

DIRECTORS' REPORT
ACCOUNTS AND ANNUAL
BUSINESS STATEMENT

31 OCTOBER 2006



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**DIRECTORS' REPORT
FOR THE YEAR ENDED 31 OCTOBER 2006**

The Directors have pleasure in presenting their annual report, together with the annual accounts and annual business statement of the Society for the year ended 31st October 2006.

Business objectives and activities

The principal purpose of the Society has continued to be the raising of funds from members for the purpose of making advances for the purchase and improvement of residential property.

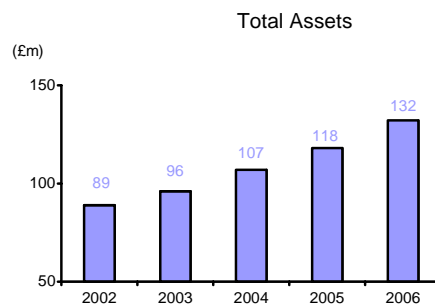
The objective is to encourage thrift and home ownership together with a high standard of service, whilst at the same time offering competitive interest rates to both investing and borrowing members.

Review of the year and key performance indicators

The directors are extremely satisfied with the business performance during the year.

Total Assets

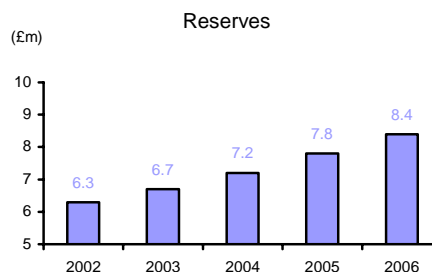
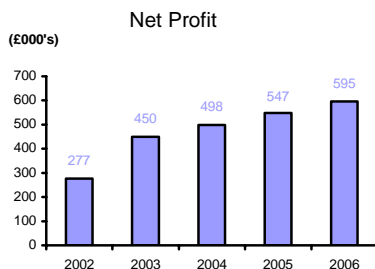
Growth in total assets is a measure of our success in our core markets of mortgages and savings. The total assets of the Society at the end of the financial year amounted to £132.2m (2005: £117.9m), an increase of £14.3m or 12.10%.



Net Profit and Reserves

The net profit for the year, after taxation, which amounted to £0.595m (2005: £0.547m), has been added to the General Reserve which now totals £8.376m (2005: £7.781m).

An appropriate level of profit is required to re-invest in the business and to maintain the capital required to satisfy regulatory requirements and to protect investors.



DIRECTORS' REPORT (CONTINUED)

Capital

At the year end the ratio of gross capital as a percentage of total share and deposit liabilities was 6.82% (2005: 7.12%) and the free capital as a similar percentage was 6.28% (2005: 6.49%). Gross capital is defined as the total reserves as shown in the balance sheet, free capital as the aggregate of gross capital and general loss provisions less fixed assets. The directors ensure that a satisfactory level of capital is maintained to protect the Society against adverse market movements or changes in economic conditions.

Liquid assets

The Society must maintain sufficient liquidity to ensure that it meets liabilities as they fall due. The liquid assets comprising cash, bank balances and authorised investments amounted to £27.3m (2005: £20.3m), representing 22.20% (2005: 18.56%) of total shares and deposit liabilities.

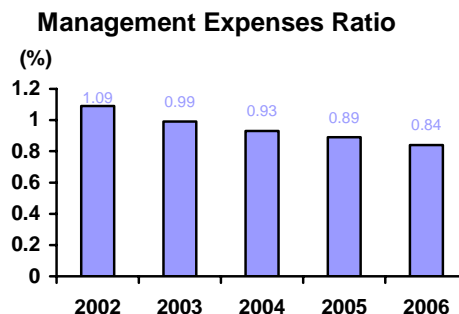
Shares and other investors

Share and other investor balances at 31st October 2006 were £122.9m (2005: £109.3m), an increase of £13.6m on the previous year.

Management expenses ratio

The ratio expresses management expenses as a percentage of average total assets. The Society continually reviews its management expenses and endeavours to contain expenditure in order to support its ability to offer excellent rates to both savers and borrowers, so a fall in this ratio achieves this objective.

During the year the management expenses ratio reduced to 0.84% (2005: 0.89%).



Loans and advances to customers

During the year the Society lent £29.125m to borrowers. Of this £23.510m was advanced on 298 new mortgages and £5.615m on 195 further advances. Advances secured on residential property and other loans increased during the year to £104.139m. At 31st October 2006 there was 1 mortgage account 12 months or more in arrears. The total amount of arrears in this case was £0.004m and the capital balance was £0.067m.

Creditor payment policy

The Society's continuing policy concerning the payment of its trade creditors is to pay invoices within the agreed terms of credit once suppliers have discharged their contractual obligations. Amounts due to relevant creditors of the Society are paid on average within 14 days of receipt of invoice.

DIRECTORS' REPORT (CONTINUED)

Staff

The directors appreciate the efforts of all the staff in promoting the prosperity and efficiency of the Society's operations.

Principal risks and uncertainties

The Society has a risk adverse culture which together with its prudent nature ensures that it maintains a low exposure to risk so as to keep public confidence and to allow the achievement of its corporate objectives.

