

The Shepherds Friendly Society Limited

Report of the Board of Management and Financial Statements

31 December 2009

The Shepherds Friendly Society Limited

Board: (as at 31st December 2009)
Roger Oakes Chairman
Joanne Hindle Vice Chairman,
Senior Independent Director
Kim Harris Distribution Director
Dianne Payne Finance Director
Geoffrey Spencer Chief Executive Officer

Registered Office: Shepherds House
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Cheadle
Cheshire
SK8 2AA

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Fax: **0161 428 3666**
Email: info@shepherds.co.uk
Website: www.shepherdsfriendly.co.uk

**Actuarial Function Holder
and With Profits Actuary:** **Christopher Critchlow** BSc FIA OAC plc

External Auditors: Brown and Batts LLP
Chartered Accountants
Registered Auditors

Internal Auditors: PKF (UK) LLP

Bankers: The Royal Bank of Scotland Plc

Investment Managers: Barings Asset Management LTD
Legal and General Asset Management LTD

Property Managers: Matthews and Goodman

Authorised and regulated by the Financial Services Authority
Incorporated under the Friendly Societies Act 1992
Registration No. 240F

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Your Board



Roger Oakes

Roger has run his own management consultancy in drug development for the Pharmaceutical Industry over the past 6 years. Prior to this his positions included being Founder and Managing Director of a Contract Research Organisation, and Executive and main board Director of a NASDAQ quoted Biotechnology Company.



Dianne Payne

Dianne was in banking for seventeen years before a career change took her into a number of industries as a qualified management accountant. These industries included Boots, a property development company and an American owned access equipment company.



Kim Harris

Kim has 22 years experience from the ground up to a senior level with the Woolwich Group. He has knowledge of both the retail and regulated arms with a strong emphasis on sales and distribution. He also has 10 years experience in the recruitment industry, specialising in providing financial services personnel. Kim is a Freeman of the City of London, a member of MENSA and has also raised in the region of £250,000 in support of local youth initiatives. He is also active in the voluntary sector being an Explorer Scout Leader and an expedition assessor for the Duke of Edinburgh Award Scheme.



Joanne Hindle

Joanne joined the financial services industry in 1986 and has held a variety of roles. Joanne has recently been on the Board of disability insurer "unum", serving for seven years as Corporate Services Director with responsibilities for all Governance matters. Having left "unum" earlier this year, she is now concentrating on chairing the charity "Employment opportunities for people with disabilities" and is Deputy Chair of the trade body "Investment & Life Assurance Group". Date appointed 18/10/08.



Geoffrey Spencer - Chief Executive

Geoff commenced his financial services career in 1974 with the Natwest Group and subsequently held senior positions at the Legal and General Group and Royal and SunAlliance Group. Prior to becoming Chief Executive of Shepherds in early 2006 he worked for two years as a Management Consultant and Interim Director when he fulfilled several Change Management roles for amongst others the Johnson Services Group, and Bradford and Bingley.

Chairman's Statement

Incorporating the Report of the Board of Management

Review of 2009

The serious difficulties in the financial markets, prevalent throughout 2008, continued into 2009. The Equity stock markets reached a low point in late March/early April 2009 but since then have rallied strongly to close substantially higher at the end of 2009 compared to the end of 2008. Whilst this has enabled the Society to end the year substantially stronger financially, the economy remained depressed for most of the year and we believe we will not see a major improvement in economic activity for at least another 12 months.

Against this difficult economic background I am pleased to confirm that we had a very successful year for new business sales and at the same time were able to contain costs. Sales were 127% higher than the previous year and our operating costs fell by 6%.

It is our intention to continue our strategy of cost control whilst seeking continued growth in our sales income as this approach, now entering its fifth year, has seen the Society come successfully through difficult times.

The financial turmoil of the last 2 years has resulted in the FSA more closely scrutinising the industry, especially with regard to governance structure and the quality of risk assessment. Particular emphasis has been placed on the competence of the non-executive directors and their level of commitment to ensure that firms are run properly. The FSA have made it very clear that they expect directors to dedicate considerably more time to the firms they serve which inevitably will have an, albeit small, impact on running costs.

I am pleased to say that we have again been able to keep our bonus rates unchanged. This does demonstrate the benefits of "smoothing" which enables us to pay bonuses both in difficult years for investments such as 2008 and in better years like 2009.

Business Objectives and Activities

The principal activity of the Society is to transact long-term assurance business for the benefit of its members. During 2009 it carried out its activities in accordance with its Memorandum and Rules.

In accordance with the requirements of the Friendly Societies Act 1992, the Board of Management confirms that all the activities carried out during the year by the Society have been carried out within its respective powers.

Solvency

The Society has maintained the required margin of solvency in accordance with FSA regulations.

Membership

As at 31st December 2009 the Society had 32,286 members (2008: 22,800).

Complaints

The Society has in place clearly documented procedures for the handling and recording of complaints. The Compliance Officer investigates all complaints thoroughly and impartially within a reasonable time.

A member who feels dissatisfied with the result of such investigation has the right to refer the complaint to the Financial Ombudsman Service.

Pension Scheme

The assets of the Society's defined benefit pension scheme are totally separate from the assets of the Society and are invested with independent fund managers. There are three trustees of the scheme, of whom one is an employee representative. The actuaries of the pension scheme are independent of those of the Society.

Political and charitable donations

No political donations were made in the year or previous year. No charitable donations were made in the year, but £133 was paid in 2008.

Appointment of Auditors

A resolution on the appointment of auditors will be proposed at the Annual General Meeting.

Statement of Disclosure of Information to Auditors

The directors who held office at the date of approval of the Report and Accounts confirm that, as far as each of them is aware, there is no information relevant to the audit of the Society's consolidated financial statements for the year ended 31st December 2009 of which the auditors are unaware. They have taken all the steps they should have taken as a director to make themselves aware of any relevant audit information and to establish that the Society's auditors are aware of that information.

