Co-operative Group Limited
Annual Report 2014

The co-operative
Here for you for life

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A Message from Group Chair – Allan Leighton

Since my childhood, when my father managed Co-op Food stores in Hereford, Nottingham and Daventry, I've understood how the Co-operative can play a unique role in the fabric of British society. No other business is held in such affection by the communities it serves.

Our job today is to hold on to everything that has served us well in the past and at the same time demonstrate our relevance to the future. It will be a challenge to get this right. But I have joined the Co-operative because I believe we have the vision and the talent to see this recovery through to long-term and sustainable success.

I am delighted to be part of the Co-operative Group's great revival story, which this annual report begins to chart, and look forward to sharing our progress with you in the years ahead.

As Chair of the Board, I look forward to working with Lesley Reznicek, our President, and the Council as they develop their new role as a body to represent the views of our members.

Allan Leighton
Chair, The Co-operative Group

Headlines

Co-operative Group returned to profitability

- Profit for the period of £216m compared with prior year loss of £2,301m

Plans in place for three-year rebuild to return all businesses to sustainable growth

- Food strategy being delivered with positive like-for-like sales increases and new Member-led strategy for General Insurance business established

Repair of the Group's balance sheet with net debt considerably reduced

- Group debt down by 43% to £0.8bn (2013: £1.4bn) following successful sale of Pharmacy and Farms businesses

Group continuing to implement far-reaching governance reform

- Board strengthened with the appointments of Allan Leighton as Chair and Sir Christopher Kelly as Senior Independent Director

Getting on the front foot with our campaigning work

- 30,000 Member customers engaged to identify the right cause that fits with our Purpose and which will have both local and national resonance for our Members

Report from Former Group Chair – Ursula Lidbetter

We are at the start of a three-year recovery programme for the Co-operative Group that has at its heart our new statement of Purpose: ***'Championing a better way of doing business for you and your communities'***. Everything we are doing – from implementing our governance reforms and making business improvements, to reducing our costs and controlling our debt – is vital if we are to deliver on that promise.

In 2014 our Members voted overwhelmingly for a radical overhaul of our constitution. These changes, essential to our recovery, were our response to the two reports, from Sir Christopher Kelly and Lord Myners, commissioned by the Group after the crisis year of 2013. Both the Kelly Report and the Myners Review pointed clearly to the need for us to address structural and cultural failures in our management and governance. We took these findings on board, as painful as they were to hear, and set to work to reform our ways of working.

At our Annual General Meeting (AGM) in May 2014 we agreed to make far-reaching changes to the way we will run our Society. Collaborating closely with our elected Members, and drawing on expertise from the wider co-operative movement, we set about writing a new Rulebook which was overwhelmingly supported at a Special General Meeting of Members held in August 2014 and approved by the Financial Conduct Authority in the autumn. It was the culmination of a great deal of reflection, careful thinking and intensive debate about what had to change to enable the long-term recovery of our Society to begin. Central to our reforms was the need to strengthen the professionalism in the boardroom and to ensure that we are truly accountable to our millions of Members.

I would like to take this opportunity to thank our Board directors and elected Members for their commitment in seeing through the reforms and for their dedication in supporting the transitional structures that have been operating since last autumn.

In February 2015 we announced the appointment of Allan Leighton as the Group's first Independent Chair. This new role is one of the highly significant governance changes we have made. Allan brings the depth and breadth of experience that is essential in overseeing a business of our scale and complexity. As Independent Chair, Allan will lead our Board as it challenges and supports our Group Executive to deliver the Rebuild programme.

Suitably qualified independent non-executive directors will comprise a majority of the Board, as well as two members of the Group Executive and three elected from the wider membership, who will also have to pass high standards of professionalism and demonstrate the requisite experience. We have already appointed Sir Christopher Kelly as our Senior Independent Director, who brings valuable experience and insight to the challenges we face. The new constitution gives us a national Members' Council, replacing the previous seven Regional Boards, with the responsibility to hold the Group Board to account, and to protect and promote our co-operative values.

For the first time in our long history all members of the Board will be subject to election or ratification by our mass membership through our new One Member One Vote constitution. At our first AGM under the new arrangements this May, our Members will also be able to vote on motions put to the meeting by the Board, the Council or by ordinary Members.

Although no corporate constitution can guarantee business success, we have greatly reduced the risk of poor decision-making in the future and addressed the lack of proper democratic oversight. Implementing our governance reforms is still work in progress and we expect it will take time before our millions of Members fully understand the opportunities we have created for their involvement in the business.

What we do over the next few years must restore the Co-operative Group to its rightful place at the heart of communities up and down the UK and revitalise our business for the next and future generations.

As this report shows, we have begun that journey, turning the huge loss of 2013 into a modest profit in 2014. Our Rescue phase is now over and we have created a stable and firm platform upon which to build. We have a comprehensive plan that we estimate will take three years to deliver. But we are up and running and we have committed and talented colleagues to see it through, led by Richard Pennycook, our Group CEO, and his Executive team. This new team was instrumental in saving the Group during the crisis of 2013 and is now beginning the hard work of rebuilding every aspect of our business.

It has been an honour for me to serve as Chair during such a challenging period in the Group's history. I wish Allan and the new Board directors, the Council and the Group Executive every success in implementing our Rebuild strategy. I also want to thank our Group colleagues and all our Members and customers for their loyalty. With their continued support we are well positioned for recovery.

Ursula Lidbetter
Former Chair, The Co-operative Group

Note – Ursula Lidbetter served the Society as Chair from November 2013 to 19 February 2015. She was therefore Chair throughout the financial period under review.

Report from Group Chief Executive Officer – Richard Pennycook

In 2013 the Group nearly failed and, had it done so, it would have been a cruel end to a 150-year proud history. In 2014 we took the necessary first steps to repair the damage and we are now set firmly on a journey of recovery. We have repaired our balance sheet, met our commitments to the Co-operative Bank and begun the implementation of fundamental governance reforms. There will be no quick fixes though, and it will take at least three years to rebuild the Co-operative, to a position where we can promise sustainable ongoing growth. Embedding our new constitution will run alongside this. The reassurance we can give to our Members is that we are now fully engaged in the work of rebuilding an iconic and much loved organisation.

This work is far more than just another commercial turnaround.

We are one of the world's largest consumer co-operatives, the largest mutual in Britain, and we must operate in a way that makes us distinct in the community. Our Rebuild plans are about ensuring we deliver this promise.

Perhaps our most important work last year was to develop and announce our new Purpose, taking the Co-operative back to what it should stand for. Announced at the AGM in May, it is ***'championing a better way of doing business for you and your communities'***. No other group of national scale could have this Purpose and the UK needs such an organisation in the 21st century as it did in the 19th.

As we worked last year to address our governance issues, we also had to deal with the financial consequences of long-term poor decision-making and inadequate business oversight that has inhibited the performance of all of our businesses. As a result of our crisis we eroded a huge proportion of the assets built up by our Members over a period of 150 years.

Our mergers and acquisitions of the past, having failed to give us the promised commercial benefits, had led to an unsustainable level of debt causing our lenders considerable concern. Reducing our debt has allowed us to take greater control of our investment decisions. Repairing our balance sheet meant selling three of our businesses, Farms, Pharmacy and Sunwin Services. We succeeded in finding good buyers and achieved excellent prices for all three businesses, yielding £0.9bn in total.

Having addressed governance and debt issues we have been able to focus on the details of our Rebuild agenda and give greater attention to a smaller portfolio of five businesses, all of which require investment.

We have developed a convincing plan to advance the commercial performance of Food, our largest business, which concentrates on improving and growing our core convenience offer where we have a track record of success and a strong nationwide presence. We have developed a detailed turnaround plan for our General Insurance business with new investment in digital technology. We want to grow our market-leading Funeralcare business and clearly define the future of our Legal Services offering.

We have already made the Group more efficient, delivering a new target operating model aligned to our Rebuild strategy and we are pushing further with efficiencies, making sure we have the appropriate running costs that allow us to invest where our customers will see the difference. Savings of over £100m were delivered in the year.

The figures in this report already show some early success in stabilising the Group. Whilst comparisons are difficult because of the extraordinary events of 2013, we have moved from a £2.3bn loss reported in 2013 to a £216m profit. Our debt is back at a more manageable level, having reached £1.5bn before our disposals. It is forecast to remain below £900m during the three years of our Rebuild strategy.

