

PARAGON FINANCE PLC

Report and Financial Statements

Year ended 30 September 2011

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DIRECTORS' REPORT

The directors present their Annual Report and the audited Financial Statements of Paragon Finance PLC ('the Company'), registration no 1917566, for the year ended 30 September 2011

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

The Company is a wholly owned subsidiary of The Paragon Group of Companies PLC ('the Group'). The principal activity of the Company continues to be the administration of loan assets owned by group companies and the provision of administration and other management services to group companies. There have been no significant changes in the Company's principal activities in the year under review. The directors are not aware, at the date of this report, of any likely major changes in the Company's activities in the next year.

As shown in the Company's profit and loss account on page 5, the Company's net interest income decreased by 38% over the prior year. This was primarily due to a constantly low LIBOR during the year, as a result interest charged on the subordinated loans provided to other group companies decreased. During the year the subordinated loans decreased by 11.5%. The provision on loans to other group companies was £8,774,000 (2010 £7,879,000) due to the effects of trading between group companies. The retained profit has fallen from £5,343,000 to £3,638,000.

The balance sheet on page 6 of the Financial Statements shows the Company's financial position at the year end. Net assets have increased by 3% due to the net effect of the retained profit for the year and actuarial loss on the pension fund. Details of amounts owed from and to other group companies are shown in notes 19 and 23.

No interim dividend was paid during the year (2010 £nil). No final dividend is proposed (2010 £nil).

The Company has entered into derivative contracts in order to provide an economic hedge against its exposure to fixed rate loans to customers. Although these instruments provide an economic hedge the prescriptive nature of the requirements of FRS 26 means that hedge accounting cannot always be achieved. This has led to the company recognising a fair value net loss of £1,262,000 in the year (2010 £6,364,000). This represents a timing difference and cumulative gains and losses recognised will tend to zero over time.

The Group manages its operations on a centralised basis. For this reason, the Company's directors believe that further key performance indicators for the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The Group's financial performance is given in the Annual Report, which does not form part of this Report.

PRINCIPAL RISKS AND UNCERTAINTIES

An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out in note 3, and a discussion of critical accounting estimates is set out in note 2.

After considering the above, the directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. This is further supported by the Group holding sufficient cash resources to support the Company's obligations as they fall due. For this reason, they continue to adopt the going concern basis in preparing the Financial Statements.

ENVIRONMENT

The Group recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by the Group's activities. The Company operates in accordance with group policies, which are described in the Group's Annual Report, which does not form part of this Report.

DIRECTORS

The directors who served during the year and subsequently were

N S Terrington

N Keen

J A Heron

R D Shelton

J G Gemmell

J A Harvey

DIRECTORS' REPORT (CONTINUED)

EMPLOYEES' INVOLVEMENT

The directors recognise the benefit of keeping employees informed of the progress of the business. Employees have been provided with regular information on the performance and plans of the Company and the financial and economic factors affecting it, through both information circulars and management presentations.

EMPLOYMENT OF DISABLED PERSONS

Full and fair consideration is given to applications for employment made by disabled persons having regard to their particular aptitudes and abilities. The Company has continued its policy of providing appropriate training and career development to such persons.

CREDITOR PAYMENT POLICY

The Company agrees terms and conditions with its suppliers. Payment is then made on the terms agreed, subject to the appropriate terms and conditions being met by the supplier. The trade creditor days figure has not been stated as the measure is not appropriate to the business.

AUDITORS

The directors have taken all necessary steps to make themselves and the Company's auditors aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditors are unaware.

A resolution for the re-appointment of Deloitte LLP as the auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors
and signed on behalf of the Board



J G Gemmell

Secretary,

17 January 2012

STATEMENT OF DIRECTORS' RESPONSIBILITIES
in relation to Financial Statements

The directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PARAGON FINANCE PLC

We have audited the Financial Statements of Paragon Finance PLC for the year ended 30 September 2011 which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet and the statement of total recognised gains and losses and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company'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 Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements

In our opinion the Financial Statements

- give a true and fair view of the state of the Company's affairs as at 30 September 2011 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.



Matthew Perkins (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditor

Birmingham, United Kingdom

17 January 2012

PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2011

	Note	2011 £000	2010 £000
Interest receivable and similar income	4	42,385	51,777
Interest payable and similar charges	5	(34,601)	(39,310)
Net interest income		<u>7,784</u>	<u>12,467</u>
Other operating income	6	16,266	17,283
Total operating income		<u>24,050</u>	<u>29,750</u>
Operating expenses		(9,010)	(8,393)
Provisions for losses	9	(8,321)	(7,488)
		<u>6,719</u>	<u>13,869</u>
Fair value net loss	10	(1,262)	(6,364)
Operating profit, being profit on ordinary activities before taxation	11	<u>5,457</u>	<u>7,505</u>
Tax on profit on ordinary activities	12	(1,819)	(2,162)
Profit on ordinary activities after taxation	22	<u>3,638</u>	<u>5,343</u>

All activities derive from continuing operations

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

YEAR ENDED 30 SEPTEMBER 2011

	2011 £000	2010 £000
Profit attributable to members of the Company	3,638	5,343
Actuarial loss on pension fund (note 24)	(253)	(5,694)
Deferred tax on actuarial loss (note 24)	(220)	1,438
Total gains and losses recognised since last Annual Report and Financial Statements	<u>3,165</u>	<u>1,087</u>

BALANCE SHEET

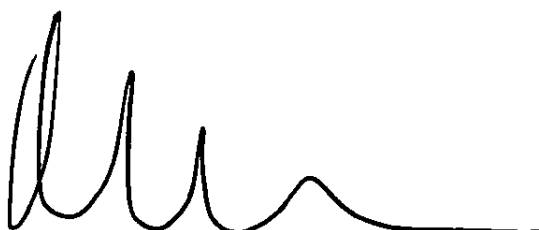
30 SEPTEMBER 2011

	Note	£000	2011 £000	£000	2010 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Tangible assets	13	3,808		1,601	
Financial assets	14	3,197		6,268	
Investments – group companies	18	134,147		151,600	
			<u>141,152</u>	<u>159,469</u>	
CURRENT ASSETS					
Debtors falling due within one year	19	340,782		619,441	
Cash at bank		-		(84)	
			<u>340,782</u>	<u>619,357</u>	
			<u>481,934</u>	<u>778,826</u>	
FINANCED BY					
SHAREHOLDERS' FUNDS					
Called up share capital	21	53,447		53,447	
Profit and loss account	22	57,722		54,557	
			<u>111,169</u>	<u>108,004</u>	
PROVISIONS FOR LIABILITIES					
	20		83		-
CREDITORS					
Amounts falling due within one year	23		359,849		658,735
RETIREMENT BENEFIT OBLIGATIONS					
	24		10,833		12,087
			<u>481,934</u>	<u>778,826</u>	

