

Annual Report and Accounts

for the year ended 31 December 2010



Linda, Bolton Branch



Piers, Duke Street Branch



Lynda, Liverpool Branch



Mandy, Grange Branch



Christine, Lancaster Branch

Ian
Ulverston Branch

**REAL PEOPLE
REAL BRANCHES
REAL SERVICE
IN THE HEART OF
YOUR COMMUNITY**

Furness 
BUILDING SOCIETY

Always with your interest at heart

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Vision and Key Highlights of the Year

Vision

To be the building society of choice in the North West

Key Highlights in 2010

Financial Strength

- Profit before tax of £2.5m
- 20% increase in mortgage advances
- Strong capital position
 - Gross capital of 8.06%
 - Free capital of 7.99%
- Strong liquidity
 - 26.09%
 - Significant level of UK government guaranteed instruments
- Reduced wholesale funding

Serving Our Customers

- Low mortgage arrears
- Branch rebranding completed
- Active supporter of the communities in which we operate

Chairman's Report

I am pleased to present the Society's 145th Annual Report and Accounts for the year ended 31 December 2010.

During 2010 the challenging economic conditions of the last couple of years continued. Building societies in general have experienced very low levels of growth, if any.

The housing market remained depressed throughout 2010 and the Bank of England base rate remained at its lowest ever level of 0.50%. We have now experienced a record period of time for the rate to have remained unchanged despite inflation remaining above target. However, there is a gathering consensus that interest rates will rise in 2011.

We do not expect the market position to significantly improve during 2011 due to the new Government's spending cuts and taxation changes which have started to take hold with rising unemployment being widely predicted.

Throughout 2010 we continued to focus on security and stability. Although our balance sheet size slightly reduced during the year, this was the result of a conscious decision to manage the business responsibly with our members' interests at heart. We did not want to take on any high risk or unprofitable business which could have a negative effect on our present very strong position. However, despite our caution, we still managed to achieve a profit before tax for the year of £2.5m, an increase on the previous year's £1.6m.

The amount we have had to pay for funds has generally increased and our interest rate margin is likely to be further squeezed in the future, particularly if the banks are called upon to repay their Special Liquidity Scheme borrowings to the Bank of England as this will then significantly increase the demand for retail funds. However, the Society hopes to take advantage of the increased level of protection for investors under the Financial Services Compensation Scheme which has risen from £50,000 per person to £85,000, by persuading investors with £50,000 invested with the Society to increase this to the new higher level. In any event, we remain a strong, well managed building society in which investors should feel very safe to invest above this 'limit'.

The low base rate scenario has not been good news for savers, as savings rates have remained at low levels, but we have tried to compensate for this by issuing some special offers for our investing members during the year.

The depressed housing market has resulted in decreased mortgage lending by the sector. It is therefore pleasing to report that the Society's mortgage lending in 2010 increased to over £96m which represents a 20% increase over the previous year.

The Society has continued to manage its business responsibly, including its prudent investment of liquid funds, and holds no foreign investments whatsoever.

We have also further improved our capital position with the Furness, at 7.99%, having one of the strongest free capital ratios in the building society industry (KPMG Building Societies Database 2010). 'Our strength is your security' certainly applies to the Society.

There has been further market consolidation through the year but the Board of Furness Building Society is firmly of the view that it is in the best interest of our members, our staff and the communities we serve, that the Society remains independent and mutual. Such independence enables us to focus on Furness and the North West and also means we have no external shareholders to whom we pay dividends. The building societies who in the past decided to convert to banks no longer remain independent institutions and the impact of this on many of their customers and communities has not been good.

Next year, the new UK Corporate Governance Code becomes effective. The Code is addressed to publicly quoted companies and The Building Societies Association (BSA) will provide guidance on how mutual societies can apply the relevant elements of the Code. Under the new Code all directors of publicly quoted companies will have to stand for re-election annually. We will comply with the BSA guidance on the re-election of directors at our 2012 Annual General Meeting. We will also be putting a new set of Model Rules, prepared by the Building Societies Association, for adoption at the 2012 Annual General Meeting. In line with good corporate governance, we have recently set up a Board Risk Committee which meets quarterly and is chaired by my fellow director, Philip Ireland, who joins the Board as a new non-executive director. Philip is a qualified solicitor with building society and stockbroking experience.

The time commitment required from non-executive directors has significantly increased in recent years and I would like to thank my fellow directors for so readily giving of their time.

The Board would especially like to thank our members for their continued support without which the Society could not succeed. Finally, I will retire immediately after the Annual General Meeting, after some 23 years with the Society, and I would like to express my gratitude to all staff and fellow directors, past and present, for their strong support over these years. I know that I leave the Society in a strong position as well as in safe and knowledgeable hands.



Avril Willis
Chairman
22 February 2011

Chief Executive's Report



2010 has been another challenging year but we are pleased to be able to provide another set of extremely creditable results.

Despite there being much competition for mortgage business, we have been able to increase our share of new lending over the year through offering competitive discount, tracker and fixed rate deals as well as developing stronger relationships with mortgage clubs and networks. We have also continued to lend up to 90% LTV in a controlled manner and, in doing so, have helped a number of buyers take their first step into the housing market. Unlike many other lenders, who increased their standard mortgage rate in 2010, we have maintained ours at 5.44%.

We continue to look for acceptable housing initiatives in which to become involved and are developing our product range which includes self build, shared equity and family mortgages. Our small commercial lending book continues to perform well. Our mortgage products were 'commended' at the recent Moneyfacts Awards.

We have been able to keep our level of mortgage arrears low despite the present financial climate and it is well below the national average. At the year end, we only had three properties in possession. Our success in this area is attributable to the sympathetic and helpful approach given by our mortgage arrears staff as well as our prudent mortgage underwriting and our generally low loan to value lending.

In the current low interest rate environment, we are very conscious of the needs of our savers and, during the year, we have brought out a number of special issues including a 4% 4 year fixed rate ISA, a 4% monthly saver account, a 3.95% 2 year fixed rate bond, a 3% 1 year fixed rate bond and an escalator bond paying 3%/3.75%/4.5% over a 3 year period. We also have brought out tracker and variable rate bonds to cater for our saving members' needs.

Our competitive Monthly Saver accounts continue to attract new members and our affinity accounts remain popular. We paid six figure sums to both St Mary's Hospice (Ulverston) and North West Air Ambulance this year. We have recently opened a new affinity scheme with North West Cancer Research Fund and are delighted to announce our first 'national' affinity account with Royal National Lifeboat Institution (RNLI). We hope that both these new affinity schemes will be very successful and further strengthen our support for the communities we serve.

We have developed new insurance relationships with Heath Lambert, on home insurance, and Cuna Mutual on mortgage payment protection insurance resulting in the Society being able to offer competitive premiums for customers. In 2011, we are further developing our relationship with Cuna Mutual by offering their FuneralProtect+ product, which is a new form of funeral cover.

Due to the problems encountered recently by certain financial institutions, regulation has increased significantly with our main regulator, the Financial Services Authority (FSA), taking a far more intrusive approach. A whole array of consultation papers and policy statements were issued by them throughout the year with probably the most momentous being the Building Societies Sourcebook which places a wide-ranging set of new guidance limits on our activities. We wait to see the potential effect of the FSA's Mortgage Market Review and hope that this does not result in further restrictions being placed on our ability to lend. We however continue to have a very good relationship with the FSA.

It will be interesting to see how regulation develops over the next few years with the FSA being replaced by two new regulators, the Financial Conduct Authority and the Prudential Regulation Authority. We hope that this does not result in the significant increase in the cost of regulation that is being predicted.

Although we have reduced our exposure to wholesale funds over the year, the Society has a good reputation in the wholesale market and funds have been available to us throughout the year. We are also well advanced in adopting the FSA's new liquidity buffer requirements.

We have further developed our marketing strategy over the year which has included the introduction of a new customer proposition 'real people, real branches, real service in the heart of your community' which we feel reflects our contribution as a mutual building society.

Our branch rebranding project was completed during the year and we have received some excellent feedback about our new look. We now have the image to go with our ethos of a modern forward-thinking building society. We are moving into new town centre premises in Bolton as, over the years, the commercial centre of the town has moved resulting in our original Bradshawgate premises being in a secondary location.

We have opened a new agency at Hopes Estate Agents in Wigton, Cumbria and initial business levels have been good. We remain on the lookout for good agency opportunities to increase our presence in our operating area and have recently appointed an Agency Co-ordinator so that we have somebody concentrating full time on our 17 agencies across the North West of England.

We continue to have a high level of community involvement at the Furness because, as a local mutual organisation, we are firmly committed to helping those communities in which we are represented. As well as giving donations and sponsorship to local worthwhile causes, our staff freely give their time to serve on local community bodies. We were delighted to be a finalist in the recent Westmorland Gazette Awards for our work in the community.

Our Chairman, Avril Willis, will retire from the Society at the end of the Annual General Meeting and, on behalf of all staff, I would like to thank her for the immense amount of support and motivation that she has given to us over many years.

Philip Shipman retired as Deputy Chief Executive on 31 October 2010 after almost 39 years with the Society. Philip made an immense contribution to the Society over these years and we owe much of our success to him. His wise counsel, dedication and friendship will be very much missed by his senior colleagues. Steve Pryer has been very deservedly promoted from Finance Director to Deputy Chief Executive and Brian Ryninks has been recruited as our new Finance Director. Brian joined us from a well known firm of stockbrokers and investment managers. We have also appointed Martin Osborne as the new General Manager of our independent financial advice subsidiary, Furness Independent. These appointments will further strengthen our senior management team.

Our independent financial advisers have been successful in achieving examination passes over the year in readiness for the Retail Distribution Review. Furness Independent is well qualified to service the needs of current and future clients.

I am delighted to report that in December the Society retained its Investors in People status for a further 3 years which demonstrates the importance we place on our staff. We are continually developing our personal development review process; we put great emphasis on training and qualification achievement and have introduced a coaching culture. Good staff communication is achieved through regular team briefings, e-mails, staff forums, walking the job and an 'open door' style of management.

May I conclude my report by thanking all the staff for their hard work and enthusiasm throughout what has been an extremely challenging year and also our agents and professional contacts for the very important contribution that they make to our business.

Rob Cairns
Chief Executive
22 February 2011

Directors' Report

The directors have pleasure in presenting the 145th Annual Report and Accounts for the year ended 31 December 2010.

Business Objectives and Activities

The main business objectives of the Group remain unchanged. These are to provide a safe home for the savings of our investing members at appropriate rates of interest and thereby raise sufficient funds to continue to provide mortgages for our borrowing members. The Group also seeks to ensure the fair treatment of customers, develop and enhance the range of services for the benefit of the Society's members and to make adequate profits for their future security. The active legal entities within the Group comprise Furness Building Society, Furness Mortgage Services Limited and Furness Independent Financial Advisers Limited.

Business Review

In accordance with Sections 75 and 75A of the 1986 Building Societies Act, the directors provide the following business review which includes the key performance indicators used by the Board to monitor the Group's performance.

- **Net Interest Margin**

The Group's net interest margin reflects the surplus that remains after deducting the Group's funding costs in the form of retail share and deposit interest, non-retail funds interest and subordinated debt interest from its interest income which is comprised of mortgage interest and interest earned on the Group's investments. The Society operates in one of the most dynamic markets in the United Kingdom and its margin is affected largely by the competitive pressures in the retail mortgages and savings markets and also by the interest that is paid or received in the wholesale money markets.

During 2010, the Society continued to experience very competitive conditions both for mortgage lending and deposits. The responsibility to produce an appropriate level of profit to maintain the Society's capital strength was and continues to be at the forefront of the Board's consideration when setting interest rates. The Board strives to meet the expectations of our investing and borrowing members wherever possible, a challenge that is even greater in a very low interest rate environment.

In December 2009 the Society reinstated a variable rate ceiling term that reduced the Society's mortgage interest received by £2.09m in 2009, but had minimal impact on the 2010 margin.

A net interest margin of £10.64m was achieved (2009: £8.05m). As a percentage of mean assets this net interest margin was 1.28% (2009: 1.06%).

- **Other Income, Fees and Commissions**

The Group generated Other (non-interest) Income from the provision of services that are related and complementary to its core activities of mortgage lending and the provision of savings and investment products. This included income from a variety of insurance related products we provided to our members through our partnerships with companies such as Heath Lambert and Cuna Mutual. Income was also earned through the provision of independent financial advice by the Group's subsidiary company, Furness Independent Financial Advisers Limited. In 2010 the Group generated Other Income of £0.54m (2009: £1.10m). This represented 4.85% of total income (2009: 12.05%) with the fall arising mainly due to the sale of more fixed rate mortgages where the application fee is amortised over the life of the mortgage, reduced insurance commission received and increased commission paid to mortgage introducers.

