



Annual
Report and
Accounts
2002

- mortgages
- investments
- savings
- insurance
- loans
- pensions
- financial planning



www.newcastle.co.uk





OUR VISION

We aim to be a friendly, caring organisation that values customer loyalty, gives value for money and contributes to the current and future well-being of the community.

We recognise that our customers, employees and the communities we serve all have a part to play in the future of the Society. We believe we can best serve the interests of all three by remaining a strong, dynamic and independent mutual building society.

Our objectives for each are:

OUR MEMBERS AND CUSTOMERS

- To provide a range of innovative and competitively priced mortgage, savings and insurance products;
- To provide a secure home for savings;
- To provide effective customer service in a prompt, courteous and efficient manner and
- To treat members and customers fairly and in a way that is consistent with mutuality.

OUR EMPLOYEES

- To provide secure and rewarding long-term employment;
- To respect our employees and endeavour to produce an environment of mutual trust and understanding and
- To provide better than average remuneration packages in return for better than average contribution.

OUR COMMUNITIES

- To be seen to be a major contributor to the economic wellbeing of the areas in which we operate and
- To support the communities in which we operate, by way of both personal and financial involvement.

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CHAIRMAN'S STATEMENT

This has been an excellent year for the Society, with profits up and management expenses ratio down. It has also seen some significant changes and gratifying recognition of our achievements.

We have developed a range of products that have proved to be very attractive, and which have resulted in the Society winning the Mortgage Finance Gazette's 'Innovator of the Year' award - for the second year running. For investors, the guiding principle is to maximise returns whilst eradicating risks to capital - ever more important in these days of turbulent markets.

We have continued to seek a fair balance between the interests of our investor and borrower members in difficult economic conditions. Our innovative approach to technology brought us three nominations for national awards, reflecting the imagination that has allowed us to develop the concept of a 'virtual organisation'. I hope that sounds intriguing, and refer you to the Chief Executive's Overview for the details. What it means, however, is that we can use the full capacity of the Society's staff, wherever they are, to handle the work that we are generating. That in turn helps us to keep our overheads down and margins tight, whilst maintaining our branch spread - a new technique to support traditional virtues.

We have changed our logo so that it reflects our business approach, and intend to run this out through a refurbishment of all branches in the coming months. The old logo has served us well but I hope you will agree that the new logo is more in keeping with today's world.

Much more has happened in the year, which you will find in the Overview, but whilst we embrace change, your Board will not lose sight of the underlying principles of a mutual organisation. The Society is run on the basis of tight executive control, and effective corporate governance for which I am grateful to my fellow directors for their support. They work tirelessly in an increasingly challenging environment to ensure that we are best able at all times to serve the interests of our customers, our employees and the communities in which we operate.

It is vital to maintain the right blend of skills in the boardroom and therefore I am pleased to report that David Holborn, Area Director of Lloyds TSB, has joined the Board, bringing with him a business lifetime's experience in this industry. He will have much to contribute.

I will end by reporting two other achievements. Firstly, the Society has become one of the first building societies to complete the securitisation of a portfolio of commercial mortgages. This is a very complex process, and to achieve this as an organisation of our size is extraordinary.

Secondly, in addition to earning a place amongst an elite group of businesses who have maintained the Investor In People (IIP) status for ten consecutive years, we were recognised as 'Best Large Company' in the IIP Outstanding Practice Awards 2002 - truly an outstanding achievement. We have an exceptional staff to whom our warm thanks are due.

**CHRIS HILTON,
CHAIRMAN
24 FEBRUARY 2003**



CHIEF EXECUTIVE'S OVERVIEW

In the Chairman's statement on page 3 Chris Hilton outlines some of the guiding principles behind the day-to-day management of Newcastle Building Society.

These principles help us to balance the needs of our borrowers and savers, guide us when setting our profit targets, and ensure we continue to invest in our business.

2002 was a year of outstanding achievement and award-winning success for the Society, which is something we are justly proud of. It was also a year of major change, during which we launched two subsidiary companies, completed our first mortgage securitisation and fundamentally changed our approach to mortgage lending. We also updated our brand image with a new logo and embarked on a programme of branch refurbishment.

FINANCIAL HIGHLIGHTS

Our financial performance was excellent and we continue to maintain profit at a level which we believe is consistent with our policy of profit sufficiency. Profit after tax was £13.1 million an increase of 8.3% when compared to 2001.

It is particularly pleasing to see that our management expenses ratio fell from 96p to 94p despite the costs of our continued significant investment in technology and branch refurbishment. It is also encouraging to report that despite the concerns over the health of the economy, our arrears and bad debts are at their lowest level for many years.

2002 saw a major change to our mortgage strategy. We securitised £210 million of commercial mortgages and we embarked on a major initiative to process and originate mortgages for other lenders.

Over the last ten years the Society has built up a high quality commercial lending portfolio. In order to create further Balance Sheet capacity, £210 million of commercial mortgages were securitised in December 2002. This effectively means these assets were sold to a new company not connected with the Society, although the Society will receive the benefit of continuing to administer these loans.

Securitisation is a complex process and Newcastle is one of only a few building societies to successfully complete a commercial mortgage securitisation. The transaction provides the opportunity to generate significant new levels of high quality business with the expectation that the securitisation exercise will be repeated in the future.

We recognise that many individuals, often through no fault of their own, experience difficulties in obtaining a mortgage. Whilst we have decided against offering so called sub-prime mortgages ourselves, we are now very active in helping any customer who has experienced problems in finding a suitable mortgage. In 2002 we either processed or originated £256 million mortgages for other lenders. We expect this part of our business to grow significantly in 2003. Our objective is to say 'yes' to any potential mortgage customer.

Total assets under management (on balance sheet assets plus securitised assets) were £2,803 million an increase of £148 million when compared to December 2001 (£2,655 million).

OUR IDENTITY

The most visible change for the Society last year was the introduction of a new logo. Apart from a slight revision two years ago the old logo had not changed since 1980, so a fresh image was certainly due. We believe the new logo is more reflective of a modern and innovative financial institution. The new green and blue logo is an obvious departure from our black and white logo, although certain elements of the old design, particularly the castle, remain. This reflects the fact we are building on our traditional strengths and values as a building society.

Our branches will also benefit enormously from a programme of refurbishment. Indeed, we will be spending more than £2.5 million on our branch network over the next few years.

PRODUCTS AND SERVICES

The financial services market is very competitive and we have attempted to compete by offering a range of innovative products and we were therefore delighted to be named 'Innovator of the Year' by the Mortgage Finance Gazette in 2002 for product development.

RETAIL SAVINGS

The Bank of England's Monetary Policy Committee kept the base rate at 4% throughout 2002. Low levels of interest rates, combined with poor global stock markets, have undoubtedly made life very difficult for savers. We have therefore taken an innovative approach to this problem.

We have offered products that combine strong growth potential with full protection of the original sum invested. During the year we offered a series of Guaranteed Property Bonds, where returns are linked to the growth in the Halifax House Price Index. With strong house price rises throughout 2002 this has been a very attractive investment for many of our savers.

We also offered products linked to the growth in equities and the performance of unit trusts. These products will enable customers to benefit from any recovery in the equity markets but with the comfort of knowing that their capital is secure should problems with equities persist.

The Society is a leading player in the provision of protected savings products and in 2002 more than £125 million worth of funds were invested by our members in such products.

MORTGAGES

The rapid increase in house prices has created severe problems for first time buyers. In response to this problem we launched a Guarantor Mortgage which is designed to allow parents to assist their children in buying their first home. As soon as the borrowers qualify for a mortgage on normal terms the parents are released from their guarantee.

House price increases have provided savers with the opportunity to release equity tied up in their property in order to make their retirement more enjoyable. This is a market that has suffered from dubious practices elsewhere in the past but we believe will be very important in the future. In 2002 we launched an equity release mortgage and as a mutual we believe we are well placed to offer this type of product as it is vitally important that borrowers trust their lender.

In December 2002 we launched an Offset Mortgage. This allows borrowers to maximise the return on their savings by offsetting any savings against their mortgage. This is a very tax efficient way of managing savings and also provides borrowers with great flexibility to use surplus funds to repay their mortgage.

INNOVATION, NEW TECHNOLOGY, OUR BRANCHES AND THE INTERNET

We believe technology and innovation are critical to our continued success, and that by embracing them we will remain one of the strongest and most forward-thinking building societies in the country. During 2002

we invested in a sophisticated new telephone system that, in essence, creates 'virtual' call centres in our branches. The technology gives our head office call centre far greater capacity during peak workload times, by routing calls to appropriately skilled staff in our branches, and even to our growing number of home-working staff. 'Virtualisation' enables us to create flexible capacity in the most cost effective way, which in turn will mean the best possible service for customers.

The new telephone system complements our 'Workflow and Document Image Processing System', which was implemented in 2001. This allows incoming correspondence to be electronically scanned, accessed and actioned by staff in head office, the branches or at home. At the end of 2002, 8 of our branches were acting as 'virtual call centres' or 'workflow branches'. This process of selectively routing work will be extended in 2003 and we expect 11 branches to be operational by the end of 2003.

Utilising branches as part of a 'virtual organisation' is a key objective for the Society. In a world where technology is leading to the closure of branch-based services, we are taking the innovative approach of using technology to keep them open.

The Society has one of the largest branch networks for its size but there is a significant danger that branch usage will decline as many new customers prefer to use the internet or our call centres. In 2002 we decided to close our Liverpool and Glasgow city centre branches when their leases expired. The decision was not taken lightly and all eight staff involved were offered alternative roles within the Society, including the option of working from home.

The Board remains committed to maintaining a strong branch network, as reflected in the refurbishment programme that has already started. As a mutual, we believe we have an obligation to consider wider community issues and we have vowed to do our utmost to avoid closing a branch which would have a detrimental effect on a local community.

We recognise that many of our customers prefer to use new technology to manage their financial affairs. The Newcastle has one of the most functionally rich online services of any financial institution and in 2002 we were delighted to launch our online wealth portal. This enables customers to manage their financial



CHIEF EXECUTIVE'S OVERVIEW Continued

affairs by having a single online view of all their savings accounts, mortgage accounts and unit trust holdings. In 2003 we will be adding further facilities with the addition of an online share dealing service.

NEWCASTLE FINANCIAL SERVICES LTD AND THE ZURICH GROUP

For many years the Society has provided regulated financial services products by introducing customers to Norwich Union. This has been a very successful relationship, but as a result of potential changes in regulation and the consequent effect on the market place the Society concluded that it would be more appropriate to employ its own financial services consultants.

A new wholly-owned subsidiary company, Newcastle Financial Services Ltd (NFSL) has been formed in partnership with Zurich and will commence trading in March 2003. This partnership will enable our staff to offer life, investments and pension products provided by Zurich.