The Society has in place a risk management structure. Through its normal operations the Society is exposed to a number of risks the most significant are as follows

Credit Risk

Credit risk is the risk of a member or counterparty not meeting their obligations as they fall due. All mortgage applications are assessed with reference to the Society's lending policy. The Assets and Liabilities Committee ensures that appropriate credit limits are established for individual counterparties, sectors and countries and ensures that these limits are controlled.

Liquidity Risk

Liquidity risk is the risk that the Society is not able to meet its financial obligations as they fall due. The Society's liquidity policy is to maintain sufficient resources to cover cash flow imbalances and fluctuations in funding, to maintain public confidence and to meet its financial obligations. This is achieved by maintaining a prudent level of liquid assets, through wholesale funding facilities, and through management control of the growth of the business.

Interest Rate Risk

Interest rate risk represents the Society's exposure to movements in interest rates and is managed on a continuous basis, within limits set by the Board. No transactions of a speculative nature are undertaken.

The interest rate sensitivity exposure of the Society can be found in Note 20 to the annual accounts.

Operational Risk

Operational risk is the risk of loss through failed or inadequate systems, human error or other external factors. All business areas have responsibility for putting in place appropriate controls and these are monitored by senior management and the Audit committee.

Events since the year end

The directors consider that there has been no event since the end of the financial year having a significant effect on the position of the Society.

Future Developments

The directors will maintain the Society's success by concentrating its efforts upon traditional building society business and offering a high standard of service to its investing and borrowing members.

DIRECTORS' REPORT (CONTINUED)

Directors

The following persons were directors of the Society during the year.

Barbara Ainger, OBE BA FCIH Chairman
W. Arthur Bailey, FCA Vice Chairman
Philip J. W. Evans, DL FRICS
Peter R. Godwin, MRICS
A. Benson Greatrex, BSc MBA
Michael R. Heenan, BSc FCA Chief Executive and Secretary
Ian A. Henderson, Dip Arch RIBA
Robert Madders
Susan J. Whiting BA ACA ATII Deputy Chief Executive

The directors who retire by rotation in accordance with rule 26(1) are W. Arthur Bailey, Ian A. Henderson and Susan J. Whiting who offer themselves for re-election.

Auditor

In accordance with Section 77 of the Building Societies Act 1986 a resolution for the re-appointment of KPMG Audit Plc as auditor is to be proposed at the Annual General Meeting.

On behalf of the Board of Directors
Barbara Ainger
Chairman
18 December 2006

DIRECTORS' REMUNERATION REPORT

Directors' Remuneration

The purpose of this report is to inform members of The Stafford Railway about our policy on the remuneration of Executive and Non-executive directors.

The Remuneration Committee

The committee comprising of all the Non-executive directors meet at least once a year to review the performance of and recommend the remuneration for the Executive directors.

Policy for Executive Directors

The Society has a contract with Messrs. Dean Statham, Chartered Accountants, for the services of the Chief Executive and the Deputy Chief Executive which contains provision for termination upon 12 months written notice by either party.

- **Basic Fee** – The method of calculation of the base fee is specified in the contract with Messrs Dean Statham dated 1st June 2001 which involves external advice being taken as to the level of the base fee each year.
- **Bonus** – The bonus is assessed by the Remuneration Committee and is based on corporate performance targets both financial and non-financial. Bonus payments are payable annually, are not guaranteed and are reviewed each year.
- **Pension** – There are no provisions within the contract for any pension arrangements for the executive directors and no pension payments are made.
- **Other Benefits** – There are no provisions within the contract for any other benefits for the executive directors and no such benefits are provided.

Policy for Non-Executive Directors

The remuneration of all Non-executive directors is reviewed annually by the Board as a whole. There are no bonus schemes for Non-executive directors and they do not qualify for pension entitlement or other benefits. Non-executive directors do not have service contracts. The remuneration of the Chairman is set at a meeting of the Board where the Chairman is not present.

Full details of Directors' Remuneration for the financial year ended 31st October 2006 can be found in Note 7 to the accounts.

Barbara Ainger
Chairman of Remuneration Committee
18 December 2006

CORPORATE GOVERNANCE

Corporate Governance

The Board provides leadership and direction with the strategic aim of promoting success with an effective and control framework.

The Stafford Railway complies with the Code of Governance for Building Societies as issued by the Financial Services Authority within the Interim Prudential Source Book for Building Societies.

The directors are committed to best practice in Corporate Governance and have also considered the Combined Code on Corporate Governance, which applies to listed companies. The Building Societies Association has provided guidance on this Combined Code and the Board has reviewed the requirements and, where appropriate to the Society, adopted them.

The Board

The Board consists of two Executive directors and seven Non-executive directors who provide the appropriate mix of skills and professional expertise required.

A Board Compliance Manual sets out those items for which decision by the Board is required and decisions delegated to the executive directors.

The following matters are prescribed as being the sole responsibility of the Board of Directors:

- a) Major investment decisions of a type not previously or usually undertaken
- b) Entering into material contractual agreements
- c) Responsibilities under the Building Societies Act 1986 and other appropriate legislation and regulations.
- d) Appointment of Chief Executive or Deputy Chief Executive
- e) Appointment of Non-executive directors
- f) Appointment of Board Committees

The offices of Chairman and Chief Executive are distinct and held by different people.