Our core Food convenience store estate is growing with 82 new convenience stores opened during 2014 and over 700 stores refurbished. Convenience store sales were up 3.2%, versus the market performance of 2.0%. We must use the profits we are now generating to address long-term underinvestment in our businesses. This means we will not be paying a Member dividend throughout the Rebuild phase of our turnaround.

Key to a successful Rebuild phase will be renewed engagement with our Members, who own the Society. Today our activities are not meaningful enough to resonate with the vast majority of Members. Out of over 8 million Members, 2.9 million Members have traded sufficiently with us to qualify to vote and we have the aspiration to increase voter turnout following our governance reforms. We need more Members engaging with us at all levels, whether through trade, community activities or the democratic process. Otherwise, we cease to be relevant. Further into the Rebuild phase, when we are ready, we will relaunch our membership proposition. It will contain compelling and clear benefits that only a co-operative can provide. Through every encounter and transaction we will demonstrate that we are making a co-operative difference. We will be testing the best of these ideas later this year.

Report from Group Chief Executive – Richard Pennycook continued

Returning to being a campaigning business, showing leadership on social issues that matter to our Members, is also back on the agenda. However, it is important that our ambitions are realistic at this stage of our recovery and we must get ourselves back in shape commercially to ensure we can make an impact with our work. Our social campaigning must be proportionate to our strength, it must resonate with our Members and it must champion a better way to do business.

Let me take this opportunity to pay tribute to our former Chair, Ursula Lidbetter, the Chief Executive of Lincolnshire Co-operative, who stepped into the role at short notice in the midst of our crisis in November 2013. Ursula showed tremendous dedication, professionalism and commitment as she steered us through a difficult period of change for our elected Members and a traumatic time for the Group as a whole. She is a credit to the co-operative movement.

We have come through difficult times but we are now clear about the journey ahead. There can be no more worthwhile job in business than rebuilding the Co-operative.

Richard Pennycook
Group Chief Executive Officer

Report from Transitional Council President – Lesley Reznicek

Five years ago, I moved to a small village on the edge of the Yorkshire Dales and naturally shopped at the local Co-operative store. The Co-op is at the heart of our small community and it helped to raise money to save the local library and rebuild the children's playground. It is this relationship between the business and the local community that we must replicate across the country. Making membership more relevant and appealing to our customers will enable that to happen.

As we begin the recovery of our organisation it will be vital that the voice of our Members is not just heard but is central to our thinking and decision making. The ability for all our Members to play a part in shaping our future is there. The challenge is to make the most of the opportunities that have been created to ensure Members participate and help create a co-operative they are proud to call their own.

Bringing a greater depth of commercial experience and expertise to the boardroom is to be welcomed, but along with that professionalism there must exist a deep commitment to our Values and Principles and the co-operative difference that has made such a contribution to British life since the Rochdale Pioneers began their work in 1844. As the Pioneers understood, we need both commercial success and social responsibility to be an effective co-op, and the Council will play its role in ensuring this is achieved.

With the changes brought about through our governance reforms we are resetting the relationship between the Board, the Group Executive and the membership. The Council will work with and support the Board and Executive in their efforts to rebuild the Co-operative Group. We must develop mature and trusting relationships founded on a shared understanding of what a successful future will look like for us. We are a member-owned business, rather than just an organisation with members, and that means membership is integral to all aspects of running the Society.

Harnessing both the democratic and commercial benefits of being a co-op will be key to our success. We have made a good start but there is still a great deal of work to do. We need to find the best way for the Council to ensure it can fulfil its role to hold the new Board to account. We must find new ways for Members to show their co-operative commitment in their local communities. We must support Group colleagues to understand what membership means so they too can be strong ambassadors for the co-operative way of working. All of this will ensure we stay firmly rooted in the lives and concerns of our customers. Further information on the work of the Council is set out in the Council's Annual Statement on page 82.

Growing up, there were three rules in our house: to be open, to be honest and to try to make a difference to other people. Later, I learnt that these are the ethical values of the Co-operative. My family has been involved in the co-operative movement for more than 100 years and I believe these values have served the movement well. If we keep them at the heart of our business today, we will have a Co-op we can all be proud of.

I'd like to offer my thanks to my Vice Presidents, the Senate and to our new Members' Council which has worked so hard to set up our new structures. We are at the beginning of a critical journey to put our Members right at the heart of the Co-operative Group. Working in a united and positive way, we can help make the Co-op difference come alive again.

S. L. Reznicek

Lesley Reznicek
Transitional Council President

Strategy – Rescue, Rebuild, Renew

During 2014, we made significant strategic progess, including launching our new Purpose and the three-stage strategy to begin to deliver this: to Rescue, Rebuild and Renew the Co-operative Group. We fulfilled our remaining commitments to the Co-operative Bank, restructured the Group's finances and transformed our governance, completing the Rescue phase. We defined and began implementing our detailed three-year Rebuild plan, lasting from 2015–2017, which will touch all aspects of the organisation – everything from our commercial operations to our membership proposition, strengthening our infrastructure and re-defining ways of working with key stakeholders.

At the heart of our programme is our new Purpose: ***'Championing a better way of doing business for you and your communities'***. The Co-operative Group is different. We exist to share our success with our Members – a trading relationship which offers reciprocal benefits. We make a positive difference to where our Members live, supporting and enabling what is important to them. For this reason, we are re-thinking membership, aiming to make it meaningful once more.

Rescue

The Rescue phase of our plan was completed in September 2014. Our key achievements were: saving the Co-operative Bank without recourse to taxpayers' money, improving the Group's financial position through the sales of Farms and Pharmacy, restructuring the Group's governance and defining the Group's new Purpose.

Rebuild

We started our three-year Rebuild phase in October 2014. Rebuilding the Group will take time. We will restructure the Group's functions and core infrastructure, creating an organisation which is fit and ready to deliver growth. The Group is pushing further with efficiencies, reducing running costs so we can focus on our colleagues who deliver our service at the front line.

We have a detailed plan for our Group businesses, with clear strategies for each one that will create competitive advantage. Our plan, running to 2017, will see new investment implemented across the majority of Food stores, growth in Funeralcare, our General Insurance business transformed into a Member-focused and data-driven operation, and Co-operative Legal Services growing in its core markets. Underpinning everything is better serving the needs and concerns of Members and customers.

Our Food business's True North transformation strategy is a priority. We are investing in growing the core convenience estate, upgrading store formats, improving the product range, getting availability right and ensuring that prices are competitive. Most importantly, our colleagues need to have the skills and tools to service our Members and customers brilliantly.

Our Purpose is the driving force for everything we do. Central to living our Purpose is making membership meaningful again. We will give people a compelling reason to become Members and give Members a compelling reason to trade with us. We will demonstrate why membership is good for them and their communities. We will also champion those key issues that are relevant to our businesses and impact our Members' lives.

By the end of 2017, we will have rebuilt the business for long-term, sustainable growth.

Renew

From 2018, the Group will move into our Renew phase. In addition to growing our existing businesses in this phase, we will bring forward a strategy for expanding into markets where our Members are poorly served and where the Co-operative Group should intervene, just as we have done successfully throughout our 150-year history.

Key Performance Indicators

Introduction

The key performance indicators (KPIs) used to monitor the Group's progress in 2014 are reported below. They focus on five areas: Financial, People, Customer, Membership and Social Responsibility. The Group is currently developing a new set of KPIs, which we will use from 2015 to monitor the progress of the new strategy we announced in 2014.

Financial

As a co-operative business, the Group operates for the benefit of our Members. We aim to grow profitability, measured in terms of underlying profit before Member payments, and to deliver an acceptable return on capital employed (ROCE). Underlying profit before Member payments is shown in a reconciliation on the Income Statement on page 92. It represents the profit from core trading performance less underlying interest. Group underlying profit before Member payments (excluding discontinued businesses) was £59m in 2014 (2013: £77m). The fall was largely due to our General Insurance business, where underlying profits declined by £43m in 2014 as explained on page 18. Trading Group ROCE rose to 9.0% for 2014 (2013: 6.9%). This improvement is due to the Trading Group (which excludes General Insurance) both increasing profit marginally and a reduction in capital employed in 2014, following the £226m impairment of Somerfield goodwill at the end of 2013.

People

Our people are vital to our success. After the challenges faced by the Group in recent years, it is essential that colleagues continue to feel a sense of belonging and commitment to the business. 2014 was a difficult year for our colleagues following the crisis at the Co-operative Bank, the reputational damage caused by our failure of governance and due to the restructuring we undertook to create a more efficient and effective organisation. As a result, our colleague engagement score in 2014 was down 7% to 67%, measured through the Talkback annual employee engagement survey.