These Financial Statements were approved by the Board of Directors on 17 January 2012

Signed on behalf of the Board of Directors

N Keen
Director



NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

1. ACCOUNTING POLICIES

The Financial Statements are prepared in accordance with applicable UK Accounting Standards. The particular accounting policies adopted are described below. They have been applied consistently throughout the current and preceding years. The Financial Statements have been prepared on a going concern basis as described in the Directors' Report.

Accounting convention

The Financial Statements are prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment.

Depreciation

Depreciation is provided on cost or valuation in equal annual instalments over the lives of the assets. The rates of depreciation are as follows:

Short leasehold premises	over the life of the lease
Plant and machinery	25% per annum
Computer equipment	25% per annum
Furniture, fixtures and office equipment	15% per annum

Loans to customers

Loans to customers are considered to be 'loans and receivables' as defined by Financial Reporting Standard 26 – 'Financial Instruments: Recognition and Measurement' (FRS 26). They are therefore accounted for on the amortised cost basis.

Such loans are valued at inception as the amount of initial advance, which is the fair value at that time, inclusive of procurement fees paid to brokers or other business providers and less initial fees paid by the customer. Thereafter they are valued at this amount less the cumulative amortisation calculated using the Effective Interest Rate ('EIR') method. The loan balances are then reduced where necessary by a provision for balances which are considered to be impaired.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the expected future cash payments and receipts arising from the loan to the initial carrying amount.

The Company's policy is to hedge against any exposure to fixed rate loan assets (note 3).

Impairment of loans and receivables

Loans and receivables are reviewed for indications of possible impairment throughout the year and at each balance sheet date, in accordance with FRS 26. Where loans exhibit objective evidence of impairment, the carrying value of the loans is reduced to the net present value of their expected future cash flows, including the value of the potential realisation of any security, discounted at the original EIR. Loans are assessed collectively, compared by risk characteristics and account is taken of any impairment arising due to events which are believed to have taken place but have not been specifically identified at the balance sheet date.

Investments

The Company's investments in subsidiary companies are valued by the directors at the Company's share of the book value of their underlying net tangible assets.

Goodwill

Goodwill arising from the purchase of the assets of other companies, representing the excess of the fair value of the purchase consideration over the fair value of the assets acquired, has previously been written off on acquisition against reserves, as a matter of accounting policy. Such amounts would be charged or credited to the profit and loss account on any future disposal of the business to which they relate.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

1. ACCOUNTING POLICIES (CONTINUED)

Retirement benefit obligations

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the profit and loss. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Recognised Gains and Losses.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets at the balance sheet date.

Both the return on investment expected in the period and the expected financing cost of the liability, as estimated at the beginning of the period, are recognised in the result for the period. Any variances against these estimates in the year form part of the actuarial gain or loss.

The assets of the scheme are held separately from those of the Group in an independently administered fund.

The charge to the profit and loss account for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

Operating leases

Rental costs under operating leases are charged to the profit and loss account on a straight line basis over the period of the leases.

Transactions with other group companies

The Company has taken advantage of the exemption granted by Financial Reporting Standard 8 - 'Related Party Disclosures' and does not therefore provide details of transactions with other group companies as it is a wholly owned subsidiary of The Paragon Group of Companies PLC, the accounts of which are publicly available.

Current tax

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in Financial Statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the profit and loss account as interest payable over the term of the borrowing on an Effective Interest Rate basis.

FRS 29 disclosure

The Company has taken advantage of the exemption granted by Financial Reporting Standard 29 - 'Financial Instruments: Disclosures' and does not therefore provide the disclosures required by the Standard as it is a wholly owned subsidiary of The Paragon Group of Companies PLC, the accounts of which are publicly available.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

1. ACCOUNTING POLICIES (CONTINUED)

Derivative financial instruments

Derivative instruments utilised by the Company comprise currency swaps and interest rate swaps. All such instruments are used for hedging purposes to alter the risk profile of the existing underlying exposure of the Company in line with the Company's risk management policies (note 3).

The Company does not enter into speculative derivative contracts.

All derivatives are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the profit and loss account, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

Hedging

For all hedges, the Company documents, at inception, the relationship between the hedging instruments and the hedged items, as well as its risk management strategy and objectives for undertaking the transaction. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by FRS 26.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of FRS 26, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk. For macro hedges (hedges of interest rate risk for a portfolio of loan assets) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of FRS 26. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the profit and loss account at the same time as the hedged item affects the profit and loss account. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction is recognised, or is no longer highly probable.

Revenue

The revenue of the Company comprises interest receivable and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

Fee and commission income

Other income includes administration fees charged to borrowers, which are credited to the profit and loss account when the related service is performed.

Share based payments

In accordance with FRS 20 – 'Share based payments', the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group's various share based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

Only those options and awards granted after 7 November 2002 and not vested at 1 January 2005 were restated on the adoption of FRS 20.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

1. ACCOUNTING POLICIES (CONTINUED)

Cash flow statement

The Company has taken advantage of the exemption granted by Financial Reporting Standard 1 - 'Cash Flow Statements' and does not therefore provide a cash flow statement as it is a wholly owned subsidiary of The Paragon Group of Companies PLC, the accounts of which are publicly available

Consolidated accounts

The Company is exempt under Section 400 of the Companies Act 2006 from the obligation to prepare group financial statements, being a wholly-owned subsidiary undertaking of The Paragon Group of Companies PLC

2. CRITICAL ACCOUNTING ESTIMATES

Certain balances reported in the Financial Statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most significant of these are

Impairment losses on loans to customers

Impairment losses on loans are calculated based on statistical models. The key assumptions revolve around estimates of future cash flows from customer's accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect the current conditions.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results or assumptions which differ from the actual outcomes.

In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided.

