use on a continuing basis. Premia and discounts arising on the purchase of debt securities held as financial fixed assets are amortised on a straight-line basis over the period to maturity.

Pension costs
The Society operates defined contribution pension schemes administered by two British life companies, the funds of which are separate from those of the Society. Contributions are charged to revenue in the year in which they are made and are included in management expenses.

Provisions for bad and doubtful debts
A mortgage loss provision is considered where the Society concludes that a loan might not be recovered in full.

Throughout the year and at the end of the year individual assessments are made of all advances meeting one or more of a number of trigger points that are considered to be indicators of where a potential loss might arise. Specific provisions are made for the extent of the likely loss. Interest continues to be charged to these accounts as it becomes due and is included in the provision. In addition, a general provision is made in respect of advances where a specific provision has not been raised.

The Society uses forbearance tools where they are deemed appropriate for individual customer circumstances. Mortgage balances subject to some form of forbearance are fully covered in the Society's provisioning methodology.

Incentives to new borrowers
Incentives not having the characteristics of interest are written off as they are incurred and are disclosed within other operating charges. Interest rate discounts reduce interest receivable over the term of the discount period.

Leases
Rental charges under "operating leases" are charged to the Income and Expenditure Account evenly over the life of the lease.

Assets held by the Society for use in operating leases are included as tangible fixed assets. Rents receivable under operating leases are recognised in the Income and Expenditure Account as they fall due.

1. PRINCIPAL ACCOUNTING POLICIES (continued)

Off-Balance Sheet Instruments

All interest-related contracts are classified at the balance sheet date as hedging contracts.

All hedging contracts are valued and income or expenditure recognised on an equivalent basis to the assets, liabilities or positions that are being hedged. If the hedging contract is terminated early, the realised gain or loss is charged immediately to the Income and Expenditure Account.

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group		Society	
	2014	2013	**2014**	2013
	£000	£000	**£000**	£000
On loans fully secured on residential property	**12,029**	11,561	**11,967**	11,490
On other loans	**827**	832	**827**	832
Net expense on financial instruments	**(487)**	(552)	**(487)**	(552)
On debt securities:				
- interest and other income	**561**	464	**561**	464
On other liquid assets:				
- interest and other income	**227**	497	**227**	497
	13,157	12,802	**13,095**	12,731

3. INTEREST PAYABLE AND SIMILAR CHARGES

Group & Society	**2014**	2013
	£000	£000
On shares held by individuals	**6,413**	6,279
On other shares	**13**	13
Net income on financial instruments	**(80)**	(37)
On deposits and other borrowings	**89**	537
	6,435	6,792

4. OTHER OPERATING CHARGES

	Group		Society	
	2014	2013	**2014**	2013
	£000	£000	**£000**	£000
Incentives to borrowers	**44**	120	**44**	120

5. ADMINISTRATIVE EXPENSES

	Group		Society	
	2014	2013	**2014**	2013
	£000	£000	**£000**	£000
Staff costs (Note 6)	**2,525**	2,233	**2,525**	2,233
Other expenses	**2,200**	2,451	**2,140**	2,380
	4,725	4,684	**4,665**	4,613
Included in other expenses are the following charges:				
- property leasing costs	**87**	105	**87**	105
- remuneration of auditors (excl. VAT):				
audit of the Annual Accounts	**50**	37	**49**	36
other services	**6**	3	**6**	3

The amount shown for the audit of the Annual Accounts in 2014 includes £8,000 of costs related to the 2013 audit which was only known and paid for following the publication of the 2013 Report & Accounts.

Additional fees paid to the auditors in relation to the Century Building Society merger are disclosed in Note 25.