R Oakes

Chairman

23rd March 2010

Chief Executive's Review

Investment Performance Review

Your Board believed that the stock markets had reached bottom during the period October 2008 to March 2009 and during this period we began to move investment funds back into equities. This strategy worked well and we benefited from the strong recovery which occurred from April onwards in the equity stock markets.

Our property investments have not fared so well with several of our investment properties having tenancy voids throughout 2009. This resulted in a loss of rental income, dilapidation repair costs and payment of empty business premise rates falling on the Society. Towards the end of 2009 there was an improvement in interest levels from prospective tenants and we expect the position to improve substantially in the coming twelve months.

The total value of our investment funds increased by 18.6% to £61.6m. The actual investment return on the whole portfolio was 15.5%.

The breakdown of our investment portfolio by asset class is shown below:

Asset Class	December 2008 %	December 2009 %
Equity Shares	33%	53%
Commercial Property	11%	15%
Gilts/Fixed Interest Bonds	40%	31%
Cash deposits	16%	1%

During 2009 the percentages of the asset classes exceeded the parameters outlined in the PPFM, but this is part of the deliberate strategy to maximise returns and minimise risk during a period of market volatility.

Operational Review

2009 was a very successful year with new business income growing by 127% and exceeding £1million. All three of our product distribution channels showed considerable increases.

We have also successfully contained operating costs and it is our intention to pursue a similar strategy of new business growth and cost containment for the next three years. We believe we can achieve this through steadily expanding the activities of our distribution channels whilst working smarter within the business administration processes we follow.

However, there are significant challenges facing us as the regulatory regime is developed and strengthened following the financial crisis. This will cause more of our surplus capital to be held as reserves and will bring significant change within our approach to how we sell new business via independent financial advisors. Projects commenced in 2009, which will run until late 2012, to ensure we are well placed to remain successful once the full impacts of these regulatory changes are in force.

G Spencer
Chief Executive
23rd March 2010

Corporate Governance Review

Throughout 2009, we have complied with the annotated version of the Combined Code on Corporate Governance published in July 2005.

In the sections below, we describe how we have complied with the requirements.

The Board

The Board meets a minimum of six times a year. Its primary responsibilities and decision taking areas are:-

- Setting the strategic direction
- Monitoring performance of the business and the executive
- Establishing the framework of systems and controls
- Monitoring risk via the framework of systems and controls
- Agreeing the appointment and remuneration levels of Executive Directors and Senior Managers

Direction of the day to day management of the Society is delegated to the Executive, who operate within defined authority limits.

The table alongside identifies the Board members, their positions and their attendance at Board and Board Sub-Committee meetings.

Board & Committee Attendance Summary

Board Meetings for 2009 =	8
David Somers (Chairman part of year)	4
Geoffrey Spencer	8
Kim Harris	6
Dianne Payne	8
Roger Oakes (Chairman part of year)	8
Joanne Hindle	8

The composition of Audit and Risk, and Nominations and Remuneration Committees changed several times during the year. All directors attended the meetings that they were expected to.

Chairman and Chief Executive

There is a clear division of responsibilities between the roles of Chairman and Chief Executive and they are conducted by different individuals. The respective roles are documented in the Board Manual.

The Chairman meets the definition of an Independent Director.

Board Balance and Independence

At the beginning of 2009 the board comprised 4 Non-Executive Directors and 2 Executive Directors, but there were some changes during the year. David Somers stood down as chairman on 24th March, later resigning from the board with effect from 27th November, the date of the AGM.

Kim Harris, then Vice Chairman took over as chairman from March until 1st October, when he became an executive director. At that time Roger Oakes was elected chairman.

Recognising the need to strengthen the Non-Executive Director numbers, two new directors have been recruited and have joined the board in 2010.

The Board contains a balance of management, investment, financial and financial services expertise, which ensures it has the appropriate skills and knowledge to direct the Society's business. Short CVs of the directors are shown on page 4.

All Non-Executive Directors are independent directors and Joanne Hindle is appointed as Senior Independent Director.

Appointments to the Board

The Society has adopted a transparent and independently managed process when making appointments to the Board. No current director has any significant other commitment.

Information and Professional Development

New Directors undergo a formal Induction Programme when appointed. All directors pursue a programme of Continuous Professional Development and this is appropriately documented and monitored by a professionally qualified HR specialist.

Board Performance Evaluation

The Board Appraisal process which involves Peer Group Assessment, analysis of the assessment, action plans and self assessment is a rolling programme during their term of office. All Board members record their Continuous Professional Development (CPD).

Re-election

The Society has procedures to ensure its Directors retire on a 3 year cycle and, if they wish, may submit for re-election. Nomination is subject to satisfactory performance assessments during the previous term. Appointment requires endorsement by membership vote.

Nominations and Remuneration

The Society has a Nominations and Remuneration Committee. It has not formed two separate committees as the Board does not believe the Society is of a size which would justify this. The Committee consists entirely of independent Non-Executive Directors and does not include the Chief Executive. The Chairman of this Committee for the majority of 2009 was Roger Oakes, but was superseded by Joanne Hindle when Roger became Chairman.

Nominations

The process to appoint Non-Executive Directors contains the following elements:-

- An open market search involving professional search agents and/or national newspaper advertising
- Initial interview by independent search agent
- Independently conducted Assessment Centre
- Final interview by Nominations and Remuneration Committee

If an Executive Director is appointed from outside the business, a similar process is followed. If an Executive Director is appointed internally, then the decision is based on past performance review and an independent assessment process.