Effective interest rates

In order to determine the effective interest rate applicable to loans an estimate must be made of the expected life of each loan and hence the cash flows relating thereto. These estimates are based on historical data and reviewed regularly. The accuracy of the effective interest rate applied would therefore be compromised by any differences between actual borrower behaviour and that predicted.

Fair values

Where financial assets and liabilities are carried at fair value, in the majority of cases this can be derived by reference to quoted market prices. Where such a quoted price is not available the valuation is based on cash flow models, based, where possible on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

Retirement benefits

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions. These are listed in note 24. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

3. FINANCIAL RISK MANAGEMENT

The Company's operations were financed principally by a mixture of share capital and loans from other group companies. In addition, various financial instruments, for example debtors, prepayments and accruals, arise directly from the Company's operations.

The principal risks arising from the Company's financial instruments are credit risk, liquidity risk and interest rate risk. The board of the Company's holding company reviews and agrees policies for all companies in the group managing each of these risks and they are summarised below. These policies have remained unchanged throughout the year and since the year end.

Credit risk

The Company's credit risk is primarily attributable to its subordinated loans to other group companies and its loans to customers. Subordinated loans made to other group companies provide the credit enhancement for the company to commence trading. The repayment of these loans is dependent on the credit performance of the loan assets in the creditor company and hence the credit risk on these balances is managed through careful management of the credit risk on the groups loans to customers.

The loans to customers in the Company and the Group are secured by first charges over residential properties in the United Kingdom. Despite this security, in assessing credit risk an applicant's ability to repay the loan remains the overriding factor in the decision to lend by the originator.

The Company administers the mortgages and the collections process is the same as that utilised for all companies in the group.

The maximum credit risk at 30 September 2011 approximates to the carrying value of loans to customers (note 15) and subordinated loans (note 18). There are no significant concentrations of credit risk due to the large number of customers included in the portfolios of other group companies.

In order to control credit risk relating to counterparties to the Company's financial instruments, the board of the Company's holding company determines on a group basis, which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits.

Liquidity risk

It is the Company's policy to ensure that adequate resources are available at all times to provide for the day to day activities of the Company and to meet regulatory requirements. Management considers the year end position satisfactorily reflects the policies and objectives set out above.

The Company has no external borrowings and liquidity is provided as part of the Group's working capital arrangements. The securitisation process and the terms of the warehouse facility effectively limit liquidity risk from the funding of the Group's loan assets. It remains to ensure that sufficient funding is available to fund the Group's participation in the SPVs, provide capital support for new loans and working capital for the Group. This responsibility rests with the Asset and Liability Committee which sets the Group's liquidity policy and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

Interest rate risk

The Company's policy is to maintain floating rate liabilities and match these with floating rate assets by the use of interest rate swap or cap agreements.

The Company's assets predominantly bear LIBOR linked interest rates or are hedged fixed rate assets. The interest rates charged on the Company's variable rate loan assets are determined by reference to, inter alia, the Company's funding costs and the rates being charged on similar products in the market. Generally this ensures the matching of changes in interest rates on the Company's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term.

Currency risk

The Company has no material exposure to foreign currency risk.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Use of derivative financial instruments

The Company uses derivative financial instruments for risk management purposes. Such instruments are used only to limit the exposure of the Company to movements in market interest or exchange rates, as described above.

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments shall be undertaken, and hence all of the Company's derivative financial instruments are for commercial hedging purposes. These are used to protect the Company from exposures principally arising from fixed rate lending or borrowing and borrowings denominated in foreign currencies. Hedge accounting is applied where appropriate, though it should be noted that some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under FRS 26 either because natural accounting offsets are expected, or obtaining hedge accounting would be especially onerous.

Fair values of financial assets and financial liabilities

Fair values have been determined for all derivatives, listed securities and any other financial assets and liabilities for which an active and liquid market exists. The fair values of cash at bank and in hand, bank loans and overdrafts are not materially different from their book values because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset on a quarterly basis.

Derivative financial instruments are stated at their fair values. The fair values of the interest rate swaps and caps have been determined by reference to prices available from the markets on which these instruments are traded.

The fair value of loans to customers is considered to be not materially different to the amortised cost value at which they are disclosed.

4. INTEREST RECEIVABLE AND SIMILAR INCOME

	2011 £000	2010 £000
On loans to other group companies	38,737	47,650
Other	6	499
	<u>38,743</u>	<u>48,149</u>
Return on pension scheme assets (note 24)	3,642	3,628
	<u>42,385</u>	<u>51,777</u>

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

5. INTEREST PAYABLE AND SIMILAR CHARGES

	2011 £000	2010 £000
On bank loans and overdrafts	41	33
On loans from other group companies	30,702	35,639
	<u>30,743</u>	<u>35,672</u>
Return on pension scheme liabilities	3,858	3,638
	<u>34,601</u>	<u>39,310</u>

6. OTHER OPERATING INCOME

Other operating income includes £15.9m (2010 £16.8m) in respect of income receivable from various special purpose vehicle companies within the group which own mortgage and loan assets administered by the Company. Further details are given in note 17.

7. DIRECTORS AND EMPLOYEES

a) Directors

	2011 £000	2010 £000
Directors' emoluments:		
Fees	-	-
Other emoluments	613	803
	<u>613</u>	<u>803</u>
Pension contributions paid in respect of directors	<u>60</u>	<u>108</u>
Emoluments of the highest paid director Excluding pension contributions	235	280
Pension contributions	17	35
	<u>252</u>	<u>315</u>

Six of the directors (2010 Six) (three of whom are directors of the parent company) are members of the Paragon Group pension scheme. At 30 September 2011 the accrued benefit under the pension scheme of the highest paid director was £64,740 (2010 £61,956).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

7. DIRECTORS AND EMPLOYEES (CONTINUED)

b) Employees

The average number of persons (including directors) employed by the Company during the year was 628 (2010 586) The costs incurred during the year in respect of these employees were

	2011	2011	2010	2010
	£000	£000	£000	£000
Share based remuneration	1,995		1,369	
Other wages and salaries	21,795		19,740	
Total wages and salaries		23,790		21,109
National insurance on share based remuneration	522		923	
Other social security costs	1,834		1,631	
Total social security costs		2,356		2,554
Defined benefit pension cost	908		1,625	
Other pension costs	142		115	
Total pension costs		1,050		1,740
Total staff costs		27,196		25,403

Details of the pension schemes operated by the Company are given in note 24

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

8. SHARE BASED REMUNERATION

During the year the Group had various share based payment arrangements with employees. They are accounted for by the Group and the Company as shown below.