The Board considers that all its Non-executive directors are independent and free of any relationship which could prejudice their use of independent judgment. Within this, the Board has considered the individual performance of any director whose service exceeds nine years and unequivocally agreed that they be considered independent. The Board also agreed as a matter of policy that all directors first appointed after the AGM in 2001 will be subject to annual re-election by the members after they have served nine years.

The Board has appointed Mr. A. B. Greatrex as Senior Independent Director.

All directors are subject to annual performance and evaluation review by the Chairman. The Chairman is reviewed by the Senior Independent Director and that review considered annually by the Non-executive directors without the Chairman present.

All directors must meet the test of fitness and propriety as laid down by the FSA as 'Approved Persons' to fulfill their Controlled Functions as directors.

The Board has agreed to review its performance and that of its committees annually, the first such review taking place in 2007, details of which will be reported next year.

CORPORATE GOVERNANCE

The Society's rules require all directors to submit themselves for election by the members at the first opportunity after their appointment and for re-election every three years.

All directors have access to the advice of the Secretary and, if necessary, are able to take independent professional advice at the Society's expense.

The Board has the following board committees.

A Remuneration Committee comprising all of the Non-executive directors under the chairmanship of Barbara Ainger (Chairman of the Board). This committee meets at least once per year to consider the remuneration and other terms of service of the executive directors.

An Audit Committee consisting entirely of Non-executive directors under the chairmanship of W. Arthur Bailey which meets four times per year and reviews the effectiveness of internal controls, the compliance function and the Society's risk management function. It considers and recommends the appointment of the internal and external auditors and monitors their effectiveness and independence. Other members of the committee are Ian A. Henderson, A. Benson Greatrex and Philip J W Evans.

An Assets and Liabilities Committee consisting entirely of Non-executive directors under the chairmanship of Robert Madders meets quarterly throughout the year and monitors and controls balance sheet risk, funding and liquidity in accordance with the Society's policy. The other members of the committee are Barbara Ainger and Peter R. Godwin.

A Nominations Committee comprising three Non-executive directors and the Chief Executive and chaired by the Chairman of the Society (except when the Committee is dealing with succession to the Chairmanship). This Committee identifies and recommends to the Board candidates for nomination as Non-executive directors. It meets when there is an appropriate vacancy to fill, but in any case at least once a year to review the skill mix of the Board. Other members of the Committee are W. Arthur Bailey and A. Benson Greatrex.

Proceedings of all Committees are formally minuted and minutes are subsequently considered by the full Board.

Attendance Table

| Name | Remuneration | Audit | ALCO | Nominations | Board |
|---------------|---------------------|--------------|-------------|--------------------|--------------|
| B. Ainger | 1 (1) | | 4 (4) | 1 (1) | 12 (12) |
| W A Bailey | 1 (1) | 4 (4) | | 1 (1) | 11 (12) |
| P J W Evans | 1 (1) | 2 (2) | 0 (1) | | 10 (12) |
| A B Greatrex | 1 (1) | 3 (4) | | 1 (1) | 10 (12) |
| P R Godwin | 1 (1) | | 4 (4) | | 12 (12) |
| I A Henderson | 1 (1) | 4 (4) | | | 11 (12) |
| R Madders | 1 (1) | | 4 (4) | | 11 (12) |
| M R Heenan | | | | 1 (1) | 11 (12) |
| S J Whiting | | | | | 12 (12) |

(figures in brackets represent maximum possible attendance)

System of internal control

The Audit Committee has reported to the Board that it is satisfied that an effective system of internal control is in place.

DIRECTORS' RESPONSIBILITIES

Directors' responsibilities for preparing the annual accounts

The following statement, which should be read in conjunction with the statement of the auditors' responsibilities on page 11, is made by the directors to explain their responsibilities in relation to the preparation of the annual accounts, annual business statement and directors' report.

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

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

In preparing those accounts, the directors are required to:

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

In addition to the accounts, the Act requires the directors to prepare, for each financial year, an annual business statement and a directors' report, each containing prescribed information relating to the business of the society.

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Society

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

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

Going Concern

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

AUDITORS' REPORT

Independent auditors' report to the members of Stafford Railway Building Society

We have audited the annual accounts of Stafford Railway Building Society for the year ended 31 October 2006 which comprise the Income and Expenditure Account, the Balance Sheet, the Cash Flow Statement and the related notes. These annual accounts have been prepared under the accounting policies set out therein.

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

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report including the Directors' Report, the Annual Business Statement and the annual accounts in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 10.

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

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

We also report to you if, in our opinion, the annual accounts are not in agreement with the accounting records or if we have not received all the information and explanations that we require for our audit.

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

AUDITORS' REPORT (CONTINUED)

Basis of audit opinion

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

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

Opinion

In our opinion:

- a) the annual accounts give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the affairs of the society as at 31 October 2006 and of the income and expenditure of the society for the year then ended;
- b) the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given;
- c) the information given in the Directors' Report is consistent with the accounting records and the annual accounts; and
- d) the annual accounts, the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it.