Customer

One of our strategic aims is to build trust and loyalty to encourage customers to become Members of the organisation. Our businesses all measure performance in customer satisfaction through regular customer surveys.

In Food, the business achieved an average customer satisfaction score of 7.4 out of 10, which was the same as 2013, although below the target of 7.7. Funeralcare's Excellence Score for 2014 was 94.7, exceeding both its target of 91.5 and the 93.8 achieved in 2013. In General Insurance, the 2014 average for overall customer satisfaction was 78% compared to 77% achieved in 2013. Legal Services scored 89% for customer satisfaction, achieving the same score as in 2013. Electrical received a customer satisfaction rating of 98% from Feefo, the customer feedback service. Generally speaking, customer satisfaction scores remained high in 2014, showing that the year's challenges did not impact front line service.

Membership

Membership engagement lies at the heart of our business. The more engaged our Members are, the more successful our business is.

The Group traditionally measured membership engagement in three ways:

- total number of Members
- the number of Members trading with more than one Co-operative business
- total customer dividend paid to Members.

As part of the Group's Rebuild plan, a new measure of member engagement will be devised. In the meantime, one additional measure of importance is the membership qualifying to vote under the new One Member One Vote democratic arrangements. For the 2015 Annual General Meeting, this is 2.9 million Members*.

During 2014, our membership grew from 8.1 million to 8.4 million. The number of Members trading with more than one Co-operative business was 507,000. As a profit share, our dividend will fluctuate according to Group profitability. Due to the reduced profit, the Group has not been able to pay a dividend in 2014 (2013: £26m). While no dividend was paid, the Group remains committed to delivering rewards to its Members. In 2014, Members redeemed £22m of Member exclusive money-off coupons in Food stores. In the lead-up to Christmas, Members were also invited to participate in a Swipe and Win prize draw with £600,000 worth of prizes.

Social responsibility

Since 2009, we have benchmarked the Group against the Corporate Responsibility Index (CRI) operated by Business in the Community (BitC).This is the foremost UK corporate responsibility benchmark and assesses management practice in a range of environmental and social impact areas, including:

- community
- environment
- marketplace
- workplace.

In 2014, we retained our score of 97% and 'Platinum Big Tick' (previously 'Platinum Plus') status.

* For the Group's 2015 Annual General Meeting, 2.9 million members are eligible to vote having met the minimum level of qualifying purchases with Group businesses during the Group's 2014 financial year. For further information see the Group's Rules and Purchases Regulations which are on the Group's website: www.co-operative.coop

Finance Review

Overview

2014 saw the Group move from Rescue into Rebuild as the recovery from the crisis of 2013 built momentum. This recovery is reflected in the financial performance for 2014 which saw a return to profit following the unprecedented losses of 2013, a strengthened balance sheet with debt reduced by almost half and final settlement of the Group's obligations to the Co-operative Bank ('the Bank') under the 2013 Liability Management Exercise (LME).

The start of the road to recovery is reflected in the Group's 2014 profit for the period of £216m, compared to a loss of £2.3bn in 2013, the improvement comprising four broad elements:

- Underlying segment operating profit of £172m marginally down from £177m in 2013. This reflected losses in our General Insurance business that offset the year on year profitability improvements in Food and Funeralcare, despite both of these businesses operating in difficult markets in 2014, together with the early benefits of cost saving initiatives in corporate costs.
- A £243m reduction in one-off costs that in 2013 included a £226m goodwill impairment relating to our Food business.
- Disposal profits of £107m in 2014, principally relating to the sale of the Farms business.
- A net profit of £109m on discontinued operations, principally relating to the profit on selling our Pharmacy business, compared to a £2.0bn loss in 2013 that arose from losses relating to the Co-operative Bank. In 2013 the Bank recorded trading losses of £1.3bn and the Group incurred a £0.6bn loss on the LME which saw its 100% ownership diluted to a 30% holding (subsequently further reduced to 20.2% following the Group's partial participation in the Bank's capital raise in June 2014).

The balance sheet also strengthened during 2014 with net debt reducing from £1.4bn to £0.8bn principally as a result of the sale of the Pharmacy and Farms businesses. The difficult decision to dispose of these businesses was unfortunate but necessary to enable the Group to address its unsustainable level of indebtedness. Importantly, we were successful in securing excellent disposal values for both businesses, as well as purchasers committed to the long-term sustainability and success of the businesses and the colleagues working within them.

On 31 December 2014, the Group paid the final part (£163m) of its 2014 £313m capital commitment to the Co-operative Bank that arose as part of the LME that was critical to the rescue of the Bank in 2013.

Headlines

	2014 £m	2013 £m
Revenue	**9,433**	9,746
Underlying segment operating profit	**172**	177
Profit/(loss) before Member payments	**124**	(255)
Profit/(loss) on discontinued operations	**109**	(2,031)
Profit/(loss) for the period	**216**	(2,301)
Capital expenditure	**294**	311
Net debt	**808**	1,400

Trading performance

Group revenue of £9.4bn was down by £0.3bn (3.2%) on 2013, principally in Food (£152m lower) and General Insurance (£105m lower). Underlying profit of £172m was 2.8% down on 2013.

Whilst Food sales (excluding VAT) of £7,085m were 2.1% lower than 2013 (£7,237m), underlying sales were strong in an intensely competitive market with the headline fall reflecting the impact of disposals of larger stores as part of our True North strategy, together with lower fuel prices. Like-for-like food store sales (excluding VAT and fuel) rose by 0.4% across the estate compared to an overall market fall of 1.8% as measured by the Institute of Grocery Distribtion (IGD). Within our core convenience estate, like-for-like sales growth was 3.2%, again outperforming the IGD convenience growth of 2.0%.

The True North strategy in Food is delivering a stronger retail proposition for our Members and customers and this, together with changes in organisational design and lower energy prices, has helped to deliver cost savings. Together with like-for-like sales growth, this has seen profit increase by 1.6% to £251m against the background of an extremely challenging trading environment.

Revenue in the General Insurance business fell 22.1% to £371m (2013: £476m) in a difficult market that saw premiums fall and increased discounting. Strategic exits from unprofitable business areas also contributed to the fall in premiums. Whilst strong focus on costs helped to partially mitigate lower income, profits fell by £43m from a £36m profit in 2013 to a loss in 2014 of £7m.

Our Funeralcare business saw funeral numbers fall year on year by more than 6,000 funerals to around 92,000 reflecting the lower national death rate. As a consequence, revenue fell by almost 2% (£7m) but operational cost savings and headcount savings offset volume decline such that underlying profit increased by 6.5% to £66m.

Co-operative Legal Services sales fell 30.3% to £23m, impacted by the prohibition in 2013 of referral fees on Personal Injury income and lower Probate income. The business has undertaken major restructuring and made significant cost savings whilst at the same time maintaining good levels of customer satisfaction. While the business traded at a loss in the first half of the year, the cost savings saw the business trade profitably in the second half, and the full year loss of £5m was £4m favourable to 2013.

Finance Review continued

Electricals performed well considering its competitive market place and the impact of poor publicity around the Group in 2013 which saw sales make a slow start to the year. Recovery in the second half of the year saw sales improve and underlying profit of £0.6m was comparable to 2013 on sales down 4.5% at £84m.

2014 saw the launch of the new target operating model programme (TOM) that is reassessing our organisational structures and processes with a view to significantly reducing corporate costs. A review of all expenditure on goods not for resale is also ongoing and we continue to impose tight control on all discretionary spend across the Group. The Group's requirement for external advisory services has been high during the last two years' Rescue phase (2014: £115m, 2013: £236m). During Rebuild, we plan to spend significantly less in general on external resource; however, the continuing costs of separating the Bank's systems will remain high for a further two years.

In 2014 corporate costs fell by £30m from £176m to £146m. Whilst the early benefits of cost saving measures played a part in the reduction, the larger element arose from movements in insurance and legal provisions and from transferring certain pension costs from corporate costs to trading businesses in 2014.

Operating profit

Whilst profit from our core trading, underlying operating profit, was broadly flat year on year, reported operating profit of £227m was £408m up on last year. This reflects the impact of one-off items unrelated to core trading, principally the profit on sale of our Farms business this year and the significant goodwill impairment in 2013.