NEWCASTLE STRATEGIC SOLUTIONS LTD (NSSL)

Our investment in technology has meant that in recent years the Society has been very successful in providing computer systems, call centre facilities and mortgage processing facilities to other financial institutions.

In December 2002 we launched Newcastle Strategic Solutions Ltd (NSSL), a wholly-owned subsidiary of the Society, to offer our skills to third parties in areas such as processing, online banking, call centres, mortgage broking, product development and commercial lending.

The formation of NSSL is a logical extension of the Society's desire to capitalise on its core skills by offering products and services to the wider financial services market. We believe NSSL is a unique offering from a building society, and once again positions us at the very forefront of innovation.

STAFF

At 31 December 2002, the Society employed 654, compared with 637 staff at the end of 2001. Staff are a key ingredient in our success, and the need to support and encourage them, and to nurture their talents, is always at the forefront of the Society's objectives. The Society has earned a place among an elite group of businesses by maintaining its

Investor in People (IIP) status for ten consecutive years. In November we were recognised as 'Best Large Company' in the IIP Outstanding Practice Awards 2002, sponsored by Business Link and the Learning and Skills Council Tyne and Wear. The Society was highly praised for its staff training and development programmes.

For some staff, parental responsibilities or difficulties with travelling to and from work make a traditional nine-to-five job almost impossible. We want to retain and recruit the best possible staff and we are using technology to offer staff that fall into this category the flexibility of working where and when they want. At the end of the year nine members of staff were working from home and we expect this number to grow significantly in the years ahead.

LOOKING FORWARD

2002 was a challenging yet highly successful and rewarding year for us. The next 12 months will present their own challenges with the ever increasing burden of regulation and relentless competition. However with our innovative approach to business and strong technology base, we are confident we are ready to meet these challenges and make the very best of the many new opportunities that are available.

Our status as a leading building society in the 21st Century is reflected in our new logo and image. Our continuing success, however, will be assured by living out our mutual values, looking after our customers, and embracing technology to realise the full potential of our staff.

**ROBERT J HOLLINSHEAD,
CHIEF EXECUTIVE**

OUR DIRECTORS



(1) CHRIS HILTON, CHAIRMAN (53) is a senior partner of Eversheds. A Director for 25 years, he is a Governor of Dame Allan's Schools and a member of the Council of the University of Newcastle upon Tyne.

(2) JAMES HEPPELL, VICE-CHAIRMAN (55) has served as a Director since 1980. Chief Executive of St Cuthbert Newcastle Estates Limited, he has a day-to-day involvement in the property sector.

(3) ROBERT HOLLINSHEAD (47) joined Newcastle Building Society in September 1992. Originally appointed Finance Director, he progressed to Operations Director in early 1997 and became Chief Executive in March 1998. After qualifying from Bristol University with an honours degree in economics, Robert's career included four years with a firm of chartered accountants before joining the financial services industry.

(4) RICHARD ALLAN (62) retired as a Partner in KPMG's London office in 1996. He has extensive experience working within the financial sector and is also a Director of Newcastle based retailers, T&G Allan Limited.

(5) TONY GLENTON (59) is the Senior Partner in Chartered Accountants, Ryecroft Glenton. He has been a Director for 16 years, six of which as Chairman. He chairs the Society's Financial Risk Committee and is Chairman of the Port of Tyne Authority.

(6) OLIVIA GRANT (56) brings with her a wide knowledge of the business community in the North East and of the personnel and skills issues the Society encounters. Olivia has numerous business and other interests, including Chairman of the Council of the University of Newcastle upon Tyne, and of the Learning and Skills Council County Durham, and trustee of the North Music Trust.

(7) SANDY HUNTER (63) a retired Senior RAF Officer, is active in the property field as Deputy Chairman of Annington Holdings plc and Chairman of Home Group Limited. He chairs the Society's Audit Committee.

(8) DICK JOHNSON (63) retired as Director of Corporate Affairs at Procter & Gamble in 1997. His marketing expertise and general business skills have proved invaluable to the Board since his appointment in 1998. He chairs the Society's Pension Committee and the Pension Trustees Committee.

(9) COLIN SECCOMBE (50) was a Senior Audit Partner with KPMG until becoming the Newcastle's Finance Director in 1997. He has a wide knowledge of finance and of working with other building societies.



DIRECTORS' REPORT

The Directors have pleasure in presenting their Annual Report together with the Audited Annual Accounts and Annual Business Statement of Newcastle Building Society Group for the year ended 31 December 2002.

OBJECTIVES AND ACTIVITIES

The principal objective of Newcastle Building Society is to attract funds, through a competitive range of personal savings and investment products, in order to make available advances secured on land and property, for the use of our members.

These mainstream activities are supported by a range of related financial products through the Society and its subsidiary companies, as authorised by the Building Societies Acts of 1986 and 1997. It is the Board's intention that Newcastle Building Society will continue to remain independent and mutual building society.

REVIEW OF THE YEAR

- Group assets under management increased by **5.5%** during the year and at 31 December 2002 were **£2.80 billion**.
- Profit after tax increased by **8.3%** to **£13.1 million**.
- At the year end, gross capital amounted to **£203 million** (2001: £165 million) which equates to a gross capital ratio of **8.63%** (2001: 6.69%). Free capital was **£182 million** (2001: £144 million) being **7.72%** (2001: 5.82%) of total shares and borrowings.
- The management expenses ratio in respect of total assets under management at 31 December 2002 was **94p** per £100 of assets (2001: 96p per £100).
- Liquid assets in the form of cash and authorised securities were **£531 million** representing **22.56%** of shares and borrowings (compared to £509 million, 20.61% of shares and borrowings in 2001).
- At 31 December 2002 there were **159** (2001: 260) mortgage accounts twelve or more months in arrears. The balances on these accounts were **£5.6 million** (2001: £10.7 million) and the total amount of arrears in these cases was **£1.7 million** (2001: £2.8 million).
- Securitisation of **£210 million** of commercial mortgages during the year, further strengthening capital ratios.
- Two wholly-owned subsidiary companies have been formed to best position the Society to provide its customers with enhanced services and products. These activities are more fully described in the Chief Executive's Overview.

CHARITABLE DONATIONS AND POLITICAL CONTRIBUTIONS

As well as providing considerable 'in-kind' support, the Society made financial donations to charities and grass roots community activities amounting to **£86,500**. There were no political contributions during the year.

SUPPLIER PAYMENT POLICY

The Society's policy regarding the payment of suppliers for the forthcoming year is to discharge supplier invoices within the agreed payment terms when they fully conform with the terms and conditions of the purchase.

The Society will agree terms of payment with suppliers at the start of trading and will pay in accordance with the contractual and other legal obligations. The creditor days at 31 December 2002 were **33 days** (2001: 39 days).

STAFF

Newcastle Building Society is committed to equal opportunities for everyone regardless of sex, race (including creed, colour, religion and ethnic background) disability and marital status. Suitable training is given to disabled employees - including those who have become disabled during their employment - to ensure they have the same career development opportunities as able-bodied staff.

Staff remuneration reviews are carried out on an annual basis and a variety of performance-related bonus schemes are in operation which enable individual and branch team efforts to be recognised and rewarded.

We are committed to effective communication at all levels and take steps to ensure that employee consultation is adequate and ongoing.

UNIFI has negotiating rights on behalf of all staff up to and including senior management level.

DIRECTORS

At 31 December 2002, the members of the Board were:

RB Allan	AAE Glenton	MO Grant
JW Heppell	CJ Hilton	RJ Hollinshead*
AFC Hunter	RW Johnson	CJ Seccombe*

Under Rule 26 (1) RB Allan, AAE Glenton and AFC Hunter retire at the Annual General Meeting. They are eligible and willing to serve on the Board. FD Holborn, who was appointed to the Board on 1 January 2003 retires under Rule 25 (4).

*Executive directors

CORPORATE GOVERNANCE

In addition to monthly board meetings, the following sub-committees of the Board meet at regular intervals:

AUDIT COMMITTEE

AFC Hunter - chairman CJ Hilton RB Allan

This committee considers all audit matters applying to the Group, in particular compliance matters under the Building Societies Acts of 1986 and 1997 and the Financial Services and Markets Act 2000. Internal controls, the scope and findings of the work of internal and external auditors, financial reporting and other relevant prudential requirements are also considered.

REMUNERATION COMMITTEE

CJ Hilton - chairman RW Johnson

This committee sets the terms of employment and remuneration of directors and senior management of the Society.

SELECTION COMMITTEE

CJ Hilton - chairman JW Heppell RJ Hollinshead

This committee advises on the structure of the Board, on nominations to the Board and the re-election of board members retiring by rotation.

FINANCIAL RISK COMMITTEE

AAE Glenton - chairman CJ Hilton JW Heppell
RJ Hollinshead CJ Seccombe

This committee is responsible for setting treasury policy and monitoring the risks associated with lending and treasury operations.

PENSION COMMITTEE

RW Johnson - chairman AAE Glenton MO Grant
RJ Hollinshead

This committee reviews all pension related issues.

AUDITORS

Following the conversion of our auditors, PricewaterhouseCoopers, into a limited liability partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 24 February 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors. A special resolution to re-appoint PricewaterhouseCoopers LLP will be proposed at the Annual General Meeting.

ON BEHALF OF THE BOARD
CJ HILTON
24 FEBRUARY 2003



REMUNERATION COMMITTEE REPORT

The Society complies with the sample Code of Governance on Boards and Management recommended by the Financial Services Authority, with the exception that the service contract of the Chief Executive, entered into prior to the Code being issued, is for a period of two years as opposed to the now recommended period of one year.

The Remuneration Committee, consisting solely of non-executive directors, considers and sets the level of remuneration for executive and non-executive members of the Board and in its consideration of remuneration levels and employment terms takes into account the following factors:

- Remuneration packages are set at a level to attract, motivate and retain executive directors of the calibre necessary to oversee the operations of the Society. Basic salaries for executive directors are set by taking into account salary levels within similar sized organisations and also the level of salaries within the market as a whole, so as to attract and retain the skills levels that are appropriate to operate an organisation as complex as the Society. Basic salary levels also reflect the individual performance of each executive director.
- An annual performance-related bonus scheme has been established for executive directors and senior executives. In any one year a bonus is determined based on the achievement of specific objectives that have been set in the Society's corporate plan.
- Executive directors and non-executive directors, with the exception of two of the latter, are members of the Newcastle Building Society Pension fund, details of which are set out in Note 32 of the Society's Annual Accounts.
- Executive directors receive a range of taxable benefits which includes a motor vehicle, private health care and subsidised mortgage scheme.
- The Chief Executive has a service contract which is terminable at any time by the Society on two years' notice or by himself on 12 months' notice. The other executive director has a service contract which is terminable at any time by the Society on one year's notice or by himself on three months' notice. There are no contracts for non-executive directors and no compensatory terms for loss of office.
- Non-executive directors' fees are set at a level appropriate to reflect the skills and time required to direct the Society's operation and progress. Fees are reviewed in light of those paid to other building society directors and reflect individual involvement in board committees and subsidiaries.
- Full details of individual directors' remuneration are contained in Note 7 to the Society's Annual Accounts.

DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the statement of the Auditors' responsibilities on page 12, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 ('the Act') to prepare, for each financial year, Annual Accounts which give a true and fair view of the state of the affairs of the Society and the Group as at the end of the financial year and of the Income and Expenditure of the Society and the Income and Expenditure and Cash Flows of the Group for the financial year. In preparing those Accounts, the directors are required to:

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

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason the Accounts continue to be prepared on the going concern basis. 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 Society and its connected undertakings.

The directors are responsible for ensuring that the Society and its connected undertakings:

- Keep records in accordance with the Building Societies Act 1986 and
- Take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to these businesses in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

ON BEHALF OF THE BOARD
CJ HILTON
24 FEBRUARY 2002



BALANCE SHEETS at 31 December 2002

	Note	GROUP		SOCIETY	
		2002	2001 As restated	2002	2001 As restated
		£m	£m	£m	£m
ASSETS					
Liquid Assets					
Cash in hand and balances with the Bank of England		4.0	3.4	4.0	3.4
Loans and advances to credit institutions	9	191.9	229.4	191.6	229.2
Debt securities	10	335.6	276.3	335.6	276.3
Loans and advances to customers					
Loans fully secured on residential property	11	1,743.3	1,722.8	1,741.0	1,719.7
Loans fully secured on land		146.8	337.2	146.8	337.2
Other loans		75.3	45.8	75.3	45.8
Loans fully secured on land subject to non-recourse finance		210.2	-	210.2	-
Non-recourse finance		(194.4)	-	(194.4)	-
		15.8	-	15.8	-
Other loans subject to non-recourse finance		39.7	-	39.7	-
Non-recourse finance		(21.6)	-	(21.6)	-
		18.1	-	18.1	-
Investments					
Investments in subsidiary undertakings	13	-	-	7.7	14.6
Intangible fixed assets					
Negative goodwill	14	(1.4)	(1.7)	(1.4)	(1.7)
Tangible fixed assets					
Other assets	15	24.9	25.0	12.5	11.9
Other assets	16	13.7	5.7	13.4	6.0
Prepayments and accrued income	17	18.7	11.5	26.8	19.1
TOTAL ASSETS		2,586.7	2,655.4	2,587.2	2,661.5

The notes on pages 17 to 47 form part of these Accounts.

BALANCE SHEETS at 31 December 2002

	Note	GROUP		SOCIETY	
		2002	2001 As restated	2002	2001 As restated
		£m	£m	£m	£m
LIABILITIES					
Shares					
Shares	18	2,047.8	1,903.7	2,047.8	1,903.7
Amounts owed to credit institutions					
Amounts owed to credit institutions	19	52.8	120.6	52.8	126.0
Amounts owed to other customers					
Amounts owed to other customers	20	249.9	405.8	252.9	408.8
Debt securities in issue					
Debt securities in issue	21	5.0	40.0	5.0	40.0
Other liabilities					
Other liabilities	22	18.5	11.1	18.3	10.4
Accruals and deferred income					
Accruals and deferred income	23	8.4	8.4	7.6	9.0
Provisions for liabilities and charges					
Provisions for liabilities and charges	24	0.9	1.0	0.8	0.8
Subordinated liabilities					
Subordinated liabilities	25	24.8	-	24.8	-
		2,408.1	2,490.6	2,410.0	2,498.7
Subscribed capital					
Subscribed capital	26	19.9	19.9	19.9	19.9
Investment property revaluation reserve					
Investment property revaluation reserve	27	0.3	(0.4)	0.3	(0.4)
General reserve					
General reserve	28	158.4	145.3	157.0	143.3
TOTAL LIABILITIES		2,586.7	2,655.4	2,587.2	2,661.5
Memorandum Items					
Commitments	30	194.3	171.6	194.3	171.6

These Accounts were approved by the Board of Directors on 24 February 2003 and signed on its behalf by:

CJ HILTON, CHAIRMAN
JW HEPPELL, VICE-CHAIRMAN
RJ HOLLINSHEAD, CHIEF EXECUTIVE

The notes on pages 17 to 47 form part of these Accounts.



CONSOLIDATED CASH FLOW STATEMENT for the year ended 31 December 2002

	Note	2002 £m	2001 £m
Net cash inflow from operating activities	29	45.7	40.6
Returns on investments and servicing of finance			
Interest paid on subordinated liabilities		(0.3)	-
Issue costs of subordinated liabilities		(0.2)	-
Interest paid on subscribed capital		(2.3)	(2.3)
Interest paid on lease purchase contracts		(0.1)	(0.1)
		(2.9)	(2.4)
Tax paid		(6.2)	(4.7)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(1.5)	(2.0)
Sale of tangible fixed assets		-	0.2
Purchase of financial fixed assets		(930.7)	(613.8)
Sale of financial fixed assets		871.5	582.7
		(60.7)	(32.9)
Net cash (outflow) / inflow before financing		(24.1)	0.6
Financing			
Issue of subordinated liabilities		25.0	-
Principal repayments under lease purchase contracts		(0.4)	(0.6)
		24.6	(0.6)
Increase in cash	29	0.5	-

The notes on pages 17 to 47 form part of these Accounts.

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

1 ACCOUNTING POLICIES

Accounting convention

The Accounts have been prepared under the historical cost convention, as modified by the revaluation of investment properties.

Basis of preparation

The Accounts have been prepared in accordance with the Building Societies (Accounts and Related Provisions) Regulations 1998 and with applicable Accounting Standards in the United Kingdom.

The Group has adopted Financial Reporting Standard 19 'Deferred Tax' (FRS 19) together with the disclosure requirements of Financial Reporting Standard 17 'Retirement Benefits' (FRS 17) in its results for the year ended 31 December 2002.

Basis of consolidation

The Group Accounts consolidate the accounts of the Society and all its subsidiary undertakings using the acquisition method of accounting. The results of subsidiary undertakings acquired or disposed of during the year are included in the Group Income and Expenditure Account from the date of acquisition or up to the date of disposal.

Liquid assets

Debt securities intended for use on a continuing basis in the Group's activities are classified as financial fixed assets. They are shown at maturity value plus any premium and less any discount not yet amortised. The premium or discount, representing the difference between the purchase price and the par value of financial fixed assets, is amortised on a straight line basis to the maturity date of the security. Any amounts so amortised are charged or credited to the Income and Expenditure Account for the relevant year. Where there is a permanent diminution in value of a financial fixed asset, a provision is made so as to write down the cost of the security to its recoverable amount.

Incentives to customers

Mortgage incentives to customers are amortised to interest receivable over the period during which they can be reclaimed on early redemption of the mortgage. The unamortised balances are included in other assets.

Acquisition of mortgage portfolios

Premiums arising on the acquisition of mortgage portfolios are capitalised in other assets and amortised over the effective life of the mortgages.

Loans subject to non-recourse finance ('securitised assets')

Loans fully secured on land subject to non-recourse finance meeting with the conditions specified in Financial Reporting Standard No. 5 are included in the Balance Sheet using the linked presentation method. All loan balances which are subject to non-recourse finance are stated at book value.

Provisions for losses on loans and advances to customers

Provisions are made to reduce the value of loans and advances to customers to the amount which the directors consider is likely to be ultimately recoverable. Individual assessments are made against all loans and advances where the arrears are 2.5% or more of the capital balance or where fraud has been identified. Specific provisions are made against those loans and advances which are considered to be impaired. A general provision is made against those loans and advances which have not been specifically identified as impaired to reflect the probability that other loans and advances may already have become impaired at the Balance Sheet date, with the result that the amount advanced may not be recovered in full.

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 balance on which is deducted from the appropriate assets in the Balance Sheet.

Loans in the Balance Sheet are shown net of specific and general provisions. The charge to the Income and Expenditure Account comprises the increase in the provisions less adjustments to provisions resulting from recoveries, together with losses written off in the year.



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

Negative goodwill

Negative goodwill arising on the acquisition of Nottingham Imperial Building Society in 2000 is being amortised over the period during which the directors expect to benefit from the fixed assets and mortgages acquired and is based on an estimate of their remaining useful lives. The income released during the year is included in depreciation and amortisation.

Tangible fixed assets and depreciation

Fixed assets, other than investment properties, are stated at cost less accumulated depreciation. Depreciation is provided at rates calculated to write down the assets to their estimated residual values over the course of their anticipated useful lives.

The rates and bases of depreciation used are as follows:

Freehold land and buildings and leasehold land and buildings with a residual lease term of greater than one hundred years	- 2% per annum, straight line
Other leasehold land and buildings	- over the term of the lease
Refurbishment expenditure	- 10% per annum, straight line
Equipment, fixtures and fittings	- 15% per annum, reducing balance
Computer equipment	- 20% per annum, straight line
Motor vehicles	- over the term of the lease, or if purchased, at 25% per annum, reducing balance

Investment properties

In accordance with Statement of Standard Accounting Practice No. 19 (SSAP 19), investment properties are revalued annually on an open market, existing use basis subject to existing tenancies. Movements on revaluation, other than permanent diminutions which are charged directly to the Income and Expenditure Account, are applied to an investment property revaluation reserve.

No depreciation has been provided in respect of investment properties. Compliance with SSAP 19 'Accounting for Investment Properties' requires a departure from the requirements of the Regulations relating to depreciation: namely to depreciate all properties, but that requirement conflicts with the generally accepted accounting principle set out in SSAP 19. The directors consider that, since these properties are held for investment purposes, then to depreciate them would result in the Group's Accounts not giving a true and fair view. The accounting policy adopted is therefore necessary for the Accounts to give a true and fair view. Investment properties are included in Note 15 to the Accounts, tangible fixed assets.

Lease purchase and leasing

The Group enters into lease purchase contracts and operating leases. Assets held under lease purchase contracts are capitalised at the fair value of the asset at the inception of the lease, with an equivalent liability categorised under other liabilities. Assets are depreciated in accordance with the relevant Society policy. Finance charges are allocated to accounting periods over the life of each lease on a straight line basis or using the sum of digits method, depending on the cashflows attaching to the agreement. Rentals under operating leases are charged on a straight line basis over the lease term.

Deferred Tax

Following the introduction of Financial Reporting Standard 19 'Deferred Tax', prior period balances have been restated to reflect the requirement of this Standard to make full provision for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in the corporation tax computations. The impact of this is more fully described in Note 8 to the Accounts.

Deferred tax is measured on a discounted basis to reflect the time value of money over the period between the Balance Sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained on government bonds with similar maturity dates to those of the deferred tax assets or liabilities.

Previously, provision for deferred tax was made on the liability basis but only insofar as assets were expected to crystallise or liabilities expected to become payable in the foreseeable future.