KPMG Audit Plc
St James' Square
Manchester
M2 6DS

*Chartered Accountants
Registered Auditor*

18 December 2006

**INCOME & EXPENDITURE ACCOUNT
FOR THE YEAR ENDED 31 OCTOBER 2006**

| Notes | Continuing Operations 2006 £000 | Continuing Operations 2005 £000 | |
|-------|---|--|-------------------|
| 2 | Interest receivable and similar income | 6,705 | 6,227 |
| 3 | Interest payable and similar charges | <u>(4,766)</u> | <u>(4,421)</u> |
| | Net Interest Receivable | 1,939 | 1,806 |
| | Fees and commissions receivable | 28 | 28 |
| | Fees and commissions payable | (23) | (23) |
| | Other operating income | <u>33</u> | <u>31</u> |
| | Total Income | 1,977 | 1,842 |
| 5 | Administrative expenses | (1,018) | (961) |
| | Depreciation and amortisation | (36) | (38) |
| 4 | Other operating charges | <u>(77)</u> | <u>(72)</u> |
| | | 846 | 771 |
| 10 | Provisions for bad and doubtful debts | <u>(9)</u> | <u>(10)</u> |
| | Profit on ordinary activities before tax | 837 | 761 |
| 8 | Tax on profit on ordinary activities | <u>(242)</u> | <u>(214)</u> |
| 17 | Profit for the financial year | <u><u>595</u></u> | <u><u>547</u></u> |

There have been no recognised gains or losses other than the profit for the year.

Profit on ordinary activities before tax represents operating profit as defined by FRS3, Reporting Financial Performance.

The notes on pages 16 to 25 form part of these accounts.

BALANCE SHEET AS AT 31 OCTOBER 2006

| | 2006 | 2006 | 2005 | 2005 |
|---|---------|----------------|--------|----------------|
| | £000 | £000 | £000 | £000 |
| Notes | | | | |
| Assets | | | | |
| 9 Liquid assets | | | | |
| Cash in hand | | 20 | | 21 |
| Loans and advances to credit institutions | | 2,057 | | 3,126 |
| Debt securities | | 25,201 | | 17,135 |
| | | <u>27,278</u> | | <u>20,282</u> |
| 11 Loans and advances to customers | | | | |
| Loans fully secured on residential property | 96,181 | | 89,837 | |
| Loans fully secured on land | 7,958 | | 7,011 | |
| | | <u>104,139</u> | | <u>96,848</u> |
| 12 Tangible fixed assets | | 782 | | 803 |
| 16 Other assets | | 25 | | 22 |
| Prepayments and accrued income | | 20 | | 17 |
| Total assets | | <u>132,244</u> | | <u>117,972</u> |
| Liabilities | | | | |
| 13 Shares | 115,391 | | 99,757 | |
| 14 Amounts owed to other customers | 7,475 | | 9,533 | |
| | | <u>122,866</u> | | <u>109,290</u> |
| 15 Other liabilities | | 805 | | 742 |
| Accruals and deferred income | | 197 | | 159 |
| 17 Reserves | | | | |
| General reserves | | 8,376 | | 7,781 |
| Total liabilities | | <u>132,244</u> | | <u>117,972</u> |

Approved by the Board of Directors on 18 December 2006

Barbara Ainger Chairman
W. Arthur Bailey Vice Chairman
Michael R. Heenan Chief Executive

The notes on pages 16 to 25 form part of these accounts

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 OCTOBER 2006

| | 2006 | 2005 |
|--|----------|----------|
| | £000 | £000 |
| Net cash inflow from operating activities | 7,144 | 2,164 |
| Taxation | (242) | (214) |
| Capital expenditure and financial investment | | |
| Purchase of debt securities | (30,170) | (19,000) |
| Proceeds from disposal of debt securities | 22,213 | 18,472 |
| Purchase of tangible fixed assets | (15) | (28) |
| (Decrease) / Increase in cash | (1,070) | 1,394 |

Reconciliation of operating profit to net cash flow from operating activities

| | | |
|---|----------|----------|
| Operating profit | 837 | 761 |
| (Increase) in prepayments and accrued income | (112) | (81) |
| Increase in accruals and deferred income | 38 | 29 |
| Increase in provision for bad and doubtful debts | 9 | 10 |
| Depreciation | 36 | 38 |
| Net cash inflow from trading activities | 808 | 757 |
| Loans and advances made to customers | (29,125) | (26,860) |
| Loans and advances repaid by customers | 21,825 | 17,717 |
| Net increase in shares | 15,634 | 11,357 |
| Net (Decrease) in amounts owed to credit institutions and other customers | (2,058) | (937) |
| Net (Increase) in other assets | (3) | (3) |
| Net increase in other liabilities | 63 | 133 |
| | 6,336 | 1,407 |
| Net cash inflow from operating activities | 7,144 | 2,164 |

Reconciliation of cash balances

| | 2005 | Cash Flow | 2006 |
|--|-------|--------------|-------|
| | £000 | £000 | £000 |
| Cash in hand | 21 | (1) | 20 |
| Loans and advances to credit institutions - repayable on demand | 3,126 | (1,069) | 2,057 |
| | 3,147 | (1,070) | 2,077 |

The notes on pages 16 to 25 form part of these accounts.

NOTES TO THE ACCOUNTS

1 Accounting policies

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

Basis of preparation

The accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards and Building Societies (Accounts and Related Provisions) Regulations 1998.

Liquid assets

Debt securities are intended for use on a continuing basis in the Society's activities and are classified as financial fixed assets and are stated at cost, adjusted to exclude accrued interest at the date of purchase. Premiums and discounts arising on the purchase of financial fixed assets are amortised over the period to the maturity date of the security. Any amounts so amortised are charged/credited to the income and expenditure account for the relevant financial year. Other liquid assets are stated at the lower of cost and net realisable value.