Remuneration

The Committee recommends remuneration packages to the Board for all Directors and the Company Secretary. It does so by reference to what levels of remuneration are necessary to attract the right calibre of individual in the context of the financial services market place. It ensures that a significant portion of overall remuneration of executives is linked to the achievement of corporate and personal targets. None of the Executive Directors hold Non-Executive director positions elsewhere.

Directors' Report on Remuneration

Nominations and Remuneration Committee

The members who served on the Committee during the year were:

Roger Oakes (Chairman)

Joanne Hindle

David Somers (part of year)

Remuneration Policy

The Committee considers the remuneration levels for Executive and Non-Executive Directors. It does so by reference to equivalent salaries paid by the financial services sector in general and by Friendly Societies. Packages are designed to attract and motivate the right calibre of individual.

Non-Executive Directors

NEDs are paid a basic salary, supplemented by a daily rate when additional work is necessary for specific projects. Due to the relatively small size of the Society, it is not felt that additional performance-related incentives are needed.

Notice periods have not been built into their Service Agreements. The Society does not pay compensation for early termination of a NED's agreement.

Executive Directors

Remuneration for Executive Directors is made up of salary, annual performance related bonus and contributions to the defined contribution pension scheme. In addition, the Chief Executive, G Spencer, has a "flex benefit" which entitles him to choose from a range of additional benefits, including cash.

The Chief Executive's bonus is linked to a number of performance indicators as decided by the Nominations and Remuneration Committee and is limited to a maximum of 50% of basic salary. Other Directors' bonuses are based on a combination of Society and personal performance.

There is no limitation on the number of years that an Executive Director may serve and the notice period can be from three to six months, depending upon the position. The CEO is entitled to 6 months notice should his contract be terminated under normal circumstances. However, if the reason for termination is that the Society has been acquired or transfers its engagements, then an additional one month's notice for each year of service is added, to a maximum of twelve months in all.

There are no long term incentive schemes in place.

Service Agreements

	Commencement	Expiry	Notice period
G Spencer	20/2/2006	N/A	6 months
D Payne	19/5/2003	N/A	3 months
K Harris (exec)	1/10/2009	N/A	3 months
R Oakes	5/6/2004	2010	N/A
J Hindle	18/10/2008	2010	N/A

Corporate Governance Review - Accountability and Audit

The Society has an Audit Committee, which is chaired by Joanne Hindle. Its Terms of Reference are published on the Society's web site.

The Committee conducts an ongoing process of reviewing the Society's system of internal controls and, where risks of significance are identified, they are managed via the Society's Risk Register.

The Audit Committee aims to meet not less than 4 times a year to conduct its affairs and will include meetings with the External Auditors and the Internal Auditors to discuss the work they conduct independently.

The Society has a documented 3 year audit programme and shares its internal audit work between its in house Compliance Department and its appointed Internal Auditors.

Corporate Governance Review - Constructive use of the AGM

The Society seeks to ensure the AGM provides an opportunity for open and transparent communication with its Members.

We distribute notice of the AGM and associated papers at least 20 working days ahead of the meeting.

Separate resolutions are published for each substantive item and the numbers of proxy votes are independently verified. The numbers of proxy votes cast for each resolution are announced at the AGM.

Statement of Responsibilities of the Board of Management

Friendly Society law and the rules of the Society require the Board of Management to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Society and its subsidiary as at the end of each financial year and the income and expenditure of the Society and its subsidiary for that period. In preparing these financial statements the Board is required to:

- select suitable 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 financial statements, and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Society will continue in business.
- The directors confirm that they have complied with the above requirements in preparing the financial statements.

The Board is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Society and its subsidiary and for ensuring that the Society and its subsidiary establishes and maintains systems of control of its business and records and of inspection and report in accordance with the Friendly Societies Act 1992.

It is also responsible for establishing satisfactory systems of control of the Society's business and records, and of inspection and report, to enable the Board and the Society to comply with the Friendly Societies Act 1992 and the Financial Services and Markets Act 2000.

The Board of Management has a general responsibility for taking such steps as are reasonably open to it to safeguard the assets of the Society and to prevent and detect fraud and other irregularities.

Independent Auditor's Report

TO THE MEMBERS OF THE SHEPHERDS FRIENDLY SOCIETY LIMITED

We have audited the financial statements of The Shepherds Friendly Society Limited (the Society) for the year ended 31 December 2009 which comprise Income and Expenditure Accounts, the Balance Sheets and related notes. These financial statements have been prepared under the accounting policies set out therein.

The maintenance and integrity of the Society's website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

This report is made solely to the Society's members as a body in accordance with section 73 of the Friendly Societies Act 1992. Our audit work has been undertaken so that we may state to the Society's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Board of Management and Auditors

The Board of Management responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards are set out in the Statement of responsibilities of the Board of Management.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it.

In addition we report to you if, in our opinion, the Society has not kept proper accounting records, or if we have not received all the information, explanations and access to documents that we require for our audit or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We also report to you our opinion as to whether the Report of the Board of Management has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it, and as to whether the information given therein is consistent with the financial statements.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises the Report of the Board of Management and Corporate Governance review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of Opinion

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

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the Society's and the Group's affairs as at 31 December 2009 and of the income and expenditure of the Society and the Group for the year then ended, and have been properly prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it.
- the Report of the Board of Management has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it and the information given therein is consistent with the financial statements for the financial year.