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

Retained mortgage risk charges

The Society charges certain borrowers a premium for its exposure to uninsured mortgage losses. This income is deferred and released to the Income and Expenditure Account on a level yield basis over the expected life of the mortgages.

Subordinated liabilities issue costs

Costs associated with the issue of subordinated liabilities are accounted for as a deduction from the amount of the liability and are being amortised over ten years.

Subscribed capital issue costs

Costs associated with the first issue of permanent interest bearing shares have been treated as a financing cost of the Society's principal office and capitalised in the Accounts of the subsidiary undertaking which owns it. Costs associated with the second issue of permanent interest bearing shares are accounted for as a deduction from the amount of the liability and are being amortised over twenty five years.

Hedging instruments

The criteria required for an instrument to be classified as a hedge are that the transaction must be reasonably expected to match or eliminate a significant proportion of the risk inherent in the assets, liabilities, other positions or cash flows being hedged and which results from potential movements in interest rates, equities or house price indices. The intention to hedge and the relationship with the underlying risk inherent in the positions being hedged must also be established at the outset of the transaction. Interest rate, equity or house price related contracts are classified at the Balance Sheet date as hedging contracts. Cash flows arising in relation to such instruments are accounted for on an accruals basis. If a hedge is terminated early, the realised gain or loss is amortised over the residual life of the underlying instrument. If the underlying instrument is redeemed, the remaining unamortised amount is recognised in the Income and Expenditure Account immediately in net interest receivable. Amounts accrued on hedging instruments are included in prepayments and accrued income or accruals and deferred income.

Pension scheme costs

The Society operates an externally managed pension scheme on behalf of directors and staff. The scheme is funded by contributions partly from the employees and partly from the Society at rates determined by independent actuaries. These contributions are invested separately from the Group's assets. Pension costs have been calculated in accordance with Statement of Standard Accounting Practice No. 24 and the transitional disclosure requirements of FRS 17 have been fully adopted in these Accounts. (see Note 32).



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

2 INTEREST RECEIVABLE AND SIMILAR INCOME

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
On loans fully secured on residential property	93.7	108.3	93.6	108.1
On other loans				
- to connected undertakings	-	-	0.1	0.2
- on other loans	25.7	23.3	25.6	23.3
On debt securities				
- interest and other income	11.0	13.2	11.0	13.2
- profits net of losses on realisation	0.8	0.3	0.8	0.3
On other liquid assets				
- interest and other income	7.2	9.1	7.2	9.1
Net expense on financial instruments	(10.3)	(4.8)	(10.3)	(4.8)
	128.1	149.4	128.0	149.4
Income derived from fixed income securities included above:	11.0	13.2	11.0	13.2
Interest on loans fully secured on residential property has been reduced by:				
Incentives provided to customers	3.6	2.5	3.6	2.5
Interest suspended on non-performing loans	0.1	0.1	0.1	0.1
	3.7	2.6	3.7	2.6
Movements in the suspended, non-recoverable interest account are as follows:				
At 1 January 2002	0.3	0.3	0.3	0.3
Interest written off during the year	-	(0.1)	-	(0.1)
Interest suspended in the year	0.1	0.1	0.1	0.1
At 31 December 2002	0.4	0.3	0.4	0.3

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

3 INTEREST PAYABLE AND SIMILAR CHARGES

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
On shares held by individuals	72.5	84.5	72.5	84.5
On subscribed capital	2.3	2.3	2.3	2.3
On deposits and other borrowings				
- subordinated liabilities	0.3	-	0.3	-
- to connected undertakings	-	-	0.2	0.4
- to other depositors and borrowers	16.6	29.5	16.6	29.5
Net income on financial instruments	0.8	(0.4)	0.8	(0.4)
	92.5	115.9	92.7	116.3

4 ADMINISTRATIVE EXPENSES

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Staff costs				
- wages and salaries	10.6	10.0	10.6	10.0
- social security costs	0.8	0.8	0.8	0.8
- other pension costs	1.8	1.3	1.8	1.3
- additional pension costs in respect of part-time staff	-	0.7	-	0.7
	13.2	12.8	13.2	12.8
Remuneration and expenses of auditors				
- audit services	0.1	0.1	0.1	0.1
Rentals under operating leases for land and buildings				
- payable to third parties	1.4	1.3	1.4	1.3
- payable to connected undertaking	-	-	0.1	0.1
Other administrative expenses	8.9	8.2	9.3	8.6
	23.6	22.4	24.1	22.9



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

5 DEPRECIATION AND AMORTISATION

	Note	GROUP		SOCIETY	
		2002 £m	2001 £m	2002 £m	2001 £m
Depreciation of tangible fixed assets	15	2.4	2.3	1.5	1.4
Amortisation of negative goodwill	14	(0.3)	(0.3)	(0.3)	(0.3)
		2.1	2.0	1.2	1.1

6 STAFF NUMBERS

GROUP and SOCIETY

The average number of persons employed during the year was:

	2002	2001
Full time	466	442
Part time	175	180
	641	622
Principal Office	381	363
Branches	260	259
	641	622

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

7 DIRECTORS' EMOLUMENTS

A report to members by the Remuneration Committee outlining the remuneration policy for directors is set out on page 10 of the Annual Report and Accounts.

Emoluments of the Society's directors from the Society and its connected undertakings are detailed below:

	Salary or Fees £000	Annual Bonus £000	Benefits £000	Increase in accrued pension £000	2002 Total £000	2001 Total £000
Executive directors						
RJ Hollinshead	162	38	18	6	224	205
CJ Seccombe	105	23	12	2	142	135
	267	61	30	8	366	340
Non-executive directors						
CJ Hilton	41	-	-	1	42	41
JW Heppell	28	-	-	1	29	27
RB Allan	28	-	-	-	28	27
E Davey (retired 26 April 2001)	-	-	-	-	-	15
AAE Glenton	32	-	-	-	32	31
MO Grant	23	-	-	1	24	23
AFC Hunter	28	-	-	-	28	29
RW Johnson	32	-	-	-	32	29
RND Stephenson (retired 26 April 2001)	-	-	-	-	-	10
	479	61	30	11	581	572



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

7 DIRECTORS' EMOLUMENTS *Continued*

Pensions disclosure

The following table shows the value of directors' pension benefits including those which are unfunded.

	Accrued pension at 31-Dec-02 £000	Transfer value of accrued pension at 31-Dec-02 £000	Transfer value of accrued pension at 31-Dec-01 £000	Director's contributions during year £000	In / (de)crease in transfer value over year net of contributions £000
Executive directors					
RJ Hollinshead	48	401	437	8	(44)
CJ Seccombe	9	85	83	5	(3)
Non-executive directors					
CJ Hilton	17	129	147	2	(20)
JW Heppell	10	87	97	1	(11)
RB Allan	-	-	-	-	-
AAE Glenton	8	101	112	2	(13)
MO Grant	3	26	25	1	-
AFC Hunter	4	71	63	1	7
RW Johnson	-	-	-	-	-

The accrued pension at 31 December 2002 is the pension which the director would have been entitled to receive, based on all their pensionable service, had he or she left on 31 December 2002. The increase in accrued pension represents the change in the annual pension to which each director is entitled as a result of changes in pensionable earnings and increases in pensionable service during their period of office.

Directors' pensions

Both of the executive directors are entitled to receive pension benefits which are unfunded. Based on actuarial advice, provision for these contracted but unfunded benefits has been made in the Accounts. The cumulative provision at 31 December 2002 was **£327,000** (2001: £285,000).

Directors' loans and transactions

The aggregate amount of loans outstanding to directors and connected persons at 31 December 2002 was **£996,985** (2001: £1,260,622) in respect of **6** (2001: 6) directors. These loans were made on normal commercial terms.

A register of these loans is available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Related party transactions

Mr CJ Hilton is a partner in Eversheds, a firm which supplied professional services amounting to **£6,726** (2001: £1,350) to the Society during the year.

Mr JW Heppell supplied professional services amounting to **£Nil** (2001: £5,000) to the Society during the year.

Throughout the year ended 31 December 2002 (and the previous year), the Society maintained loans on commercial terms with Home Group Limited, a housing association group of which Mr AFC Hunter is chairman, St Cuthbert Newcastle Estates Limited, a company of which Mr JW Heppell is a director and The MEA Trust, an organisation of which Mr RJ Hollinshead is a director.

Throughout the year ended 31 December 2002 (and the previous year), the Society rented premises to and was a principal member of Newcastle Gateshead Initiative, a charity in which Mr RJ Hollinshead is a director.

The Society is party to an agreement for branded savings products with the charity Shelter. Mr RB Allan is a member of this organisation's audit and finance committees. During 2002, the Society paid Shelter **£Nil** (2001: £12,679).

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

8 TAX ON PROFIT ON ORDINARY ACTIVITIES

Following the introduction of FRS 19: 'Deferred Tax', the prior period balances have been restated to reflect the requirement in this Standard to make full provision for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in the corporation tax computations.

As a result of adopting this Standard:

In the Group

The cumulative tax charge for the years prior to and including 31 December 2001 has been increased by £0.4 million. Consequently, as a result of this prior year adjustment, other assets at 31 December 2001 have been decreased by £0.4 million with a corresponding decrease in the general reserve.

In the Society

The cumulative tax charge for the years prior to and including 31 December 2001 has been decreased by £0.1 million. Consequently, as a result of this prior year adjustment, other assets at 31 December 2001 have been decreased by £0.1 million with a corresponding increase in the general reserve.

The impact on both Group and Society results for the year ended 31 December 2002 was immaterial.

	Note	GROUP		SOCIETY	
		2002 £m	2001 As restated £m	2002 £m	2001 As restated £m
Current tax					
UK corporation tax at 30% (2001: 30%) on profits for the year		5.0	5.9	5.0	5.7
Over underprovision in respect of previous years					
Corporation tax		-	(0.1)	(0.1)	(0.1)
Group relief		-	-	(0.3)	-
Total current tax		5.0	5.8	4.6	5.6
Deferred tax					
Origination and reversal of timing differences	24	(0.1)	(0.4)	-	(0.3)
Total deferred tax		(0.1)	(0.4)	-	(0.3)
Total tax on profit on ordinary activities		4.9	5.4	4.6	5.3
Analysis of tax charge for the year					
Profit on ordinary activities before tax		18.0	17.5	18.3	17.3
Profit on ordinary activities before tax at the standard rate of corporation tax in the UK of 30% (2001: 30%)		5.4	5.3	5.5	5.2
Group relief		-	-	(0.3)	-
Non-taxable income		(0.5)	(0.1)	(0.9)	(0.1)
Expenses not deductible for tax purposes		-	0.6	0.3	0.6
Capital allowances for year in excess of depreciation		0.1	0.1	0.1	-
Overprovision in respect of previous years		-	(0.1)	(0.1)	(0.1)
Current tax charge for year		5.0	5.8	4.6	5.6

Factors affecting future tax charges

There are no known factors which are expected to materially affect future tax charges.