Provision for loans and advances

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

Throughout the year and at the year-end individual assessments are made of loans and advances on properties which are in possession, or in arrears by 2.5% or more. Specific provision is made against those loans and advances which are considered to be impaired. In considering the specific provision for impaired loans, account is taken of any discount which may be needed against the value of the property at the balance sheet date to agree a sale including anticipated realisation costs. The directors recognise that not all accounts in arrears will result in possession and apply a factor based on recent experience to reflect this probability when calculating the provision for accounts in arrears.

A general provision is made against all advances to the extent that the Society's experience and general economic climate would indicate that it is prudent for such a provision to be made. Interest in respect of all loans is credited to the income and expenditure account as it becomes receivable, including interest in respect of advances where the property has been taken into possession. The general provision has been increased in line with the growth in the mortgage book. Loans and advances in the balance sheet are shown net of provisions. The charge to the income and expenditure account comprises the increase in the provisions.

Depreciation

Depreciation is provided by the Society to write off the cost or valuation less the estimated residual value of tangible fixed assets by equal installments over their estimated useful economic lives as follows:

| | |
|--|--------------|
| Freehold buildings | 50 years |
| Computer equipment | 3 years |
| Fixtures and Fittings and Office equipment | 5 – 10 years |

NOTES TO THE ACCOUNTS (CONTINUED)

Pension costs

The Society operates a money purchase pension scheme. The Society's contributions are charged against profits in the year in which they are made. The charge to the income & expenditure account for the year is shown in note 6 to the accounts.

Taxation

Corporation tax is provided on the profit for the year.

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

Incentive Scheme

The Society offers an incentive to borrowers which consists of a free valuation. These costs are charged to other operating charges in the income and expenditure account as incurred.

| | 2006 | 2005 |
|---|-------|-------|
| | £000 | £000 |
| 2 Interest receivable and similar income | | |
| On loans fully secured on residential property | 5,188 | 4,903 |
| On other loans | 456 | 442 |
| On debt securities | | |
| Interest and other income | 903 | 795 |
| Profit net of losses | 10 | 0 |
| On other liquid assets | | |
| Interest and other income | 148 | 87 |
| | 6,705 | 6,227 |
| | 6,705 | 6,227 |
| Total income from fixed income securities was £903,117 (2005: £795,287) | | |
| 3 Interest payable and similar charges | | |
| On shares held by individuals | 4,454 | 4,030 |
| On other shares | 1 | 1 |
| On deposits and other borrowings | 311 | 390 |
| | 4,766 | 4,421 |
| | 4,766 | 4,421 |
| 4 Operating charges | | |
| Valuation Fees (Mortgage Incentives) | 75 | 66 |
| Solicitor Incentive Scheme | 2 | 6 |
| | 77 | 72 |
| | 77 | 72 |
| 5 Administrative expenses | | |
| Staff Costs (Note 6) | 491 | 466 |
| Other Expenses | 527 | 495 |
| | 1,018 | 961 |
| | 1,018 | 961 |
| Included in other expenses are the following: | | |
| Remuneration of auditors for audit work (inc. VAT) | 29 | 30 |
| Remuneration of auditors and their associates for Non-audit work | 0 | 0 |

NOTES TO THE ACCOUNTS (CONTINUED)

| | | | | | |
|------------------------------------|--|--------------|--------------|--------------|--------------|
| 6 Staff numbers and costs | | 2006 | | 2005 | |
| | | Full time | Part time | Full time | Part time |
| | The average monthly number of persons employed during the year was | 9 | 7 | 10 | 6 |
| | | | | 2006 £000 | 2005 £000 |
| | The aggregate cost of these persons was as follows: | | | | |
| | Wages and Salaries | | 436 | | 417 |
| | Social security costs | | 23 | | 21 |
| | Other pension costs (Note 19) | | 32 | | 28 |
| | | | <u>491</u> | | <u>466</u> |
| | | | | 2006 £000 | 2005 £000 |
| 7 Remuneration of directors | | | | | |
| a) Remuneration of directors | Directors emoluments | | | | |
| | For services as a director | | 58.1 | | 56.2 |
| | For executive services | | 4.6 | | 4.6 |
| | | | <u>62.7</u> | | <u>60.8</u> |
| | Total emoluments of the Society's directors are listed below: | | | 2006 £000 | 2005 £000 |
| | For services as a director | | | Fees | Fees |
| | B. Ainger (Chairman) | | 13.6 | | 13.0 |
| | W. A. Bailey (Vice Chairman from 20.03.06) | | 9.4 | | 7.5 |
| | P. J. W. Evans (Vice Chairman to 20.03.06) | | 7.9 | | 9.7 |
| | P. R. Godwin | | 6.8 | | 6.5 |
| | A.B. Greatrex | | 6.8 | | 6.5 |
| | I. A. Henderson | | 6.8 | | 6.5 |
| | R. Madders | | 6.8 | | 6.5 |
| | M. R. Heenan | | 2.3 | | 2.3 |
| | S. J. Whiting | | 2.3 | | 2.3 |
| | | | <u>62.7</u> | | <u>60.8</u> |

NOTES TO THE ACCOUNTS (CONTINUED)