Brown & Batts (Registered Auditors, Chartered Accountants)
25-29 Harper Road
London Bridge
London SE1 1AW
23rd March 2010

Society Income and Expenditure Account for the year ended 31 December 2009

	Notes	2009 £	2009 £	2008 £	2008 £
Technical account - Long term business					
Earned premiums					
Gross premiums written	2	8,381,375		3,995,110	
Outward reinsurance premiums		<u>(24,540)</u>		<u>(11,082)</u>	
Net premiums			8,356,835		3,984,028
Investment income					
Land and buildings		464,865		614,687	
Other investments		1,681,794		1,974,141	
Losses on the realisation of investments		<u>(175,156)</u>		<u>(1,346,713)</u>	
			1,971,503		1,242,115
Unrealised gains/losses on investments					
Other technical income	1		<u>2,546</u>		<u>171</u>
Total technical income			<u>16,734,867</u>		<u>(3,144,557)</u>

	Notes	2009 £	2009 £	2008 £	2008 £
Claims incurred					
Claims paid - gross amount		4,882,666		5,204,041	
Change in the provision for claims		<u>(69,715)</u>		<u>47,448</u>	
			4,812,951		5,251,489
Changes in other technical provisions					
Long term business provision transfer	11		4,015,761		860,182
Other expenditure					
Net operating expenses					
Other operating expenses	3	2,309,074		2,481,212	
Investment expenses		<u>97,090</u>		<u>94,121</u>	
			2,406,164		2,575,333
Other technical charges	1		311,000		45,000
Taxation	7		0		0
Transfer: Fund for Future Appropriations	11		5,188,991		(11,876,561)
Total technical expenditure			<u>16,734,867</u>		<u>(3,144,557)</u>
Balance on technical account - long term business			0		0

The attached notes form part of these accounts. All income and expenditure relates to continuing operations of the Society. There were no recognised gains or losses in 2009 or 2008 other than those shown in the accounts.

Group Income and Expenditure Account for the year ended 31 December 2009

	Notes	2009 £	2009 £	2008 £	2008 £
Technical account - long term business					
Earned premiums					
Gross premiums written	2	8,381,375		3,995,110	
Outward reinsurance premiums		<u>(24,540)</u>		<u>(11,082)</u>	
Net Premiums			8,356,835		3,984,028
Investment income					
Land and buildings		464,865		614,687	
Other investments		1,675,842		1,932,541	
Losses on the realisation of investments		<u>(175,156)</u>		<u>(1,346,713)</u>	
			1,956,551		1,200,515
Unrealised gains/losses on investments					
Other technical income	1		<u>233,060</u>		<u>123,087</u>
Total technical income			<u>16,959,429</u>		<u>(3,063,241)</u>

	Notes	2009 £	2009 £	2008 £	2008 £
Claims incurred					
Claims paid - gross amount		4,882,666		5,204,041	
Change in the provision for claims		<u>(69,715)</u>		<u>47,448</u>	
			4,812,951		5,251,489
Changes in other technical provisions					
Long term business provision transfer	11		4,015,761		860,182
Net operating expenses	3				
Other operating expenses		2,133,794		2,279,358	
Investment expenses		<u>97,090</u>		<u>94,121</u>	
			2,230,884		2,373,479
Other technical charges	1		<u>728,915</u>		<u>413,087</u>
Taxation	7				
Transfer: Fund for Future Appropriations	11		<u>5,170,918</u>		<u>(11,961,478)</u>
Total technical expenditure			<u>16,959,429</u>		<u>(3,063,241)</u>
Balance on technical account - long term business			0		0

The attached notes form part of these accounts. All income and expenditure relates to continuing operations of the Society. There were no recognised gains or losses in 2008 or 2009 other than those shown in the accounts.

Society Balance Sheet as at 31 December 2009

ASSETS	Notes	2009 £	2009 £	2008 £	2008 £
Investments					
Land and buildings	9	9,525,504		5,843,000	
Other financial investments	9	<u>52,182,431</u>		<u>37,949,541</u>	
			61,707,935		43,792,541
Debtors					
Debtors arising out of direct insurance operations with members		53,154		25,826	
Other debtors	10	<u>(8,570)</u>		<u>(7,844)</u>	
			44,584		17,982
Other assets					
Tangible assets	12	86,679		116,604	
Cash at bank and in hand		<u>396,427</u>		<u>8,551,742</u>	
			483,106		8,668,346
Prepayments and accrued income					
Accrued interest and rent		67,097		67,785	
Deferred acquisition expenses	1	324,792		354,422	
Other prepayments and accrued income		<u>227,960</u>		<u>442,409</u>	
Total prepayments and accrued income			<u>619,849</u>		<u>864,616</u>
Total assets excluding pensions asset			62,855,474		53,343,485
Net Pension Asset	14				149,000
Total Assets			<u>62,855,474</u>		<u>53,492,485</u>

LIABILITIES	Notes	2009 £	2009 £	2008 £	2008 £
Reserves					
Revaluation reserve	8			(3,407,267)	
Fund for future appropriations	11	<u>17,314,547</u>	17,314,547	<u>15,532,823</u>	12,125,556
Technical provisions					
Long term business provision	11	44,621,627		40,605,866	
Claims outstanding		<u>25,270</u>	44,646,897	<u>94,985</u>	40,700,851
Provisions for other risks and charges					
Creditors					
Creditors arising from direct insurance operations		217,586		196,000	
Other creditors, including taxation and social security		<u>138,833</u>	356,419	<u>154,678</u>	350,678
Accruals and deferred income			<u>375,611</u>		<u>315,400</u>
Total Liabilities excluding pension liability			62,693,474		53,492,485
Pension liability	14		<u>162,000</u>		
Total Liabilities			<u>62,855,474</u>		<u>53,492,485</u>