- **Management Expenses**

These expenses reflect the cost to the Group of providing the products and services mentioned above. In 2010 this ratio was 0.99% (2009: 0.84%) of mean total assets. The average for the Society's peer group for the 2009 year end as per the KPMG Building Societies Database 2010 was 0.97%. The key elements of this ratio are the level of costs and the size of the balance sheet that the Group achieves whilst maintaining an adequate capital strength to protect its investing members. During 2010, the level of costs were inflated by non recurring items, for example the cost of the rebranding exercise which, combined with the slight reduction in the balance sheet that was approved by the Board, contributed to a deteriorating ratio. Adjusting for non recurring elements would have resulted in a ratio of 0.92% of mean total assets.

- **Arrears and Provisions**

On occasions borrowers experience difficulties which impact on their ability to meet their mortgage obligations. The Society identifies borrowers whose mortgage accounts have gone into arrears and immediately consults with them in order to ascertain the reason for the arrears and to establish what course of action can be taken to bring the accounts up to date.

Directors' Report continued

Despite the Society's best efforts to help borrowers in such circumstances, there are occasions when properties have to be repossessed and sold, sometimes at a loss to the Society. When potential losses are envisaged the Group makes provisions to cover such circumstances.

The Group continues to follow prudent lending policies which also contribute to the low level of provisions. Stress and scenario testing of the Group's residential lending portfolio has confirmed that we have the financial strength to withstand a significant downturn in the economy.

At the end of the year, there were 16 cases (2009: 11) where repayments were 12 months or more in arrear. The total amount of arrears on these cases was £155,900 (2009: £145,831). Balances on accounts 12 months or more in arrear totalled £888,026 (2009: £872,750). At 31 December 2010 the Group's total provisions represented 0.29% of total mortgage assets (2009: 0.23%).

- **Reserves**

The Board considers that the maintenance of adequate reserves to protect the Society's members from any unexpected adverse situations is of paramount importance and maintains the Group's reserves at a level well in excess of the minimum capital level required by the FSA.

- **Liquidity**

At 31 December 2010, the Group's liquid assets were £195.1m (2009: £194.2m). As a percentage of share and deposit liabilities, liquidity represented 26.09% (2009: 24.96%). During the year the Group adhered to its conservative risk approach to the investment of surplus funds, investing these for short periods in United Kingdom government debt instruments and with large reputable banks and other building societies. At the year end, the Society had a liquidity buffer of 77.9% compared to the regulatory requirement of 30%.

The return on liquid assets totalled £1.2m (2009: £2.1m) reflecting the low interest rate environment experienced during 2010 and the low return available from the conservative investments noted above.

- **Gross Lending**

Gross Lending totalled £96.4m which was £15.8m higher than the equivalent figure for 2009. This was achieved without compromising our lending criteria. There was, however, a 4.7% reduction of the Society's net mortgage assets of £30.3m (2009: reduction of £34.6m). The net mortgage assets of the Society's subsidiary company Furness Mortgage Services Limited fell by £0.6m (2008: £1.5m).

- **Funding**

The Society's retail share and deposit balances decreased by £12.6m (2009: £22.3m decrease) reflecting the Society's balanced approach to interest rate management. The Society reduced its wholesale borrowings from the money markets from £70.4m at the beginning of 2010 to £49.2m at 31 December 2010.

Capital and Profits

In 2010, the Group generated after tax profits of £1.76m (2009: £1.16m) which the Board considers to be a creditable result in the light of the economic conditions that prevailed throughout the year.

At 31 December 2010, gross capital amounted to £60.3m (2009: £58.4m) or 8.06% (2009: 7.50%) of total share and deposit liabilities. Free capital amounted to £59.8m (2009: £56.6m) or 7.99% (2009: 7.41%) of total share and deposit liabilities. Gross capital represents the general reserve and subordinated liabilities shown in the balance sheet. Free capital represents gross capital and general provision for bad and doubtful debts less tangible fixed assets as shown in the balance sheet.

Principal Risks and Uncertainties

The main uncertainties affecting the Group are considered to relate to the current economic environment. The condition of the domestic economy has a direct impact on investing members' sentiment regarding saving and on borrowers' ability to meet their mortgage commitments. The Monetary Policy Committee of the Bank of England retained the base rate at the historical low of 0.50% throughout 2010. Whereas this low interest rate environment has benefitted the Group's borrowers with low borrowing costs, this has adversely affected the income that the Society's savers received from their investments with the Society.

Economic forecasts have seen a moving timeframe for predicting if and when the base rate might increase. The housing market

Directors' Report continued

is not currently expected to improve during 2011 and anticipated increases in unemployment as a result of public sector funding cuts could have an increased negative impact on mortgage arrears. We have factored these potential events into our planning for 2011 and are confident that the Group has both the resources and the resolve to cope with these challenges.

During 2010 the Society continued to position itself appropriately for the FSA's new liquidity regulations that involved holding a higher proportion of its liquid asset investments in the form of UK government debt instruments which are perceived by the FSA to be the safest form of liquidity. Whereas these new liquidity regulations are being phased in over a further four year period, the Society increased its holdings of such instruments well in advance of the regulatory requirements but this has adversely affected the margins and profitability of the Society.

The liability to the Financial Services Compensation Scheme (FSCS) continues to be an uncertain cost and the failure of any other firms covered by the scheme could also add to the existing liability. A charge of £277,691 (2009: £150,792) has been recognised in the Society's 2010 accounts relating to the FSCS levy. The Board consider that the Group is financially sound and able to meet the currently anticipated cost of the FSCS levy for the coming year.

Consolidation within the building society movement continued to occur in 2010 and further activity of this type is quite possible in 2011. However, because of the Society's strong capital position, adequate liquidity and conservative approach to business, we currently have no reason to believe that the Society will feature in such activity.

The Society's directors are pleased to report that they continue to hold the view that it is in the members' best interests for the Society to remain as an independent regional building society.

The Group faces a variety of risks, which fall into the following categories:

- **Credit Risk**

This is the risk that borrowers or counterparties to whom the Society has lent money may default on their obligation to repay what they owe the Society. The Society manages the risk associated with mortgage borrowers by means of a prudent lending policy that includes both an assessment of the creditworthiness of the borrower and the value of the proposed security. Mortgages are monitored closely on an ongoing basis after completion with timely action being taken for those mortgages that fall into arrears. The Society has a credit risk committee that meets regularly and considers the risks associated with this lending.

In the case of liquid asset investments the credit risk associated with lending to financial institutions is addressed by the Society's Assets and Liabilities Committee (ALCO) which ensures that lending is restricted to UK government issued debt instruments, 'blue chip' banks with high quality credit ratings or those guaranteed by the UK government and to building societies that are closely regulated by the FSA. In addition, the Society also keeps abreast of developments affecting financial sector firms and takes appropriate action to safeguard the Society's investments.

- **Liquidity Risk**

The Group's liquidity risk reflects the situation under which the Group is unable to meet its financial obligations as they fall due. The purpose of the liquidity policy is to ensure that these commitments can be met in a timely manner and that the Group maintains the confidence of its existing and potential investors and suppliers.

On a day to day basis the Group's liquidity position is managed by the treasury function which is responsible for the liquid asset portfolio and arranging contingency plans. Liquidity risk is monitored by the ALCO which meets on a frequent basis and receives a variety of reports that enable it to monitor the amount and composition of the liquid asset portfolio and ensure Group compliance with the prudential regulations covering liquidity.

- **Operational Risk**

This relates to the risk of loss as a direct result of failed systems and procedures and could include items such as defective title, incorrect financial advice, money transmission errors etc. The operational risks faced by the Society, and its two active subsidiary companies, are assessed on a regular basis and an appropriate system of control exists to mitigate these risks. This control system is reviewed by both internal and external audit on an ongoing basis. The Group's Pillar 3 disclosures, which set out the capital and risk management policies and objectives can be found on the Society's website www.furnessbs.co.uk. This information is updated annually after the Society's Annual General Meeting.

Directors' Report continued

• Price Risk

Price risk relates to the potential for loss on the sale of a financial instrument as a result of a change in the price of that instrument. The Society does not take aggressive views on future interest rate movements when investing the Society's surplus funds. The Society does not actively trade financial investments and holds them to maturity other than for regulatory realisation testing, which reduces the risk mentioned above.

• Treasury Risk Management and Interest Rate Risk

This refers to the risks associated with the Society's treasury management activity which includes the investment of the Society's surplus funds and the execution of derivative transactions to hedge the Society's fixed rate products. The Society operates a conservative and risk averse treasury policy. On an ongoing basis the ALCO monitors the Society's adherence to this policy to ensure that the interest rate risk that the Group is exposed to, on both sides of the balance sheet, is adequately controlled.

• Conduct Risk

The Board has primary responsibility for ensuring that the manner in which the Society conducts dealings with its customers is fair and in their interests. Not only does the logo of "Always with your interest at heart" embed this culture throughout the Society but on a formal basis, a dedicated committee considers matters that would impact upon treating customers fairly. These measures encompass product development as well as the terms and conditions of whatever is sold to customers and includes ensuring that staff are trained accordingly.

Financial Risk Management Policies and Objectives

The Group's activities include arranging financial instruments in the form of mortgages, savings and insurance products, and also wholesale money market related investments and borrowings. The Board has established a formal structure to address its objective of managing the risk associated with these activities. As mentioned above, the price, credit and liquidity risks are monitored by ALCO and reported to the Board.

Donations

During the year, the Society, made numerous donations to a variety of good causes, of which £3,725 (2009: £3,901) was donated purely for charitable purposes. This sum was in addition to affinity account payments totalling £363,853 (2009: £351,053) and other donation and sponsorship payments totalling £5,792 (2009: £6,290) to charities and other local community organisations.

No contributions were made for political purposes. Organisations that received donations included:

- | | |
|--------------------------------------|---------------------------------|
| • Alzheimer's Society | • Help for Heroes |
| • Anchor Trust | • Kidney Research UK |
| • Arnside Choral Society | • MENCAP |
| • Cereba | • Millom Recreation Centre |
| • Coniston Mountain Rescue | • MIND in Furness |
| • Dalton Old People's Welfare Centre | • Myasthenia Gravis Association |
| • Furness Falcons | • South Cumbria Musical Society |
| • Girl Guiding UK | • The Sick Children's Trust |

Supplier Payment Policy

The Group's policy is to discharge supplier invoices within the agreed payment terms when they fully conform with the terms and conditions of the purchase. The average time to settle invoices over the year was 24 days (2009: 26).

Directors

Directors who served during the year are listed on page 17 within the Corporate Governance Report. None of the directors had an interest in shares or debentures of any associated body of the Society at any time during the financial year.

Approved by the Board of Directors on 22 February 2011.

Avril Willis
Chairman
22 February 2011

Statement of Directors' Responsibilities

DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT, THE ANNUAL BUSINESS STATEMENT, THE DIRECTORS' REPORT AND THE ANNUAL ACCOUNTS

The directors are responsible for preparing the annual report, annual business statement, directors' report and the annual accounts in accordance with applicable law and regulations.

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

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

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

- select suitable accounting policies and then apply them consistently;
- make judgments 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;
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

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

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

GOING CONCERN

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Avril Willis
Chairman
22 February 2011

The Board of Directors and Secretary



AVRIL CASSON WILLIS

Avril, aged 63, became a director of the Society in March 1988 and has been Chairman since April 2008. Avril chairs the Nominations Committee and one of the Society's subsidiary companies, Furness Mortgage Services Limited.

Born in Barrow-in-Furness, Avril has a BA and an MBA degree and is a Fellow of the Royal Society of Arts and the Chartered Institute of Personnel and Development. She was the National Director for Quality and Standards with the Learning & Skills Council. Previously, she held a number of senior management positions, including Senior Inspector of Colleges with the Further Education Funding Council and Chief Executive of the Furness Business Initiative.

PETER RICHARD WAVELL HENSMAN

Peter, aged 62, became a non-executive director of the Society in 2003. He is currently the Society's Vice-Chairman and chairs the Society's Remuneration Committee. He studied Engineering at Cambridge University and subsequently qualified as a Chartered Accountant.

He was Finance Director and then Managing Director of Gilbert Gilkes and Gordon, the Kendal engineers, between 1980 and 2000. Today he is director of various tourism related businesses including Ullswater Steamers and the Ravenglass and Eskdale Railway. He is also a member of the Board of the Northwest Regional Development Agency, a director of Business Link Northwest, Chairman of Cumbria Rural Enterprise Agency and Kendal Futures Board.



ROBERT JAMES CAIRNS

Rob, aged 59, was appointed to the Board when he joined the Society as Chief Executive on 1 August 1997, following a long building society career which spans over 30 years. He is Chairman of the Assets and Liabilities Committee and a director of each of the Society's subsidiary companies.

Rob has a BA (Honours) degree in Social Psychology and is a Fellow of both the Chartered Institute of Bankers and the Chartered Management Institute. His current community activities include being Chairman of Barrow Regeneration, Barrow Community Trust and More Music, President of Walney Junior Amateur Operatic Society and Trustee of Cumbria Community Foundation.

Rob also sits on the Committee of Cumberland County Cricket Club.