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

9 LOANS AND ADVANCES TO CREDIT INSTITUTIONS

Repayable from the date of the Balance Sheet in the ordinary course of business as follows:

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Accrued interest	0.6	1.0	0.6	1.0
On demand	4.5	4.6	4.2	4.4
In not more than three months	175.3	214.8	175.3	214.8
In more than three months but not more than one year	2.0	4.0	2.0	4.0
In more than one year but not more than five years	9.5	5.0	9.5	5.0
	191.9	229.4	191.6	229.2

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

10 DEBT SECURITIES

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Comprise:				
Transferable debt securities				
Issued by public bodies - listed	6.3	5.7	6.3	5.7
Issued by other borrowers - unlisted	329.3	270.6	329.3	270.6
	335.6	276.3	335.6	276.3
Debt securities have remaining maturities as follows:				
Accrued interest	2.7	2.5	2.7	2.5
In not more than one year	269.5	205.5	269.5	205.5
In more than one year	63.4	68.3	63.4	68.3
	335.6	276.3	335.6	276.3
Market value of listed transferable debt securities	6.4	5.6	6.4	5.6
Included in debt securities are:				
Unamortised premiums	0.3	0.9	0.3	0.9

The directors consider that the primary purpose of holding securities is to comply with prudential requirements. All transferable debt securities are held with the intention of use on a continuing basis in the Group's activities and are therefore classified as financial fixed assets.

Movements in financial fixed assets (excluding accrued interest) during the year were as follows:

GROUP and SOCIETY	£m
Adjusted cost and net book value	
At 1 January 2002	273.8
Additions	930.7
Disposals / maturities	(871.5)
Premiums (net of discounts) written off during the year	(0.1)
At 31 December 2002	332.9



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

11 LOANS AND ADVANCES TO CUSTOMERS

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Loans fully secured on residential property	1,743.3	1,722.8	1,741.0	1,719.7
Other loans				
Loans fully secured on land	146.8	337.2	146.8	337.2
Other loans	75.3	45.8	75.3	45.8
Loans fully secured on land subject to non-recourse finance	210.2	-	210.2	-
Non-recourse finance	(194.4)	-	(194.4)	-
	15.8	-	15.8	-
Other loans subject to non-recourse finance	39.7	-	39.7	-
Non-recourse finance	(21.6)	-	(21.6)	-
	18.1	-	18.1	-
	1,999.3	2,105.8	1,997.0	2,102.7

Other loans fully secured on land include: Group and Society **£0.2 million** (2001: £0.2 million) in respect of loans which are fully secured on residential property and which were made to corporate bodies such as Housing Associations prior to 1 October 1998, the date the Society adopted the powers of the Building Societies Act 1997. The classification of these assets is not consistent with the treatment of similar loans made or renegotiated after 1 October 1998, which are included in 'loans fully secured on residential property' but is necessary to comply with the requirements of the Building Societies Act 1997.

Loans and advances to customers have remaining maturities as follows:

	Note	GROUP		SOCIETY	
		2002 £m	2001 £m	2002 £m	2001 £m
On demand		4.0	4.0	4.0	4.0
In not more than three months		6.8	6.3	6.8	6.3
In more than three months but not more than one year		25.2	22.8	25.2	22.7
In more than one year but not more than five years		148.4	139.3	148.1	139.1
In more than five years		2,035.2	1,937.8	2,033.2	1,935.0
		2,219.6	2,110.2	2,217.3	2,107.1
Less: Provisions for bad and doubtful debts	12	(4.3)	(4.4)	(4.3)	(4.4)
Less: Non-recourse finance		(216.0)	-	(216.0)	-
		1,999.3	2,105.8	1,997.0	2,102.7

Where a loan is repayable by instalment, each such instalment has been treated as a separate repayment in the maturity analysis set out above. The Group's experience is that in many cases mortgages are redeemed before their scheduled maturity date. As a consequence, the maturity analysis illustrated above may not reflect actual experience.

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

11 LOANS AND ADVANCES TO CUSTOMERS Continued

Other loans subject to non-recourse finance ('securitised assets')

Loans fully secured on land

A quasi-subsiary of the Society, Bamburgh Finance No.1 plc has advances secured on land subject to non-recourse finance. As clearly stated in agreements with the providers of the funding, the Society is not obliged to support any losses in respect of these advances other than to the extent of its subordinated funding, nor does it intend to do so. Repayment of the non-recourse funding facilities and the deferred consideration will be made solely from the cash flows generated by the underlying mortgages.

The Society has rights to the residual income from mortgages amounting to £202.7 million in Bamburgh Finance No.1 plc and its rights are subordinated to all other creditors of the company. Non-Group providers of finance have no recourse other than to the assets of Bamburgh Finance No.1 plc.

Bamburgh Finance No.1 plc has total funding of £220.8 million, £10.6 million of which has been funded by the Society.

The results of Bamburgh Finance No.1 plc have been incorporated using the linked presentation method as a quasi-subsiary. The summarised Balance Sheet of this company at 31 December 2002 is set out below:

	£m
Assets	
Advances fully secured on land subject to non-recourse finance	202.7
Cash at bank	18.1
	220.8
Capital and liabilities	
Notes in issue	210.0
Subordinated funding from Newcastle Building Society	10.6
Other liabilities	0.2
	220.8

An Income and Expenditure Account has not been presented since the company only commenced trading on 19 December 2002 and, in the opinion of the directors, its results are immaterial in the context of the Group's results as a whole.

Other loans

The Society has entered into a sub-participation agreement with other lenders in respect of certain other loans amounting to £39.7 million. The sub-participants to the agreements have no rights of recourse to the Society.



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

12 PROVISIONS FOR BAD AND DOUBTFUL DEBTS

GROUP	Note	Overall Total £m	Loans fully secured on residential property		Loans fully secured on land		Other loans
			Specific £m	General £m	Specific £m	General £m	General £m
At 1 January 2002		4.4	2.3	1.3	0.3	0.5	-
Amounts written off		(0.3)	(0.3)	-	-	-	-
Charge for the year		0.2	0.1	-	-	-	0.1
At 31 December 2002	11	4.3	2.1	1.3	0.3	0.5	0.1

SOCIETY	Note	Overall Total £m	Loans fully secured on residential property		Loans fully secured on land		Other loans
			Specific £m	General £m	Specific £m	General £m	General £m
At 1 January 2002		4.4	2.3	1.3	0.3	0.5	-
Amounts written off		(0.3)	(0.3)	-	-	-	-
Charge for the year		0.2	0.1	-	-	-	0.1
At 31 December 2002	11	4.3	2.1	1.3	0.3	0.5	0.1

During the year, both Group and Society recovered **£0.2 million** (2001: £0.2 million) against amounts previously written off.

13 INVESTMENTS

SOCIETY	Shares £m	Loans £m	Total £m
Investments in subsidiary undertakings			
Cost			
At 1 January 2002	12.2	5.2	17.4
Additions	-	0.5	0.5
Repayments received	(4.4)	(2.4)	(6.8)
At 31 December 2002	7.8	3.3	11.1
Provisions			
At 1 January 2002	1.0	1.8	2.8
Increase during the year	0.5	0.1	0.6
At 31 December 2002	1.5	1.9	3.4
Net book value at 31 December 2002	6.3	1.4	7.7
Net book value at 31 December 2001	11.2	3.4	14.6

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

13 INVESTMENTS Continued

The Society directly holds 100% of the issued ordinary share capital of all its subsidiary undertakings except for Newton Facilities Management Limited, where the Society's holding is 75%.

Name of principal undertaking	Principal activity
Newcastle Financial Services Limited	Provision of financial services
Newcastle Mortgage Corporation Limited	Mortgage financiers
Newcastle Portland House Limited	Commercial property rental
Newcastle Strategic Solutions Limited	Provision of specialised products and services
Newton Facilities Management Limited	Provision of managed IT services
Newton Facilities Computer Purchasing Limited	Purchase, sale and leasing of IT equipment
Newton Facilities Computer Leasing Limited	Leasing of IT equipment

All the above subsidiary undertakings are incorporated in England and Wales and operate principally in Great Britain.

A Group segmental analysis is not provided as in the opinion of the directors, the Group's activities are predominantly UK based and within one business sector.

Quasi-subidiaries

The companies considered by the directors to be quasi-subidiaries as defined in Financial Reporting Standard No. 5 ('Reporting the Substance of Transactions') are set out below:

Name	Principal activity
Bamburgh Finance No.1 plc	Securitisation vehicle
Bamburgh Mortgages Trustee Limited	Securitisation vehicle
Bamburgh Holdings Limited	Holding company

The Society has no shareholdings in any of the companies listed above.

Bamburgh Finance No.1 plc is incorporated and operates in England. The other quasi-subidiaries are incorporated in Jersey.

14 INTANGIBLE FIXED ASSETS

Negative goodwill	£m
GROUP and SOCIETY	
Cost	
At 1 January 2002 and 31 December 2002	2.4
Amortisation	
At 1 January 2002	(0.7)
Released during year	(0.3)
At 31 December 2002	(1.0)
Net book value at 31 December 2002	1.4
Net book value at 31 December 2001	1.7

The negative goodwill arose as a result of the acquisition of Nottingham Imperial Building Society which transferred its engagements to Newcastle Building Society with effect from 1 February 2000. This negative goodwill is being amortised over seven years which is the period over which the directors expect to benefit from the fixed assets and mortgages acquired and is based on an estimate of their remaining useful lives.



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

15 TANGIBLE FIXED ASSETS

GROUP	Freehold Land and Buildings £m	Leasehold Land and Buildings £m	Investment Properties £m	Equipment, Fixtures, Fittings & Motor Vehicles £m	Total £m
Cost or valuation					
At 1 January 2002	3.6	15.4	2.4	15.7	37.1
Additions	0.2	0.2	-	1.4	1.8
Disposals	-	-	-	(0.3)	(0.3)
Transfers	(0.1)	-	-	0.1	-
Revaluations	-	-	0.7	-	0.7
At 31 December 2002	3.7	15.6	3.1	16.9	39.3
Depreciation					
At 1 January 2002	0.2	3.4	-	8.5	12.1
Charge for the year	0.1	0.3	-	2.0	2.4
Disposals	-	-	-	(0.1)	(0.1)
At 31 December 2002	0.3	3.7	-	10.4	14.4
Net book value at 31 December 2002	3.4	11.9	3.1	6.5	24.9
Net book value at 31 December 2001	3.4	12.0	2.4	7.2	25.0

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

15 TANGIBLE FIXED ASSETS Continued

SOCIETY	Freehold Land and Buildings £m	Leasehold Land and Buildings £m	Investment Properties £m	Equipment, Fixtures, Fittings & Motor Vehicles £m	Total £m
Cost or valuation					
At 1 January 2002	3.6	4.3	2.4	10.7	21.0
Additions	0.2	0.1	-	1.4	1.7
Disposals	-	-	-	(0.3)	(0.3)
Transfers	(0.1)	-	-	0.1	-
Revaluations	-	-	0.7	-	0.7
At 31 December 2002	3.7	4.4	3.1	11.9	23.1
Depreciation					
At 1 January 2002	0.2	2.9	-	6.0	9.1
Charge for the year	0.1	0.2	-	1.3	1.6
Disposals	-	-	-	(0.1)	(0.1)
At 31 December 2002	0.3	3.1	-	7.2	10.6
Net book value at 31 December 2002	3.4	1.3	3.1	4.7	12.5
Net book value at 31 December 2001	3.4	1.4	2.4	4.7	11.9

Included in the total net book value of equipment, fixtures, fittings and motor vehicles for both Group and Society is **£0.6 million** (2001: £0.8 million) in respect of assets held under lease purchase contracts. Depreciation for the year on these assets was **£0.2 million** (2001: £0.3 million).