6. STAFF NUMBERS AND COSTS

The average number of persons employed by the Group and Society (including Executive Directors) during the year was as follows:

	Full time		Part time	
	2014	2013	**2014**	2013
Head Office	**26**	26	**4**	3
Branch offices	**21**	20	**12**	11
	47	46	**16**	14

The aggregate costs of employment of these persons were as follows:

	2014	2013
	£000	£000
Wages and salaries	**2,091**	1,807
Social security costs	**212**	184
Pension costs	**222**	242
	2,525	2,233

7. DIRECTORS' REMUNERATION

Group & Society	**2014**	2013
	£000	£000
For services as Non-Executive Directors	**131**	121
For Executive services	**266**	203
Pension contributions	**25**	38
	422	362

The amounts shown above for Executive services in 2014 include the payment made to Mr Kay on his resignation as Chief Executive amounting to £122,000.

Individual Directors' remuneration is detailed in the Directors' Remuneration Report on pages 18 & 19.

8. TAX ON PROFIT ON ORDINARY ACTIVITIES

	Group		Society	
	2014	2013	**2014**	2013
	£000	£000	**£000**	£000
Current tax				
Corporation tax charge for the year at 20% (2013: 24.3%)	**22**	187	**22**	187
Adjustment in respect of prior year	**(9)**	**-**	**(9)**	-
Total current tax charge for the year	**13**	187	**13**	187
Deferred tax				
Deferred tax for the year (Note 20)	**34**	17	**34**	17
Total tax charge for the year	**47**	204	**47**	204

The UK Government announced in March 2012 that the main rate of UK corporation tax would reduce from 26% to 24% from 1 April 2012. That rate reduction was substantively enacted in March 2012 with a further reduction in the rate to 23% from 1 April 2013 substantively enacted in July 2012. This results in a weighted average main rate of corporation tax of 23.2% for the year ended 31 January 2014 (2013: 24.3%). However, for the year ended 31 January 2014 the taxable profits of the Society fall to be taxed at the small profits rate of 20%.

It was announced in December 2012 that the main rate of UK corporation tax would reduce from 23% to 21% from 1 April 2014. It was then subsequently announced in March 2013 that the main rate would be subject to a further reduction to 20% from 1 April 2015. Both of these rate reductions were substantively enacted in July 2013. The substantive enactment of these rate reductions has been reflected in the computation of the net deferred tax liability recognised by the Society with account taken of the tax rates that will apply when the various timing differences are expected to reverse.

The tax assessed for the year differs from the small profits rate of corporation tax in the UK of 20%; the differences are explained below:

	Group 2014	Group 2013	Society 2014	Society 2013
Profit on ordinary activities before taxation	**1,066**	786	**1,064**	786
Profit on ordinary activities multiplied by the statutory rate of corporation tax of 20% (2013: 24.3%)	**213**	191	**213**	191
Effects of:				
Difference between capital allowances and depreciation	**(18)**	9	**(18)**	9
Expenses not deductible for corporation tax purposes	**52**	10	**52**	10
Net effect of differing tax rates of subsidiary undertaking	**-**	-	**-**	-
Other timing differences	**(6)**	(23)	**(6)**	(23)
Loss relief arising on merger with Century Building Society	**(219)**	-	**(219)**	-
Adjustment in respect of prior year	**(9)**	-	**(9)**	-
Total current tax charge for the year	**13**	187	**13**	187

9. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

Group & Society	**2014**	2013
	£000	£000
Accrued interest	**88**	154
Repayable on demand	**7,753**	21,603
In not more than three months	**12,000**	12,000
In more than three months but not more than one year	**12,000**	11,500
	31,841	45,257