The reconciliation of underlying operating profit to reported operating profit and profit before tax is summarised and explained below.

	2014 £m	2013 £m
Underlying segment operating profit	**172**	177
One-off items	**(68)**	(311)
Property and business disposals	**107**	(29)
Change in value of investment properties	**16**	(18)
Operating profit / (loss)	**227**	(181)
Underlying interest payable	**(113)**	(100)
Finance income	**69**	15
Non-cash finance (costs) / income	**(30)**	11
Accelerated interest due to early repayment of debt	**(26)**	-
Share of loss of associates and joint ventures	**(3)**	-
Profit/(loss) before Member payments	**124**	(255)
Member payments	**-**	(55)
Profit/(loss) before tax	**124**	(310)

In 2014 one-off items of £68m related principally to restructuring including the TOM and associated redundancies (£31m) and the governance review, Board and Executive changes (£21m), offset by a credit in respect of pensions past service costs (£11m). A further £20m related to the final stage of the supply chain restructuring in Food earlier in 2014. 2013 one-off costs included a goodwill impairment charge of £239m and restructuring costs of £60m.

Disposal profits of £107m (2013: £29m loss) mainly related to the sale of our Farms business to the Wellcome Trust but also included profits on the divestment of some larger food stores as part of our True North strategy and the sale of the Sunwin Services business to Cardtronics. The disposal of the Pharmacy business is included within the profit on discontinued operations.

The improving commercial property market together with some planning and development gains has seen the value of our investment property portfolio increase by £16m in 2014, compared to a loss of £18m in 2013.

Underlying interest

Although net debt almost halved by year end, underlying interest of £113m was £13m higher than 2013. The debt repayment took place towards the end of quarter three with the repayment of the Group's £450m term loan. The benefit of this in quarter four was largely offset by one-off costs of £26m relating to the debt repayment, including swap closure payments and the write-off of arrangement fees. Interest on the notes issued by the Group to the Bank's ex-bondholders as part of the LME in December 2013 added a further £14m of interest year on year.

Share of loss of associates and joint ventures

	2014 £m	2013 £m
The Co-operative Bank	**(10)**	-
Travel	**6**	-
NOMA	**1**	-
Share of loss of associates and joint ventures	**(3)**	-

The Group accounts for its investment in the Co-operative Bank as an associate. Following the completion of the LME in December 2013, the Group retained an initial 30% stake in the Bank, which was diluted to 20.2% in May 2014 following the Group's partial participation in the Bank's rights issue. The amounts included within the income statement therefore represent 30% of the Bank's result up to May 2014 and then 20.2% for the remainder of the year.

Finance Review continued

The Bank reported a loss after tax for the year of £225m compared to a loss of £777m in the corresponding period in 2013, the improvement principally reflecting significant reductions in the level of impairments and lower conduct risk charges, including Payment Protection Insurance (PPI). The performance reflects considerable early progress on the implementation of the Bank's new business plan, especially in the disposal of non-core assets.

The Group has reported its share of the loss in the Bank at £10m comprising its share of the Bank's loss after tax of £50m, a credit of £133m relating to fair value adjustments recorded at the date of the LME, which are now unwinding periodically, and an adjustment of £93m to revalue the Bank investment down to its fair value.

In June the Group completed a 50/50 joint venture agreement with Hermes Real Estate for the development of the NOMA estate in Manchester City Centre. This 20-acre estate was part of the Group's estate of head office buildings. The ten-year, £800m redevelopment programme will create a mixed-use urban neighbourhood, incorporating office space, residential, and leisure facilities. Our share of the NOMA profits for the year was £1m.

The Group's travel joint venture with Thomas Cook, TCCT Holdings, generated a £6m profit for the Group in 2014.

Discontinued activities

The profit/(loss) on discontinued activities comprises:

	2014 £m	2013 £m
The Co-operative Bank trading loss	**-**	(1,205)
The Co-operative Bank loss on disposal (see below)	**(49)**	(651)
Pharmacy	**172**	-
Life and Savings	**(12)**	(6)
Tax	**(2)**	(169)
Profit/(loss) on discontinued operations	**109**	(2,031)

The £49m charge in 2014 in respect of the loss on disposal of the Co-operative Bank primarily relates to additional costs to separate the IT systems of the Bank and our insurance business. £39m was provided for this in 2013 within the £651m loss.

On 6 October 2014 the Group completed the sale of its Pharmacy business to Bestway Group for consideration of £640m, generating a profit on disposal of £122m. Unlike Farms and Sunwin Services, Pharmacy was reported as a major business segment in the 2013 accounts and as such it is reported as a discontinued operation in 2014. In addition to the £122m profit on disposal, the business also reported trading profits of £50m (2013: full year profits of £33m) in the period up to sale, although this result benefitted by £20m from ceasing both amortisation of its licenses and depreciation of its assets from the point at which it became held for sale at the end of February 2014 up to its eventual sale.

The Group sold its Life and Savings business to Royal London in 2013 and as part of the sale terms the Group was required to build a separate clone IT system for the new business. An additional £12m has been provided in 2014 to meet these costs.

Financial position and cash flow

At the start of 2014, net debt stood at £1.4bn and the Group was committed to make a further £313m capital contribution to The Co-operative Bank. The debt ratios were excessive compared to our peers and this was reflected in our sub-investment grade credit rating of B+. The sale of our Pharmacy and Farms businesses was necessary to address this unsustainable level of debt and we were successful in achieving full value from the sales. We ended the year with a much stronger financial position; our net debt was £0.8bn, almost halved, our bank ratios are now comfortable and the capital commitments to the Bank have been satisfied in full.

The sale of Pharmacy and Farms in late autumn generated proceeds of £844m and we received a further £33m from the sale of our Sunwin Services business. These proceeds were used to repay our £450m term loan and to retain cash in the business for investment. We satisfied our 2014 capital commitments to the Bank with payments of £50m in January, £100m in June and the final payment of £163m at the end of December which was funded by the receipt of the deferred proceeds from the sale of our Life and Savings business in 2013.

Strong control of working capital and continued focus on cost savings have also supported our cashflow in the year and we were able to invest £294m in our businesses, principally in Food, which was funded by property disposals both from churning our food stores and selling investment and vacant non-trading properties.

Net capital expenditure

	2014 £m	2013 £m
Capital Expenditure	**294**	311
Disposal Proceeds	**(345)**	(375)

The Group continued to invest in its businesses during the year with capital investment of £294m chiefly comprising store/branch refurbishments of £106m (2013: £63m), acquisition of new stores/branches of £55m (2013: £31m) and distribution depots and equipment of £31m (2013: £48m) as we continually improve the customer offer in our stores and branches.

Disposal proceeds principally arose from the sale of larger non-core food stores that are outside of our True North strategy, together with investment properties and other non-trading properties.

Finance Review continued

Tax

The tax charge on continuing business in 2014 is £17m (2013: £40m credit restated), an effective tax rate of 14% compared to the standard blended rate of 21.5%. The effective rate of tax is lower than the standard rate because a significant proportion of the profits before tax relate to profits arising on the disposal of the Farms and Sunwin Services businesses, which are not subject to tax because the substantial shareholdings exemption applied to these transactions. This served to reduce the total tax charge by 23%. A full reconcilliation of the tax charge to the standard blended rate of tax is shown at Note 8.

Pensions

The key movements in the pension schemes' valuations during the year were:

	2014* £m	2013* £m
Combined net opening surplus	**173**	191
Service cost and administrative expenses	**(83)**	(89)
Net finance credit	**12**	14
Net actuarial gains/(losses)	**723**	(82)
Contributions	**149**	150
Past service credit	**11**	-
Other	**4**	(11)
Combined closing net surplus	**989**	173

*includes the Bank's share (see note 16 for further details)

The IAS 19 net surplus has increased substantially from £173m to £989m at the year end, principally as a result of large falls in gilt yields in the latter half of 2014 that have caused an exceptionally large actuarial gain on scheme assets. Under accounting assumptions the discount rate on liabilities, as determined by reference to AA Corporate bonds, changed from 4.45% to 3.7%, an increase to liabilities of £0.9bn. However the value of liability matching/debt assets increased by £2.2bn (offset by a £0.6bn loss on equities) reflecting principally the movement in gilt yields. The accounting surplus therefore arises broadly because corporate bond yields used to measure liabilities have not fallen as sharply as gilt yields that are driving the asset growth.