The attached notes form part of these accounts

Approved by the Board on 23rd March 2010

R Oakes Chairman

J Hindle Vice Chairman

Group Balance Sheet as at 31 December 2009

ASSETS	Notes	2009 £	2009 £	2008 £	2008 £
Investments					
Land and buildings	9	9,525,504		5,843,000	
Other financial investments	9	<u>51,682,431</u>		<u>37,449,541</u>	
			61,207,935		43,292,541
Debtors					
Debtors arising out of direct insurance operations with members		53,154		25,826	
Other debtors	10	<u>(8,570)</u>		<u>(7,844)</u>	
			44,584		17,982
Other assets					
Tangible assets	12	86,921		117,511	
Cash at bank and in hand		<u>505,510</u>		<u>8,669,065</u>	
			592,431		8,786,576
Prepayments and accrued income					
Accrued interest and rent		67,097		67,785	
Deferred acquisition expenses	1	324,792		354,422	
Other prepayments and accrued income		<u>235,269</u>		<u>446,601</u>	
Total prepayments and accrued income			<u>627,158</u>		<u>868,808</u>
Total assets excluding pensions asset			<u>62,472,108</u>		<u>52,965,907</u>
Net Pension Asset	14				149,000
Total Assets			<u>62,472,108</u>		<u>53,114,907</u>

LIABILITIES	Notes	2009 £	2009 £	2008 £	2008 £
Reserves					
Revaluation reserve	8			(3,407,267)	
Fund for future appropriations	11	<u>16,916,834</u>	16,916,834	<u>15,153,183</u>	11,745,916
Technical provisions					
Long term business provision	11	44,621,627		40,605,866	
Claims outstanding		<u>25,270</u>	44,646,897	<u>94,985</u>	40,700,851
Provisions for other risks and charges					
Creditors					
Creditors arising from direct insurance operations		217,586		196,000	
Other creditors, including taxation and social security		<u>153,180</u>		<u>156,740</u>	
			370,766		352,740
Accruals and deferred income			<u>375,611</u>		<u>315,400</u>
Total Liabilities excluding pension liability			62,310,108		53,114,907
Pension liability			<u>162,000</u>		
Total Liabilities			<u>62,472,108</u>		<u>53,114,907</u>

The attached notes form part of these accounts

Approved by the Board on 23rd March 2010

R Oakes Chairman

J Hindle Vice Chairman

Notes to the Accounts

1 Accounting policies

Basis of Accounting

The accounts have been prepared in accordance with the Friendly Societies Act 1992, the Friendly Societies (Accounts and Related Provisions) Regulations 1994, with applicable accounting standards and with the Statement of Recommended Practices issued by the Association of British Insurers "The ABI Sorp" in December 2005 and revised in December 2006.

Basis of Consolidation

The Group Accounts comprise the assets, liabilities, and income and expenditure account transactions of the Society and its subsidiary. The ongoing results of the subsidiary are included with Other Technical Income and Other Technical Charges. The net results are included in the Fund for Future Appropriations for the Group. The activities of the Society and Group are accounted for in the Income and Expenditure Technical Account.

Premium Income

Premium income is included in the income and expenditure account on the basis of premiums due from members during the year. Reinsurance premiums are included when they are payable.

Claims

Claims are included on the following basis:

- Maturities when they become due
- Deaths when notified to the Society
- Surrenders when the policies ceases to be included in the long term business provision
- Reinsurance receipts are brought into account to match the recognition of the claim

Investment Income

Investment income includes dividends, interest, rents and realised gains and losses on investments. They are all included on an accruals basis except for realised gains and losses, which are included as the difference between the net sale proceeds and the original cost of purchase. Unrealised gains and losses are calculated as the difference between the valuation of the investments at the balance sheet date and the valuation at the last balance sheet date.

Investments

These are shown on the balance sheet at the following values:

- Land and buildings: at the last independent professional valuation
- Quoted investments: at the mid-market value at the accounting date
- Authorised unit trusts: at the published bid prices at the accounting date

No depreciation or amortisation is provided in respect of freehold or leasehold properties. As properties are included in the financial statements at their open market values the Board consider that no depreciation is required to give a true and fair view. It would be neither practical or of real value to determine depreciation or amortisation taken into account in arriving at open market values.

Tangible Fixed Assets

Tangible assets are capitalised and depreciated by equal annual instalments over their estimated useful life. The principal rates use for this purpose are as follows:

- Computer equipment is depreciated over 2 years
- Other equipment is depreciated over 4 years.

Technical Provisions

The provisions are determined by the Society's Actuarial Function Holder following his annual investigation of the long term business. The methods and assumptions used in the valuation have been approved by the Board.

Tax attributable to long term business

Taxes are provided for at the current rates in respect of the taxable element in the Society's business. As a registered Friendly Society the Society is only subject to tax on part of its life and endowment business.

Deferred Taxation

In accordance with Financial Reporting Standard 19 deferred taxation is provided for in full on all material timing differences that have originated but not reversed at the balance sheet date.

Deferred tax assets are recognised to the extent that it is considered that more likely than not they will be recovered.

Deferred Acquisition Expenses

For single premium and Holloway (sickness) policies no acquisition expenses are deferred. For regular premium assurance policies the deferred acquisition expenses have been determined using a Zilmerisation approach and have been calculated on the basis of a prudential assessment of their recovery from the margins contained in the future premiums.

Other technical income and technical charges

Other technical income and charges in the Society are in relation to the Society's superannuation fund and are in accordance with FRS 17. In addition, other technical income and charges in the Group refers to income and expenditure incurred by the subsidiary.

Notes to the Accounts

2 Premium Analysis

All premiums are written in the United Kingdom on a direct basis and relate to individual business. The following note refers to the Society and not the Group.