STEVEN LINDSAY PRYER

Steve, aged 49 was appointed to the Board in 2004 and has worked for the Society since 1993. Prior to his promotion to Deputy Chief Executive upon Philip Shipman's retirement, Steve was the Society's Finance Director. Steve's business qualifications include a Bachelor of Commerce Honours degree, an MBA and three coaching qualifications, in addition to being a Chartered Manager and a Fellow of the Chartered Management Institute.

Prior to joining the Society, Steve gained significant finance related experience working for an American oil company and a very large American bank. Steve is a member of the Society's Assets and Liabilities Committee and the Society's Corporate Planning Committee.

Born in Barrow-in-Furness, Steve is a mentor for the Prince's Trust and is a member of the Cumbria Branch of the Chartered Management Institute.



BRIAN PRESTON RYNINKS

Brian, aged 51, was appointed to the Board on 1 November 2010 having joined the Society in August 2010, after a career with investment management / stock broking firms. These firms included his most recent appointment at EFG Harris Allday in Birmingham as Head of Finance and Operations since 1996 as well as at J M Finn in London.

He completed a Bachelor of Commerce before serving articles with Deloitte Haskins & Sells and qualifying as a Chartered Accountant. He is a member of the Institute of Chartered Accountants in England & Wales.

Brian is a member of the Society's Assets and Liabilities Committee, Board Risk Committee and Corporate Planning Committee.

The Board of Directors and Secretary continued



ALAN THOMAS FERGUSON HUNTER

Alan, aged 60, was appointed to the Board in July 2008. He is a Fellow of the Institute of Chartered Accountants and holds a B.Sc. degree in Economics. He is Chairman of the Society's Audit Committee and a director of Furness Independent Financial Advisers Limited.

He spent the majority of his working career in senior management positions in the banking and financial services sector in London. Latterly he was Finance Director of the Rea Brothers Group and was previously Finance and Operations Director, of Mase Westpac, the bullion bank.

CHRISTOPHER STUART FAIRCLOUGH

Stuart, aged 60, was appointed to the Board as a non-executive director in June 2005.

He has spent his entire working career in the financial services industry initially in the UK life assurance market as an actuary based in Kendal for nearly 20 years. More latterly he has worked in the international life and investment markets as Chief Executive of a major cross border insurance company until taking early retirement. Stuart has a 1st Class Honours degree in Mathematics and is a Fellow of the Institute of Actuaries.

During his career he has been on a number of industry bodies including holding Chairmanships of the Association of International Life Offices and the Manx Actuarial Society.

He is currently a director of a number of international financial services companies and is Chairman of one of the Society's subsidiary companies, Furness Independent Financial Advisers Limited.



COLIN STEWART MILLAR

Colin, aged 64, was appointed to the Board in September 2006. He is the Society's Senior Independent Director and a member of the Society's Remuneration and Nominations Committees. He has a degree in Industrial Economics from the University of Nottingham.

His early career was in brand marketing with Unilever, principally in the UK but he also worked for a time in Japan and East Africa. Subsequently he was a General Manager with Birmingham Midshires and Yorkshire Building Societies and Marketing Director with The Mortgage Corporation. For fourteen years he then owned and ran a marketing information company, supplying marketing data to companies and trade organisations throughout the world.

He is Chairman of an NHS Foundation Trust.

PHILIP ANTHONY IRELAND

Philip, aged 58, joined the board in 2010 and is chairman of the Board Risk Committee which he helped to set up at the end of last year.

He is a solicitor with a law degree from Liverpool University and an MBA degree from Bradford.

After a short period in private practice he has spent over 30 years in financial services including 9 years at Halifax Building Society and 12 years with the Yorkshire Building Society. He moved into stockbroking in 1996 and is a director at TD Waterhouse Investor Services based in Leeds.



SUSAN JANE HERON

Sue, aged 47, was appointed to the role of Secretary on 1 August 2008.

Sue has worked for the Society since 1995, starting her career in Lancaster Branch before moving to Head Office to hold management positions within Furness Direct and the Compliance function. In addition to her role as Secretary, Sue currently manages the Risk, Compliance and Audit functions.

Sue's qualifications include FdSc in Financial Markets and Management. She is also Secretary to the Board of Furness Independent Financial Advisers Limited and is a member of the Board Risk Committee.

Corporate Governance Report

The Board is committed to good practice in corporate governance believing that it plays an essential role in discharging the Board's responsibilities to the Society's Members. This report explains how the Society applies the principles in the Combined Code on Corporate Governance (the 'Code') issued by the Financial Reporting Council in June 2008.

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

The Board considers that the Society complies with all Code provisions unless the contrary is stated.

DIRECTORS

The Board

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

Society Practice: The principle functions of the Board are to determine the strategy and policies of the Group, to review business performance and to ensure that appropriate financial and business systems and controls are in place for the management of prudential risk and to safeguard the interests of members. The Board has established its own Terms of Reference which includes a specific list of matters reserved to it.

The Board operates by scheduling regular meetings and through its main committees. The Board met twelve times in 2010 for scheduled meetings and also met for its annual strategy review meeting which was held over two days. The Chairman met with the non-executive directors in the absence of the executive directors during 2010.

The Board has a number of committees, which are responsible for specific aspects of board matters. The Board sets clear Terms of Reference for the committees and the minutes of the committee meetings are reported to the Board. The Board receives recommendations from the committees within their Terms of Reference and also receives an annual report on their conclusions. The main committees operating throughout 2010 were Audit, Remuneration and Nominations and at the end of 2010 a Board Risk Committee was formed. Each of these committees is described on pages 18 to 19.

The Terms of Reference of these Committees are available to each member on written request to the Society's Secretary.

Chairman and Chief Executive

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

Society Practice: The role of the Chairman and the Chief Executive are held by different people and each role is clearly defined and documented and agreed by the Board. The Chairman's main role is to lead the Board, ensuring that it acts effectively and in addition to facilitate communication with the Society's members on behalf of the Board.

The role of the Chief Executive is to manage the Society's business on a day to day basis, being accountable to the Board for the financial and operational performance of the group and for the formulation of a corporate plan to achieve the strategic objectives set by the Board.

The role of the Chairman is vital in leading the Board to effectively develop and challenge strategy, whilst providing independent judgment, knowledge and experience. It is therefore essential that the Chairman possesses considerable knowledge and experience of the Society's operations to discharge these duties effectively. In taking these requirements into account, directors unanimously re-appointed Mrs. Avril Willis as Chairman of the Board in April 2010, whilst acknowledging that her service exceeded the maximum 9 year term recommended by the Code of Corporate Governance. The Board considered Mrs. Willis to be independent in character and judgment on her appointment.

Board Balance and Independence

Code Principle: The Board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the Board's decision making.

Society Practice: At the end of 2010 the Board comprised six non-executive directors and three executive directors. The

Corporate Governance Report **continued**

Chairman and Vice Chairman are both non-executive directors. The Code recommends that non executive directors should not serve more than a 9 year period of service and the Board has adopted a succession policy to address the provisions of The Code. The Board's general policy is that non-executive directors are initially appointed for a three year term and should not serve more than 3 full three year terms. On the retirement of Mrs Willis, immediately following the 2011 Annual General Meeting, the composition of the Board will be consistent with this general policy.

All of the non-executive directors are considered by the Board to be independent in character and judgment and free of relationships or interests likely to affect their judgment.

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

Appointment to the Board

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

Society Practice: The appointment of new directors is considered by the Nominations Committee which considers the balance of skills, knowledge and experience required for the growth and development of the Society and makes recommendations to the Board. Candidates are identified in a number of ways which include open advertising, with appointments to the Board made on merit and against objective criteria. All directors must meet and maintain the FSA's fitness and propriety standards and must be approved by the FSA in order to hold the Controlled Function of director.

Information and Professional Development

Code Principle: The Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the Board and should regularly update and refresh their skills and knowledge.

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

On appointment, directors are given appropriate induction training. Ongoing development and training needs are identified through an annual performance evaluation process and directors regularly attend industry events, seminars and training courses to ensure that their skills and knowledge remain up to date. Each director maintains a training log which is reviewed annually at their performance review.

Performance Evaluation

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

Society Practice: During 2010 the Board maintained the established process whereby each director received an appraisal on their role as director from the Chairman. In addition each executive director received an individual formal appraisal in respect of their executive duties. The Chairman was appraised by the Senior Independent Director following input from each Board member. A report was then delivered to the Board in the absence of the Chairman. The Board evaluates its own performance and that of its committees annually.

Re-election

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

Society Practice: All new directors are subject to election by members at the next appropriate Annual General Meeting following their appointment. Directors are required to seek re-election every three years thereafter and do not generally serve more than three full terms.

Any non-executive director serving for a period in excess of 9 years is subject to annual re-election by the members.

Corporate Governance Report continued

Mrs Avril Willis was re-elected by the members in 2010, following a rigorous performance evaluation that concluded that Mrs Willis had continued to make a significant and effective contribution to the Board during the year. Mrs Willis will retire immediately following the 2011 Annual General Meeting.

REMUNERATION

The Report of the Directors on remuneration is on pages 21 - 22.

Attendance at the Board and Board Committee Meetings

	Board	Nominations	Audit	Remuneration	Risk
A C Willis (Chairman)	12 (12)	5 (6)	5 (5)		
P R W Hensman (Vice Chairman)	11 (12)	6 (6)	5 (5)	7 (7)	
R J Cairns (Chief Executive)	12 (12)	6 (6)			
C S Fairclough	10 (12)			5 (7)	
A T F Hunter	12 (12)	4 (5)****	5 (5)		1 (1)
P A Ireland	7 (7)*				1 (1)
C S Millar	12 (12)	6 (6)		7 (7)	
S L Pryer	12 (12)				
B P Ryninks	2 (2)***				1 (1)
P L Shipman	10 (10)**				
Number of meetings held	12	6	5	7	1

- *Mr P A Ireland was appointed to the Board on 15 June 2010
- **Mr P L Shipman retired on 31 October 2010
- ***Mr B P Ryninks was appointed to the Board on 1 November 2010
- **** Mr A T F Hunter was appointed as a member of the Nominations Committee in May 2010.

ACCOUNTABILITY AND AUDIT

Financial Reporting

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

Society Practice: The directors' responsibilities for preparing the Group's annual accounts and a statement that the Group's business is a going concern are contained in the Directors' Report on page 8. Business performance is reviewed in the Chairman's Report, Chief Executive's Report and the Business Review section of the Director's Report.

Internal Control

Code Principle: The Board should maintain a sound system of internal control to safeguard shareholder's investments and the company's assets.

Society Practice: The Board determines the Society's risk appetite and has ultimate responsibility for the maintenance of an effective internal control system. The Board reviews the effectiveness of the Group's internal controls by receiving quarterly reports from the Audit Committee and a more formal annual summary report. The Board's review covers all material controls, including financial, operational and compliance controls and risk management systems.

At the end of 2010 and in accordance with best industry practice, the Board further strengthened the existing risk framework by establishing a Board Risk Committee. The primary responsibility of the Board Risk Committee is to review the risk management framework to ensure that it is appropriate to manage and mitigate current and emerging risks arising from current and future business activities. The Committee held its first meeting in December 2010. The Board Risk Committee reports to the Board with the minutes of the meetings also considered by the Audit Committee. The Board Risk Committee forms part of the Society's Risk Structure which includes a number of management risk committees including the Credit Risk Committee, the Management Risk Committee and the Assets and Liabilities Committee which are chaired by the Chief Executive.

Corporate Governance Report continued

Audit Committee and Auditors

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

Society Practice: The Audit Committee comprises three non-executive directors, is chaired by Mr Alan Hunter and meets on a regular basis, at least quarterly. The Board is satisfied that at least one member of the Committee has recent and relevant financial experience. The Chairman of the Board is a member of the Committee. The Committee invites other regular attendees to meetings including the Executive Directors, the Group Secretary and the internal and external auditors. Minutes of the meetings are routinely distributed to all members of the Board.

The Audit Committee operates under a Terms of Reference and its main role is to review the effectiveness of the Group's systems of internal control and risk management process. Other functions of the Committee include:

- Monitoring and reviewing the effectiveness of the internal and external audit functions
- considering internal and external audit reports
- considering compliance with regulatory and legal requirements
- considering and monitoring the integrity of financial reports including the Society's Annual Report and Accounts and Summary Financial Statement
- approving and monitoring the annual internal audit plan

The Committee oversees the relationship with the external auditors and has a framework for monitoring auditor independence, competence, objectivity and effectiveness. This includes a policy which defines the extent of non audit services which can be provided by the external auditors in order to ensure that their independence and objectivity is maintained. A limited amount of such work is currently provided by KPMG for the Group. The payment for non-audit work is separately identified in the Accounts (see Note 4).

The Society's internal audit function is provided by Deloitte LLP. The internal audit function has a vital role to play in supporting the business and evaluating the major business risks. Deloitte agree an annual plan of work with the Audit Committee and through the delivery of this plan they are able to provide assurance to the Audit Committee on the effectiveness of the Society's controls.