The effect of the share based payment arrangements on the Company's profit is shown in note 7.

(a) Share option schemes

Options under the Executive Share Option ('Executive') schemes have been granted to directors and senior employees from time to time, on the basis of performance and at the discretion of the Remuneration Committee. These options vest so long as the grantee is still employed by the Group at the end of the vesting period and, where applicable, performance criteria have been satisfied. It is not the present intention of the Group that any further awards should be made under the Executive schemes.

The Group also operates an All Employee Share Option ('Sharesave') scheme. Grants under this scheme vest after the completion of the appropriate service period and subject to a savings requirement.

A reconciliation of movements in the number and weighted average exercise price of options over £1 ordinary shares during the year ended 30 September 2011 and the year ended 30 September 2010 is shown below.

	2011 Number	2011 Weighted average exercise price p	2010 Number	2010 Weighted average exercise price p
Options outstanding £1 ordinary shares				
At 1 October 2010	4,751,394	177.17	4,214,600	190.70
Granted in the year	-	-	712,869	100.32
Exercised in the year	(1,122,985)	63.00	(6,845)	525.52
Lapsed during the year	(243,021)	350.10	(169,230)	194.66
At 30 September 2011	3,385,388	202.63	4,751,394	177.17
Options exercisable	1,688,482	326.87	1,500,460	405.32

The weighted average remaining contractual life of options outstanding at 30 September 2011 was 12.7 months (2010: 17.1 months).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

8. SHARE BASED REMUNERATION (CONTINUED)

Options are outstanding under the Executive and Sharesave schemes to purchase ordinary shares in the parent company are as follows

Grant date	Period exercisable	Exercise price	Number 2011	Number 2010
<i>Executive Schemes</i>				
27/11/2001	27/11/2004 to 27/11/2011	395 34p	313,650	319,923
29/07/2002	29/07/2005 to 29/07/2012	297 30p	238,374	244,647
14/03/2003	14/03/2006 to 14/03/2013	297 30p	336,348	413,110
18/12/2003	18/12/2006 to 18/12/2013	540 40p	188,190	225,199
01/06/2004	01/06/2007 to 01/06/2014	514 10p	-	25,092
01/12/2004	01/12/2007 to 01/12/2014	555 34p	236,942	264,672
			<hr/> 1,313,504	<hr/> 1,492,643
<i>Sharesave Schemes</i>				
23/06/2005	01/08/2010 to 01/02/2011	520 89p	-	4,880
28/07/2006	01/09/2011 to 01/03/2012	837 73p	191	191
20/06/2007	01/08/2010 to 01/02/2011	685 84p	-	2,937
20/06/2007	01/08/2012 to 01/02/2013	685 84p	4,006	4,006
18/07/2008	01/09/2011 to 01/03/2012	63 00p	374,787	1,512,873
18/07/2008	01/09/2013 to 01/03/2014	63 00p	1,031,760	1,031,760
20/06/2010	01/08/2013 to 01/02/2014	100 32p	471,104	505,908
20/07/2010	01/08/2015 to 01/02/2016	100 32p	190,036	196,196
			<hr/> 2,071,884	<hr/> 3,258,751
			<hr/> 3,385,388	<hr/> 4,751,394

The number of share options outstanding and the exercise price under each of the arrangements shown above was adjusted in accordance with the respective scheme rules, following the share consolidation on 29 January 2008 and the rights issue on 21 February 2008 were adjusted in accordance with the respective scheme rules

A number of the above options were granted to former employees whose rights terminate at the later of twelve months following redundancy or forty-two months after the issue of the options

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

8. SHARE BASED REMUNERATION (CONTINUED)

The fair value of options granted is determined using a Binomial model. No awards were made in the year ended 30 September 2011. Details of the awards over £1 ordinary shares made in the year ended 30 September 2010, which were all made under the Sharesave scheme, are shown below.

Grant date	20/07/10	20/07/10
Number of awards granted	516,673	196,196
Market price at date of grant	120.0p	120.0p
Contractual life (years)	3.0	5.0
Fair value per share at date of grant	57.88p	57.16p
<hr/>		
Inputs to valuation model		
Expected volatility	86.87%	86.87%
Expected life at grant date (years)	3.41	5.43
Risk-free interest rate	1.71%	1.71%
Expected dividend yield	2.82%	2.82%
Expected annual departures	5.00%	5.00%
<hr/>		

The expected volatility of the share price used in determining the fair value is based on the annualised standard deviation of daily changes in price over the six years preceding the grant.

(b) Paragon Performance Share Plan

Awards under this plan comprise a right to acquire ordinary shares in the parent company for nil or nominal payment and will vest on the third anniversary of their granting, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group. The awards will lapse to the extent that the performance condition has not been satisfied on the third anniversary.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

8. SHARE BASED REMUNERATION (CONTINUED)

The conditional entitlements outstanding under this scheme at 30 September 2011 and 30 September 2010 were

Grant date	Period exercisable	Number 2011	Number 2010
09/01/2007	09/01/2010 to 09/07/2017 †	3,294	3,294
28/03/2007	28/03/2010 to 28/09/2017 †	3,164	3,514
14/06/2007	14/06/2010 to 14/12/2017 †	27,964	36,550
26/09/2007	26/09/2010 to 26/03/2017 †	54,423	64,545
26/11/2007	26/11/2010 to 26/05/2017 †	97,578	312,421
18/03/2008	18/03/2011 to 18/09/2018 †	103,345	725,000
29/09/2008	29/09/2011 to 29/03/2018 †	1,638,646	1,926,686
21/05/2009	21/05/2012 to 21/11/2019*	3,221,335	3,221,335
04/01/2010	04/01/2013 to 04/07/2020*	1,797,822	1,797,822
02/09/2010	02/09/2013 to 02/03/2020*	141,844	141,844
17/12/2010	17/12/2013 to 17/12/2020*	1,906,736	-
		<hr/> 8,996,151	<hr/> 8,233,011

† These awards, which were conditional on the achievement of performance based criteria, have now vested