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Included in leasehold land and buildings:				
Leaseholds with lives greater than fifty years	10.8	10.9	0.2	0.3
Other leaseholds	1.1	1.1	1.1	1.1
	11.9	12.0	1.3	1.4
Land and buildings occupied by the Group or Society for its own activities	11.5	11.5	3.4	3.3

Investment properties stated at **£2.8 million** (2001: £2.1 million) in both the Group and Society Accounts, were valued by Chesterton plc, property consultants on 28 January 2003. The remaining investment properties are included at directors' valuation.



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

16 OTHER ASSETS

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Amounts receivable from subsidiary undertakings	-	-	0.3	-
Unamortised incentives paid to customers	-	3.9	-	3.9
Other	13.7	1.8	13.1	2.1
	13.7	5.7	13.4	6.0

17 PREPAYMENTS AND ACCRUED INCOME

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Interest receivable on financial instruments	13.8	9.9	13.8	9.9
Other	4.9	1.6	13.0	9.2
	18.7	11.5	26.8	19.1

18 SHARES

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Held by individuals	2,046.8	1,902.7	2,046.8	1,902.7
Other shares	1.0	1.0	1.0	1.0
	2,047.8	1,903.7	2,047.8	1,903.7
Repayable from the date of the Balance Sheet in the ordinary course of business as follows:				
Accrued interest	57.0	24.6	57.0	24.6
On demand	1,612.8	1,536.2	1,612.8	1,536.2
In not more than three months	35.3	18.1	35.3	18.1
In more than three months but not more than one year	61.6	133.9	61.6	133.9
In more than one year but not more than five years	281.1	190.9	281.1	190.9
	2,047.8	1,903.7	2,047.8	1,903.7

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

19 AMOUNTS OWED TO CREDIT INSTITUTIONS

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Amounts owed to subsidiary undertakings	-	-	-	5.4
Other	52.8	120.6	52.8	120.6
	52.8	120.6	52.8	126.0
Repayable from the date of the Balance Sheet in the ordinary course of business as follows:				
Accrued interest	0.3	0.8	0.3	0.8
On demand	20.5	18.9	20.5	24.3
In not more than three months	29.0	98.9	29.0	98.9
In more than three months but not more than one year	3.0	1.0	3.0	1.0
In more than one year but not more than five years	-	1.0	-	1.0
	52.8	120.6	52.8	126.0

20 AMOUNTS OWED TO OTHER CUSTOMERS

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Amounts owed to subsidiary undertakings	-	-	3.0	3.0
Other	249.9	405.8	249.9	405.8
	249.9	405.8	252.9	408.8
Repayable from the date of the Balance Sheet in the ordinary course of business as follows:				
Accrued interest	2.1	3.8	2.0	3.8
On demand	68.7	62.8	71.8	65.8
In not more than three months	126.3	234.0	126.3	234.0
In more than three months but not more than one year	42.8	104.7	42.8	104.7
In more than one year but not more than five years	10.0	0.5	10.0	0.5
	249.9	405.8	252.9	408.8



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

21 DEBT SECURITIES IN ISSUE

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Certificates of deposit	5.0	40.0	5.0	40.0
Repayable from the date of the Balance Sheet in the ordinary course of business as follows:				
Accrued interest	-	0.5	-	0.5
In not more than one year	5.0	39.5	5.0	39.5
	5.0	40.0	5.0	40.0

22 OTHER LIABILITIES

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Income tax	4.3	4.7	4.3	4.7
Corporation tax	3.4	4.7	2.9	4.3
Group relief payable	-	-	-	0.1
Amounts owed to subsidiary undertakings	-	-	-	0.1
Obligations under lease purchase contracts	0.6	0.7	0.6	0.7
Other creditors	10.2	1.0	10.5	0.5
	18.5	11.1	18.3	10.4
Obligations under lease purchase contracts fall due as follows:				
Within one year	0.3	0.3	0.3	0.3
In one to two years	0.2	0.2	0.2	0.2
In two to five years	0.1	0.2	0.1	0.2
	0.6	0.7	0.6	0.7

The lease purchase contracts are secured by charges over the assets to which they relate.

23 ACCRUALS AND DEFERRED INCOME

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Interest accrued on subordinated liabilities	0.4	-	0.4	-
Interest accrued on subscribed capital	0.4	0.4	0.4	0.4
Retained mortgage risk charge premiums	1.3	2.0	1.3	2.0
Other	6.3	6.0	5.5	6.6
	8.4	8.4	7.6	9.0

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

24 PROVISIONS FOR LIABILITIES AND CHARGES

	GROUP		SOCIETY	
	2002 £m	2001 As restated £m	2002 £m	2001 As restated £m
Provision for deferred tax	0.1	0.2	-	-
Provision for pension costs in respect of part-time staff	0.7	0.7	0.7	0.7
Provision for claims	0.1	0.1	0.1	0.1
	0.9	1.0	0.8	0.8

Deferred tax

	GROUP		SOCIETY	
	2002 £m	2001 As restated £m	2002 £m	2001 As restated £m
Accelerated capital allowances	1.6	1.7	0.5	0.5
Short term timing differences	(0.9)	(0.9)	(0.9)	(0.9)
Undiscounted provision for deferred tax	0.7	0.8	(0.4)	(0.4)
Discount	(0.6)	(0.6)	(0.1)	(0.1)
Discounted provision for deferred tax	0.1	0.2	(0.5)	(0.5)

Provision

At 1 January 2002	0.2	(0.5)
Income and Expenditure Account	(0.1)	-
At 31 December 2002	0.1	(0.5)

The Society's deferred tax asset is included in 'Other Assets'. There is no unprovided deferred tax.

Provision for pension costs

Recent legislation has determined that part-time staff originally excluded from pension schemes should in fact, have been eligible for membership. Consequently, this provision has been established to meet obligations of the Society as a result of these legislative changes.

25 SUBORDINATED LIABILITIES

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Fixed rate subordinated notes 2017	25.0	-	25.0	-
Less: Unamortised issue costs	(0.2)	-	(0.2)	-
	24.8	-	24.8	-

On 2 October 2002, the Society issued £25 million of fixed rate subordinated debt. On a winding up, the claims of the noteholders are subordinated in right of payment to depositors and other creditors, and those holding shares where the Society remains a building society. Interest is payable at 6.19% and the notes are repayable at the Society's option and with the prior consent of the Financial Services Authority, on any interest date within five years of the maturity date.



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

26 SUBSCRIBED CAPITAL

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
12.625% permanent interest bearing shares	10.0	10.0	10.0	10.0
10.750% permanent interest bearing shares	10.0	10.0	10.0	10.0
	20.0	20.0	20.0	20.0
Less: Unamortised issue costs	(0.1)	(0.1)	(0.1)	(0.1)
	19.9	19.9	19.9	19.9

The subscribed capital, which is denominated in sterling, was issued for an indeterminate period and is only repayable in the event of the winding up of the Society.

27 INVESTMENT PROPERTY REVALUATION RESERVE

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
At 1 January 2002	(0.4)	(0.4)	(0.4)	(0.5)
Revaluation surplus for the year	0.7	0.1	0.7	0.1
Transferred to general reserve on sales of property	-	(0.1)	-	-
At 31 December 2002	0.3	(0.4)	0.3	(0.4)

28 GENERAL RESERVE

	Note	GROUP		SOCIETY	
		2002 £m	2001 As restated £m	2002 £m	2001 As restated £m
At 1 January 2002					
As previously reported		145.3	133.5	143.3	131.2
Prior year adjustment - deferred tax	8	-	(0.4)	-	0.1
As restated		145.3	133.1	143.3	131.3
Profit for the financial year		13.1	12.1	13.7	12.0
Transferred from investment property revaluation reserve on sales of property		-	0.1	-	-
At 31 December 2002		158.4	145.3	157.0	143.3

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

29 CONSOLIDATED CASH FLOW STATEMENT

	2002 £m	2001 £m	
Reconciliation of operating profit to net cash inflow from operating activities			
Operating profit	18.0	17.5	
(Increase) / decrease in prepayments and accrued income	(6.9)	9.7	
Increase in accruals and deferred income	-	1.6	
Provisions for bad and doubtful debts	0.2	1.2	
Net advances written off	(0.3)	(0.3)	
Depreciation and amortisation	2.1	2.0	
Profit on disposal of investment properties	-	(0.1)	
Interest on subordinated liabilities	0.3	-	
Interest on subscribed capital	2.3	2.3	
Interest on lease purchase contracts	0.1	0.1	
Other non-cash movements	0.1	(0.5)	
Net cash inflow from trading activities	15.9	33.5	
(Decrease) / increase in loans and advances to customers	106.7	(201.6)	
Decrease / (increase) in loans and advances to credit institutions	37.0	(20.8)	
Decrease in amounts owed to credit institutions	(67.8)	(1.1)	
(Decrease) / increase in amounts owed to customers	(11.8)	231.2	
Decrease in debt securities in issue	(35.0)	(4.4)	
(Increase) / decrease in other assets	(8.0)	1.8	
Increase in other liabilities	8.7	2.0	
Net cash inflow from operating activities	45.7	40.6	
Analysis of changes in cash during the year			
At 1 January	8.0	8.0	
Net cash inflow	0.5	-	
At 31 December	8.5	8.0	
Analysis of the balances of cash as shown in the Balance Sheet	2002 £m	Flows £m	2001 £m
Cash in hand and balances with Bank of England	4.0	(0.6)	3.4
Loans and advances to credit institutions repayable on demand	4.5	0.1	4.6
	8.5	(0.5)	8.0

The Group is required to maintain balances with the Bank of England which at 31 December 2002 amounted to **£2.6 million** (2001: £2.1 million).