10. DEBT SECURITIES AND TREASURY BILLS

Group & Society	2014 £000	2013 £000
Debt Securities		
Issued by other borrowers	33,169	28,741
Debt securities have remaining maturities as follows:		
Accrued interest	122	226
In not more than one year	29,545	25,011
In more than one year	3,502	3,504
	33,169	28,741
Transferable debt securities (excluding accrued interest) comprise:		
Listed	5,008	3,500
Unlisted	28,000	25,000
Unamortised premia	39	15
	33,047	28,515
Market value of listed debt securities	5,044	3,501
Movements during the year of debt securities:		
At 1 February 2013	28,515	21,507
Acquired on transfer of engagements	1,574	-
Additions	33,519	44,028
Disposals and maturities	(30,561)	(37,020)
As at 31 January 2014	33,047	28,515
Treasury Bills		
Movements during the year of treasury bills:		
At 1 February 2013	-	16,980
Additions	-	79,380
Disposals and maturities	-	(96,360)
As at 31 January 2014	-	-

The Directors of the Society consider that the primary purpose of holding debt securities and treasury bills 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.

11. LOANS AND ADVANCES TO CUSTOMERS

Maturity analysis

The remaining maturity of loans and advances to customers as at the date of the balance sheet is as follows:

	Group		Society	
	2014	2013	**2014**	2013
	£000	£000	**£000**	£000
On call and at short notice	**1,215**	1,153	**1,215**	1,153
In not more than three months	**2,132**	2,038	**2,120**	2,026
In more than three months but not more than one year	**7,664**	7,086	**7,630**	7,051
In more than one year but not more than five years	**49,432**	45,798	**49,189**	45,534
In more than five years	**215,282**	221,049	**214,453**	220,170
	275,725	277,124	**274,607**	275,934
Less provisions (Note 12)	**(341)**	(462)	**(341)**	(462)
	275,384	276,662	**274,266**	275,472

12. PROVISIONS FOR BAD AND DOUBTFUL DEBTS

Group & Society	Specific £000	General £000	**Total £000**
Loans fully secured on residential property:			
At 1 February 2013	280	182	**462**
Amounts written off during year	(164)	-	**(164)**
Charge/(credit) to Income and Expenditure Account	65	(22)	**43**
Amounts recovered	-	-	**-**
As at 31 January 2014	**181**	**160**	**341**

13. MOVEMENTS IN VALUES OF ACQUIRED ASSETS

Group & Society	**2014 £000**	2013 £000
Further impairment of acquired assets	**145**	-
Increase in value of acquired assets	**(145)**	-
	-	-

14. INVESTMENT IN SUBSIDIARY UNDERTAKING

The Society has a 100% holding of the ordinary share capital in its sole subsidiary, SBS Mortgages Ltd, a company incorporated in Scotland under the Companies Act. The company's principal activities are mortgage lending and the acquisition of domestic mortgage portfolios from third-party lenders.

The investment by the Society in its subsidiary during the year was as follows:

	Shares £000	Loan £000	**Total £000**
Cost at 1 February 2013	10	(374)	**(364)**
Invested in year	-	60	**60**
Repayments received	-	(134)	**(134)**
Cost at 31 January 2014	**10**	**(448)**	**(438)**

The inter-company creditor balance of £448,000 is shown under Other Liabilities (Note 19).

15. TANGIBLE FIXED ASSETS

Group & Society	Land & Buildings Freehold £000	Land & Buildings Short Leasehold £000	Office Equipment £000	Motor Vehicles £000	Total £000
Cost					
As at 1 February 2013	1,634	153	1,364	165	3,316
Acquired on transfer of engagements	681	-	176	-	857
Additions	-	25	277	59	361
Disposals	(681)	-	(409)	(64)	(1,154)
As at 31 January 2014	1,634	178	1,408	160	3,380
Depreciation					
As at 1 February 2013	250	148	917	92	1,407
Acquired on transfer of engagements	-	-	175	-	175
Charged in year	33	7	170	35	245
Disposals	-	-	(406)	(41)	(447)
As at 31 January 2014	283	155	856	86	1,380
Net book value					
As at 31 January 2014	**1,351**	**23**	**552**	**74**	**2,000**
As at 31 January 2013	1,384	5	447	73	1,909

The net book value of freehold and leasehold property occupied by the Group and Society for its own activities was as follows:

	2014 £000	2013 £000
As at 31 January	**1,374**	1,389

16. SHARES

Group & Society

	2014 £000	2013 £000
a) Held by individuals	**359,533**	343,191
Other shares	**552**	686
	360,085	343,877

b) Repayable from the date of the balance sheet in the ordinary course of business as follows:

	2014 £000	2013 £000
Accrued interest	**3,201**	4,049
On demand	**278,968**	225,076
In not more than three months	**27,440**	8,068
In more than three months but not more than one year	**43,735**	71,236
In more than one year but not more than five years	**6,741**	35,448
	360,085	343,877

17. AMOUNTS OWED TO CREDIT INSTITUTIONS

Group & Society

Repayable from the date of the balance sheet in the ordinary course of business as follows:

	2014 £000	2013 £000
Accrued interest	**-**	70
In not more than three months	**-**	2,000
In more than three months but not more than one year	**-**	1,500
	-	3,570

18. AMOUNTS OWED TO OTHER CUSTOMERS

Group & Society

Repayable from the date of the balance sheet in the ordinary course of business as follows:

	2014 £000	2013 £000
Accrued interest	**2**	63
Repayable on demand	**6,049**	6,692
In not more than three months	**893**	2,939
In more than three months but not more than one year	**154**	2,329
	7,098	12,023

19. OTHER LIABILITIES

	Group		Society	
	2014	2013	**2014**	2013
	£000	£000	**£000**	£000
Other liabilities comprise:				
Corporation tax	**-**	115	**-**	115
Income tax	**460**	537	**460**	537
Amounts due to subsidiary (Note 14)	**-**	-	**448**	374
Other creditors	**176**	93	**176**	93
Deferred tax (Note 20)	**53**	19	**53**	19
	689	764	**1,137**	1,138

20. DEFERRED TAX

	2014	2013	**2014**	2013
	£000	£000	**£000**	£000
Provided:				
Timing differences between capital allowances and depreciation	**(87)**	(61)	**(87)**	(61)
General mortgage loss provision	**34**	42	**34**	42
	(53)	(19)	**(53)**	(19)
As at 1 February 2013	**(19)**	(2)	**(19)**	(2)
Deferred tax (charge) for the financial year (Note 8)	**(34)**	(17)	**(34)**	(17)
As at 31 January 2014	**(53)**	(19)	**(53)**	(19)

A deferred tax asset amounting to £222,000 in relation to tax losses incurred by Century Building Society (CBS) as at 31 January 2013 has not been recognised due to uncertainty that there will be future notional taxable profits in CBS available for offset.

21. PROVISIONS FOR LIABILITIES

Financial Services Compensation Scheme

Group & Society	**2014** **£000**	2013 £000
As at 1 February 2013	**382**	311
Acquired on transfer of engagements	**29**	-
Paid in year	**(244)**	(116)
Charge to Income and Expenditure Account:		
Increase in Provision	**258**	187
As at 31 January 2014	**425**	382

Financial Services Compensation Scheme

Based on its share of protected deposits, the Society, in common with all regulated UK deposit takers, pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. The FSCS levy consists of two parts – a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it.

In September 2008 a claim was triggered against the FSCS by the transfer of Bradford & Bingley plc's retail deposit business to Abbey National plc. In October 2008 a further claim was triggered against the FSCS by the transfer of Kaupthing Singer and Friedlander's (KSF) internet deposit business (Kaupthing Edge) and Heritable Bank's (a subsidiary of Landsbanki hf) deposit business to ING Direct. The FSCS will also be liable to claims from depositors of Landsbanki hf and KSF whose balances have not been transferred to ING Direct but are covered by the FSCS. Additional claims arose relating to the default of London Scottish Bank plc in 2008 and Dunfermline Building Society in 2009.