* The receipt of these shares was subject to a performance condition comparing the rank of the parent company's TSR against a comparator group of companies comprising the constituents of the FTSE-250 on the date of the grant over the three years commencing on the date of grant 25% of the awards will vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance

The number of awards outstanding and the exercise price under each of the arrangements shown above which were outstanding at the time of the share consolidation on 29 January 2008 and the rights issue on 21 February 2008 were adjusted in accordance with the respective scheme rules

During the year ended 30 September 2010 the outstanding awards were modified so that awards vesting would be exercisable for a period of seven years after the vesting date rather than six months This change had no incremental effect on the fair value of the awards, as it implied no changes in any of the assumptions used in the valuations

The fair value of awards granted under the Performance Share Plan is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition Details of the awards over £1 ordinary shares made in the year ended 30 September 2011 and the year ended 30 September 2010 are shown below

Grant date	17/12/10	02/09/10	04/01/10
Number of awards granted	1,907,433	141,844	1,903,737
Market price at date of grant	182 00p	140 00p	135 20p
Fair value per share at date of grant	123 86p	103 35p	99 36p
	<hr/>	<hr/>	<hr/>
Inputs to valuation model			
Expected volatility	72 58%	85 51%	84 76%
Risk-free interest rate	1 98%	1 51%	2 04%
Expected dividend yield	1 69%	2 43%	2 44%
	<hr/>	<hr/>	<hr/>

For all of the above grants the contractual life and expected life at grant date is three years and no departures are expected

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

8. SHARE BASED REMUNERATION (CONTINUED)

For awards granted before 18 July 2008 the expected volatility of the share price used in determining the fair value was based on the annualised standard deviation of daily changes in price over the previous year from the grant date. The expected volatility for awards granted between this date and 30 September 2008 is calculated using the same method but using daily changes in price over the six years preceding the grant date. The expected volatility for awards granted after this date is calculated using the same method but using daily changes in price over the three years preceding the grant date.

(c) Deferred Bonus awards

Awards under this scheme comprise a right to acquire ordinary shares in the parent company for nil or nominal payment and will vest on the third anniversary of their granting.

The conditional entitlements outstanding under this scheme at 30 September 2011 and 30 September 2010 were

Grant date	Transfer date	Number 2011	Number 2010
28/12/2007	01/10/2010	-	21,120
05/01/2010	01/10/2012	169,287	169,287
11/01/2011	01/10/2013	215,654	-
		<hr/>	<hr/>
		384,941	190,407
		<hr/>	<hr/>

The shares awarded will be transferred to the scheme participants as soon as is reasonably practicable after the transfer date.

The number of awards outstanding and the exercise price under the arrangement shown above which was outstanding at the time of the share consolidation on 29 January 2008 and the rights issue on 21 February 2008 were adjusted in accordance with the applicable scheme rules.

The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2011 and the year ended 30 September 2010 are shown below.

Grant date	11/01/11	05/01/10
Number of awards granted	215,654	169,287
Market price at date of grant	188.50p	133.40p
Fair value per share at date of grant	178.00p	124.64p
	<hr/>	<hr/>
Inputs to valuation model		
Risk-free interest rate	2.16%	2.04%
Expected dividend yield	1.91%	2.47%
	<hr/>	<hr/>

(d) Matching Share Plan

Awards under this plan comprise a right to acquire ordinary shares in the parent company for nil or nominal payment and will vest on the third anniversary of their granting to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group. The awards will lapse to the extent that the performance condition has not been satisfied on the third anniversary.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

8. SHARE BASED REMUNERATION (CONTINUED)

The conditional entitlements outstanding under this scheme at 30 September 2011 and at 30 September 2010 were

Grant Date	Transfer date	Number 2011	Number 2010
09/01/2007	09/01/2010 †	5,625	5,625
02/01/2008	02/01/2011 †	22,329	56,680
05/01/2010	05/01/2013 *	142,347	142,347
		<hr/> 170,301	<hr/> 204,652

† These awards, which were conditional on the achievement of performance based criteria, have now vested

* The receipt of these shares is subject to a performance condition comparing the rank of the Company's TSR against a comparator group of companies comprising the constituents of the FTSE-250 on the date of grant over the three years commencing on the date of grant 25% of the awards will vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance

The numbers of share options outstanding and the exercise prices under each of the arrangements shown above which was outstanding at the time of the share consolidation on 29 January 2008 and the rights issue on 21 February 2008 were adjusted in accordance with the respective scheme rules

During the year ended 30 September 2010 the outstanding awards were modified so that awards vesting would be exercisable for the period of seven years after the vesting date rather than six months This change had no incremental effect on the fair value of the awards, as it implied no changes in any of the assumptions used in the valuations

The fair value of awards granted under the Matching Share Plan is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition No awards were made in the year ended 30 September 2011 Details of the awards over £1 ordinary shares made in the year ended 30 September 2010 are shown below

Grant date	05/01/10
Number of awards granted	142,347
Market price at date of grant	133 40p
Fair value per share at date of grant	97 96p
<hr/>	
Inputs to valuation model	
Expected volatility	84 76%
Risk-free interest rate	2 04%
Expected dividend yield	2 47%
<hr/>	

For all of the above grants the contractual life and expected life at grant date is three years and no departures are expected

For awards granted before 18 July 2008 the expected volatility of the share price used in determining the fair value was based on the annualised standard deviation of daily changes in price over the previous year from the grant date The expected volatility for awards granted between this date and 30 September 2008 is calculated using the same method but using daily changes in price over the six years preceding the grant date The expected volatility for awards granted after this date is calculated using the same method but using daily changes in price over the three years preceding the grant date

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

9. PROVISIONS FOR LOSSES

	2011	2010
	£000	£000
Impairment of financial assets		
First mortgage loans	1,192	2,102
Investments in group companies	(1,645)	(2,493)
Loans to group companies	8,774	7,879
	<u>8,321</u>	<u>7,488</u>

10. FAIR VALUE NET LOSS

The fair value net loss of £1,262,000 (2010 £6,364,000) represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The loss is primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities.