The Society's compliance function also submits a plan for annual agreement by the Audit Committee. The Group Secretary gives a regular report to the Audit Committee on regulatory issues and progress against the plan. Actions arising from issues identified in compliance work are tracked through the Audit Committee. Through delivery of the compliance plan, regular reporting and issue tracking, the compliance function provides assurance to the Board on the Society's regulatory compliance.

The Committee is also responsible for ensuring that there are satisfactory whistleblowing arrangements to enable employees to confidentially raise any concerns about possible improprieties and that there are effective arrangements for investigation of any such concerns.

RELATIONS WITH MEMBERS

Dialogue with Members

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

Society Practice: As a mutual building society, the Society has members rather than shareholders and the Board wishes to maintain and extend close relations with the Society's members. Each year we issue our 'Rapport' magazine and try to always offer at least one product exclusively for members and/or give members first refusal of a limited offer. We encourage members to attend our Annual General Meeting, where they can ask questions and voice their opinions. We are increasing dialogue with our members through development of our website, increased telephone contact and satisfaction surveys.

Constructive Use of the Annual General Meeting (AGM)

Code Principle: The Board should use the AGM to communicate with investors and to encourage their participation.

Society Practice: Each year notice of the AGM is given to all members who are eligible to vote. Members are sent voting forms and are encouraged to vote online, by post, at a local branch or in person or by proxy at the AGM. All members of the Board are present at the AGM each year unless there are exceptional circumstances. The Chairs of the Audit, Risk, Remuneration and Nominations Committees are therefore available to answer questions at the meeting.

Corporate Governance Report **continued**

NOMINATIONS COMMITTEE

The Nominations Committee comprises four non-executive directors together with the Chief Executive and considers the succession to and composition of the Board, potential Board candidates and makes recommendations to the Board.

The Committee is chaired by the Society's Chairman although there is a provision in the Terms of Reference for another member of the Committee to take the Chair in appropriate circumstances if the Committee is considering the succession of the Society's Chairman.

The Committee maintains a list of potential suitable candidates that includes approaches from the membership who are encouraged to apply or to advise the Society of potential candidates.

When a vacancy occurs the Committee considers the skill mix of the remaining members of the Board and identifies any gaps which could be filled by the replacement director. A desirable list of skills is considered and used in the identification of which candidates may be best suited to the role.

The Society then employs a variety of ways to identify suitable candidates.

- a list of potential building society Board candidates is maintained by the Building Societies Association and may be consulted
- a list of members responding to our standing invitation to apply for Board membership is retained
- the Society may advertise in selected newspapers or publications normally within our operating area
- if considered appropriate an external search consultant would be employed

Furthermore, the Society's Rules make provision for members of the Society to nominate candidates for election to the Board.

REMUNERATION COMMITTEE

The Committee's main role is to consider and approve the remuneration for executive directors and other members of the Society's senior management team.

The Committee also approves the level of fees for the Chairman and makes recommendations to the Board on other non-executive directors fees.

A report on directors' remuneration is provided on pages 21 and 22 giving details of remuneration policy, remuneration levels and directors' service contracts.

The Committee comprises non-executive members of the Board and is chaired by the Vice Chairman. At least two meetings are held annually.

BOARD RISK COMMITTEE

The Board Risk Committee was formed at the end of 2010 and comprises 2 non-executive directors, the Finance Director and the Group Secretary. Mr Philip Ireland chairs the Committee, with the other non-executive director being the Chair of the Audit Committee. The Chairman of the Board and the Chief Executive are not members of the Committee although they usually attend the meetings of the Committee by standing invitation. The responsibilities of the Board Risk Committee include reviewing and making recommendations to the Board on risk appetite, strategies and risk policies. The Board Risk Committee met once in 2010 and is scheduled to meet 4 times in 2011.

Corporate Social Responsibility at the Furness

As a mutual building society we understand that we have a special duty of responsibility to our members, staff and the communities in which we operate. We have a proud tradition of being involved in our local communities and have a high level of engagement with our key stakeholders and members. In order to embed these values, the Society has a Corporate Social Responsibility policy which provides a framework upon which to base our operational decisions.

Corporate social responsibility at the Society covers:

1. THE WORKPLACE

At the Furness we know our staff are our most important asset and we are committed to developing their skills to ensure that they offer an exemplary service. We are able to do this through our annual personal development reviews and training plans which allow us to address individual staff development needs.

2. THE ENVIRONMENT

We are endeavouring to improve our operational efficiencies to lessen our impact on the environment. During 2010 we continued to work with our recycling and confidential waste management partners to reduce the numbers of journeys required to efficiently manage our confidential waste management. We developed and embedded a culture of recycling within the organisation maintaining staff enthusiasm for this in 2010. We closely manage the quantity of leaflet and poster production and during the year have developed innovative promotional material which embeds the Society's new brand in an effective and efficient way in order to continue to meet our customer needs. We use a combination of paper from sustainable, controlled and recycled sources for our letterhead, 'Rapport' (our member magazine), Annual Report and Accounts documents and Annual General Meeting (AGM) voting documentation.

We manage all ongoing energy efficiencies and these were an integral element of the Society's rebranding programme that was completed during the year. We also encourage our staff to use public transport for business journeys, where appropriate.

Our staff make suggestions to improve efficiencies in many areas, demonstrating the commitment and increased awareness of our environmental responsibilities.

3. THE COMMUNITY

We place great importance on our close links with local communities throughout our operating area. Our communities support us and we recognise that it is only fair that we give something back. We encourage staff to become involved in community activities and our sponsorship and donations programmes have been very active through the year.

We have again been able to develop further affinity scheme relationships allowing customers a diverse choice of charities and clubs that can be supported through opening an account and receiving our highest available instant access rate. Through these affinity schemes, the Society makes a donation to each of the organisations which is the equivalent of up to 1% of the average total balances in each affinity scheme.

The Society continues to support affordable home ownership through lending initiatives on shared housing schemes.

4. MEMBER INVOLVEMENT

Our members always come first and as a mutual it is important that we continue to communicate with and listen to feedback through existing communication channels open to all members, through the website and direct feedback opportunities. 'Rapport' is well received and during 2010, this was tailored to the relevant branch areas. This is issued every autumn whilst a further member update is issued with the annual Summary Financial Statement report to members.

We recognise that feedback from our members plays a very important role in our endeavour to improve our products and services to meet ever changing needs.

We live in a very fast changing world and so we will continue to look at ways that the Furness can improve the impact it makes. This is applicable to all our products and services for members together with how we do business with our partners and the environment in which we work.

Directors' Remuneration Report

INTRODUCTION

The purpose of this report is to inform members of the Society, in line with good corporate governance practice, of the policy for the remuneration of executive and non-executive directors. It provides details of the elements of director's remuneration and the process for setting them. Although building societies are not required to hold an advisory vote on the Report on Directors' Remuneration, the Board has continued to follow the requirements for listed companies and an appropriate resolution will be put to members at this year's Annual General Meeting.

This report has been prepared by the Remuneration Committee, which comprises entirely of non-executive directors. Details of the Committee's members and attendance at meetings are given under the Corporate Governance Report on Page 17.

POLICY FOR EXECUTIVE DIRECTORS

As a mutual organisation, the Board of Furness Building Society is committed to endeavour to follow as best practice the Financial Services Authority's (FSA) Remuneration Code. The Society's strategy is to attract and retain suitably qualified and competent individuals who have the motivation and ability to ensure the Society's continuing success in an increasingly regulated and competitive market. The Remuneration Committee determines the level of remuneration for executive directors which is reviewed annually taking into account rates and benefits paid by comparable peer group organisations, together with individual responsibilities, experience, expertise and overall contributions.

Executive directors receive formal appraisals on an annual basis, which focus on performance in relation to agreed objectives. The Chief Executive appraises his fellow executive directors and receives his own appraisal from the Chairman or Vice-Chairman. The executive directors also receive an appraisal from the Chairman in respect of their performance as a director.

The elements of the remuneration policy are set out below:-

Basic Salary

Basic salaries take into account job content and responsibilities and external market salaries paid by comparable peer group organisations, whilst ensuring alignment to FSA policy pronouncements. With the exception of salary increases which were the result of promotion, executive directors voluntarily waived any potential increase in basic salary in 2010.

Performance Pay

Unlike a public company, the Society is not able to offer participation in share option schemes.

The executive directors participate in an incentive scheme by which they may receive a non-pensionable bonus depending upon performance in relation to pre-determined objectives.

The objectives are set by the Board at the beginning of each year and are linked to the Society's strategic objectives in order to give executive directors an incentive to perform at the highest levels in the interest of its members whilst maintaining alignment to the risk appetite of the Society.

In 2010 the maximum amount of performance pay was set at 10% of basic salary for each executive director. The amount paid for 2010 was 4.75% of basic pay.

Benefits in Kind

Each executive director is provided with a company car, long term disability and private medical insurance.

The Society also operates a life assurance scheme for all employees of the Society, providing a lump sum equivalent to four times basic salary.

Pensions

All executive directors who started with the Society before 18 September 2000 are members of the Society's contributory final salary scheme. In common with all other members of the final salary scheme, the executive directors' future pensionable increases are restricted to a maximum of 2.5% per annum. They are, however, able to top up their pension through the Group Personal Pension Scheme.

Those executive directors who commenced employment with the Society after 18 September 2000 have been given the option of participating in the Group Personal Pension Scheme.

Service Contracts

All executive directors are employed on service contracts which are terminable by either party on one year's notice or by the payment by the Society of an amount equivalent to one year's remuneration.

POLICY FOR NON-EXECUTIVE DIRECTORS

The level of remuneration for non-executive directors is determined by the full Board taking into account market rates paid by comparable peer building societies and the maximum amount allowed under the Society's rules. The Remuneration Committee approves the level of fees to the Chairman of the Board.

An additional amount is paid to the Society Chairman, Vice Chairman, Committee Chairmen and the Chairman of Furness Independent in recognition of the additional time commitment required for these functions.

There are no bonus schemes for non-executive directors and they are not entitled to any pension in respect of their services. The fees for non-executive directors reflect the responsibility undertaken and the time spent on Society affairs. A small element of the remuneration package includes compensation for travelling on Society business.

Non-executive directors do not have service contracts.

Directors' Remuneration Report continued

DIRECTORS' REMUNERATION

EXECUTIVE DIRECTORS

2010	Salary **	Bonus **	Taxable Benefits	Sub-total	Increase in Accrued Pension ***	Defined Contribution Scheme	TOTAL £
R J Cairns	134,270	6,378	6,766	147,414	3,414	1,087	151,915
P L Shipman (retired 31/10/10)	82,972	3,942	4,617	91,531	0	8,299	99,830
S L Pryer (appointed to Deputy Chief Executive 1/11/10)	88,119	4,185	6,056	98,360	1,761	1,179	101,300
B P Ryninks (appointed 1/11/10)	14,166	673	1,135	15,974	0	708	16,682
	<u>319,527</u>	<u>15,178</u>	<u>18,574</u>	<u>353,279</u>	<u>5,175</u>	<u>11,273</u>	<u>369,727</u>
2009	Salary **	Bonus **	Taxable Benefits	Sub-total	Increase in Accrued Pension***	Defined Contribution Scheme	TOTAL £
R J Cairns	134,270	0	6,498	140,768	3,843	1,087	145,698
P L Shipman	99,584	0	5,083	104,667	0	2,635	107,302
S L Pryer	83,919	0	5,522	89,441	1,903	976	92,320
	<u>317,773</u>	<u>0</u>	<u>17,103</u>	<u>334,876</u>	<u>5,746</u>	<u>4,698</u>	<u>345,320</u>

**With the exception of salary increases which were the result of promotion, the executive directors voluntarily waived any potential increase in basic salary in 2010 and their contractual rights to bonus payments relating to 2009.

***The increase in accrued pension represents the change in the annual pension to which the director is entitled as a result of changes in pensionable earnings (excluding inflation) and increases in pensionable service during the year.

NON-EXECUTIVE DIRECTORS

	2010 £	Fees 2009 £
A C Willis (Chairman)	39,314	38,044
P R W Hensman (Vice Chairman)	26,254	25,176
D Parkin (Chairman of Audit Committee until 27/04/09)	0	5,902
C S Fairclough (Chairman of Furness Independent from 28/04/09)	24,664	19,694
A T F Hunter (Chairman of Audit Committee from 28/04/09)	24,664	22,630
C S Millar	20,689	19,694
P A Ireland (Appointed 15/6/10)	12,069	0
TOTAL	<u>147,654</u>	<u>131,140</u>

Changes in the fees paid to non-executive directors arise from additional responsibilities undertaken and an element of compensation for travel.

Peter Hensman
Chairman of the Remuneration Committee
22 February 2011

Independent Auditor's Report to the Members of Furness Building Society

We have audited the Group and Society annual accounts of Furness Building Society for the year ended 31 December 2010 set out on pages 24 to 45. 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 12, 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 (APB'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 APB's website at www.frc.org.uk/apb/scope/private.cfm.

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 December 2010 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.