7 a) Amounts paid for Services of Chief Executive, Deputy Chief Executive and Secretary are cont'd as follows:

| | 2006 £000 | 2005 £000 |
|----------|--------------|--------------|
| Base Fee | 133 | 128 |
| Bonus | 18 | 17 |
| VAT | 26 | 25 |
| Total | <u>177</u> | <u>170</u> |

b) Directors loans and related party transactions

At 31 October 2006 there were outstanding mortgage loans granted in the ordinary course of business, at the Society's standard variable mortgage rate, to 3 directors and 1 connected person amounting in aggregate to £711,723 (2005: 4 directors and 2 connected persons amounting in aggregate to £891,686). Under section 68 of the Building Societies Act 1986, a register is maintained at the head office of the Society which shows details of all loans, transactions and arrangements with directors and connected persons. A statement, for the current financial year, of the appropriate details contained in the register will be available for inspection at the head office for a period of 15 days up to and including the day of the annual general meeting.

The Society has a contract with Messrs. Dean Statham, Chartered Accountants, for the services of Chief Executive, Deputy Chief Executive and Secretary. Mr M R Heenan and Mrs S J Whiting are both partners in this firm. During the year there were amounts received from Messrs. Dean Statham for the rent of office accommodation amounting to £28,067 (2005 - £26,400). The Society made payments to Dean Statham for some staff services and some office accommodation amounting to £27,085 (2005 - £26,297). At 31 October 2006 there was an accrual of £35,813 (2005 - £32,186).

| | 2006 £000 | 2005 £000 |
|---------------------------------------|--------------|--------------|
| 8 Taxation | | |
| a) Analysis of tax charge in the year | | |
| Current tax at 30% (2005 – 30%) | <u>245</u> | <u>217</u> |
| Deferred Tax | <u>(3)</u> | <u>(3)</u> |
| Total Deferred Tax | <u>(3)</u> | <u>(3)</u> |
| Tax on Profit on Ordinary Activities | <u>242</u> | <u>214</u> |

Factors affecting the current tax charge in year

The Current tax charge for the period is lower (2005 : lower) than the standard rate of corporation tax in the UK (30%), (2005: 30%). The differences are explained below.

NOTES TO THE ACCOUNTS (CONTINUED)

| 8 cont'd | 2006 £000 | 2005 £000 |
|--|--------------|--------------|
| b) Profit on ordinary activities before tax | 837 | 761 |
| Tax on profit on ordinary activities at UK standard rate | 251 | 228 |
| Expenses not deductible for tax purposes | 7 | 6 |
| Capital allowances in excess of qualifying depreciation | 0 | (1) |
| Increases in other timing differences | 3 | 4 |
| Marginal relief | (16) | (20) |
| Prior year adjustments | 0 | 0 |
| Current tax charge for year | 245 | 217 |
| 9 Liquid Assets | | |
| a) Repayable from the date of the balance sheet in the ordinary course of business as follows: | | |
| Loans and advances to credit institutions | | |
| Repayable on demand | 2,057 | 3,126 |
| Debt securities | | |
| Accrued interest | 643 | 534 |
| In not more than one year | 22,525 | 13,504 |
| In more than one year | 2,033 | 3,097 |
| | 25,201 | 17,135 |
| b) Analysis of debt securities | | |
| Transferable debt securities | | |
| Listed | 4,137 | 4,203 |
| Unlisted | 21,064 | 12,932 |
| | 25,201 | 17,135 |
| Market value of listed debt securities | 4,001 | 4,087 |
| c) Transferable securities held as financial fixed assets | | |
| Maturity value | 24,520 | 16,500 |
| Unamortised premium | 38 | 101 |
| | 24,558 | 16,601 |
| Accrued interest | 643 | 534 |
| | 25,201 | 17,135 |

All debt securities are held with the intention of use on a continuing basis in the Society's activities and are classified as financial fixed assets.

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

NOTES TO THE ACCOUNTS (CONTINUED)

| | |
|-----------------------------------|---------------|
| 9 c) Cost | £000 |
| cont'd | |
| At 1 st November 2005 | 16,909 |
| Additions | 30,170 |
| Disposals | 22,251 |
| At 31 st October 2006 | <u>24,828</u> |
| Provision for diminution in value | |
| At 1 st November 2005 | 308 |
| Amounts charged for the year | 78 |
| On disposals | 116 |
| At 31 st October 2006 | <u>270</u> |
| Net Book Value | |
| At 31 st October 2006 | <u>24,558</u> |
| At 31 st October 2005 | <u>16,601</u> |

10 Provisions

| | Loans fully secured on Residential Property | | Loans fully secured on Land | | Total £000 |
|---|---|-----------------|-----------------------------|-----------------|---------------|
| | Specific £000 | General £000 | Specific £000 | General £000 | |
| Balance at 1 st November 2005 | 0 | 104 | 0 | 10 | 114 |
| Charge for the year | 0 | 9 | 0 | 0 | 9 |
| Balances at 31 st October 2006 | <u>0</u> | <u>113</u> | <u>0</u> | <u>10</u> | <u>123</u> |