As well as the discount rate reduction, the RPI inflation assumption has fallen from 3.6% to 3.3%, reducing liabilities by £0.4bn and mortality assumptions have been aligned to those used in the recent Pace triennial valuation, increasing liabilities by approximately £120m.

Although this reflects a valuation as at the year end using accounting assumptions, it does not reflect the longer term funding position of the scheme, measured in accordance with the statutory funding objective required under UK pension legislation. The Group values the estimated cost of pension benefits under this funding regime by reference to gilt yields, not corporate bonds. Gilts are held within the asset portfolio for liability matching purposes to reduce the risk and volatility of contributions payable. In general, the statutory funding objective places a greater value on the estimated cost of pension benefits than under IAS19. There is currently a shortfall in scheme assets to meet the statutory funding objective and recovery plans are in place to pay contributions to remove this shortfall. Recovery plans vary in length and tend to be renegotiated every three years as part of a scheme's formal actuarial valuation. Under current recovery plans, the Group has agreed to pay contributions to remove shortfalls of £360m. The Group paid £48m during 2014 towards the removal of the shortfall.

The accounting surplus measured under IAS 19 is merely a snapshot taken at a point in time when market movements were volatile and this needs to be set against the context of a shortfall from a statutory funding objective. Importantly, it is the statutory funding objective that determines the future cash obligations of the Group, not the IAS 19 position at year end. Furthermore, given the size of Pace, the Group's largest pension scheme, small changes in market conditions and assumed life expectancy can have a financially significant impact on the long term funding position, which, together with margins for prudence required under the UK funding regime, can result in relatively large changes in cash funding requirements.

Pace is a multi-employer scheme of which the Co-operative Bank is a participant. Discussions are ongoing with the Bank regarding its continued participation in the scheme and in agreeing its precise share of the scheme. Since the Bank cannot demonstrate that it has an unconditional right to a share of the IAS 19 surplus, the full surplus is recognised in the Group accounts. Were the Bank to formally separate from the Pace scheme in the future, this would crystallise a profit or loss on disposal in the Group accounts for that portion of the deficit or surplus transferred to the Bank at that time.

Member payments

No payments to Members were approved at the 2014 Annual General Meeting or Half Yearly Meeting in light of the £2.3bn loss reported in 2013 and the funding position in the earlier part of the year.

Business Review

Food

Revenue	Underlying operating profit
£7.09bn (down from £7.24bn)	£251m (up from £247m)
Employees	**Stores**
60,265	2,796

The UK grocery market was volatile in 2014. Food retailing has polarised, with upmarket retailers, convenience stores and hard discounters growing market share at the expense of larger supermarkets. Fierce competition led to discounting, and food price deflation emerged in the second half of 2014 for the first time in living memory.

Shopping habits are changing. Customers are buying little and often, benefitting our Food business, which is focused mainly on convenience stores. Sales rose by 0.4% in 2014 on a like-for-like basis – for stores open more than a year – compared with the previous year. By contrast, food retailing sales fell nationally by 1.8%, according to the Institute of Grocery Disribution (IGD). Food's convenience stores (stores up to 3,000 sq ft) saw like-for-like sales rise by 3.2%, outperforming equivalent growth of 2.0% across convenience stores nationally, as measured by IGD.

The disposal of larger stores and falling fuel prices led to lower reported revenues of £7.09bn (2013: £7.24bn). However, underlying operating profit rose to £251m (2013: £247m), due to a strengthening store estate and increased efficiency across the business. Significant progress was made towards a leaner operating model, which released money for lowering prices.

In line with the Group's Purpose and ownership, Food has a store in every postal area and is at the heart of the community. Throughout the year we've worked hard on improving the basics of our offer in our convenience stores and customers are starting to tell us that they are seeing the improvements.

True North's early success

The business's strong like-for-like performance against the market testified to the progress of the True North strategy, which completed its first full year of delivery in 2014, after being introduced in March 2013.

True North focused on growing Food's core convenience estate, upgrading store formats, improving the product range, getting availability better throughout the day, ensuring that prices were competitive and improving customer service.

We acquired 82 new convenience stores in 2014, taking our total convenience estate to 2,079 sites at year end, and sold 37 larger stores during the year, leaving 717 large stores in the business. 336 stores had Gen2 format refits during 2014, with positive sales uplifts. Finally, a cost saving programme cut £93m from annual costs.

The product range was improved and made more competitive. In 2014, our products won 170 awards for quality, including 20 golds. Notably, we were named 'Chilled Retailer of the Year' and 11 of our products won Good Housekeeping Institute accreditation.

Customers had been telling us that price was their biggest barrier to shopping with us, so we lowered prices across 40 categories in 2014, reducing the price of many products by as much as 20%. We continue to roll out our price programme into 2015 across remaining categories.

Our co-operative approach

The Co-operative has a unique position in communities, not only serving them but also championing them. In order to reinforce our position at the heart of communities, we appointed community pioneers in 500 stores. They engage with the local community, helping it in the ways that are most needed – for example, organising events and providing meeting places. Our Food business is building strong links with local communities, both sourcing produce from regional suppliers and tailoring its range to local demographics. In Scotland, we pledged to reinvest profits from our entire carrier bag range in community projects, expecting to raise as much as £750,000 each year.

Social responsibility lies at the heart of our co-operative approach. We recognise that we have both a responsibility and an opportunity to have a positive social impact through both our supply chain, and the products and services we sell. We have established six dedicated farming groups, through which we have been developing long-term relationships with carefully selected meat and dairy suppliers, helping to reduce supply chain environmental impacts and improve animal welfare.

When undertaken fairly, trade has an unparalleled capacity to improve quality of life. In 2014, the Group celebrated 20 years of championing Fairtrade. Co-operative stores sold 218 Fairtrade product lines during the year, 132 of which were own-brand, paying Fairtrade producers an estimated £2.6m premium (2013: £3.1m (restated)).

Outlook

In 2015, the food retailing environment will continue to be volatile, as pressure on prices continues and the large grocers respond to competitive pressure. We are confident that True North is the right way to transform our business and will continue to progress this strategy, aiming to be recognised as the best community convenience retailer in the UK.

Business Review continued

Electrical

Revenue £84m (down from £88m)	**Underlying operating profit** £0.6m (down from £0.7m)
Employees 102	**Sites** 3 (Manchester, Luton, Barnsley)

The Co-operative Electrical is one of the UK's leading online retailers for customer service. Reflecting our high-quality service, Electrical received a 98% 'excellent' feedback rating from customers on Feefo, the customer feedback service, earning us a *Gold Trusted Merchant Accreditation*. Additionally, an annual survey of *Which?* readers ranked Co-operative Electrical the UK's second best online electrical retailer.

An increasing share of electrical goods sales are conducted online, although negative publicity about the Group's financial difficulties prevented us from claiming our share of this in the first half of 2014. Sales recovered later in the year, after Co-operative Electrical became the first electrical retailer to sell electrical goods warranties at cost price.

While sales and underlying operating profit were significantly down on 2013 for most of the year, this late recovery lifted them to approaching the previous year's levels. Revenues were slightly lower at £84m for 2014 (2013: £88m), as was underlying operating profit of £0.6m (2013: £0.7m).

Co-operative Electrical offered exclusive deals to Members, discounting televisions and other electrical goods for specific offer periods.

Outlook

In 2015, Co-operative Electrical will launch a new website with better content and product information. We are reviewing the business's strategy with a view to playing a stronger role in communities and rolling out our digital model across a broader product range.

Funeralcare

Revenue £363m (down from £370m)	**Underlying operating profit** £66m (up from £62m)
Employees 4,116	**Funeral homes** 961

With over 100 years' experience, Co-operative Funeralcare is the UK's leading funeral director and part of the fabric of the communities where we are based. Working with people at the most difficult times in their lives, we seek to provide our customers with a highly personalised service and guidance when making funeral arrangements.

2014 saw a relatively low number of deaths in the UK, which led to a fall in the total number of funerals. We arranged approximately 92,000 funerals, roughly 6,000 fewer than in 2013. Pre-paid funeral plan volumes remained largely flat at approximately 28,000. While revenues fell to £363m (2013: £370m), underlying operating profit rose to £66m (2013: £62m). Targeted cost initiatives played a key part in growing the business's underlying profitability.