J L Ellacott (Senior Statutory Auditor) for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants

1 The Embankment

Neville Street

Leeds

LS1 4DW

22 February 2011

Income and Expenditure Account

For the year ended 31 December 2010

	Notes	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
Interest receivable and similar income	2	24,753	24,497	25,267	25,111
Interest payable and similar charges	3	14,115	14,115	17,219	17,219
Net interest receivable		<u>10,638</u>	<u>10,382</u>	<u>8,048</u>	<u>7,892</u>
Pension income/(expense)	27	33	33	(94)	(94)
Fees and commissions receivable		717	424	1,056	653
Fees and commissions payable		(871)	(871)	(694)	(694)
Other operating income		<u>663</u>	<u>662</u>	<u>834</u>	<u>833</u>
Total income		<u>11,180</u>	<u>10,630</u>	<u>9,150</u>	<u>8,590</u>
Administrative expenses	4	7,850	7,432	6,874	6,502
Depreciation and amortisation	13	<u>337</u>	<u>337</u>	<u>325</u>	<u>325</u>
		<u>2,993</u>	<u>2,861</u>	<u>1,951</u>	<u>1,763</u>
Provisions for bad and doubtful debts	11	213	375	195	270
Operating profit before FSCS levy		<u>2,780</u>	<u>2,486</u>	<u>1,756</u>	<u>1,493</u>
Provision for FSCS levy	21	<u>278</u>	<u>278</u>	<u>151</u>	<u>151</u>
Profit on ordinary activities before tax		<u>2,502</u>	<u>2,208</u>	<u>1,605</u>	<u>1,342</u>
Tax on profit on ordinary activities	7	<u>743</u>	<u>665</u>	<u>448</u>	<u>385</u>
Profit for the financial year	24	<u><u>1,759</u></u>	<u><u>1,543</u></u>	<u><u>1,157</u></u>	<u><u>957</u></u>

Statement of Total Recognised Gains & Losses

For the year ended 31 December 2010

	Notes	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
Profit for the financial year		1,759	1,543	1,157	957
Actuarial gain/(loss) recognised in the pension scheme	27	199	199	(1,399)	(1,399)
Movement in deferred taxation relating to pension scheme		(56)	(56)	392	392
Total recognised gains/(losses) in the year		<u>1,902</u>	<u>1,686</u>	<u>150</u>	<u>(50)</u>

The notes on pages 27 to 45 form part of these accounts.

Balance Sheet

As at 31 December 2010

	Notes	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
ASSETS					
Liquid assets					
Cash in hand and balances with the Bank of England		30,993	30,993	837	837
Treasury bills and other eligible bills		49,212	49,212	38,598	38,598
Loans and advances to credit institutions	8	78,469	78,371	96,165	96,118
Debt securities	9	36,397	36,397	58,591	58,591
Loans and advances to customers					
Loans fully secured on residential property	10	592,016	582,542	613,961	603,979
Other loans	10	21,126	21,126	29,527	29,527
Investments					
Investments in subsidiary undertakings	12	-	8,719	-	9,559
Tangible fixed assets	13	1,788	1,788	1,733	1,733
Other assets	14	517	511	398	378
Prepayments and accrued income	15	2,941	2,935	2,800	2,771
Total assets		<u>813,459</u>	<u>812,594</u>	<u>842,610</u>	<u>842,091</u>
LIABILITIES					
Shares	16	673,404	673,404	685,976	685,976
Amounts owed to credit institutions	17	23,722	23,722	38,159	38,159
Amounts owed to other customers	18	50,464	50,464	53,745	53,745
Other liabilities	19	3,191	3,482	3,499	3,918
Accruals and deferred income	20	641	593	681	635
Provisions for liabilities	21	676	676	743	743
Net pension liability	27	1,086	1,086	1,440	1,440
Subordinated liabilities	23	4,962	4,962	4,956	4,956
		<u>758,146</u>	<u>758,389</u>	<u>789,199</u>	<u>789,572</u>
Reserves					
General reserves	24	55,313	54,205	53,411	52,519
Total liabilities		<u>813,459</u>	<u>812,594</u>	<u>842,610</u>	<u>842,091</u>

The notes on pages 27 to 45 form part of these accounts.

The accounts were approved by the Board of Directors on 22 February 2011 and were signed on its behalf by:

A C Willis
Chairman

P R W Hensman
Vice-Chairman

R J Cairns
Director and Chief Executive

Group Cash Flow Statement

For the year ended 31 December 2010

	Group 2010 £000	Group 2009 £000			
Net cash inflow from operating activities	12,546	32,081			
Returns on investments and servicing of finance					
Interest paid on subordinated loan	(288)	(319)			
Taxation	(367)	(462)			
Capital expenditure and financial investment					
Purchase of debt securities	(142,115)	(266,053)			
Proceeds from disposal and maturity of debt securities	164,311	271,039			
Purchase of tangible fixed assets	(409)	(98)			
Proceeds from disposal of tangible fixed assets	11	26			
Increase in cash	<u>33,689</u>	<u>36,214</u>			
Reconciliation of operating profit to net cash inflow from operating activities					
Operating profit	2,502	1,605			
(Decrease) in prepayments and accrued income	(88)	(15,144)			
(Increase)/decrease in accruals and deferred income	(40)	120			
Provisions for bad and doubtful debts	387	145			
Loans and advances written off net of recoveries	(74)	(765)			
Depreciation and amortisation	301	331			
Interest on subordinated loan	288	319			
(Decrease) in provision for liabilities and charges	(67)	(344)			
Pension fund payments	(362)	(375)			
Other non-cash movements	199	245			
Net cash inflow/(outflow) from operating activities	<u>3,046</u>	<u>(13,863)</u>			
Loans and advances made to customers	(96,453)	(80,645)			
Loans and advances repaid by customers	126,486	117,386			
Net (decrease) in shares	(12,702)	(11,255)			
Net (increase) in amounts owed to credit institutions and other customers	(17,633)	(16,987)			
Net decrease in loans and advances to credit institutions	21,220	71,580			
Net (increase) in treasury bills and similar securities	(10,614)	(36,599)			
Net (decrease) in other assets	(45)	(11)			
Net (decrease)/increase in other liabilities	(759)	2,475			
Net cash inflow from operating activities	<u>12,546</u>	<u>32,081</u>			
Reconciliation of cash balances	2008	Cash flow	2009	Cash flow	2010
Cash in hand	1,138	(301)	837	30,156	30,993
Loans and advances to credit institutions					
- repayable on demand	23,744	36,515	60,259	3,533	63,792
	<u>24,882</u>	<u>36,214</u>	<u>61,096</u>	<u>33,689</u>	<u>94,785</u>

Notes to the Accounts

1. PRINCIPAL ACCOUNTING POLICIES

Basis of preparation

The accounts are prepared under the historical cost convention and in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 and UK applicable accounting standards. The Society is presumed to be carrying on business as a going concern, and so, where Group accounts are prepared, shall the Society and its subsidiary undertakings.

Basis of consolidation

The consolidated income and expenditure account and balance sheet incorporate the Society and its subsidiary undertakings all of which have year ends of 31 December. Uniform accounting policies are used throughout the Group and are consistent with the prior year.

Corporation tax

Corporation tax is charged on the profit on ordinary activities for the year as adjusted for taxation purposes.

Deferred taxation

Provision for deferred tax is made on a non-discounted basis in respect of all timing differences that have originated but not reversed by the balance sheet date (See Note 22). Timing differences represent differences between gains and losses recognised for tax purposes in periods different from those in which they are recognised in financial statements. No deferred tax is recognised on permanent differences between the Group's taxable gains and losses and its results as stated in the financial statements. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Fixed assets and depreciation

The Group capitalises the cost of additions and major alterations to office premises and equipment. In the case of freehold premises and leasehold premises with a term remaining in excess of fifty years, depreciation of the original cost of these items is charged to the income and expenditure account at a rate of two per cent per annum. The cost of other fixed assets is written off on a straight line basis over their estimated useful lives as follows:

Equipment, fixtures, fittings and vehicles are written off over periods between 2 and 10 years. Leasehold premises with less than 50 years unexpired are written off over the unexpired period of the lease.

Leasing

All payments under operating lease contracts are charged to the income and expenditure account on a straight line basis over the life of the lease.

Repairs and renewals

The cost of repairs and renewals is charged to the income and expenditure account in the year in which it is incurred.

Liquid assets

Debt securities are stated at their cost to the Society, adjusted to exclude interest accrued at the date of purchase. A similar adjustment is also made on realisation. Where the adjusted purchase price differs from par value, the premium or discount is amortised over the period to maturity. Provision is made for any impairment in value if necessary. Other liquid assets are stated at the lower of the cost and net realisable value.

Pension costs

The Society operates a defined benefit pension scheme administered by trustees, the funds of which are separate from those of the Society. The pension costs relating to the defined benefit scheme are assessed in accordance with the advice of a qualified actuary using the projected unit method. Actuarial surpluses and deficits are reported immediately on the balance sheet net of deferred taxation and any resulting actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

Notes to the Accounts continued

The Society also contributes to a Group Personal Pension scheme which is a money purchase scheme. The assets of this scheme are held separately from those of the Society in an independently administered fund. The amount charged to the income and expenditure account represents the contributions payable to the scheme in respect of the accounting period.

Provisions for bad and doubtful debts

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

The specific provision is established following a year-end appraisal of all advances where repayments are 3 months or more in arrear or where the mortgaged property has been taken into possession. In respect of loans which are 3 months or more in arrear but where the property has not been taken into possession, the directors, in accordance with recommended practice, apply a factor to take account of the probability of the cases resulting in repossession when calculating the specific provision to be taken.

A general provision is made against advances not specifically identified above in order to reflect potential losses at the balance sheet date which, in the opinion of the directors, may eventually be realised, having regard to the Group's experience and the general economic conditions.

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

The provisions charged to the income and expenditure account comprise the increase in the provisions together with losses written off in the year net of any recoveries of amounts previously written off.

Loans and advances in the balance sheet are shown net of provisions, specific and general, and net of the balance in the interest suspense account.

Incentives to borrowers

The Society offers a number of incentives to borrowers, including interest discounts. Cashback costs are charged to interest receivable in full during the year in which they are incurred. The costs of mortgage interest rate discounts are charged to mortgage interest over the period in which they apply.

Premiums on the acquisition of mortgages

As with cashbacks, premiums paid on the acquisition of mortgages are charged to interest receivable in full during the year in which they are incurred.

Costs associated with the acquisition of mortgages

Costs incurred on the acquisition of mortgages are charged to interest receivable and administrative expenses in full in the year in which they are incurred.

Hedging contracts

All interest rate related contracts and instruments are entered into by the Group for hedging purposes to reduce the risks arising on transactions undertaken into in the normal course of business. These financial instruments are recognised in the accounts in accordance with the accounting treatment of the underlying transaction or transactions being hedged. Amounts accrued on hedging contracts and instruments are included within prepayments and accrued income or accruals and deferred income.

Dividends

On occasions the Society's wholly owned subsidiaries may make dividend payments to their parent. Such dividends are decided at the discretion of the Companies' Board of Directors and are reflected in the annual report and accounts of the respective entities when this occurs. Dividends are only recognised when approved and paid.

Other income/fees and commissions

Within the income and expenditure account the Group's policy is to recognise insurance related commission within fees and commission receivable and mortgage related fees within other operating income.

Notes to the Accounts continued

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
On loans fully secured on residential property	24,139	23,719	24,053	23,558
On other loans:				
Fully secured on land	1,216	1,216	1,497	1,497
To subsidiary undertakings	-	164	-	339
On debt securities:				
Interest and other income	284	284	928	928
Loss on disposal	(2)	(2)	-	-
On other liquid assets:				
Interest and other income	958	958	1,219	1,219
Net expense on financial instruments	<u>(1,842)</u>	<u>(1,842)</u>	<u>(2,430)</u>	<u>(2,430)</u>
	<u>24,753</u>	<u>24,497</u>	<u>25,267</u>	<u>25,111</u>

Income from fixed income securities is £768,396 (2009: £1,502,000) for both Group and Society. Interest on loans fully secured on residential property and on other loans has been decreased by £28,000 (2009: £48,000 decrease) representing interest irrecoverable on non-performing loans in accordance with the Society's accounting policy. Movements in the interest suspense account are as follows:

At 1 January	8	8	205	110
Interest now considered recoverable	-	-	1	1
Interest written off during the year	(25)	(25)	(244)	(147)
Interest suspended in the year	<u>28</u>	<u>28</u>	<u>48</u>	<u>46</u>
At 31 December	<u>11</u>	<u>11</u>	<u>8</u>	<u>8</u>

The amount of interest suspended at 31 December 2010 has been deducted from the appropriate loans in the balance sheet.