We understand that the FSCS has met, or will meet, the claims by way of loans received from HM Treasury. The FSCS has, in turn, acquired the rights to the realisation of the assets of these banks. The FSCS is liable to pay interest on the loans from the Bank of England. The term of these loans was interest-only for the first three years, with the FSCS recovering the interest cost, together with its own management expenses, through annual levies on its members. The initial three-year term expired in September 2011, and under the re-negotiated terms, the interest rate was re-set from 12-month Libor + 30bps to 12-month Libor + 100bps.

As a result of notifications it has received from the Financial Conduct Authority, the Society has recognised in this year's results a provision for a levy of £118,000 for the scheme year 2013/2014, and a levy of £153,000 for the scheme year 2014/2015, which are calculated with reference to the protected deposits it held at 31 December 2012 and 31 December 2013, respectively.

With effect from 2013/14, the FSCS started to repay the principal of the Treasury loans and to the extent that there is a shortfall from realisations of the assets of the banks, there will be a further levy in this respect. The latest estimate from the FSCS is that there will be a shortfall of around £1,086million, and this is being levied on deposit-takers in three annual instalments. Accordingly, the Society has also recognised in this year's results a levy of £125,000 for the year 2014/15.

At the date of signing these Accounts there remains uncertainty over the amounts provided. The amounts above do not take account of any compensation levies which may arise from any ultimate payout on claims.

22. GENERAL RESERVES

	Group £000	Society £000
As at 1 February 2013	26,536	24,982
Acquired on transfer of engagements	734	734
Profit for the year	1,019	1,017
As at 31 January 2014	**28,289**	**26,733**

23. GUARANTEES AND OTHER FINANCIAL COMMITMENTS

a) The Society has a contingent liability in respect of further contributions to the Financial Services Compensation Scheme provided under the Financial Services and Markets Act 2000, in addition to the specific liability detailed in Note 21.

b) Section 22 of the Building Societies Act 1986 was repealed with effect from 11 June 1996 and the Society therefore has no obligation to stand by its subsidiary in respect of liabilities incurred after this date. However it is the intention of the Board to continue to support fully its subsidiary undertaking.

c) At 31 January 2014, annual commitments under operating leases for land and buildings were:

Group & Society	**2014 £000**	2013 £000
Expiring within one year	**31**	-
Expiring between two and five years	**23**	54
Expiring after five years	**25**	25
	79	79

23. GUARANTEES AND OTHER FINANCIAL COMMITMENTS (continued)

d) **Off-Balance Sheet Hedging Instruments**

The Group's core business is to provide its members with financial products appropriate to their needs. The Group uses wholesale financial instruments to invest in liquid assets and to raise funds from wholesale money markets in support of its retail savings operations. These instruments also allow it to manage the risks arising from these business activities.

The Group has a well-established formal structure for managing risks which includes formal risk policies, risk limits, reporting structures, mandates and control procedures. This structure begins with the Board of Directors and its Assets & Liabilities Committee.

Financial instruments used by the Group for risk management purposes include off-balance sheet derivative instruments. In accordance with the Building Societies Act 1986 such instruments are only used to limit the extent to which the Group will be affected by changes in interest rates.

As part of its responsibilities, the Board approves the use of specified off-balance sheet instruments within approved limits and business activities. The Group does not undertake transactions for trading or speculative purposes and consequently all off-balance sheet financial instruments are classified as hedging contracts.

The Board approves the use of interest rate caps and swaps as off-balance sheet instruments in order to manage the Group's balance sheet risk exposures. These instruments are used to protect the Group from exposures arising principally from fixed-rate and capped-rate mortgage lending, and they could also be used against exposures arising from fixed-rate savings products and deposit funding if the need arose. The duration of the off-balance sheet contracts is generally short to medium term and their maturity profile reflects the nature of exposures arising from underlying business activities.

The notional principal of these instruments reflects the extent of the Group's involvement in the instruments, but does not represent its exposure to credit risk which is assessed by reference to the fair value.