11. OPERATING PROFIT, BEING PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2011	2010
	£000	£000
Operating profit is after charging / (recharging)		
Depreciation	847	708
Auditors' remuneration - audit services	77	76
Loss on disposal of fixed assets	2	-
Hire of plant and machinery	363	345
Hire of motor vehicles	165	-
Property rents	2,358	2,929
Costs recharged to other group companies	<u>(18,951)</u>	<u>(15,546)</u>

Non audit fees provided to the Group are disclosed in the accounts of the parent company and the exemption from disclosure of fees payable to the Company's auditors in respect to non-audit services in these financial statements has been taken.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

12. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax charge for the year

	2011 £000	2010 £000
Current tax		
Corporation tax	747	1,981
Group relief	2,111	3,558
Prior year credit	(2,483)	(3,641)
	<u>375</u>	<u>1,898</u>
Deferred tax (note 20)		
Prior year adjustment	54	15
Origination and reversal of timing differences	1,297	205
Rate change	93	44
	<u>1,444</u>	<u>264</u>
	<u>1,819</u>	<u>2,162</u>

b) Factors affecting the current tax charge

	2011 £000	2010 £000
Profit before tax	5,457	7,505
UK corporation tax at 27% (2010 28%) based on the profit for the year	1,474	2,101
Effects of		
Provisions and expenses not deductible for tax purposes	2,006	1,592
Accelerated capital allowances	48	81
Movement on short term timing differences	(670)	257
Prior year credit	(2,483)	(3,641)
Losses not recognised	-	1,508
	<u>375</u>	<u>1,898</u>

During the year ended 30 September 2010 the United Kingdom Government enacted provisions reducing the standard rate of corporation tax from 28% to 27% with effect from 1 April 2011. During the year ended 30 September 2011 it enacted further provisions reducing the rate to 26% with effect from 1 April 2011 and 25% from 1 April 2012. Therefore the standard rate of corporation tax applicable to the Company for the year ended 30 September 2011 is 27% and the rate is expected to be 25.5% in the year ending 30 September 2012 and 25% thereafter. The expected impact of the change to 27% on the values at which deferred tax amounts are expected to crystallise was accounted for in the year ended 30 September 2010, while the expected impacts of the changes to 26% and 25% have been accounted for in the year ended 30 September 2011.

The Government has announced its intention to make further reductions in the rate of corporation tax in future years. The effect of any such changes on deferred tax balances will be accounted for in the period in which any such changes are enacted.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

13. TANGIBLE FIXED ASSETS

	Short leasehold premises £000	Plant and machinery £000	Total £000
Cost			
At 1 October 2009	2,405	6,930	9,335
Additions	-	595	595
Disposals	-	(168)	(168)
At 30 September 2010	2,405	7,357	9,762
Additions	566	2,490	3,056
Disposals	(78)	(1,591)	(1,669)
At 30 September 2011	2,893	8,256	11,149
Accumulated depreciation			
At 1 October 2009	1,600	6,022	7,622
Charge for the year	136	571	707
On disposals	-	(168)	(168)
At 30 September 2010	1,736	6,425	8,161
Charge for the year	154	693	847
On disposals	(78)	(1,589)	(1,667)
At 30 September 2011	1,812	5,529	7,341
Net book value			
At 30 September 2011	1,081	2,727	3,808
At 30 September 2010	669	932	1,601

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

14. FINANCIAL ASSETS

	2011	2010
	£000	£000
Loans to customers (note 15)	1,493	2,767
Derivative financial assets (note 16)	1,704	3,501
	<u>3,197</u>	<u>6,268</u>

15. LOANS TO CUSTOMERS

Loans to customers at 30 September 2011 and 30 September 2010, which are all denominated and payable in sterling, are first mortgages which are secured on residential property within the United Kingdom and which are categorised as loans and receivables as defined by FRS 26

Mortgage loans have a contractual term of up to thirty years, the borrower is entitled to settle the loan at any point and in most cases such early settlement does take place. All borrowers are required to make monthly payments, except where an initial deferred period is included in the contractual terms

	2011	2010
	£000	£000
Balance at 1 October 2010	2,767	4,903
Other movements	(1,235)	(2,174)
Repayments and redemptions	(39)	38
Balance at 30 September 2011	<u>1,493</u>	<u>2,767</u>

Other movements include primarily interest charged to customers on loans outstanding, impairment movements on these loans and other changes in the amortised cost of the assets caused by the effective interest rate method

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

16. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES

All of the Company's financial derivatives are held for economic hedging purposes, although not all may be designated for hedge accounting in accordance with the provisions of FRS 26. The analysis of the derivatives is shown below

	2011	2011	2011	2010	2010	2010
	Notional amount £000	Assets £000	Liabilities £000	Notional amount £000	Assets £000	Liabilities £000
Other derivatives						
Interest rate swaps	19,612	1,704	(262)	41,407	3,499	(553)
Interest rate caps	15,772	-	-	25,439	2	-
Total recognised derivative assets / (liabilities)	35,384	1,704	(262)	66,846	3,501	(553)

17. SECURITISATIONS

As part of the Group's financing arrangements, the Company has sold portfolios of mortgages to a number of other group companies referred to as 'special purpose vehicles' or SPVs

The SPVs have issued securities which are secured on the mortgages acquired, to finance the purchase of those mortgages. In each case the Company has provided a subordinated loan to the issuer and met certain of its front end expenses which will be recovered over time. In certain cases the Company has also taken a minority shareholding or subscribed for loan stock.

The Company has entered into agreements with the SPVs under which it administers and manages the mortgages purchased by those companies. Other than its responsibilities with regard to these arrangements and the warranties given in the mortgage sale agreements, the Company has no commitment to repurchase the mortgages acquired by the SPVs and has no other liability in respect thereof.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

18. INVESTMENTS - GROUP COMPANIES

	2011 £000	2010 £000
Valuation		
At 1 October 2010	151,600	163,824
Investment during the year	-	-
Provisions movement (note 9)	1,645	2,493
Repayment of loans	(19,098)	(14,717)
At 30 September 2011	134,147	151,600
Cost		
At 1 October 2010	186,589	201,306
Investment during the year	-	-
Repayment of loans	(19,098)	(14,717)
At 30 September 2011	167,491	186,589

The investments are loans to group companies which are not subsidiaries of the Company. The investments include subordinated loans amounting to £133,022,000 (2010 £150,476,000) and shares in subsidiaries amounting to £15,000 (2010 £15,000).

The Company itself is a wholly-owned subsidiary and, therefore, no consolidated accounts have been prepared.

The directors consider that the value of the investments in subsidiary companies is at least equal to the amounts at which they are stated.