11 Loans and Advances to customers – Maturity Analysis

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

| | 2006 £000 | 2005 £000 |
|--|----------------|---------------|
| On call and at short notice | 225 | 225 |
| In not more than three months | 430 | 431 |
| In more than three months but not more than one year | 2,018 | 2,015 |
| In more than one year but not more than five years | 10,336 | 10,387 |
| In more than five years | 91,253 | 83,904 |
| | <u>104,262</u> | <u>96,962</u> |
| Less provisions | (123) | (114) |
| | <u>104,139</u> | <u>96,848</u> |

NOTES TO THE ACCOUNTS (CONTINUED)

12 Tangible Fixed Assets

| | Freehold Premises | Computer Equipment | Office Equipment, Fixtures & Fittings | Total |
|----------------------------------|----------------------|-----------------------|--|-------|
| | £000 | £000 | £000 | £000 |
| Cost at 1 November 2005 | 756 | 71 | 318 | 1,145 |
| Additions | 0 | 9 | 6 | 15 |
| At 31 st October 2006 | 756 | 80 | 324 | 1,160 |
| Depreciation | | | | |
| At 1 st November 2005 | 57 | 66 | 219 | 342 |
| Charged in year | 15 | 4 | 17 | 36 |
| At 31 st October 2006 | 72 | 70 | 236 | 378 |
| Net Book Value | | | | |
| At 31 st October 2006 | 684 | 10 | 88 | 782 |
| At 31 st October 2005 | 699 | 5 | 99 | 803 |

The Society occupies the freehold premises to an amount of £342,000 (2005 - £349,500) of the net book value.

| 13 Shares | 2006 £000 | 2005 £000 |
|--|--------------|--------------|
| Held by individuals | 115,375 | 99,741 |
| Other shares | 16 | 16 |
| | 115,391 | 99,757 |
| Shares are repayable from the date of the balance sheet in the ordinary course of business as follows: | | |
| Repayable on demand | 115,391 | 99,757 |

14 Amounts owed to other customers

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

| | 2006 £000 | 2005 £000 |
|----------------------------|--------------|--------------|
| Accrued interest | 0 | 11 |
| Repayable on demand | 7,475 | 8,411 |
| Not more than three months | 0 | 1,111 |
| | 7,475 | 9,533 |

NOTES TO THE ACCOUNTS (CONTINUED)

| | | | |
|-----------|--------------------------|------|------|
| 15 | Other Liabilities | 2006 | 2005 |
| | | £000 | £000 |

Other liabilities due within 1 year comprise:

| | | |
|-----------------|-----|-----|
| Corporation tax | 245 | 217 |
| Income tax | 560 | 525 |
| | 805 | 742 |

16 Other Assets

a) Other assets comprises:
Deferred tax

| | | |
|--|----|----|
| | 25 | 22 |
|--|----|----|

b) Deferred tax
At 1st November 2005
Amount credited to Income and Expenditure Account during year
At 31st October 2006

| | | |
|--|----|----|
| | 22 | 19 |
| | 3 | 3 |
| | 25 | 22 |

Deferred tax has been provided in full at 30% as follows:

| | | |
|--|------|------|
| Excess of capital allowances over depreciation | (12) | (12) |
| General Mortgage Loss Provisions | 37 | 34 |
| | 25 | 22 |

17 Reserves

General Reserves

£000

At 1st November 2005
Profit for the financial year
At 31st October 2006

| | |
|--|-------|
| | 7,781 |
| | 595 |
| | 8,376 |

18 Guarantees and other Financial commitments

Financial Services Compensation Scheme

The Society has a contingent liability in respect of contributions to the Financial Services Compensation Scheme provided for under the Financial Services and Markets Act 2000.

19 Pension Scheme

During the year, the Society has contributed to the personal pension plans of its staff. The pension charge in relation to these plans for the year was £31,873 (2005 - £28,202). At 31st October 2006 there were no accrued contributions.

NOTES TO THE ACCOUNTS (CONTINUED)

20 Financial Instruments

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

The Society does not use financial derivatives.

Liquidity Risks

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

NOTES TO THE ACCOUNTS (CONTINUED)

20 **Interest Rate Risk**
cont'd

The Society is exposed to movements in interest rates, and manages this exposure on a continuous basis, within limits set by the Board, using only instruments recorded on the balance sheet. The following table details the repricing exposures. Items are allocated to time bands by reference to the maturity date. The interest rate sensitivity of the Society at 31st October 2006 was (see table below)