Long Term Life Business	2009 £	2009 £	2008 £	2008 £
Non Profit Policies				
Periodic premiums	104,814		70,259	
Reinsurance	<u>(13,988)</u>	90,826	<u>(10,481)</u>	59,778
With Profit Policies				
Periodic premiums	3,884,029		3,758,675	
Reinsurance	<u>(10,552)</u>	3,873,477	<u>(601)</u>	3,758,074
Single premium		<u>4,392,532</u>		<u>166,176</u>
		8,356,835		3,984,028
Annualised new business written: Society and Group			2009 £	2008 £
Single Premium			35,574	18,984
Life Assurance			530,653	165,607
Sickness			<u>335,810</u>	<u>203,656</u>
			902,037	388,247

3 Society and Group Net Operating Expenses

	Society 2009 £	Group 2009 £	Society 2008 £	Group 2008 £
Acquisition costs	1,358,355	1,183,075	1,217,910	1,016,056
Changes in deferred acquisition cost	29,630	29,630	52,489	52,489
Administration expenses	<u>921,089</u>	<u>921,089</u>	<u>1,210,813</u>	<u>1,210,813</u>
	2,309,074	2,133,794	2,481,212	2,279,358

Also included in the operating expenses are:

	Society 2009 £	Group 2009 £	Society 2008 £	Group 2008 £
Auditor's remuneration and expenses for audit services:	32,700	34,040	17,500	17,500
For non-audit services	3,500	3,850	9,800	10,500

Notes to the Accounts

4 Staff Costs

The staff costs for the Group, including directors' fees, for the year, were:

	2009 £	2008 £		2009	2008
Wages and salaries	795,695	751,400	Average number of employees:		
Social security costs	78,269	74,890	Sales	6	4
Pension costs	<u>42,904</u>	<u>40,221</u>	Administration	22	18
	916,868	866,511	Board	<u>6</u>	<u>6</u>
				34	28

5 Board Remuneration

	Salary £	Bonus £	Other Benefits £	Total 2009 £	Total 2008 £
G Spencer	80,542	10,324	5,435	96,301	98,800
D Payne	40,618	5,945	3,249	49,812	66,824
K Harris	32,513		3,986	36,499	17,937
J Hindle	17,308		1,506	18,814	2,256
D Somers	13,883		1,022	14,905	19,937
R Oakes	22,883		1,643	24,526	16,639
Total	207,747	16,269	16,841	240,857	222,393

Other benefits include contributions to money purchase schemes of £9,977 plus car allowance of £1,875, for executive directors. Non-executive directors receive expenses for travel to and from board meetings at Head Office. These are taxed through PAYE and are included under 'Other Benefits'.

6 Related Party Transactions

K Harris is a director of a company, Peak Search and Select Ltd, which provided services during the year totalling £36,877 including VAT. (2008: nil)

Advantage has been taken of the exemption in FRS 8 not to disclose transactions with entities that are part of the Shepherds Friendly group.

7 Taxation

The Society has tax losses to carry forward and as such there is no tax liability for the current year. These losses would normally create a deferred tax asset but they cannot be recognised under FRS 19 on the basis that foreseeable recovery cannot be determined with reasonable certainty.

8 Revaluation Reserve

The revaluation reserve has been a component of the Fund for Future Appropriations, and, in line with other Friendly Societies, it has been decided to combine the two reserves.

9 Society Investments

Land and buildings.

	Cost 2009 £	Market Valuation 2009 £	Cost 2008 £	Market Valuation 2008 £
Freehold properties partly occupied by the Society	361,483	250,333	361,483	267,000
Other investment properties	1,758,350	6,100,171	1,828,350	2,621,000
Long leasehold	805,067	3,175,000	805,067	2,955,000
	2,924,900	9,525,504	2,994,900	5,843,000

The properties were valued in full at 31st December 2005 by Dunlop Haywards, Chartered Surveyors. The properties were valued on an open market existing use basis. In December 2009 Matthews and Goodman, Chartered Surveyors, fully valued one third of the properties and undertook a 'desktop' valuation of the remaining two thirds. The full value of the property occupied by the Society is £750,000, of which the Society occupies one third.

Notes to the Accounts

Other financial investments

	Cost 2009 £	Market Valuation 2009 £	Cost 2008 £	Market Valuation 2008 £
UK and overseas listed shares	32,413,084	32,071,179	22,536,626	16,466,060
UK listed fixed interest securities	18,102,378	19,306,025	15,333,581	16,089,605
Overseas fixed interest securities	0	0	4,325,027	4,267,863
Real Estate Investment Trust	1,550,458	305,227	1,507,525	626,013
	52,065,920	51,682,431	43,702,759	37,449,541

Investment in subsidiary.

The Society owns 100% of the ordinary share capital of Shepherds Network Limited.

	Shares in subsidiary £	Loans to subsidiary £
As 31 December 2009	500,000	0

10 Other Debtors

	2009 £	2008 £
Gift vouchers	530	
Other (Provision for bad debt)	(9,100)	(7,844)
	(8,570)	(7,844)

11 Movements in Provisions and Appropriations

Fund for future appropriations (Group)

	2008 £	2008 £	2009 £	2009 £
Balance at 1 January		15,153,183		18,743,791
Transfer from/to income and expenditure account	5,170,918		(11,961,478)	
Transfer from/to revaluation reserve	(3,407,267)		8,370,870	
		1,763,651		(3,590,608)
Balance at 31 December (Group and Society)		16,916,834		15,153,183
Loss realised in subsidiary		397,713		379,640
Balance at 31 December (Society)		17,314,547		15,532,823
Less pension asset (FRS 17)		162,000		(149,000)
Balance at 31 December less pension asset		17,476,547		15,383,823

Long term business provision

	2009 £	2008 £
Balance at 1 January	40,605,866	39,745,684
Transfer from income and expenditure account	4,015,761	860,182
Balance 31 December	44,621,627	40,605,866

The technical provisions were calculated by the Society's Actuarial Function Holder, using assumptions as follows:

1 Life and Endowment Fund

The net premium valuation method was adopted using a per annum interest rate of 3.5% and 3.0% for tax exempt and taxable non-profit business respectively and 2.0% for all with-profits. (2008: 3.5%, 3.0%, 2.0% respectively) Mortality based on A67/70 tables with a four year deduction for female lives was assumed.

Old table assurances were valued as the maximum sum assured under the contracts. With profit bonds were taken at face value as at 31 December 2009.