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 Prudential Regulation Authority, and is based on the replacement cost, but also takes into account measures of the extent of potential future exposure and the nature of the counterparty. 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 Group's maximum exposure should all counterparties default.

Group & Society	**2014**	2013
	£000	£000
Unmatured interest rate swaps		
Notional principal amount	**61,000**	46,000
Credit risk weighted amount	**89**	214
Replacement cost	**135**	195

e) **Risk Management**

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

Credit Risk - All loan applications are assessed with reference to the Group's lending policy. Changes to policy are recommended by the Credit Committee and approved by the Board and loan applications are approved in accordance with delegated lending authorities. The Assets & Liabilities Committee is responsible for approving treasury counterparties.

23. GUARANTEES AND OTHER FINANCIAL COMMITMENTS (continued)

Liquidity Risk - The Group's policy is to maintain sufficient funds in a liquid form at all times to ensure that the Group can meet its liabilities as they fall due. The objective of liquidity is to help smooth mismatches between maturing assets and liabilities and to provide a degree of protection against any unexpected developments that might arise.

Interest Rate Risk - The Group 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 Group manages this exposure continually by using both on-balance sheet and off-balance sheet instruments.

f) **Interest Rate Risk Exposure**

The table below summarises these re-pricing mismatches as at 31 January 2014. Items are allocated to time bands by reference to the earlier of the next interest rate re-pricing date and the maturity date.

Group	Three Months or Less £000	More than Three Months less than Six Months £000	More than Six Months less than One Year £000	More than One Year less than Five Years £000	More Than Five Years £000	Non-interest Bearing £000	Total £000
Assets							
Liquid Assets	87,021	1,005	30,101	-	-	1,036	119,163
Loans and Advances to Customers	215,690	11,744	8,015	39,935	-	-	275,384
Tangible Fixed Assets	-	-	-	-	-	2,000	2,000
Other Assets	-	-	-	-	-	273	273
Prepayment and Accrued Income	-	-	-	-	-	412	412
Total Assets	302,711	12,749	38,116	39,935	-	3,721	397,232
Liabilities							
Shares	306,408	20,079	23,656	6,741	-	3,201	360,085
Amounts Owed to Credit Institutions	-	-	-	-	-	-	-
Amounts Owed to Other Customers	6,942	154	-	-	-	2	7,098
Other Liabilities	-	-	-	-	-	689	689
Accruals and Deferred Income	-	-	-	-	-	646	646
Provision for Liabilities	-	-	-	-	-	425	425
Reserves	-	-	-	-	-	28,289	28,289
Total Liabilities	313,350	20,233	23,656	6,741	-	33,252	397,232
Off-Balance Sheet Items (see Note)	41,500	(9,500)	(7,000)	(25,000)	-	-	-
Interest Rate Sensitivity Gap	30,861	(16,984)	7,460	8,194	-	(29,531)	-
Cumulative Gap	30,861	13,877	21,337	29,531	29,531	-	

Note:

Off-balance sheet items represents the notional amount on the interest rate swaps entered into by the Society in order to hedge the interest rate risk in fixed-rate mortgages. The maturity dates shown indicate the periods in which the individual contracts expire.

23. GUARANTEES AND OTHER FINANCIAL COMMITMENTS (continued)

g) **Interest Rate Risk Exposure (continued)**
The comparatives as at 31 January 2013 were as follows:

Group	Three Months or Less £000	More than Three Months less than Six Months £000	More than Six Months less than One Year £000	More than One Year less than Five Years £000	More Than Five Years £000	Non-interest Bearing £000	Total £000
Assets							
Liquid Assets	81,748	13,010	10,001	3,504	-	390	108,653
Loans and Advances to Customers	225,135	4,459	1,827	45,241	-	-	276,662
Tangible Fixed Assets	-	-	-	-	-	1,909	1,909
Other Assets	-	-	-	-	-	64	64
Prepayment and Accrued Income	-	-	-	-	-	507	507
Total Assets	306,883	17,469	11,828	48,745	-	2,870	387,795
Liabilities							
Shares	229,212	32,287	42,881	35,448	-	4,049	343,877
Amounts Owed to Credit Institutions	2,000	1,500	-	-	-	70	3,570
Amounts Owed to Other Customers	9,631	2,329	-	-	-	63	12,023
Other Liabilities	-	-	-	-	-	764	764
Accruals and Deferred Income	-	-	-	-	-	643	643
Provision for Liabilities	-	-	-	-	-	382	382
Reserves	-	-	-	-	-	26,536	26,536
Total Liabilities	240,843	36,116	42,881	35,448	-	32,507	387,795
Off-Balance Sheet Items (see Note)	31,500	-	-	(31,500)	-	-	-
Interest Rate Sensitivity Gap	97,540	(18,647)	(31,053)	(18,203)	-	(29,637)	-
Cumulative Gap	97,540	78,893	47,840	29,637	29,637	-	

Note:
Off-balance sheet items represents the notional amount on the interest rate swaps entered into by the Society in order to hedge the interest rate risk in fixed-rate mortgages. The maturity dates shown indicate the periods in which the individual contracts expire.

23. GUARANTEES AND OTHER FINANCIAL COMMITMENTS (continued)

h) **Fair Values of Financial Assets and Financial Liabilities**
Set out below is a comparison of carrying values and fair values of some of the Group's financial assets and financial liabilities as at 31 January 2014. The Group does not undertake transactions for trading or speculative purposes. The table excludes certain financial assets and financial liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. It therefore excludes items such as mortgages, share accounts and deposits with credit institutions.

Financial Assets (Liabilities) for which active financial markets exist:

	Book value £000	Fair value £000	Unrecognised (Loss)/Gain £000
On-Balance sheet instruments Debt securities and treasury bills:			
At 31 January 2014	**33,169**	**33,155**	**(14)**
At 31 January 2013	28,515	28,768	253
Off-Balance sheet instruments Interest rate swaps:			
At 31 January 2014	**59**	**(142)**	**(142)**
At 31 January 2013	52	(545)	(545)

Market values have been used to determine the fair value of interest rate swaps held. Unrealised gains and losses on instruments used for hedging are not booked, as these hedges are accounted for on an accruals basis in line with the underlying instruments being hedged.

Hedges: Hedges which comprise interest rate swaps 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 January 2014.

Group	2014 Gains £000	2014 Losses £000	2014 Net Gains/(Losses) £000
Gains and losses unrecognised at the start of the financial year	198	(743)	(545)
Items unrecognised at the start of the year recognised in the year	(63)	470	407
Items unrecognised at the start of the year and unrecognised in the year	135	(273)	(138)
Gains and losses arising in the year unrecognised in the year	-	(4)	(4)
Unrecognised at the end of the financial year	135	(277)	(142)
Of which:			
Expected to be realised in the year to 31 January 2015	135	(200)	(65)
Expected to be realised after 31 January 2015	-	(77)	(77)
Unrecognised at the end of the financial year	135	(277)	(142)

24. DIRECTORS' LOANS AND TRANSACTIONS

The aggregate amount outstanding at 31 January 2014 in respect of loans, transactions and arrangements made by the Society to Directors or persons connected with a Director was £243,382 and comprised three loans to two Directors (2013: £569,794 comprising two loans to one Director and one loan to a connected person).

A Register of loans and transactions subsisting between the Society and its Directors (and connected persons) is maintained. This Register is available for inspection by any member of the Society at the Society's Head Office for a period of fifteen days prior to the Annual General Meeting and at the Annual General Meeting.

Mrs Alexa Henderson's husband is a partner in the firm of Johnston Carmichael, which provided Internal Audit services to the Society until 31 January 2014.

25. TRANSFER OF ENGAGEMENTS

On 1 February 2013, the Society merged with Century Building Society (CBS). The assets and liabilities acquired, together with fair value adjustments, are set out below. The adjustments relate to the revaluation of tangible fixed assets and loans and advances to customers.