3. INTEREST PAYABLE AND SIMILAR CHARGES

On shares held by individuals	13,164	13,164	14,547	14,547
On other shares	12	12	3	3
On subordinated liabilities	293	293	320	320
On deposits and other borrowings	1,301	1,301	2,663	2,663
Net income on financial instruments	<u>(655)</u>	<u>(655)</u>	<u>(314)</u>	<u>(314)</u>
	<u>14,115</u>	<u>14,115</u>	<u>17,219</u>	<u>17,219</u>

4. ADMINISTRATIVE EXPENSES

Staff costs (Note 5)	3,748	3,505	3,675	3,447
Other expenses	<u>4,102</u>	<u>3,927</u>	<u>3,199</u>	<u>3,055</u>
	<u>7,850</u>	<u>7,432</u>	<u>6,874</u>	<u>6,502</u>
Other expenses include:				
Auditor's remuneration:				
Audit fees				
- Audit of parent and group by parent company auditors	54	42	52	43
- Audit of subsidiaries	9	-	9	-
Non-audit fees:				
- Tax services	13	13	12	12
- Other services	27	27	-	-
Amounts payable under operating leases	119	119	113	113

Notes to the Accounts *continued*

5. STAFF NUMBERS AND COSTS

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

	Number of Employees			
	Group 2010	Society 2010	Group 2009	Society 2009
FULL TIME				
Principal office and administration centre	56	50	54	49
Branch offices	37	37	36	36
	<u>93</u>	<u>87</u>	<u>90</u>	<u>85</u>
PART TIME				
Principal office and administration centre	32	31	34	31
Branch offices	28	28	30	30
	<u>60</u>	<u>59</u>	<u>64</u>	<u>61</u>
The aggregated costs of these persons were as follows:	£000	£000	£000	£000
Wages and salaries	3,219	3,002	3,224	3,019
Social security costs	276	252	264	242
Other pension costs	253	251	187	186
	<u>3,748</u>	<u>3,505</u>	<u>3,675</u>	<u>3,447</u>

6. REMUNERATION OF AND TRANSACTIONS WITH DIRECTORS

Total directors' remuneration amounted to £517,381 (2009: £476,460). Full details are given in the Directors' Remuneration Report on pages 21 to 22.

None of the directors had an interest in shares or debentures of any associated body of the Society at any time during the financial year.

At 31 December 2010 there were 9 (2009: 9) outstanding loans granted in the ordinary course of business to one director and one connected person, amounting to in aggregate £395,642 (2009: £415,001). A register is maintained at the Head Office of the Society which shows details of all loans, transactions and arrangements with connected persons. A statement, for the current financial year, of the appropriate details contained in the register will be available for inspection at the Head Office for a period of 15 days up to and including the Annual General Meeting.

Notes to the Accounts continued

7. TAX ON PROFIT ON ORDINARY ACTIVITIES

	Group	Society	Group	Society
	2010	2010	2009	2009
	£000	£000	£000	£000
a) Analysis of charge in year:				
UK corporation tax				
Current tax on income for the period	817	753	460	397
Adjustments in respect of prior periods	1	1	14	14
Total current tax	<u>818</u>	<u>754</u>	<u>474</u>	<u>411</u>
Deferred tax:				
Origination and reversal of timing differences	(91)	(105)	1	1
Effect of increased/decreased tax rate	17	17	-	-
Adjustment in respect of previous years	(1)	(1)	(27)	(27)
Total deferred tax	<u>(75)</u>	<u>(89)</u>	<u>(26)</u>	<u>(26)</u>
Tax on profit on ordinary activities	<u>743</u>	<u>665</u>	<u>448</u>	<u>385</u>
b) Factors affecting the tax charge in year:				
Current tax reconciliation				
Profit on ordinary activities before tax	<u>2,502</u>	<u>2,208</u>	<u>1,605</u>	<u>1,342</u>
Corporation tax at 28% (2009: 28%)	701	618	449	376
Effects of:				
Expenses not deductible for tax purposes	30	30	23	23
Fixed asset timing differences	26	26	4	4
Small company rate	(4)	-	(10)	-
Other timing differences	-	-	(5)	(5)
Adjustment to tax charge in respect of previous periods	1	1	13	13
Short term timing differences	64	79	-	-
Total current tax charge (see above)	<u>818</u>	<u>754</u>	<u>474</u>	<u>411</u>

The Society expects its effective tax rate in future years to be broadly in line with the standard rate of corporation tax in the UK. The deferred tax rate for 2010 was reduced from 28% to 27%.

8. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

Accrued interest	32	32	41	41
Repayable on demand	63,792	63,694	60,259	60,212
Other loans and advances by remaining maturity repayable:				
In not more than three months	11,500	11,500	34,750	34,750
In more than three months but not more than one year	3,145	3,145	1,103	1,103
In more than one year but not more than five years	-	-	12	12
	<u>78,469</u>	<u>78,371</u>	<u>96,165</u>	<u>96,118</u>

Notes to the Accounts continued

9. DEBT SECURITIES

	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
Issued by other borrowers	36,397	36,397	58,591	58,591
	<u>36,397</u>	<u>36,397</u>	<u>58,591</u>	<u>58,591</u>
Debt securities have remaining maturities as follows:				
Accrued interest	79	79	77	77
In not more than one year	32,313	32,313	54,505	54,505
In more than one year	4,005	4,005	4,009	4,009
	<u>36,397</u>	<u>36,397</u>	<u>58,591</u>	<u>58,591</u>
Transferable debt securities comprise:				
Unlisted Certificates of Deposit	36,397	36,397	58,591	58,591
	<u>36,397</u>	<u>36,397</u>	<u>58,591</u>	<u>58,591</u>
Transferable securities held as financial fixed assets at cost less amounts written off	36,397	36,397	58,591	58,591
	<u>36,397</u>	<u>36,397</u>	<u>58,591</u>	<u>58,591</u>
Movements during the year of debt securities held as financial fixed assets are analysed as follows:				
Cost at 1 January	58,514	58,514	63,500	63,500
Additions	142,115	142,115	266,053	266,053
Disposals and maturities	(164,311)	(164,311)	(271,039)	(271,039)
At 31 December	<u>36,318</u>	<u>36,318</u>	<u>58,514</u>	<u>58,514</u>

Liquid assets classified as financial fixed assets are held with the intention of use on a continuing basis in the Group's activities except where sale is required for regulatory realisation testing. The Group currently holds no securities for trading purposes.

10. LOANS AND ADVANCES TO CUSTOMERS

Loans fully secured on residential property	592,016	582,542	613,961	603,979
Other loans:				
Loans fully secured on land	21,126	21,126	29,527	29,527
	<u>613,142</u>	<u>603,668</u>	<u>643,488</u>	<u>633,506</u>

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

Other loans and advances by remaining maturity repayable:				
In not more than three months	1,341	1,310	2,129	2,129
In more than three months but not more than one year	5,963	5,815	2,899	2,878
In more than one year but not more than five years	36,212	35,059	38,637	38,107
In more than five years	571,394	563,182	601,278	591,777
	<u>614,910</u>	<u>605,366</u>	<u>644,943</u>	<u>634,891</u>
Less				
Provisions for bad and doubtful debts	1,768	1,698	1,455	1,385
	<u>613,142</u>	<u>603,668</u>	<u>643,488</u>	<u>633,506</u>

The actual experience of repayments may differ from the above since many loans and advances are repaid early.

Notes to the Accounts continued

11. PROVISIONS FOR BAD AND DOUBTFUL DEBTS

Group	Loans fully secured on residential property		Loans fully secured on land		Total	
	Specific £000	General £000	Specific £000	General £000	Specific £000	General £000
At 1 January 2010	271	720	214	250	485	970
Net of write-offs	100	-	-	-	100	-
Sub-total	<u>371</u>	<u>720</u>	<u>214</u>	<u>250</u>	<u>585</u>	<u>970</u>
Income and expenditure account:						
Provisions for bad and doubtful debts	207	300	(90)	-	117	300
Adjustments resulting from (recoveries)	(204)	-	-	-	(204)	-
Charge for the year	<u>3</u>	<u>300</u>	<u>(90)</u>	<u>-</u>	<u>(87)</u>	<u>300</u>
At 31 December 2010	<u>374</u>	<u>1,020</u>	<u>124</u>	<u>250</u>	<u>498</u>	<u>1,270</u>
Society						
At 1 January 2010	271	650	214	250	485	900
Net of write-offs and recoveries	(62)	-	-	-	(62)	-
Sub-total	<u>209</u>	<u>650</u>	<u>214</u>	<u>250</u>	<u>423</u>	<u>900</u>
Income and expenditure account:						
Provisions for bad and doubtful debts	157	350	-	-	157	350
Adjustments resulting from (recoveries)	(42)	-	(90)	-	(132)	-
Charge for the year	<u>115</u>	<u>350</u>	<u>(90)</u>	<u>-</u>	<u>25</u>	<u>350</u>
-						
At 31 December 2010	<u>324</u>	<u>1,000</u>	<u>124</u>	<u>250</u>	<u>448</u>	<u>1,250</u>

These provisions have been deducted from the appropriate loans in the balance sheet.

12. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Society 2010 £000	Society 2009 £000
Loan to subsidiary undertaking	<u>8,719</u>	<u>9,599</u>
Movements at cost, in the above loan during the year are as follows:		
At 1 January	9,559	11,214
Advances	-	31
Repayments	(840)	(1,686)
At 31 December	<u>8,719</u>	<u>9,559</u>

Notes to the Accounts *continued*

12. INVESTMENT IN SUBSIDIARY UNDERTAKINGS *continued*

The Society has the following subsidiary undertakings in which it directly holds all of the issued shares at a total cost of £6. Each is a company within the meaning of the Companies Act 2006 and is incorporated in United Kingdom.

Company Name	Class of Share Held	Society's Interest	Cost of Shares
Furness Mortgage Services Limited	Ordinary	100%	£1
Furness Independent Financial Advisers Limited	Ordinary	100%	£1
Furness Authorised Financial Advisers Limited	Ordinary	100%	£1
Furness Financial Advisers Limited	Ordinary	100%	£1
Furness Financial Services Limited	Ordinary	100%	£1
Ultimate Mortgages Limited	Ordinary	100%	£1

With the exception of Furness Mortgage Services Limited and Furness Independent Financial Advisers Limited, none of the subsidiary undertakings carried on business during the year. The principal activities of each of the operating subsidiaries are as follows:

Furness Mortgage Services Limited:	Acquisition and management of secondary mortgage portfolios and to make advances secured on land in the United Kingdom
Furness Independent Financial Advisers Limited:	Provision of independent financial advice and mortgage broking services

All of the Society's subsidiary companies share the same registered address as the Society.

13. TANGIBLE FIXED ASSETS

	Land & Buildings £000	Equipment, Fixtures, Fittings and Vehicles £000	Total £000
Group and Society Cost			
At 1 January 2010	1,460	3,980	5,440
Additions	-	409	409
Disposals	-	(41)	(41)
At 31 December 2010	<u>1,460</u>	<u>4,348</u>	<u>5,808</u>
Depreciation			
At 1 January 2010	425	3,282	3,707
Charges in year	40	297	337
Disposals	-	(24)	(24)
At 31 December 2010	<u>465</u>	<u>3,555</u>	<u>4,020</u>
Net book value			
At 31 December 2010	<u>995</u>	<u>793</u>	<u>1,788</u>
At 31 December 2009	<u>1,035</u>	<u>698</u>	<u>1,733</u>

The net book value of land and buildings comprises:

	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
Freehold	942	942	967	967
Short lease (less than 50 years unexpired)	53	53	68	68
	<u>995</u>	<u>995</u>	<u>1,035</u>	<u>1,035</u>
Land and buildings occupied by the Group/Society for its own activities	<u>867</u>	<u>867</u>	<u>907</u>	<u>907</u>

Notes to the Accounts *continued*

14. OTHER ASSETS

	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
Due within one year:				
Others	56	56	12	12
Due after one year:				
Deferred tax asset (Note 22)	461	455	386	366
	<u>517</u>	<u>511</u>	<u>398</u>	<u>378</u>

15. PREPAYMENTS AND ACCRUED INCOME

Rents paid in advance	36	36	28	28
Other	2,905	2,899	2,772	2,743
	<u>2,941</u>	<u>2,935</u>	<u>2,800</u>	<u>2,771</u>

Other represents mainly uncleared receipts of £2.174m (2009: £2.403m)

16. SHARES

Held by individuals	672,803	672,803	685,812	685,812
Other shares	601	601	164	164
	<u>673,404</u>	<u>673,404</u>	<u>685,976</u>	<u>685,976</u>

Shares are repayable from the balance sheet date in the ordinary course of business as follows:

Accrued interest	7,017	7,017	6,887	6,887
Repayable on demand	579,140	579,140	625,598	625,598
Other shares by remaining maturity repayable:				
In more than three months but not more than one year	56,275	56,275	19,348	19,348
In more than one year but not more than five years	30,972	30,972	34,143	34,143
	<u>673,404</u>	<u>673,404</u>	<u>685,976</u>	<u>685,976</u>