No allowance for bonus at 31 December 2009 was made in calculating the above provisions.

2 Sickness Fund

Sickness benefits were valued by a gross premium valuation method using an interest rate of 3.5% per annum, 100% of A67/70 mortality, and sickness rates of 80% of Manchester Unity AHJ sickness rates. An allowance for expenses of 15% of premiums and a notional dividend of £2.70 per unit (£1.35 per share) for adult business and £3.15 per unit (£1.575 per share) for juvenile business were assumed.

3 Members' Individual Credit Funds

Members' individual credit funds were taken at face value at 31 December 2009 and allowing for members' allocations (but excluding interest) at that date.

4 Pension Fund

Unitised with profits pension policies were valued at the face value of the units allocated at 31 December 2008 including bonuses added throughout 2009.

Notes to the Accounts

12 Tangible Assets: Society

Cost	Motor Vehicles £	Equipment and Furniture £	Total £
At 1 January 2009	82,813	158,891	241,704
Additions	0	46,750	46,750
Disposals	0	(94,311)	(94,311)
At 31 December 2009	82,813	111,330	194,143
Depreciation			
At 1 January 2009	24,577	100,524	125,101
Provided in year	20,703	55,971	76,674
Disposals	0	(94,311)	(94,311)
At 31 December 2009	45,280	62,184	107,464
Net book value			
31 December 2009	37,533	49,146	86,679
31 December 2008	58,236	58,367	116,603

13 Statement in accordance with Section 77 of the Friendly Societies Act 1992

The following information has been provided in accordance with Section 77 of the Friendly Societies Act 1992:

- 1 The Actuarial Function Holder and the With Profits Actuary during the year was Mr C. Critchlow BSc FIA, an employee of OAC plc. Neither Mr Critchlow, his wife or his children were members of the Society at any time during 2009.
- 2 Neither Mr Critchlow, his wife or children had any financial interest in any transaction with the Society at any time during 2009, other than as an employee of OAC plc.
- 3 The only remuneration was the fee for professional services paid to OAC plc for the services provided by Mr Critchlow and his support team. The amount payable in this respect amounted to £134,119 exclusive of VAT (2008: £120,607). No other benefits, emoluments, pensions or compensation were paid.
- 4 Mr Critchlow did not receive, and will not receive, any other financial benefit.

14 Staff Pension Scheme: Society and Group

The Society operates a defined benefit scheme in the UK. A full actuarial valuation was carried out at 5 April 2006 and updated to 31 December 2009 by a qualified independent actuary.

FRS 17 figures for the period ending 31 December 2009:

The amounts recognised in the balance sheet are:	Year ending 31 December 2009 £000	Year ending 31 December 2008 £000
Present value of funded obligations	3,834	3,279
Fair value of plan assets	<u>3,672</u>	<u>3,428</u>
Surplus/(deficit) in the plan	(162)	149
Restriction on recoverable surplus	0	0
Present value of unfunded obligations	0	0
Unrecognised past service cost	<u>0</u>	<u>0</u>
Total surplus/(deficit) recognised	(162)	149
Related deferred tax asset	<u>0</u>	<u>0</u>
Net asset/liability recognised	(162)	149
Amounts recognised in profit or loss are:		
Current service cost (company)	6	9
Interest on obligation	210	216
(expected return on plan assets)	(206)	(257)
Past service costs	0	0
Losses/(gains) on curtailments and settlements	0	0
Impact, if any, of limit on recognisable surplus	<u>0</u>	<u>0</u>
Total amount recognised	10	(32)

Notes to the Accounts

Amounts recognised in statement of total recognised gains and losses:	Year ending 31 December 2009 £000	Year ending 31 December 2008 £000
Actuarial gains/(losses) on the assets and liabilities	(309)	(263)
(Restriction due to limit on recoverable surplus)	0	0
Total gain/(loss) recognised	(309)	(263)
Recognition of change in defined benefit scheme obligation:		
Opening defined benefit obligation	3,279	3,878
Current service costs (company only)	6	9
Interest cost	210	216
Actual contributions paid by plan participants	4	7
Actuarial (gains)/losses on obligation	637	(509)
Foreign currency exchange rate impact	0	0
(Benefits paid – including insurance premiums)	(302)	(319)
Past service costs	0	0
Business combinations	0	0
Curtailment losses/(gains)	0	0
Settlement losses/(gains)	0	0
Closing defined benefit obligation	3,834	3,279
Reconciliation of change in plan assets:		
Fair value of plan assets at start of accounting period	3,428	4,250
Expected return on plan assets	206	257
Actuarial gains/(losses) on assets	328	(772)
Gains/(losses) due to foreign currency exchange rate changes	0	0
Contributions paid by the employer	8	8
Actual contributions paid by plan participants	4	4
(Benefits paid)	(302)	(319)
Business combinations	0	0
Settlements	0	0
Fair value of plan assets at end of accounting period	3,672	3,428

Further disclosures relating to the plan assets:

The major categories of plan assets, measured at fair value are:	Year ending 31 December 2009 £000	Year ending 31 December 2009 £000
Equities/property	1,508	1,051
Gilts and bonds	1,998	2,202
Cash	166	175
Other	0	0
Total fair value of assets	3,672	3,428
Amount included in fair value of assets for the following items:		
Each category of the company's own financial instruments	0	0
Property or other assets used by the company	0	0
Total	0	0
Actuarial return on plan assets during the period is	534	(515)
Principal actuarial assumptions at the end of the accounting period		
Discount rate at the end of the period (%pa)	5.70%	6.70%
Expected return on plan assets (%pa)	5.80%	6.26%
Rate of increase in salaries (%pa)	5.0%	4.1%
Rate of future inflation (%pa)	3.5%	2.6%
Rate in increase (%pa) in future pensions in payment, split:		
Inflation linked up to 5%pa	3.5%	2.6%
Inflation linked up to 2.5%pa	2.4%	2.15%
Mortality table pre and post retirement	PA92 YOB mc+2	PA92 YOB mc+2
Allowance for early retirements (Y/N)	N	N
Allowance for members to commute pension for tax-free cash (Y/N)	N	N

Notes to the Accounts

Narrative for determining the overall expected rate of return on the assets:

The overall expected return assumption is calculated as the weighted average of the individual expected return assumptions for each of the major asset classes. The individual return assumptions are based on investment market conditions in the UK, specifically with regard to yields on Government gilts, high quality AA rated corporate bonds, and interest rates set by the Bank of England. Equity returns in well established global markets are generally expected to outperform the return on gilts by 3% pa or more in the long term, and such anticipated outperformance has been taken into account in deriving the expected return from equity type investments.