Recognising the popularity of web-based technology, we launched a number of digital services in 2014, including an online memorial service. This allows the bereaved to create a lasting legacy of their loved one that can include an obituary, sharing details of the funeral with friends and family, making charitable donations and ordering flowers. The lives of loved ones can be celebrated by creating an online memorial, with family and friends posting photos, films and stories. More broadly, we are seeing an increasing trend to digital and remote channels for a number of our services, with more funeral plans being sold through our website.

Excelling at customer service is one of Funeralcare's key goals and 2014 was an outstanding year in this regard. 98.8% of customers reported they were 'satisfied' or 'very satisfied' with their overall experience. Furthermore, customer surveys suggest that 98% of our customers would recommend our services in the future.

Expansion of the branch network continued. Some 37 new branches were opened, lifting the total across the UK to 961.

Funeralcare is at the heart of its communities. In 2014, our employees carried out more than 9,000 community activities, ranging from charity fundraising to organising local events.

Business Review continued

Social responsibility

Funeralcare conducted research in partnership with Stonewall, which revealed poor treatment of grieving gay people, with one in ten saying they have experienced discrimination at a funeral or when arranging one.

To directly address some of the issues raised through the research, Funeralcare and Stonewall developed a guide for lesbian, gay and bisexual (LGB) people on planning for later life. The guide achieved extensive online coverage, as it was well supported by the LGB community online. As one of Stonewall's top UK employers, diversity awareness forms a crucial part of the Co-operative's skills training.

In 2014, 97% of the coffins manufactured by the Co-operative Funeralcare (FSC® C008811) were made from FSC® (Forest Stewardship Council®) certified wood from certified forests and other controlled sources. We are committed to working with suppliers to push for further certification and sustainable sourcing in the future.

Outlook

2015 has already proven to be a busier time for funeral directors as the cold winter has led to a higher number of deaths early in the year. With the strong service platform and the Group's reputation also recovering, we expect business performance to continue to improve over the coming year.

Looking further to the future, growing Funeralcare is at the heart of the Group's Rebuild strategy. Championing and transforming attitudes to later life and bereavement with our membership and broader communities is at the heart of our strategic agenda. In 2015, we plan to open a further 40 branches, expanding our geographical reach, while continuing our programme to improve processes and IT systems. High-quality customer service remains at the heart of our success, and we will continue to focus on this during 2015 as the platform for future growth.

General Insurance

Revenue £371m (down from £476m)	**Underlying operating loss** £7m (down from £36m profit)
Employees 1,137	**Sites** 5 (Manchester, Nottingham, Rugby, London, Bury St Edmunds)

In a challenging year, the team worked to develop a new strategy, seeking to make Co-operative Insurance the 'go-to insurer for Members'. This strategy is built on three sources of competitive advantage: the Co-operative brand, the Group's distribution reach and insight from membership data. Execution of the strategy will be enabled by investment in a new technology platform, which will lead to reduced costs and greater product flexibility.

2014 illustrated the difficult conditions facing the general insurance sector as a whole. Premiums reduced across both home and motor, with aggressive discounting and value promotions. Additionally, low interest rates depressed investment yields, further suppressing profitability.

Co-operative Insurance's revenues fell after it exited business areas with low levels of profitability. Net earned premiums reduced to £371m (2013: £476m). Although premiums declined and claims ratios improved due to management action, costs were broadly unchanged, driving the business to an underlying operating loss of £7m (2013: £36m profit). The result underlines the importance of the new strategy for the business and the delivery of technology-enabled cost reduction.

Our home portfolio continued to be profitable, although its claims ratio reverted to more normal levels following unusually low claims in 2013. Actions to improve risk selection and pricing capability in the motor portfolio improved its loss ratio, but overall profitability fell as a consequence of reduced scale.

We invested substantially in the Co-operative Insurance brand, using television advertising to grow brand recognition. During the latter part of 2014, our marketing activity focused more directly on Members of the Co-operative, for example offering £50 of Co-operative Food vouchers to Members taking out either motor or combined home insurance cover.

Ethical approach

Co-operative Insurance's ethical investment policy continued to screen the fixed-income portfolios underpinning insurance policies to avoid companies that do not match up to our standards in the areas of human rights, environment, trade and animal welfare.

We believe that ethical options should be available to everyone. Our innovative 'ecoinsurance' motor policy reduces a car's environmental impacts by offsetting 20% of an average car's carbon dioxide emissions for every policy held. The offsets work by supporting carbon reduction projects in developing countries.

Outlook

Market conditions will remain challenging over the next 12 to 18 months, even if motor premiums continue their modest up-turn. Home pricing is expected to remain weak over at least the first half of 2015. Investment returns are forecast to be subdued for some time, as interest rates remain low. We will continue to execute our strategy to transform Co-operative Insurance, leveraging its three competitive advantages and a new technology platform from 2016.

Business Review continued

Co-operative Legal Services

Revenue	Underlying operating loss
£23m (down from £33m)	£5m (down from £9m loss)
Employees	**Sites**
342	3 (Manchester, London, Bristol)

In 2014, Co-operative Legal Services revenue declined by almost a third to £23m (2013: £33m). This was largely due to a decline in Personal Injury income following the regulatory changes to referral fees and the restructuring of the business. The Family and Wills practices reported positive growth, and our Probate practice recorded a strong performance in a competitive market that faced a decline in the UK death rate. In response to the overall decline in revenue, the operating costs of the business were restructured in the first half of the year to align to the expected trading revenues.

The business made an underlying operating loss of £5m (2013: £9m loss) for the full year. While the business traded at a loss in the first half of the year, following the restructuring it traded profitably during the second half (Half 1: £5.05m loss; Half 2: £0.05m profit).

Outlook

We believe that the legal services market remains fragmented, and many Member and customer needs are not being effectively met. We are now looking to better define our approach to this market, as we build the business as part of the overall Group Rebuild programme. We are focused on developing a range of products and services to support our customer and Member needs. Our aspiration is to offer fair and transparent pricing for our services, to ensure our customers and Members have access to affordable legal services when they need them.

2015 is the foundation year for our Legal Services business. We have planned investments in people, process re-engineering and our technology platform, to ensure we are offering our customers the products and services they require. With legal services increasingly a multi-channel, digitised market, we are enhancing our digital platform and capability, which will be released in early quarter 3 2015.

As a business we remain focused on customer satisfaction. During 2014 our customer satisfaction score remained consistent at 89%. Our investments in people, process and platform will continue during 2015, to support our aspiration to provide our Members and customers a leading customer service within the legal services market.

Estates

The Co-operative Estates is a property development business that is redeveloping a 20-acre site in Manchester's city centre, which was part of the Group's estate of head office buildings, and is known as the NOMA scheme. In June 2014, Estates completed a 50/50 joint venture agreement with Hermes Real Estate to take the development of the NOMA scheme to its next stage. Over the next ten years, the £800m programme will create a mixed-use district in the heart of Manchester, including 2.5m sq ft of offices, 1m sq ft of residential, and 0.5m sq ft of retail and leisure. Approximately 30,000 people are expected to live and work in the area.

Disposals

The Group took some difficult actions in late 2013 to deal with the high levels of debt that had built up from a series of underperforming acquisitions in prior years and to deliver on the 2014 financial commitments made under the Liability Management Exercise (LME) to rescue the Co-operative Bank. As a consequence, the decision to sell the Pharmacy and Farms businesses was announced in early 2014 and the sale of both businesses was completed in the second half of 2014. Importantly the Group secured good value for both businesses and together with the sale of the Sunwin Services business, total proceeds exceeded £850m. We used the proceeds to repay a £450m loan and to invest in our business, whilst paying £150m of the £313m capital commitments to the Bank under the LME. The final £163m portion of the LME capital contribution was paid in December 2014 using the deferred proceeds received from the sale of the Life and Savings business sold in 2013.

The Farms business was sold to the Wellcome Trust on 2 August for £234m generating a profit on sale of £121m. The Wellcome Trust is committed to the long-term future of the business and its employees, which we regard as particulary important. The sale of Sunwin Services to Cardtronics in November for £41.5m also generated a profit for the Group of £13m.

The results of the Farms and Sunwin Services businesses up to the period of sale are included within underlying operating profit since they were not separate major operations of the business. Sunwin Services made a profit of £3.4m (2013: £6.0m) on sales of £30m (2013: £38m) in the period up to sale on 3 November 2014. In the period up to sale on 2 August 2014, Farms made £3.1m of profit (2013: £3.3m) on sales of £15m (2013: £31m).