Group & Society	CBS Cessation Accounts £000	Adjustments £000	CBS Take-On Balances £000
Assets			
Liquid assets	5,171	-	5,171
Loans and advances to customers	17,001	(1,080)	15,921
Fixed and other assets	135	547	682
Total Assets	22,307	(533)	21,774
Liabilities			
Shares	20,972	-	20,972
Other liabilities	68	-	68
Reserves	1,267	(533)	734
Total Liabilities	22,307	(533)	21,774

Included within merger costs for the year is £40,000 (excluding VAT) in relation to assurance services provided by KPMG Audit Plc.

1. STATUTORY PERCENTAGES

	%	Statutory Limit %
a) Lending limit	**6.64**	**25.0**
b) Funding limit	**2.08**	**50.0**

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

The statutory limits are prescribed in building society legislation and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. OTHER PERCENTAGES

	2014 %	2013 %
As a percentage of shares and borrowings:		
a) Gross capital	**7.70**	7.38
b) Free capital	**7.20**	6.90
c) Liquid assets	**32.45**	30.23
Profit after tax as a percentage of mean total assets	**0.26**	0.16
Profit after tax (excluding FSCS levy and merger costs after tax) as a percentage of mean total assets	**0.32**	0.20
Management expenses as a percentage of mean total assets	**1.27**	1.33

Explanation of terms

All of the above percentages are based on Group figures.

Shares and borrowings represents the total of shares, amounts owed to credit institutions and amounts owed to other customers (all including accrued interest).

Gross capital is the general reserves as shown in the balance sheet.

Free capital represents gross capital and general mortgage loss provision less fixed assets.

Mean total assets represents the average of total assets shown in the relevant balance sheets. These amounted to £365,244 for 2013, increasing to £392,514 for 2014.

Management expenses represents the aggregate of administrative expenses and depreciation.

3. DIRECTORS AND OTHER OFFICERS AS AT 31 JANUARY 2014

Directors

Name and Business Occupation	Date of Birth	Date of Appointment	Other Directorships
Raymond J Abbott Company Director	02.03.59	01.06.13	Foresight 4 VCT PLC Galleria Holdings Ltd Essex Group Holdings Ltd Essex Services Group PLC
Robert Golbourn Banker	08.06.45	25.10.06	None
Alexa H Henderson Chartered Accountant	16.02.61	28.03.01	SBS Mortgages Ltd Adam & Company Group PLC Adam & Company PLC Adam & Company Investment Management Ltd James Walker (Leith) Ltd Dunedin Smaller Companies Investment Trust PLC
John C Ogston Chartered Banker	28.04.57	01.07.13	Airth Capital Ltd Trojan Capital Ltd
David Peebles Company Director	14.02.62	25.10.06	XM International Associates Ltd The Canmore Property Syndicate LLP
Moira R Sibbald Solicitor & Company Secretary	11.12.58	29.10.08	SBS Mortgages Ltd CALA Management Ltd CALA (ESOP) Trustees Ltd
Mark L Thomson Building Society Chief Executive	22.04.66	12.10.12	SBS Mortgages Ltd

Documents may be served on any of the above-named Directors c/o KPMG LLP at the following address:
Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EG

Executive Directors' Service Contracts

Mr Thomson has a rolling service contract with the Society dated 2 April 2012 which can be terminated by either party giving six months' notice.

Officers

Name	Business Occupation	Other Directorships
Andrew J W Tristram	Secretary & Head of Compliance	None
Graeme L Chandler	Head of Finance	None
Andrew Moses	Head of Operations & Lending	None
John H Lloyd	Head of Sales & Marketing	None
Alison I Quilter	Head of IT	None
Emily Dixon	Head of Human Resources	None

Head Office: SBS House, 193 Dalry Road, Edinburgh EH11 2EF.