17. AMOUNTS OWED TO CREDIT INSTITUTIONS

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

Accrued interest	72	72	159	159
Other amounts owed to credit institutions by remaining maturity repayable:				
In not more than three months	6,650	6,650	16,500	16,500
In more than three months but not more than one year	17,000	17,000	21,500	21,500
	<u>23,722</u>	<u>23,722</u>	<u>38,159</u>	<u>38,159</u>

Notes to the Accounts continued

18. AMOUNTS OWED TO OTHER CUSTOMERS

	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
Amounts owed to other customers are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	266	266	264	264
Repayable on demand	21,933	21,933	21,019	21,019
Other amounts owed to other customers with remaining maturity repayable:				
In not more than three months	5,000	5,000	23,050	23,050
In more than three months but not more than one year	20,544	20,544	8,269	8,269
In more than one year but not more than five years	2,721	2,721	1,143	1,143
	<u>50,464</u>	<u>50,464</u>	<u>53,745</u>	<u>53,745</u>

19. OTHER LIABILITIES

Other liabilities comprise:				
Corporation tax	514	450	64	-
Income tax	166	166	157	157
Other creditors	2,511	2,866	3,278	3,761
	<u>3,191</u>	<u>3,482</u>	<u>3,499</u>	<u>3,918</u>

Other creditors represents mainly unpresented cheques of £2.097m (2009: £2.516m)

20. ACCRUALS AND DEFERRED INCOME

Staff related costs	101	85	181	164
Outsourcing costs	36	34	36	34
Others	504	474	464	437
	<u>641</u>	<u>593</u>	<u>681</u>	<u>635</u>

21. PROVISIONS FOR LIABILITIES

FSCS levy				
At 1 January	654	654	794	794
Amount paid in the year (See Note 25)	(276)	(276)	(291)	(291)
Amount charged to the Income and Expenditure account in the year (See Note 25)	278	278	151	151
At 31 December	<u>656</u>	<u>656</u>	<u>654</u>	<u>654</u>
Regulatory & Other				
At 1 January	89	89	293	293
Amounts utilised in the year	-	-	(5)	(5)
Amount (released) to the Income and Expenditure Account in the year	(69)	(69)	(199)	(199)
At 31 December	<u>20</u>	<u>20</u>	<u>89</u>	<u>89</u>
Total provisions for liabilities	<u>676</u>	<u>676</u>	<u>743</u>	<u>743</u>

The amount released to the Income and Expenditure Account in the year relates to a reduction in the amount required to settle endowment related compensation claims.

Notes to the Accounts *continued*

22. DEFERRED TAXATION

The elements of deferred taxation are as follows:

	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
Difference between accumulated depreciation and amortisation and capital allowances	112	112	89	89
General mortgage loss provisions	<u>349</u>	<u>343</u>	<u>297</u>	<u>277</u>
Deferred tax asset (Note 14)	<u>461</u>	<u>455</u>	<u>386</u>	<u>366</u>
At 1 January	386	366	360	340
Amount charged to income and expenditure account	<u>75</u>	<u>89</u>	<u>26</u>	<u>26</u>
At 31 December	<u>461</u>	<u>455</u>	<u>386</u>	<u>366</u>

23. SUBORDINATED LIABILITIES

Sterling subordinated loan repayable 25 June 2020	5,000	5,000	5,000	5,000
Less unamortised issuance costs	<u>(38)</u>	<u>(38)</u>	<u>(44)</u>	<u>(44)</u>
	<u>4,962</u>	<u>4,962</u>	<u>4,956</u>	<u>4,956</u>

With the prior consent of the FSA the Society can prepay all outstanding drawings five years before the final repayment date. Subordinated liabilities are unsecured and denominated in sterling. Interest rate payments are made at an agreed margin above the standard variable mortgage rate of the top five building societies ranked by asset size. The rights of repayment of the holders of subordinated debt are subordinated to the claims of all depositors, creditors and investing members of the Society.

24. GENERAL RESERVES

At 1 January	53,411	52,519	53,261	52,569
Profit for the financial year	1,759	1,543	1,157	957
Actuarial gains/(losses) net of deferred tax	143	143	(1,007)	(1,007)
At 31 December	<u>55,313</u>	<u>54,205</u>	<u>53,411</u>	<u>52,519</u>

Notes to the Accounts continued

25. FINANCIAL COMMITMENTS

(a) Financial Services Compensation Scheme (FSCS) levy

In common with all regulated UK deposit takers, the Society pays levies to the 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. Similar claims have since been made in relation to London Scottish Bank Plc and the transfer of core parts of Dunfermline Building Society to Nationwide Building Society in the first half of 2009.

The FSCS has met the claims by way of loans received from HM Treasury on which it is liable to pay interest. The FSCS has, in turn, acquired the rights to the realisation of the assets of these banks. To the extent that the loans have not been repaid in full by 31 March 2012, the FSCS will agree a schedule of repayments with HM Treasury and levy the industry, including the Society, accordingly.

In the current year the Society paid £275,721 in respect of 2009/10 levy (see note 21).

The Society has revised its provision for the scheme year 2010/11 levy to £282,239 (£369,021 provided in 2009) and provided £373,392 for the scheme year 2011/12, which is the Society's best estimate, calculated with reference to the protected deposits it held at 31 December 2009 and 31 December 2010 respectively, the FSCS's latest estimates of the management expenses levy for the scheme years and estimated LIBOR rates. This has resulted in a net charge for the income and expenditure account of £277,691 (see note 21). No provision is made in Furness Independent as amounts are charged as incurred as part of the cost of support services received by Furness Independent from its IFA service provider.

Group	Society	Group	Society
2010	2010	2009	2009
£000	£000	£000	£000

(b) Annual commitments under non-cancellable operating leases:

Land and Buildings:

Which expire after five years

144	144	113	113
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26. FINANCIAL INSTRUMENTS

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

The Group has a formal structure for managing risk, including establishing risk limits, reporting lines, mandates and other control procedures. The structure is reviewed regularly by the Society's Assets and Liabilities Committee, which is charged with the responsibility for managing the Group's balance sheet exposure and the use of financial instruments for risk management purposes.

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

Notes to the Accounts continued

NOTE 26 FINANCIAL INSTRUMENTS continued

Derivatives

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

At the year end, the contract or underlying principal amount of derivative financial instruments, together with their risk weighted amount and replacement cost were:

	Group 2010 £000	Society 2010 £000	Group 2009 £000	Society 2009 £000
Interest rate contracts:				
Underlying principal amount	116,250	116,250	99,750	99,750
Risk weighted amount	316	316	139	139
Replacement cost	240	240	2,101	2,101

The nominal principal amount denotes the volume of business outstanding at the balance sheet date and does not represent amounts at risk. The risk weighted amount, which is calculated by rules specified by the FSA, is based on the replacement cost, but also takes into account a measure of the extent of potential exposure and the nature of the counterparty. The replacement cost represents the cost of replacing contracts with positive values, calculated at market rates prevailing at the balance sheet date and represents the Society's maximum exposure should all counterparties default.

The accounting policies for derivatives are described in note 1 to the accounts under 'Hedging contracts'.

Risk management

The main financial risks arising from the Society's activities are credit risk, liquidity risk and interest rate risk. The Board determines policies for 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 approved by the Board and the approval of loan applications is mandated. The Board is responsible for approving treasury counterparties.

Liquidity risk

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

Interest rate risk

The Group is exposed to movements in interest rates and manages the exposure on a continuous basis, within limits set by the Board, using a combination of on and off balance sheet instruments.

Notes to the Accounts *continued*

NOTE 26 FINANCIAL INSTRUMENTS *continued*

The interest rate sensitivity of the Group at 31 December 2010 was:

	Not more than three months £000	More than three months but not more than six months £000	More than six months but not more than one year £000	More than one year but not more than five years £000	More than five years but not more than ten years £000	Non interest bearing £000	Total £000
Assets							
Liquid assets	141,870	34,803	14,035	3,120	-	1,243	195,071
Loan assets secured on residential property and other loans	561,256	479	5,118	45,279	1,010	-	613,142
Tangible fixed assets	-	-	-	-	-	1,788	1,788
Other assets	-	-	-	-	-	3,458	3,458
Total assets	703,126	35,282	19,153	48,399	1,010	6,489	813,459
Liabilities							
Shares	550,795	23,344	47,688	44,560	-	7,017	673,404
Deposits and other borrowings	36,348	24,000	11,000	2,500	-	338	74,186
Other liabilities	-	-	-	-	-	5,594	5,594
Subordinated liabilities	-	4,962	-	-	-	-	4,962
Reserves	-	-	-	-	-	55,313	55,313
Total liabilities	587,143	52,306	58,688	47,060	-	68,262	813,459
Net on balance sheet mismatches	115,983	(17,024)	(39,535)	1,339	1,010	(61,773)	-
Off balance sheet items	(12,760)	8,000	11,300	(5,540)	(1,000)	-	-
Interest rate sensitivity gap	103,223	(9,024)	(28,235)	(4,201)	10	(61,773)	-
Cumulative gap	103,223	94,199	65,964	61,763	61,773	-	-

Notes to the Accounts continued

NOTE 26 FINANCIAL INSTRUMENTS continued

The interest rate sensitivity of the Group at 31 December 2009 was:

	Not more than three months £000	More than three months but not more than six months £000	More than six months but not more than one year £000	More than one year but not more than five years £000	More than five years but not more than ten years £000	Non interest bearing £000	Total £000
Assets							
Liquid assets	182,115	7,000	-	4,012	-	1,064	194,191
Loan assets secured on residential property and other loans	596,586	6,652	11,332	27,769	1,149	-	643,488
Tangible fixed assets	-	-	-	-	-	1,733	1,733
Other assets	-	-	-	-	-	3,198	3,198
Total assets	778,701	13,652	11,332	31,781	1,149	5,995	842,610
Liabilities							
Shares	588,107	15,803	41,026	34,153	-	6,887	685,976
Deposits and other borrowings	61,981	15,500	13,000	1,000	-	423	91,904
Other liabilities	-	-	-	-	-	6,363	6,363
Subordinated liabilities	-	4,956	-	-	-	-	4,956
Reserves	-	-	-	-	-	53,411	53,411
Total liabilities	650,088	36,259	54,026	35,153	-	67,084	842,610
Net balance sheet mismatches	128,613	(22,607)	(42,694)	(3,372)	1,149	(61,089)	-
Off balance sheet items	12,750	(5,000)	(9,500)	2,750	(1,000)	-	-
Interest rate sensitivity gap	141,363	(27,607)	(52,194)	(622)	149	(61,089)	-
Cumulative gap	141,363	113,756	61,562	60,940	61,089	-	-

Fair values of financial instruments

Set out below is a comparison of the book and fair values of the Group's financial instruments by category as at 31 December 2010 and 31 December 2009. The analysis excludes certain financial instruments 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 banks.

	Book value 2010 £000	Fair value amount 2010 £000	Book value 2009 £000	Fair value amount 2009 £000
Financial instruments for which an active market exists:				
Debt securities	36,397	36,427	58,591	58,620
Treasury bills	49,212	49,232	38,598	38,601
Interest rate swaps	315	240	24	2,101

Market values have been used to determine the fair values of interest rate swaps and debt securities held. The fair values of interest rate caps have been calculated using option-pricing models.

Hedges

Gains and losses on hedging instruments are recognised in the income and expenditure account over the residual life of the underlying instruments. A gain or loss is otherwise recognised only 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 ended 31 December 2010.

Notes to the Accounts continued

NOTE 26 FINANCIAL INSTRUMENTS continued

Table of gains and losses

	Unrecognised gains £000	Unrecognised losses £000	Net gain/(loss) £000
1 January 2010	2,484	(383)	2,101
Movement in items unrecognised at the start of the year	<u>(1,633)</u>	<u>(138)</u>	<u>(1,771)</u>
Items unrecognised at the start of the year unrecognised at the year end	851	(521)	330
Gains and (losses) arising in the year unrecognised in the year	<u>528</u>	<u>(618)</u>	<u>(90)</u>
31 December 2010	<u>1,379</u>	<u>(1,139)</u>	<u>240</u>
Of which:			
Expected to be realised in the year ending 31 December 2011	233	(85)	148
Expected to be realised after the year ending 31 December 2011	<u>1,146</u>	<u>(1,054)</u>	<u>92</u>
	<u>1,379</u>	<u>(1,139)</u>	<u>240</u>

27. PENSIONS

The Society operates a pension scheme providing benefits based on final pensionable pay, contributions being charged to the income and expenditure account so as to spread the cost of pensions over employees' working lives with the Society. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. The most recent triennial valuation was at 6 April 2008 and this identified a scheme deficit of £880K. The main actuarial assumptions at this date were that investment growth will be 7.4% per annum before retirement and 5% after retirement, that price inflation will be 3.5% and that following an agreement with scheme members, going forward, pensionable salary growth will be at 2.50%.

The Society's Board and the Trustees of the defined benefit scheme have agreed a schedule of payments designed to eliminate the triennial valuation deficit calculated by the Actuary at the date on the Ongoing Valuation basis, over a period of 6 years from April 2009.