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

30 MEMORANDUM ITEMS

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Commitments				
Irrevocable undrawn committed loan facilities	194.3	171.6	194.3	171.6

31 GUARANTEES AND FINANCIAL COMMITMENTS

- (i) Until 11 June 1996, under Section 22 of the Building Societies Act 1986, the Society had an obligation to discharge the liabilities of its subsidiary undertakings insofar as they were unable to discharge the liabilities out of their own assets. Subsequently, the Society has voluntarily agreed to provide continued support to all of its subsidiary undertakings, insofar as any liabilities are not covered by legislation.
- (ii) In common with other financial institutions, the Society has a contingent liability in respect of contributions to the Financial Services Compensation Scheme established under the Financial Services and Markets Act 2000. The Society has not been notified of any claims against the scheme.

(iii) Capital commitments at 31 December 2002 not provided for in these Accounts

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Capital expenditure contracted but not provided for	0.5	0.2	0.5	0.2

(iv) Operating lease commitments

The Group and Society are committed in the year ahead to the following payments under operating lease agreements in respect of land and buildings.

	GROUP		SOCIETY	
	2002 £m	2001 £m	2002 £m	2001 £m
Commitments which expire:				
Within one year	0.1	0.2	0.1	0.2
In one to five years	0.2	0.1	0.2	0.1
Over five years	1.1	1.1	1.2	1.2
	1.4	1.4	1.5	1.5

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

32 RETIREMENT BENEFITS

Pension Schemes

The Group operates both a defined benefit pension scheme and a defined contribution scheme. Costs are assessed by an independent qualified actuary on the basis of triennial valuations using the attained age method. The most recent Actuarial valuation of the Scheme was at 1 July 2001 and the market value of the Scheme's assets at that date was £22.0 million which represented 77% of the value of the benefits that had accrued to members, with a deficit of £6.5 million.

The SSAP 24 figures were calculated at 1 July 2001 based on the following assumptions:

Future price inflation		2.50%
Discount rate		5.75%
Increases in earnings		4.00%
Increases in pensions	Pre 1 July 2000	5.00%
	Post 30 June 2000	2.50%

The pension charge for the period was: Group and Society **£1.8 million** (2001: £2.0 million). The current contribution rates for the defined benefit scheme paid by the Society and by Scheme Members are 21% and 5% respectively. During 2002, the Society made a lump sum payment of £2.0 million into the Scheme.

The actuarial valuation used in assessing the FRS 17 disclosures was carried out as at 1 July 2001, and has been updated by Watson Wyatt Partners to take account of the requirements of FRS 17 and to assess the assets and liabilities of the Scheme at 31 December 2002. Scheme assets are stated at their market value on 31 December 2002.

The liabilities of the Scheme under FRS 17 were calculated using the projected unit method with the following assumptions:

	At 31-Dec-02		At 31-Dec-01	
Future price inflation	2.40%		2.50%	
Discount rate	5.80%		5.75%	
Increases in earnings	3.90%		4.00%	
Increases in pensions		Pre 1 July 2000	5.00%	5.00%
		Post 30 June 2000	2.40%	2.50%

The Scheme is closed to new entrants. Under the projected unit method, the current service cost will increase as members of the Scheme approach retirement.



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

32 RETIREMENT BENEFITS Continued

The assets of the Scheme and the expected rates of return were:

	Long term expected rate of return per annum at		Value at 31-Dec-02 £m	Value at 31-Dec-01 £m
	31-Dec-02 % pa	31-Dec-01 % pa		
Equities	8.50%	7.75%	12.1	12.0
Fixed Interest Bonds	5.15%	5.37%	8.0	7.9
Index Linked Bonds	4.60%	4.75%	1.9	2.0
Cash	3.90%	4.50%	0.2	0.2
Total market value of assets at 31 December			22.2	22.1
Present value of liabilities of the Scheme			34.0	31.6
Deficit in the Scheme			(11.8)	(9.5)
Related deferred tax asset			3.5	2.9
Net pension liability			8.3	6.6

Movement in deficit during the year

Deficit in the Scheme at beginning of year	9.5
Current service cost	1.0
Contributions	(3.1)
Past service cost	-
Other financing cost	0.3
Actuarial loss	4.1
Deficit in the Scheme at end of year	11.8

If FRS 17 had been fully adopted in these Accounts, then the impact would have been as follows:

	Note	GROUP 2002 £m	GROUP 2001 As restated £m
Other liabilities			
Other liabilities excluding pension liability	22	18.5	11.1
Pension liability		8.3	6.6
Total other liabilities		26.8	17.7
Reserves			
General reserve excluding pension liability	28	158.4	145.3
Pension liability		(8.3)	(6.6)
Investment property revaluation reserve	27	0.3	(0.4)
Total reserves		150.4	138.3

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

32 RETIREMENT BENEFITS Continued

	GROUP 2002 £m
Analysis of the amount charged to operating profit	
Current service cost	1.0
Past service cost	-
Total operating charge	1.0
Analysis of the amount charged to other financing cost	
Expected return on pension scheme assets	(1.5)
Interest on pension scheme liabilities	1.8
Net return	0.3
Analysis of amounts recognised in the Statement of Recognised Gains and Losses	
Loss on pension scheme assets	4.0
Experience loss arising on the scheme liabilities	0.6
Gain on change in assumptions underlying the present value of the scheme liabilities	(0.5)
Actual loss recognised	4.1
The experience gains and losses for the year ended 31 December 2002 were as follows:	
(Gain) / loss on scheme assets	
Amount	£4.0 million
Percentage of scheme assets	18%
Experience (gain) / loss on scheme liabilities	
Amount	£0.6 million
Percentage of the present value of the scheme liabilities	2%
Total amount recognised in the Statement of Recognised Gains and Losses	
Amount	£4.1 million
Percentage of the present value of the scheme liabilities	12%



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

33 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, mainly in the form of mortgages and savings products. It also uses wholesale financial instruments to invest liquid asset balances, raise wholesale funding and to manage the risks arising from its operations. 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 in the contract or agreement, such as interest rates, equity indices or house price indices.

The Group uses derivatives only in accordance with the Building Societies Act 1986 to limit the extent to which its activities may be affected by changes in interest rates or other factors specified in the legislation. Derivatives are not used in trading activity or for speculative purposes and all derivatives are therefore designated as hedging instruments.

Control of derivatives

The Board has authorised use of derivatives, retains overall responsibility for the Group's treasury activities and has appointed a Financial Risk Committee and Assets and Liabilities Committee to control and supervise these functions. The Group has a formal structure for managing risk which includes established risk limits, reporting lines, mandates and other control procedures. The structure is reviewed by the Financial Risk Committee and its minutes are presented to the Board on a regular basis.

Types of derivatives

The only derivatives used in balance sheet risk management are interest rate contracts which are used to hedge Group balance sheet exposures arising from fixed rate mortgage lending and savings products and from fixed rate funding and fixed rate investments. The risk associated with such activities is sensitivity to changes in interest rates. Such risk may alternatively be managed using on balance sheet instruments as part of the Group's integrated approach to risk management. Derivative products which are combinations of more basic derivatives are used only in circumstances where the underlying position being hedged contains the same risk characteristics. For example, where guaranteed equity bonds are issued by the Group these would be hedged with a single contract incorporating both the interest rate and equity index risk features. In such cases, the derivatives used will be designed to match exactly the risks of the underlying asset or liability so that exposure to market risk on such contracts is fully hedged.

The following table analyses the derivatives by type of contract and maturity and shows the nominal principal amount, credit risk weighted amount and replacement cost of the contracts. Nominal principal amount indicates the volume of business outstanding at the Balance Sheet date and does not represent amounts at risk. The replacement cost represents the cost of replacing contracts with positive values, calculated at market rates current at the Balance Sheet date and reflects the Group's exposure, should the counterparties default. The credit risk weighted amount, which is calculated in accordance with the rules specified by the Financial Services Authority, is based on the replacement cost but also takes into account measures of the extent of potential future exposure and the nature of the counterparty.

GROUP and SOCIETY

	Nominal Principal Amount 2002 £m	Credit Risk Weighted Amount 2002 £m	Replacement Cost 2002 £m	Nominal Principal Amount 2001 £m	Credit Risk Weighted Amount 2001 £m	Replacement Cost 2001 £m
Interest rate contracts						
Interest rate swaps	1,290.6	15.0	63.0	911.1	6.4	25.5
Caps, collars and floors	253.5	0.3	1.0	598.5	0.4	1.2
	1,544.1	15.3	64.0	1,509.6	6.8	26.7
Under one year	296.4	2.3	11.6	746.2	1.2	5.9
Between one and five years	634.5	9.0	41.8	430.7	4.2	18.8
Over five years	613.2	4.0	10.6	332.7	1.4	2.0
	1,544.1	15.3	64.0	1,509.6	6.8	26.7

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

33 FINANCIAL INSTRUMENTS Continued

The financial risks faced by the Group include credit risk, liquidity risk and interest rate risk. The Group has no exposure to foreign currency rate risk.

Credit risk

Credit risk is the risk that counterparties will not be able to meet their obligations as they fall due. The Financial Risk Committee is responsible for monitoring and, through the application of the Group's lending and financial risk policies, approving the Group's credit exposure.

Liquidity risk

The Group's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to adhere to the solvency ratios and to enable the Group to meet its financial obligations as and when they fall due. This is achieved through maintaining a prudent level of liquid assets, through committed wholesale funding facilities and through managed control of growth of the business.

Interest rate risk

The net interest income and economic value of the Group is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using a combination of on and off balance sheet instruments. The tables below set out the interest rate sensitivity exposure after taking into account the various derivatives entered into by the Group. Items are allocated to time bands by reference to the earlier of the next repricing date and the maturity date.