19. DEBTORS

	2011 £000	2010 £000
Amounts falling due within one year		
Amounts owed by parent undertaking	8,610	81,322
Amounts due from group companies	322,151	518,018
Corporation tax	4,283	2,279
Deferred tax (note 20)	-	721
Other debtors	2,168	2,452
Prepayments and accrued income	3,570	14,649
	340,782	619,441

The fair value of the above items are not considered to be materially different to their carrying values.

The amounts owed by parent undertaking is interest bearing and included in the amount due from group companies is £321,523,000 (2010 £517,279,000) which is interest bearing.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

20. DEFERRED TAX

The movements in the net asset for deferred tax are as follows

	2011 £000	2010 £000
Balance at 1 October 2010	5,192	4,013
Charge to reserves	(220)	1,443
Prior year profit and loss charge	(54)	(15)
Profit and loss charge	(1,297)	(205)
Rate change (note 12)	(93)	(44)
Balance at 30 September 2011	<u>3,528</u>	<u>5,192</u>

The net deferred tax asset recognised is analysed as follows

	2011 £000	2010 £000
Accelerated tax depreciation	220	285
Retirement benefit obligations	3,611	4,471
Impairment and other provisions	(303)	436
Net deferred tax asset	<u>3,528</u>	<u>5,192</u>

The balances are analysed as follows

	2011 £000	2010 £000
Deferred tax (creditor) /debtor	(83)	721
Retirement benefit liability	3,611	4,471
Net deferred tax asset	<u>3,528</u>	<u>5,192</u>

21. CALLED UP SHARE CAPITAL

	2011 £000	2010 £000
Allotted		
71,262,521 ordinary shares of 75p each	<u>53,447</u>	<u>53,447</u>

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

22. COMBINED STATEMENT OF MOVEMENT IN SHAREHOLDERS' FUNDS AND STATEMENT OF MOVEMENT ON RESERVES

	Share Capital	Profit and loss account	Shareholders' Funds
	£000	£000	£000
At 1 October 2009	53,447	53,470	106,917
Profit for the financial year	-	5,343	5,343
Actuarial loss on pension fund net of tax	-	(4,256)	(4,256)
At 30 September 2010	53,447	54,557	108,004
Profit for the financial year	-	3,638	3,638
Actuarial loss on pension fund net of tax	-	(473)	(473)
At 30 September 2011	53,447	57,722	111,169

The cumulative amount of goodwill on acquisitions written off to reserves is £24,712,000 (2010 £24,712,000). This goodwill is included in the profit and loss account to ensure compliance with Financial Reporting Standard 10 - 'Goodwill and intangible assets'. The inclusion of the goodwill in the Profit and Loss Account has of itself no effect on the distributable profits of the Company.

23. CREDITORS

	2011 £000	2010 £000
Amounts falling due within one year		
Bank loan and overdrafts	540	-
Amounts due to group companies	348,299	650,324
Derivative financial liabilities (note 16)	262	553
Accruals and deferred income	10,748	7,858
	<u>359,849</u>	<u>658,735</u>

Included in the amount due to group companies is £334,398,000 (2010 £575,704,000) which is interest bearing.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

24. RETIREMENT BENEFIT OBLIGATIONS

The Group operates a defined benefit pension scheme in the UK, which is sponsored by the Company. A full actuarial valuation was carried out at 31 March 2010 and updated to 30 September 2011 by a qualified independent actuary.

The liabilities of the benefit scheme are measured by discounting the best estimate of future cash flows to be paid out by the scheme using the Projected Unit method. This amount is reflected in the liability in the balance sheet. The Projected Unit method is an accrued benefits valuation method in which the technical provisions are calculated based on service up until the valuation date allowing for future salary growth until the date of retirement, withdrawal or death, as appropriate. The future service rate is then calculated as the contribution rate required to fund the service accruing over the control period again allowing for future salary growth. As a result of the pension scheme being closed to new entrants, the service cost as a percentage of pensionable salaries is expected to increase as the members of the Plan approach retirement. However the membership is expected to reduce so that the service charge in monetary terms will gradually reduce. The major weighted average assumptions used by the actuary were (in nominal terms)

	30 September 2011	30 September 2010
In determining net pension cost for the year		
Discount rate	5.20%	5.70%
Expected long term rate of return on scheme assets	6.30%	6.60%
Rate of compensation increase	4.00%	4.20%
Rate of increase of pensions		
in payment (accrued before 6 April 2006)	3.00%	3.20%
in payment (accrued after 5 April 2006)	3.00%	2.50%
in deferment	3.00%	3.20%
In determining benefit obligations		
Discount rate	5.25%	5.20%
Rate of compensation increase	4.10%	4.00%
Rate of increase of pensions		
in payment (accrued before 6 April 2006)	3.10%	3.00%
in payment (accrued after 5 April 2006)	3.10%	2.50%
in deferment	3.00%	3.00%
Further life expectancy at age 60		
Pensioner (male)	30	30
Pensioner (female)	32	33
Non-retired member (male)	32	31
Non-retired member (female)	34	35

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

24. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The assets in the Plan at 30 September 2011 and 30 September 2010 and the expected rate of return were

	At 30 September 2011	Value	At 30 September 2010	Value
	Long term		Long term	
	rate of		rate of	
	return		return	
	expected	£000	expected	£000
Equities	6.75%	33,951	7.25%	35,209
Bonds	4.65%	19,249	4.40%	16,741
Other	5.30%	5,845	5.80%	5,200
Total market value of assets	5.90%	59,045	7.70%	57,150
Present value of scheme liabilities		(73,489)		(73,708)
Deficit in the scheme		(14,444)		(16,558)
Related deferred tax (note 20)		3,611		4,471
Net pension liability		(10,833)		(12,087)

The Plan assets are held in a separate trustee-administered fund to meet long-term pension liabilities to past and present employees. The trustees of the Plan are required to act in the best interests of the Plan's beneficiaries. The appointment of trustees to the Plan is determined by the scheme's trust documentation. The Group has a policy that one third of all trustees should be nominated by active and pensioner members of the Plan.

At 30 September 2011 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and gilt investments. The majority of the equities held by the Plan are in developed markets. The target asset allocations for the year ending 30 September 2012 are 50% equities, 30% bonds and 20% other assets.