The Society's defined benefit scheme was closed to new entrants in September 2000. Eligible employees can join a Group Personal Pension Scheme under which the Society assists with contributions. In 2010, the Society contributed £88,589 to this scheme (2009: £65,374).

The Society has implemented Financial Reporting Standard 17 (FRS17) 'Retirement Benefits' which covers the accounting and disclosure requirements for employee pensions. FRS17 requires that the assets of defined benefit schemes are included within the balance sheet together with related liabilities. The scheme deficit at 31 December 2010 of £1,508,000 (2009: £2,000,000) after related deferred tax of £422,000 (2009: £560,000) is shown in the balance sheet as a net pension liability.

The most recent interim FRS17 valuation showed that the market value of the scheme's assets was £16.9m at 31 December 2010 and that the actuarial value of those assets represented 91.84% of the benefits that had accrued to members, after allowing for expected future increases in earnings.

The Scheme's assets include no assets from the Society's own financial instruments and do not include any property occupied by, or other assets used by the Society.

The valuation at 6 April 2008 has been updated by the actuary on an FRS17 basis as at 31 December 2010.

During the financial year, the U.K. government indicated a change in the statutory inflation index used in pension calculations, to use the consumer price index rather than the retail price index. The Society has taken legal advice and a decision was taken to consult pension trustees before any final decisions are made.

Notes to the Accounts continued

NOTE 27 PENSIONS continued

The major assumptions used in this valuation were:	2010	2009
Rate of increase in salaries	2.30%	2.30%
Rate of increase of pensions in payment	3.50%	3.70%
Discount rate	5.40%	5.70%
Inflation assumption	3.50%	3.70%

In determining the expected return on the pension scheme assets the following has been assumed:

Bonds: the weighted average of government and corporate bond yields according to the level of the relevant holdings on the portfolio.

Equities: Government bond yield plus 3%.

Cash: a minimal rate due the very small amount of cash

Secured pensions: the discount rate of liabilities

Pre-retirement mortality is based on 70% of the mortality table known as AMC00 for males and AFC00 for females. The post retirement mortality assumptions are based on the mortality table known as PCMA00 for males and PCFA00 for females with reference to members' years of birth. Allowances have been made for improvements in mortality in the recent past and currently expected in the future. The assumptions are equivalent to expecting male and female members retiring at 62 at the accounting date to live a further 24.4 years and 26.2 years respectively. As a result of improvements in mortality in the future, the future expectation of life at retirement for a member retiring at 62 in 20 years time would be 26.4 years for males and 28.0 years for females. It is estimated that the Society will contribute £272,000 to the pension scheme in 2011. In terms of cash commutation based on actual experience it has been assumed that 70% of members take the maximum permissible cash commutation and 30% take no cash commutation.

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.

Scheme assets

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

	Long term rate of return 31.12.10	Value at 31.12.10 £000	Long term rate of return 31.12.09	Value at 31.12.09 £000	Long term rate of return 31.12.08	Value at 31.12.08 £000
Equities	7.5%	11,064	7.5%	9,914	6.8%	8,425
Bonds	5.1%	4,563	5.1%	4,306	5.2%	3,334
Other – Cash	0.5%	62	0.5%	59	2.0%	33
Other – Annuities	5.7%	1,285	5.70%	1,244	6.7%	1,056
Total market value of assets		16,974		15,523		12,848
Present value of scheme liabilities		(18,482)		(17,523)		(13,635)
Deficit in the scheme		(1,508)		(2,000)		(787)
Related deferred tax asset (2010, 2009 and 2008: 28%)		422		560		220
Net pension liability		<u>(1,086)</u>		<u>(1,440)</u>		<u>(567)</u>

Annuities were not separately disclosed at 31 December 2010. The actuary has confirmed that the assets were equally matched with the liabilities.

Notes to the Accounts continued

NOTE 27 PENSIONS continued

The amount of the net pension liability would have the following consequential effect on reserves.

Movement in deficit during the year:

	2010	2009
	£000	£000
Deficit in the scheme at beginning of year	(2,000)	(787)
Current service cost	(79)	(75)
Expected return on assets	1,019	820
Interest cost	(986)	(914)
Actuarial gain/(losses)	199	(1,399)
Employer contributions paid (gross of charges)	362	375
Expenses paid by the scheme	<u>(23)</u>	<u>(20)</u>
Deficit in the scheme at end of year	<u>(1,508)</u>	<u>(2,000)</u>

The pension cost for defined benefit schemes in the financial statements was:
Analysis of other pension costs charged in arriving at operating profit

	2010	2009
	£000	£000
Current service cost	<u>(79)</u>	<u>(75)</u>

Analysis of amounts included in other finance income/costs:

	2010	2009
	£000	£000
Expected return on pension scheme assets	1,019	820
Interest on pension scheme liabilities	<u>(986)</u>	<u>(914)</u>
	<u>33</u>	<u>(94)</u>

Analysis of amount recognised in the Statement of Total Recognised Gains and Losses:

Changes in the present value of the defined benefit obligation are as follows:

	2010	2009
	£000	£000
Opening defined benefit obligation	17,523	13,635
Service cost	176	177
Interest cost	986	914
Actuarial losses	701	2,994
Benefits paid	(858)	(526)
Experience (loss)/gain on liabilities	(18)	210
Experience change in secured pensioner value due to mortality experience and change in assumptions	<u>(28)</u>	<u>119</u>
Closing defined benefit obligation	<u>18,482</u>	<u>17,523</u>

Changes in the fair value of scheme assets are as follows:

	2010	2009
	£000	£000
Opening fair value of scheme assets	15,523	12,848
Expected return	1,019	820
Actuarial gains	882	1,805
Contributions by employer	362	375
Contributions by scheme members	100	129
Death in service insurance premiums paid	(3)	(27)
Experience change in secured pensioner value due to mortality experience and change in assumptions	<u>(28)</u>	<u>119</u>
Expenses paid by Scheme	<u>(23)</u>	<u>(20)</u>
Benefits paid	<u>(858)</u>	<u>(526)</u>
Closing fair value of scheme assets	<u>16,974</u>	<u>15,523</u>

Notes to the Accounts *continued*

NOTE 27 PENSIONS *continued*

Analysis of amount recognised in the Statement of Total Recognised Gains and Losses:

	2010	2009	2008	2007	2006
	£000/%	£000/%	£000/%	£000/%	£000/%
Actual return less expected return on scheme assets	882	1,805	(3,771)	29	484
Percentage of year end scheme assets	5.20%	11.6%	(29.4%)	0.19%	3.52%
Experience gains and (losses) arising on scheme liabilities	18	(210)	(126)	(222)	(73)
Percentage of present value of year end scheme liabilities	0.10%	(1.20%)	(0.92%)	(1.36%)	(0.44%)
Changes in assumptions underlying the present value of scheme liabilities	(701)	(2,994)	3,518	882	1,442
Percentage of present value of year end scheme liabilities	(3.79%)	(17.09%)	25.80%	5.39%	8.74%
Actuarial gain recognised in the statement of total recognised gains and losses	<u>199</u>	<u>(1,399)</u>	<u>(379)</u>	<u>689</u>	<u>1,853</u>
As a percentage of the present value of year end scheme liabilities	1.08%	(7.98%)	(2.78%)	4.21%	11.24%
Movement in deferred tax relating to the pension scheme	56	392	(106)	193	555
	Value at	Value at	Value at	Value at	Value at
	31.12.10	31.12.09	31.12.08	31.12.07	31.12.06
	£000	£000	£000	£000	£000
Total market value of assets	16,974	15,523	12,848	15,600	13,766
Present value of scheme liabilities	<u>18,482</u>	<u>17,523</u>	<u>(13,635)</u>	<u>(16,353)</u>	<u>(16,492)</u>
Deficit in the scheme	(1,508)	(2,000)	(787)	(753)	(2,726)
Related deferred tax asset	422	560	220	211	818
(2010, 2009, 2008 & 2007: 28%, 2006: 30%)					
Net pension liability	<u>(1,086)</u>	<u>(1,440)</u>	<u>(567)</u>	<u>(542)</u>	<u>(1,908)</u>

The total actuarial gain recognised in the Statement of Realised Gains and Losses (STRGL) in 2010 was £199,000 (2009: loss of £1,399,000). The cumulative losses recognised since adoption of FRS17 in the year ended 31 December 2002 are £2,693,720 .

28. RELATED PARTY TRANSACTIONS

As at 31 December 2010 the Society had a loan outstanding to its subsidiary, Furness Mortgage Services Limited, of £8,719,456 (2009 £9,559,321).

The Society owed its subsidiary Furness Independent Financial Advisers Limited £355,539 (2009 £483,139).

Annual Business Statement

For the year ended 31 December 2010

	At 31.12.2010	Statutory Limit
1. STATUTORY PERCENTAGES		
Proportion of business assets not in the form of loans fully secured on residential property (the 'lending limit')	4.04%	25%
Proportion of shares and borrowings not in the form of shares held by individuals (the 'funding limit')	10.00%	50%

The above percentages have been prepared from the Group's accounts.

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

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

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

	At 31.12.2010	At 31.12.2009
2. OTHER PERCENTAGES		
As a percentage of shares and borrowings:		
Gross capital	8.06%	7.50%
Free capital	7.99%	7.41%
Liquid assets	26.09%	24.96%
	For 2010	For 2009
As a percentage of mean total assets:		
Profit after taxation	0.21%	0.13%
Management expenses	0.99%	0.84%

The above percentages have been prepared from the Group's accounts.

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

Annual Business Statement continued

3. DIRECTORS AS AT 31 DECEMBER 2010

Name	Date of birth	Date of appointment	Business occupation	Other directorships
R J Cairns	1/6/51	1/8/97	Chief Executive	Cumbria Vision Ltd Furness Authorised Financial Advisers Ltd Furness Financial Advisers Ltd Furness Financial Services Ltd Furness Independent Financial Advisers Ltd Furness Mortgage Services Ltd More Music in Morecambe Ltd Ultimate Mortgages Ltd
C S Fairclough	28/11/50	17/5/05	Company Director	Casterton School Furness Independent Financial Advisers Ltd LCL Holdings (Isle of Man) Ltd LCL Services (Isle of Man) Ltd LCL International Life Assurance Company Ltd Tokio Marine Bluebell Re. Ltd Zurich International Life Ltd
P R W Hensman	30/8/48	21/1/03	Company Director	Battlefields Holdings Ltd Cumbria Rural Enterprise Agency Ltd Furness Mortgage Services Ltd Grasmere Sports Committee Ltd Greatdale Ltd Lake District Estates Company Ltd North West Business Link Ltd Orion Molecular Services Ltd Ravenglass & Eskdale Railway Company Ltd Ullswater Navigation & Transit Company Ltd
A T F Hunter	8/7/50	8/7/08	Company Director	Alan Ferguson Hunter Associates Ltd Furness Independent Financial Advisers Ltd Trafalgar Tea Company Ltd
P A Ireland	19/11/52	15/6/10	Company Director	Corporate Services (T D Waterhouse) Nominees Ltd Dealwise Ltd D L J Direct Internaxx Bank SA Secondco Ltd T D Waterhouse Corporate Services (Financial) Ltd T D Waterhouse Corporate Services (Holdings) Ltd T D Waterhouse Holdings (UK) Ltd T D Waterhouse Investor Services (Europe) Ltd T D Waterhouse Investor Services (UK) Ltd T D Waterhouse Properties (UK) Ltd T D Waterhouse Corporate Services (Securities) TDWCS LLP TDWSCH Holding Company Ltd Wellington Street Nominees Ltd Yorkshire Ltd Yorkshire Nominees Ltd

Annual Business Statement continued

Name	Date of birth	Date of appointment	Business occupation	Other directorships
C S Millar	12/1/47	19/9/06	Company Director	Airedale NHS Foundation Trust St. Gemma's Hospice
S L Pryer	13/9/61	20/1/04	Deputy Chief Executive	Furness Authorised Financial Advisers Ltd Furness Enterprise Ltd Furness Financial Advisers Ltd Furness Financial Services Ltd Furness Independent Financial Advisers Ltd Furness Mortgage Services Ltd Ultimate Mortgages Ltd
B P Ryninks	6/5/59	1/11/10	Finance Director	–
Mrs A C Willis	3/12/47	8/3/88	Retired Director	Furness Mortgage Services Ltd Premiss Ltd

4. OTHER OFFICERS

Name	Business occupation	Directorships
I R Bell	General Manager (Marketing and Development)	–
Mrs S J Heron	Secretary	–

5. PARTICULARS OF DIRECTORS' SERVICE CONTRACTS

Details of directors' service contracts can be found in the Directors' Remuneration Report on pages 21 and 22.

AUDITOR KPMG Audit Plc Chartered Accountants | The Embankment, Neville Street, Leeds LS1 4DW

BANKERS National Westminster Bank plc & The Royal Bank of Scotland plc

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For a list of the Society's agents please refer to our website.

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Authorised and regulated by the
Financial Services Authority

Member of the Building Societies
Association

Eligible for investment by Trustees