At 31 December 2002

	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non interest bearing £m	Total £m
Assets							
Liquid assets	460.5	23.3	30.2	8.2	-	9.3	531.5
Loans and advances to customers	1,328.5	27.3	40.0	328.3	275.2	-	1,999.3
Tangible and intangible fixed assets	-	-	-	-	-	23.5	23.5
Other assets	-	-	-	0.4	7.6	24.4	32.4
Total Assets	1,789.0	50.6	70.2	336.9	282.8	57.2	2,586.7
Liabilities							
Shares	1,506.0	29.8	38.6	382.2	91.2	-	2,047.8
Amounts owed to credit institutions, other customers and debt securities in issue	255.7	11.7	30.2	10.0	0.1	-	307.7
Other liabilities	-	-	-	-	-	27.8	27.8
Subordinated debt	-	-	-	-	-	24.8	24.8
Subscribed capital	-	-	-	-	-	19.9	19.9
Reserves	-	-	-	-	-	158.7	158.7
Total Liabilities	1,761.7	41.5	68.8	392.2	91.3	231.2	2,586.7
Off balance sheet items	221.4	(168.7)	14.5	159.8	(227.0)	-	-
Interest rate sensitivity gap	248.7	(159.6)	15.9	104.5	(35.5)	(174.0)	-
Cumulative gap	248.7	89.1	105.0	209.5	174.0	-	-



NOTES TO THE ACCOUNTS for the year ended 31 December 2002

33 FINANCIAL INSTRUMENTS *Continued*

At 31 December 2001

	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non interest bearing £m	Total £m
Assets							
Liquid assets	451.5	11.1	14.6	26.7	-	5.2	509.1
Loans and advances to customers	1,240.5	92.7	116.7	322.5	333.4	-	2,105.8
Tangible assets	-	-	-	-	-	23.3	23.3
Other assets	-	-	-	-	1.6	15.6	17.2
Total Assets	1,692.0	103.8	131.3	349.2	335.0	44.1	2,655.4
Liabilities							
Shares	1,371.3	87.8	62.8	290.8	91.0	-	1,903.7
Amounts owed to credit institutions, other customers and debt securities in issue	458.0	58.7	31.7	17.7	0.3	-	566.4
Other liabilities	-	-	-	-	-	20.5	20.5
Subscribed capital	-	-	-	-	-	19.9	19.9
Reserves	-	-	-	-	-	144.9	144.9
Total Liabilities	1,829.3	146.5	94.5	308.5	91.3	185.3	2,655.4
Off balance sheet items	328.5	(126.5)	26.0	96.6	(324.6)	-	-
Interest rate sensitivity gap	191.2	(169.2)	62.8	137.3	(80.9)	(141.2)	-
Cumulative gap	191.2	22.0	84.8	222.1	141.2	-	-

Liquid assets include cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. Other assets include other assets, prepayments and accrued income. Other liabilities include other liabilities, accruals and deferred income, provisions for liabilities and charges.

NOTES TO THE ACCOUNTS for the year ended 31 December 2002

33 FINANCIAL INSTRUMENTS *Continued*

Fair values of financial instruments

The table below compares the book and fair values of some of the Group's financial instruments by category at 31 December 2002 and 31 December 2001.

	2002 Book Value £m	2002 Fair Value £m	2001 Book Value £m	2001 Fair Value £m
On Balance Sheet instruments				
Liquid assets	531.5	532.0	509.1	508.9
Amounts owed to credit institutions, other customers and debt securities in issue	275.8	275.8	549.4	549.4
Off Balance Sheet and similar instruments	-	17.9	-	7.2

The table excludes certain financial assets and liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. It excludes mortgages, retail savings and other balance sheet items whose book and fair values may differ. Liquid assets include cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. Market values have been used to determine the fair values of all financial instruments. The fair values of all other items have been calculated by discounting expected future cash flows at prevailing interest rates.

Gains and losses on hedges

Hedges which comprise 'Off Balance Sheet and similar instruments' referred to above are used to reduce the risk of loss arising from changes in interest rates. Gains and losses on instruments used for hedging are generally not recognised until the exposure which is being hedged is itself recognised.

Unrecognised gains and losses on these instruments, and the movements therein are as follows:

	Total gains £m	Total losses £m	Total net gains / (losses) £m
Unrecognised gains and losses on hedges at 1 January 2002	26.7	(19.5)	7.2
Gains and losses arising in previous year that were recognised in year to 31 December 2002	(5.8)	1.0	(4.8)
Gains and losses arising before 1 January 2002 that were not recognised in year to 31 December 2002	20.9	(18.5)	2.4
Gains and losses arising in year to 31 December 2002 that were not recognised in the same year	43.2	(27.7)	15.5
Unrecognised gains and losses on hedges at 31 December 2002	64.1	(46.2)	17.9
Of which:			
Gains and losses expected to be recognised in the year to 31 December 2003	11.6	(0.5)	11.1
Gains and losses expected to be recognised after 31 December 2003	52.5	(45.7)	6.8
	64.1	(46.2)	17.9



ANNUAL BUSINESS STATEMENT for the year ended 31 December 2002

1 STATUTORY PERCENTAGES

	2002 %	Statutory %
Lending limit	14.21	25.0
Funding limit	13.06	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The statutory limits are as laid down under the Building Societies Act 1986, as amended by the Building Societies Act 1997, and ensure that the principal purpose of a building society is that of making loans which are fully secured on residential property and are funded substantially by its members.

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as $(X-Y)/X$ where:

X= business assets, being the total assets as shown in the Group Balance Sheet plus provisions for bad and doubtful debts and negative goodwill, less tangible fixed assets and liquid assets.

Y= the principal of, and interest accrued on, loans fully secured on residential property owed to the Group.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as $(X-Y)/X$ where:

X= shares and borrowings, being the aggregate of

- (i) the principal value of, and interest accrued on, shares in the Society
- (ii) the principal value of, and interest accrued on, sums deposited with the Society or any subsidiary undertaking of the Society and
- (iii) the principal value of, and interest accrued on, instruments or agreements creating or acknowledging indebtedness and accepted, issued or entered into by the Society or any subsidiary undertaking, less any amounts qualifying as own funds.

Y= the principal value of, and interest accrued on, shares held by individuals otherwise than as a bare or simple trustee for bodies corporate or for persons who include bodies corporate.

ANNUAL BUSINESS STATEMENT for the year ended 31 December 2002

2 OTHER PERCENTAGES

	2002 %	2001 As restated %
As a percentage of shares and borrowings:		
Gross capital	8.63	6.69
Free capital	7.72	5.82
Liquid assets	22.56	20.61
Profit for the financial year as a percentage of mean total assets	0.50	0.48
Management expenses as a percentage of mean total assets	0.98	0.96
Management expenses as a percentage of mean total assets under management	0.94	0.96

The above percentages have been prepared from the Group Accounts.

Gross capital represents the general reserve together with the investment property revaluation reserve, subordinated liabilities, subscribed capital and minority interests.

Free capital represents the gross capital plus general provisions for bad and doubtful debts and negative goodwill less tangible fixed assets.

Liquid assets are as shown in the Group Balance Sheet.

Shares and borrowings represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Management expenses represent the aggregate of administrative expenses, depreciation and amortisation.

Mean total assets are the average of the 2002 and 2001 total assets.

Mean total assets under management include those assets administered by the Society which are subject to non-recourse finance.



ANNUAL BUSINESS STATEMENT for the year ended 31 December 2002

DIRECTORS

		Date of Birth	Date of Appointment	Occupation
CJ Hilton MA	Chairman	19.1.50	1.1.78	Solicitor
	Other Directorships: Council Member of the University of Newcastle Upon Tyne; Dame Allan's Schools; NEPIA Trust Company Limited.			
JW Heppell	Vice Chairman	30.8.47	5.12.80	Company Director
	Other Directorships: Adamscastle Limited; Adamson Newcastle Limited; Bank of Newcastle Limited; Grainger Newcastle Properties Limited; NBS Financial Services Limited; Newcastle Bank Limited; Newcastle Developments Limited; Newcastle Financial Services Limited; Newcastle Mortgage Corporation Limited; Newcastle Portland House Limited; Newcastle Strategic Solutions Limited; Newton Facilities Computer Leasing Limited; Newton Facilities Computer Purchasing Limited; Northern Football Ground Limited; Paramount Homes Limited; St. Cuthbert Newcastle Estates Limited; Strachans (Newcastle) Limited.			
RJ Hollinshead BSc (Hons) ACA AT11	Chief Executive	20.5.55	8.9.92	Building Society Chief Executive
	Other Directorships: Adamscastle Limited; Adamson Newcastle Limited; Bank of Newcastle Limited; Common Purpose; Community Foundation Serving Tyne & Wear and Northumberland; NBS Financial Services Limited; Newcastle Bank Limited; Newcastle Developments Limited; Newcastle Financial Services Limited; Newcastle Gateshead Initiative; Newcastle Mortgage Corporation Limited; Newcastle Portland House Limited; Newcastle Strategic Solutions Limited; Newton Facilities Computer Leasing Limited; Newton Facilities Computer Purchasing Limited; Newton Facilities Management Limited; Strachans (Newcastle) Limited; The MEA Trust; Tyne & Wear Foundation Limited; Tyne & Wear Play Association.			
RB Allan MA FCA	-	2.8.40	1.5.99	Chartered Accountant
	Other Directorships: Shelter Trading Limited; T & G Allan Limited; The British Museum Friends.			
AAE Glenton CBE TD FCA DL	-	21.3.43	20.11.87	Chartered Accountant
	Other Directorships: Port of Tyne Authority; Portland Financial Management Limited; Ryecroft Glenton Services Limited; Charles W Taylor & Son Limited.			
MO Grant BA (Hons) OBE FRSA	-	16.8.46	22.5.95	Company Managing Director
	Other Directorships: Aroline Limited; Bio Sci North Limited; Council Member of the University of Newcastle Upon Tyne; County Durham Development Company Limited; Learning and Skills Council, County Durham; North Music Trust; Northern Cultural Skills Partnership; Port of Tyne Authority.			
AFC Hunter CBE AFC MA LLB DL	-	8.3.39	1.5.93	Company Director
	Other Directorships: Annington Holdings plc; Home Group Limited; Home Housing Trust; Kenton Bar Bunker Company Limited; Paramount Homes Limited; Urban Housing Trust Limited.			
RW Johnson MA FCIM FMS	-	22.3.39	1.5.98	Company Director
	Other Directorships: Northumberland Golf Club Limited.			
CJ Seccombe BSc (Hons) FCA	-	28.10.52	1.9.97	Building Society Finance Director
	Other Directorships: Bamburgh Finance No. 1 plc; Bamburgh Options Limited; NBS Financial Services Limited; Newcastle Mortgage Corporation Limited; Newcastle Portland House Limited; Newton Facilities Computer Leasing Limited; Newton Facilities Computer Purchasing Limited; Strachans (Newcastle) Limited.			

OTHER OFFICERS

C Greaves	Building Society Executive, Director of Newcastle Strategic Solutions Limited; Newton Facilities Management Limited.
L Todd	Building Society Executive, Director of NBS Financial Services Limited; Newcastle Mortgage Corporation Limited; Newton Facilities Management Limited; Strachans (Newcastle) Limited.
S Marks	Building Society Executive, Director of Newcastle Financial Services Limited.
A Macnaughton	Building Society Executive, Director of Newcastle Strategic Solutions Limited.
M Lant	Building Society Executive
AM Russell	Building Society Executive
JV Towers	Building Society Executive
SA Urwin	Building Society Executive

Documents marked 'private and confidential' may be served on the above named directors at the following address: Portland House, New Bridge Street, Newcastle Upon Tyne NE1 8AL.
 Mr RJ Hollinshead has a service contract entered into on 1 March 1998 which is terminable at any time by the Society on two year's notice or by himself on one year's notice.
 Mr CJ Seccombe has a service contract entered into on 16 September 1997 which is terminable at any time by the Society on one year's notice or by himself on three month's notice.