In conjunction with the trustees, the Group has continued to conduct asset-liability reviews of the Plan. These studies are used to assist the trustees and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the studies are used to assist the trustees in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the investment strategy of the Plan.

Following the 2010 actuarial valuation, the trustees put in place a recovery plan. The trustees' recovery plan aims to meet the statutory funding objective within seven years and three months from the date of valuation, i.e. by 30 June 2017.

The rate of return expected on scheme assets is based on the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

24. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The movement in the market value of the scheme assets during the year was as follows

	2011 £000	2010 £000
At 1 October 2010	57,150	51,981
Movement in year		
Contributions by the Group	3,491	2,264
Contributions by scheme members	283	324
Benefits paid	(1,114)	(1,426)
Expected return on scheme assets	3,642	3,628
Actuarial (loss) / gain	(4,407)	379
At 30 September 2011	59,045	57,150

The actual return on scheme assets in the year ended 30 September 2011 was £(800,000) (2010 £4,000,000)

The movement in the present value of the scheme liabilities during the year was as follows

	2011 £000	2010 £000
At 1 October 2010	73,708	63,474
Movement in year		
Current service cost	1,608	1,625
Past service costs	-	-
Contributions by scheme members	283	324
Plan curtailments	(700)	-
Benefits paid	(1,114)	(1,426)
Finance cost	3,858	3,638
Actuarial (gain) / loss	(4,154)	6,073
At 30 September 2011	73,489	73,708

The most recent valuation of the scheme liabilities on a buy out basis obtained by the Trustees in accordance with section 224 of the Pensions Act 2004 was calculated at 31 March 2010, when the valuation on that basis was £85.6m

The sensitivity of the valuation of the scheme liabilities to the principal assumptions disclosed above at 30 September 2011 is as follows

Assumption	Increase in assumption	Impact on scheme liabilities
Discount rate	0.1%	Decrease by 2.6%
Rate of inflation *	0.1%	Increase by 2.1%
Rate of salary growth	0.1%	Increase by 0.5%
Rates of mortality	1 year of life expectancy	Increase by 1.8%

* maintaining a 1% real increase in salary growth

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

24. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The duration of the scheme's liabilities are shown in the table below

Category of member	Duration of liability	Duration of liability
	Years	Years
	2011	2010
Active members	28	28
Deferred pensioners	29	27
Current pensioners	15	14
All members	28	27

The agreed rate of employer contributions was 27.4% of gross salaries for participating employees up to and including 26 June 2011. With effect from 27 June 2011, the employer contribution rate decreased to 26.6% of gross salaries, following the finalisation of the 31 March 2010 actuarial valuation.

Since 1 July 2008 an additional contribution of £500,000 per annum has been paid by monthly instalments. During the year this was increased to £1,500,000 per annum backdated to 1 July 2010.

The present best estimate of the contributions to be made to the Plan by the group in the year ending 30 September 2012 is £3.0m.

The amounts charged in the profit and loss account in respect of the pension scheme are

	2011 £000	2010 £000
Current service cost	1,608	1,625
Past service cost	-	-
Plan curtailments	(700)	-
Included within operating expenses	908	1,625
Expected return on scheme assets	(3,642)	(3,628)
Funding cost of scheme liability	3,858	3,638
Total expense recognised in profit	1,124	1,635

The actuarial losses and gains in the statement of recognised gains and losses in respect of the pension scheme are

	2011 £000	2010 £000
Gain / (loss) on scheme assets	(4,407)	379
(Loss) / profit on scheme liabilities	4,154	(6,073)
Total actuarial loss	(253)	(5,694)
Tax (credit) / charge thereon (note 20)	(220)	1,438
Net actuarial loss	(473)	(4,256)

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

24. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The tax shown above is disproportionate to the actuarial losses recorded in the periods due to the effect on deferred tax of the changes in tax rate described in note 12

The cumulative value of actuarial losses charged to the Statement of Recognised Gains and Losses since 1 October 2001, is £33.7m (2010 £33.4m)

The five year history of experience adjustments on the scheme is as shown below

	2011 £000	2010 £000	2009 £000	2008 £000	2007 £000
Fair value of scheme assets	59,045	57,150	51,981	43,853	49,203
Present value of scheme obligations	(73,489)	(73,708)	(63,474)	(48,848)	(45,021)
(Deficit) / surplus in the scheme	(14,444)	(16,558)	(11,493)	(4,995)	4,182
Experience adjustments on scheme assets					
Amount (£000)	(4,407)	379	2,770	(10,438)	881
Percentage of scheme assets	(7.5)%	0.6%	5.3%	(23.8)%	1.8%
Experience adjustments on scheme liabilities					
Amount (£000)	2,818	-	-	201	2,519
Percentage of scheme liabilities	3.8%	0.0%	0.0%	0.4%	5.6%

In addition to the Group Pension Scheme, the Group operates a defined contribution (Stakeholder) pension scheme. Contributions made by the Company to this scheme in the year ended 30 September 2011 were £0.2m (2010 £0.2m)

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2011

25. FINANCIAL COMMITMENTS

At 30 September 2011 the Company had commitments to make annual payments under operating leases which expire as follows

	2011 £000	2010 £000
Plant and machinery		
Within one year	332	7
Between two and five years	476	-
	<hr/> 808	<hr/> 7
Land and buildings		
Within one year	-	115
Between two and five years	1,237	611
Over five years	975	1,352
	<hr/> 2,212	<hr/> 2,078
	<hr/> 3,020	<hr/> 2,085

26. CAPITAL COMMITMENTS

At 30 September 2011 the Company had capital commitments of £942,242 (2010 £nil) contracted but not provided for

27. RELATED PARTY TRANSACTIONS

On 27 May 2010, Mr A K Fletcher, an independent non-executive director of the Group, was appointed as a trustee of the Group Pension Plan. In respect of this appointment he was paid £10,000 (2010 £3,000) in the year ended 30 September 2011 by Paragon Finance plc, the sponsoring company of the Plan.

28. ULTIMATE PARENT COMPANY

The smallest and largest group into which the Company is consolidated, and the Company's immediate and ultimate parent company and ultimate controlling party is The Paragon Group of Companies PLC, a company registered in England and Wales.

Copies of the Group's financial statements are available from that company's registered office at St Catherine's Court, Herbert Road, Solihull, West Midlands, B91 3QE.