We completed the sale of the Pharmacy business to Bestway Group on 6 October 2014 with proceeds of £640m generating a profit on disposal of £122m. In the nine months up to the sale, Pharmacy reported sales of £578m (2013: £760m) and a profit of £50m (2013: £33m), although the 2014 result benefitted by £20m as amortisation and depreciation on its assets ceased from the point at which it became held for sale at the end of February 2014.

Business Review continued

The Co-operative Bank plc

The Liability Management Exercise (LME) to recapitalise The Co-operative Bank completed in December 2013. At the end of 2014, the Group successfully fulfilled its obligations arising from the LME with the payment (£163m) of the final element of the £333m LME capital commitment.

The Group's holding in the Bank fell from a 100%-owned subsidiary to a 30%-owned associate as a result of the LME. In May 2014, the Bank sought to raise an additional £400m of capital through a rights issue. The Group participated in this by selling (at full price) sufficient shares to subscribe for a portion of our entitlement (at a deep discount). This transaction resulted in our percentage holding moving to 20.2%.

In 2014 the Bank contributed a loss of £10m to the Group income statement, comprising the Group's share of the Bank's loss of £50m, an adjustment to unwind the fair value differences arising on acquisition of the Bank associate of £133m and an adjustment of £93m to revalue the Bank investment down to its fair value. In the year end balance sheet the investment in the Bank is recorded at £224m, compared to £221m at the start of the year.

The Group and the Bank continue to work together closely. We aim to deliver a smooth separation of the Bank from the Group, focusing particularly on the IT systems and the Pace pension scheme.

Our People

Our people are at the heart of our three-year Rebuild plan, which started in 2014. We are re-designing how we are structured and how we work, to be simpler, more effective and more efficient. The Group needs a capable and engaged workforce to deliver on our promise to our Members, customers and colleagues, while building a competitive advantage in the face of constant change.

In 2014, the Co-operative Group's restructuring led to a significant reshaping of our workforce, which had some impact on engagement. We also started to plan a new deal for colleagues, to be clear about what working here means and offers.

Restructuring

The Group's workforce shrank by a fifth during the year, from 86,953 to 69,241. Our separation from the Bank and the sales of our Farms, Pharmacy and Sunwin Services businesses led to the majority of the reduction. Further reductions were the result of cost cutting programmes and the adjustment to a new target operating model and were managed through some redundancies. Overall, the number of colleagues leaving has increased from 26% in 2013 to 30% in 2014. The number of voluntary leavers, which mainly includes resignations, has risen this year by just under 5% to 22%. This was to be expected at a time of great uncertainty within the Co-operative Group.

Leadership

Improving the ability of leadership to fulfil our Group's strategy and Purpose resulted in a number of Board and senior management appointments. Most notably, we appointed a new Chief Executive Officer in 2014, and a new Chair shortly after the year end. The Board was reorganised to make it leaner and more agile, with a different set of skills, capabilities and experiences – equipping it to provide governance oversight and lead the Group's Rebuild. We also reinforced the depth of our leadership talent through a number of senior hires. Additionally, we assessed our 60 senior leaders against key capabilities and skills to drive future growth.

Within Food, we are developing our 300 senior leaders, viewing this as essential in order to achieve our ambitions for the business. We are also building a strong leadership pipeline of store managers, who can lead in a customer-focused, community-centred and ethical way.

Following 2014's improvements, we are confident that our leaders are on track to drive the Group's revival.

Fair Pay

In order to be clear about the rewards and benefits of working for the Group, we started to work on a plan to deliver a new deal for colleagues based on the concept of Fair Pay. While our approach to remuneration will be affordable, controlled and sustainable, we will also ensure it is transparent and fairly rewards performance.

Engagement

Engagement is a strategic priority for the Co-operative Group. Following the Group's challenges in 2013 and 2014, we expected the results of our annual employee engagement survey to dip. Overall engagement in 2014 was down 7% to 67%, with 82% of colleagues completing the Talkback survey (2013: 86%). The survey measures motivation to deliver for our customers, as well as looking more broadly at different aspects of people's experience at work.

Emotional connection to our brand was particularly impacted over the year, reflecting the changes that have taken place within the business, as well as the reputational damage experienced. Most other aspects of colleagues' experiences at work have also declined year on year.

Engagement is firmly embedded within the Rebuild strategy. In particular, we plan to help colleagues feel proud of the organisation once more.

Diversity

The Group believes that our diverse mix of customers must be reflected in the workforce. We promote diversity among our people in terms of sexuality, race, gender and age.

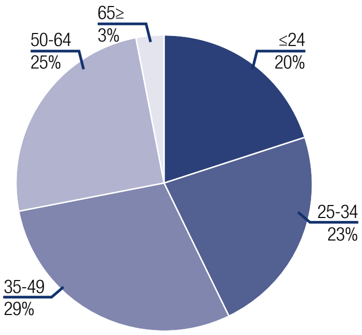
The Group was ranked 26th in the Stonewall Workplace Equality Index 2015. This index showcases and promotes Britain's top 100 employers taking a proactive approach to encouraging a fully inclusive culture and officially recognised as the most 'gay-friendly' places to work. Our Lesbian, Gay, Bisexual and Transgender (LGBT) employee network, Respect, has around 600 members and 9,000 followers on Twitter. Respect activities help to raise awareness of LGBT issues and the network supports the professional development of its members across the business. The Group supported four Pride events across Manchester, Brighton, Bristol and Doncaster during 2014 and Respect has been shortlisted for the Outstanding Diversity Network Award by the Excellence in Diversity Awards 2015.

In terms of gender, we are a signatory to the Government's 'Think Act Report' initiative, which encourages businesses to embrace gender equality at work by considering issues such as recruitment and retention. We remain committed to monitoring and reviewing equal pay across the business. Our employee network, Aspire, is led by and for female colleagues. It provides career advice, mentoring, personal development and access to senior managers. In 2014, the Co-operative Group was ranked in The Times Top 50 Employers for women.

In 2014, we continued a three-year project started in 2013 to identify the health and wellbeing needs of an ageing workforce, seeking to discover how to optimise employee health and business productivity. An internal report will be published at the end of the project to help formulate best policy and practice to support our employees. Also, since 2006 we have not enforced a retirement age.

Our People continued

Proportion of employees in each age band



Proportion of female, ethnic minority and disabled employees and managers

	Group	Managers
Female	57%	43%
Ethnic minority [1]	2.26%	2.62%
Disabled [2]	0.96%	0.88%

Youth employment

Our Apprenticeship Academy was launched in 2011 to counter growing unemployment and the lack of training opportunities for young people. It gives apprentices the opportunity to study for a nationally recognised qualification while working in our businesses and earning a competitive salary. During 2014, we took on 644 apprentices, lifting the total number since the Academy's launch to 2,700.

Apprenticeship has been particularly successful in Funeralcare, which uses it to train all new staff. Almost 500 apprentices started in this business during 2014.

In summary

In 2015, people will continue to play an important part in our Rebuild strategy. We will deliver a new target operating model, reinforce leadership capability, develop a Group-wide total reward proposition and improve our engagement strategy.

1 Based on employees identifying themselves as belonging to an ethnic group
2 Based on employees identifying themselves as having a disability

Sustainability Review

As a business with a strong campaigning heritage, we are proud of our roots and our approach to responsible business. We believe that progress requires the management and development of business in a sustainable way and we aim to be among the leading businesses in areas such as supporting the communities in which we operate, responsible retailing, protecting the environment and stakeholder engagement.

Our sustainability reporting (for 2014 this constitutes this Sustainability Review alongside a new Sustainability Datacentre [3]) sets out how we are addressing the key sustainability issues for our business. We are making solid progress in certain areas of our sustainability performance but, as set out in this report, we still face challenges across our businesses and have experienced some setbacks during 2014. As always, we seek to report on these in an open and honest manner.

As we progress through the Rebuild phase of the Society's turnaround programme, a very different business is emerging. In light of our focus on convenience retailing within our Food business, the disposal of the Pharmacy and Farms businesses and our reduced interest in the Co-operative Bank, we are undertaking a review of our sustainability priorities and approach.

We continue to be guided by the long-established co-operative values of self-help, self-responsibility, democracy, equality, equity and solidarity, alongside our commitment to ecological sustainability and social responsibility, as set out in our Sustainable Development Policy [4].

Key data presented within this Sustainability Review section have been independently audited by sustainability assurance provider, DNV GL, as identified by the symbol: ◊. An audit statement is available online [5]. Where an inaccuracy has been identified in previously reported data, or a methodology for calculating data has changed, information is restated, as identified by: [r].