| | Not more than 3 months | More than 3 mths but no more than 6 months | More than 6 months but not more than one year | More than 1 year but not more than five years | Non interest bearing | Total |
|---|------------------------|--|---|---|----------------------|----------------|
| <u>31st October 2006</u> | £000 | £000 | £000 | £000 | £000 | £000 |
| Assets | | | | | | |
| Liquid assets | 12,442 | 5,140 | 7,000 | 2,033 | 663 | 27,278 |
| Loans fully secured on residential property | 96,181 | | | | | 96,181 |
| Other loans | 7,958 | | | | | 7,958 |
| Tangible fixed assets | | | | | 782 | 782 |
| Other assets | | | | | 45 | 45 |
| | <u>116,581</u> | <u>5,140</u> | <u>7,000</u> | <u>2,033</u> | <u>1,490</u> | <u>132,244</u> |
| Liabilities | | | | | | |
| Shares | 115,391 | | | | | 115,391 |
| Deposits and other borrowings | 7,475 | | | | | 7,475 |
| Other liabilities | | | | | 1,002 | 1,002 |
| Reserves | | | | | 8,376 | 8,376 |
| | <u>122,866</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>9,378</u> | <u>132,244</u> |
| Interest rate sensitivity gap | (6,285) | 5,140 | 7,000 | 2,033 | (7,888) | 0 |
| <u>31st October 2005</u> | £000 | £000 | £000 | £000 | £000 | £000 |
| Assets | | | | | | |
| Liquid assets | 11,630 | 2,000 | 3,000 | 3,097 | 555 | 20,282 |
| Loans fully secured on residential property | 89,837 | | | | | 89,837 |
| Other loans | 7,011 | | | | | 7,011 |
| Tangible fixed assets | | | | | 803 | 803 |
| Other assets | | | | | 39 | 39 |
| | <u>108,478</u> | <u>2,000</u> | <u>3,000</u> | <u>3,097</u> | <u>1,397</u> | <u>117,972</u> |
| Liabilities | | | | | | |
| Shares | 99,757 | | | | | 99,757 |
| Deposits and other borrowings | 9,522 | | | | 11 | 9,533 |
| Other liabilities | | | | | 901 | 901 |
| Reserves | | | | | 7,781 | 7,781 |
| | <u>109,279</u> | <u></u> | <u></u> | <u></u> | <u>8,693</u> | <u>117,972</u> |
| Interest rate sensitivity gap | (801) | 2,000 | 3,000 | 3,097 | (7,296) | 0 |

**ANNUAL BUSINESS STATEMENT
FOR THE YEAR ENDED 31 OCTOBER 2006**

| | Percentage at 31 Oct 2006 | Statutory Limit |
|---|------------------------------|--------------------|
| 1 Statutory Percentages | | |
| Proportion of business assets not in the form of loans fully secured on residential property (the "Lending limit"). | 7.68% | 25% |
| Proportion of shares and deposits not in the form of shares held by individuals (the "Funding limit") | 6.10% | 50% |
| <p>The percentages are calculated in accordance with, and the statutory limits are those prescribed by, section 6 and 7 of the Building Societies Act 1986 as amended by the Building Societies Act 1997.</p> <p>Business assets are the total assets of the Society as shown in the balance sheet plus provision for bad and doubtful debts, less fixed assets and liquid assets.</p> <p>Loans fully secured on residential property are the amount of the principal owing by borrowers and interest accrued not yet payable. This is the amount shown in the balance sheet plus provision for bad and doubtful debts.</p> | | |
| 2 Other percentages | 31 Oct 2006 % | 31 Oct 2005 % |
| Gross capital as a percentage of share and deposit liabilities | 6.82 | 7.12 |
| Free capital as a percentage of share and deposit liabilities | 6.28 | 6.49 |
| Liquid assets as a percentage of share and deposit liabilities | 22.20 | 18.56 |
| As a percentage of mean assets | | |
| Profit after taxation | 0.48 | 0.49 |
| Management expenses | 0.84 | 0.89 |

ANNUAL BUSINESS STATEMENT (CONTINUED)

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

- Shares and deposits represent the total of shares and amounts owed to other customers
- 'Gross capital' represents the general reserves.
- 'Free capital' represents the aggregate of gross capital and general mortgage 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 cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

ANNUAL BUSINESS STATEMENT (CONTINUED)

3. Information relating to the Directors at 31 October 2006

| Name & Date of Birth | Occupation & Date of Appointment | Other Directorships |
|---|---|---|
| Barbara Ainger Chairman 13.07.46 | Consultant 15.10.01 | The Building Exploratory Limited Stonebridge Housing Action Trust |
| W. Arthur Bailey Vice-Chairman 12.08.43 | Chartered Accountant 24.04.03 | Wilde Sinclair International Limited Ice Cool International Limited Bright Light Venture Limited North Staffordshire Risk Capital Fund PLC European Football Scouting Limited |
| Philip J.W. Evans 24.11.46 | Chartered Surveyor 09.08.88 | Harpfield Estate Limited Partnership Assuring A Safer Staffordshire Ltd Staffordshire Environmental Fund Limited Staffordshire Blind Limited |
| Peter R. Godwin 04.01.47 | Chartered Quantity Surveyor 12.08.85 | Sandy & Co (Contractors) Limited A. J. Godwin & Sons Limited |
| A. Benson Greatrex 28.05.52 | Company Director 28.01.80 | Greatrex Limited The Inglewood Investment Co. Limited Valley Flying Company Limited ISE Estates Limited |
| *Michael R. Heenan 27.02.51 | Chartered Accountant 01.11.89 | The Inglewood Investment Co. Limited B-Solve Limited |
| Ian A. Henderson 17.03.49 | Architect 16.09.91 | Horsley Huber Architects Limited |
| Robert Madders 13.08.43 | Farmer 01.11.94 | Stafford Showground Limited |
| ** Susan J Whiting 09.01.64 | Chartered Accountant 01.07.04 | None |

* Chief Executive and Secretary

** Deputy Chief Executive

Documents may be served on the above directors care of The Stafford Railway Building Society, 4 Market Square, Stafford, ST16 2JH.

Service None of the Non-executive directors has a service contract.

Contracts: The Society has a service agreement with Messrs. Dean Statham commencing 1st June 2001 for the services of Chief Executive, Deputy Chief Executive and Secretary which contains provision for termination upon 12 months written notice by either party.