The weightings used for the overall expected return are in line with the proportions invested in each of the major asset classes, and a deduction to allow for investment expenses has been made.

Presentation of amounts for the current and previous : four periods are as follows	2009 £	2008 £	2007 £	2006 £	2005 £
Defined benefit obligation	3,834	3,279	3,878	4,077	4,280
Plan assets	<u>3,672</u>	<u>3,428</u>	<u>4,250</u>	<u>4,400</u>	<u>4,335</u>
Surplus/(deficit)	(162)	149	372	323	55
Experience adjustments on plan liabilities: gains/(losses)	34	(48)	13	(6)	128
Experience adjustments on plan assets	328	(772)	(141)	23	265

Other disclosures – including description of plan and expected contributions

- 1 The plan is a final salary pension arrangement where members receive benefits based on their final salary.
- 2 The plan is closed to new entrants.
- 3 The plan also provides benefits to spouses/dependants in the event of a member's death before or after retirement.
- 4 The company/group expects to pay contributions in the region of £8,000 to the plan during the next accounting period.

15 Capital Statement

The Society adopted Financial Reporting Standard 27(FRS27), issued in December 2004. The disclosure requirements of the standard largely focus on with-profit funds that fall under the Financial Services Authority (FSA) realistic reporting regime and the Society is not required to report under such regime, therefore less detail is required in order to comply with FRS 27 Life Assurance. The Society is required to hold sufficient capital to comply with the Individual Capital Assessment, as amended by the Individual Capital Guidance.

The Society maintains an efficient capital structure consistent with the Society's risk profile and the regulatory and market requirement of its business

In reporting our financial strength, capital and solvency is measured using the regulations prescribed by the FSA. These regulatory capital tests are based upon required levels of solvency capital and a series of prudent assumptions in respect of the type of business written by the Society.

Capital Management policies and objectives

The Company's objectives in managing its capital are;

- To match the profile of its assets and liabilities, taking account of the risks inherent in the business,
- To maintain financial strength to support new business growth,
- To satisfy the requirements of its policyholders and regulators,

Restrictions on available capital resources

It remains the intention of management to ensure that there is adequate capital to exceed the Society's regulatory requirements

Capital Position Statement

	2009 £000	2009 £000	2008 £000	2008 £000
Society's reserves		17,315		12,126
Adjustment on regulatory basis:				
Inadmissible assets of regulated related undertaking	(500)		(500)	
DAC	(325)		(354)	
Other asset adjustment	162		(149)	
Expense closure reserve and life & sickness bonus and interest surplus not in R&A	(1,871)		(880)	
		<u>(2,534)</u>		<u>(1,883)</u>
Total available capital resources		<u>14,781</u>		<u>10,243</u>

Capital resource sensitivities:

The capital position is sensitive to changes in market conditions, which may affect the value of assets and liabilities. The key risks are a fall in equity and/or property values and a sharp rise in interest rates. Following the events of 2008 and 2009 the Society's finances remain strong and the Board of Management remains of the opinion that it has sufficient capital to cope with a sudden fall in asset values, such as a stock market crash, but if necessary immediate action would be taken to reduce the impact. These actions may include the immediate sale of higher risk assets or reducing overheads.

The Board of Management is fully aware of the impact of changes in market conditions, and the sensitivities have been included in the calculations made in arriving at the capital requirement in the Individual Capital Assessment.

Glossary

Corporate Governance

An internal system encompassing processes, policies and people by directing management activities with objectivity accountability and integrity.

Deferred Acquisition Expenses

Certain costs of acquiring new business are spread over the life of the policy, and are treated as an asset in the accounts.

FRS 17

A Financial Reporting Standard issued by the Accounting Standards Board. FRS 17 states how a firm's pension fund should be accounted for.

Fund for Future Appropriations

The accumulated profits of the Society. Equivalent to Retained Profits in a company's accounts.

Long Term Business Provision

An actuarial calculation of the amounts due to policyholders. It is also known as technical provisions.

Realised and unrealised gains or losses

A realised gain or loss occurs when an asset is sold and is the difference between the sale proceeds and the cost. Insurance companies are required to revalue their assets every year, and the increase or decrease in value since the previous year is classed as an unrealised gain or loss.

Reinsurance

The Society pays a premium to a larger insurer to share the risks for larger sums assured.

Smoothing

The principle of reducing bonuses in good years to prevent lower bonuses in poor years.

Valuation methods

Note 11 of the Report and Accounts refers to the assumptions that the actuary uses in calculating the Long Term Business Provision. The references are to standard actuarial tables for calculating death and sickness rates.

With Profits Fund

All members/policyholders participate in the profits and losses of the fund.

Zilmerisation

This is an actuarial method of calculating the Deferred Acquisition Cost.



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The Head office and Registered office of the Shepherds Friendly Society is based in the United Kingdom.

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THE SHEPHERDS FRIENDLY SOCIETY IS INCORPORATED UNDER THE 1992 FRIENDLY SOCIETIES ACT NO.240F.