Reviewing sustainability priorities

Through 2014 and into 2015 we progressed a review of our social goals and sustainability priorities. We have set out a path for co-creating (with Members and key stakeholders) campaigns and activities around a small number of priority issues, as well as establishing processes to embed these in our core business practices. Thirty thousand Members and customers engaged with us via Let's Talk, our online engagement platform. Members contributed via Area Member Conferences and our Members' Council is engaged in the process. Contributions have helped prioritise the themes we will be using to frame our future activities, namely: Sustainable Food; Youth Empowerment; and Resilient Communities.

We have also clarified our commitment to the sustainability fundamentals of delivering a 'better way of doing business' (as our Group Purpose commits us to). We will ensure our sustainability practices – such as supply chain management and sound sourcing, minimising the environmental impact of our operations and employee and stakeholder relations – continue to meet our Member and wider stakeholder expectations and are underpinned by robust sustainability management and reporting practices. We will continue to set ourselves challenging targets and report back to our Members and other stakeholders on our performance, both good and bad. Targets and more detailed sustainability information and data will be available in our online datacentre.

A summary of our sustainability activities and performance for 2014 is set out below, using the Group Purpose statement to structure their presentation: ***'Championing a better way of doing business for you and your communities'***.

You and your communities

Concern for community is enshrined in our co-operative principles and our Group Purpose puts 'you and your communities' at the heart of everything we do. We are a community retailer and have a presence in every UK postal area. Through our community investment, we aim to support and strengthen the communities in which we trade.

In 2014, our community activity led to an investment of £8.1m◊ in UK communities. This refers to our donation of money, goods and time – along with donations by employees, customers, Members and suppliers, known as leverage.

As a co-operative we have for many years funded our community investment from our profits ('community dividend'). As we did not return any profits in 2013, and made no dividend payment in 2014 as a result, our total 2014 community investment has decreased compared with previous years. Despite this, community investment continued, albeit at a lower level than in previous years, through our businesses, our membership and a range of Group-wide programmes.

UK community investment◊	2014 £m	2013 £m
Cash	**1.5**	5.7 [r]
Employee time	**0.9**	1.3
Gifts in kind	**0.7**	0.3
Management costs	**0.3**	0.5
Leverage from Charity of the Year activity	**n/a**	3.3
Leverage from the Co-operative Foundation	**3.4**	1.0
All other leverage	**1.3**	2.7
Total	**8.1**	14.8 [r]

3 To be launched in summer 2015; www.co-operative.coop/sustainabilitydata
4 www.co-operative.coop/our-ethics/resources/
5 www.co-operative.coop/our-ethics/resources/

Sustainability Review continued

The Co-operative Foundation

Of the total £8.1m invested in 2014, the Co-operative Foundation ('the Foundation') contributed £3.4m◊. The Foundation is an independent charitable trust which exists to make grants to organisations, including charities supporting young people. In 2014, the work of the Foundation was independently reviewed by PwC.

Through its Truth about Youth grant-making scheme that was set up in 2009, the Foundation worked in partnership with seven youth charities across the UK, that are enabling young people to lead change within their communities and challenge the negative perceptions about younger generations. Trustees are considering how to maintain the momentum of this work going forward.

The Co-operative Membership Community Fund

The Foundation is also responsible for administering the Co-operative Membership Community Fund ('the Community Fund'), which supports voluntary and self-help organisations by awarding small grants. In previous years, the Community Fund distributed monies from Members, who donated part or all of their share of profit each year [6]. No dividend was paid out in 2014 so, to enable the Community Fund to continue making grants, the Co-operative Foundation made a contribution of £1.8m◊, as detailed in the table below.

The Co-operative Membership Community Fund awards	2014	2013
Number of awards	**1,567**	2,270
Total dispersed	**£1.8m◊**	£2.8m
Average award	**£1,158◊**	£1,233

Foundation Trustees are currently reviewing the Foundation's strategy, taking account of best practice, the potential role of independent Trustees and alignment with the Group's Purpose.

Community activities and volunteering

During 2014, 7,746◊ colleagues (2013: 11,164 [r]) from across our businesses took part in community activities during work time [7], contributing the equivalent of £0.9m◊. The lower number in 2014 compared with 2013 reflects, in part, the biennial nature of our Charity of the Year programme.Of this total, 3,074◊ (2013: 1,693) took part in formal volunteering or community engagement, either through our volunteer programme or through locally-organised initiatives, such as our Community Pioneers initiative.

Our store colleagues and membership officers are ideally placed to understand the needs of their local communities and to connect with community organisations. Community Pioneers are a team of designated store-based colleagues who are provided with additional hours and budget to engage in community outreach at a local level. Trialled since 2013, there are currently 500 stores supporting Community Pioneers, with further stores planned to roll out in 2015, which will take on board learnings from the programme to date.

Our Funeralcare business has a long tradition of community outreach. In 2014 this included fundraising initiatives, support for bereaved children and educational and development activities.

As set out on page 10 in this report, making membership meaningful is central to our Rebuild strategy. In 2015, we will be rolling out a number of community-based pilot programmes, to connect our business with Members and their communities.

International communities

As well as the UK communities in which we trade, we source goods from many overseas suppliers and seek to play a responsible role in the sustainability of those communities. During 2014, we invested £1.2m◊ (2013: £1.8m [r]) through our work to support international communities, in particular via sales of our own-brand bottled water, Fairbourne Springs. For every bottle sold, three pence per litre is donated to The One Foundation to fund clean water projects in rural communities across Africa. Since the start of our partnership with The One Foundation in 2007, £5.7m has been raised, funding improved access to clean water for 1.3 million people (£651,000◊ was raised, benefitting 126,000 people during 2014).

We look to link such projects with our own supply chain where possible, for example 'access to water' projects have been funded in our Fairtrade tea and sugar producer communities in Malawi.

Championing

We have a long history of campaigning on issues that are relevant to our Members and today, 'championing' is a core element of our Purpose.

The review of our social goals and sustainability priorities that is underway will help to frame our campaigning activity in future years.

Working on waste

We participated in the Institute of Grocery Distribution's Working on Waste initiative, which brought UK food and grocery companies together to help their employees reduce household food waste. In 2014, we took the initiative a step further, creating a campaign that engaged with employees, Members and customers in seven pilot communities across the UK. Working with community groups, the campaign called on people to pledge to cut their food waste, and engaged thousands via social media and in-store.

6 2013 Community Fund investment is reflected in the 'all other leverage' (£1.8m) and 'cash' (£0.8m) rows of the 'UK community investment' table.

7 Including project management time, payroll giving and, for 2013, staff engagement relating to Charity of the Year.

Sustainability Review continued

Modern Slavery Bill

We support the introduction of a 'transparency in the supply chain' amendment to the Modern Slavery Bill, which will continue through the parliamentary process during 2015. In 2014, we called for businesses to report on what they have done to eradicate modern slavery. Further detail of recent activities in this area is provided under Ethical Trade on page 28.

Clean Energy Revolution

In January 2014, the UK Government launched its first Community Energy Strategy. A key driver for this, was the Group's Clean Energy Revolution campaign (2011 to 2013), to empower communities to control and benefit from their own energy projects.

Co-operation

As the UK's largest co-operative, we are committed to the principle of 'co-operation between co-operatives'. We continue to provide support to the co-operative movement, which in 2014 amounted to £2.1m, with the largest donation being made to Co-operatives UK, the national trade body that campaigns to promote, develop and unite co-operative enterprises. While less than in previous years, this remains a substantial level of support, and is underpinned by Service Level Agreements with principal parts of the co-operative movement, setting out levels of ongoing funding to be provided, and services to be received in return. Support for co-operative enterprise through the Co-operative Enterprise Hub, our programme to support the co-operative business model, was lower than in recent years, as new applications were suspended and we focused on redefining our priorities.

In 2014, we supported Co-operatives Fortnight, working collaboratively to promote the co-operative movement.

	Support to representative bodies of the Co-operative Movement	Support via the Co-operative Enterprise Hub
2011	£2.7m	£1.5m
2012	£2.7m	£1.9m
2013	£2.6m	£1.4m
2014	**£1.8m**	**£0.3m◊**

We provide an education programme based on co-operative values, which includes support for Co-operative Trust schools via the Schools Co-operative Society, and our sponsorship of seven academy schools in Manchester, Leeds and Stoke-on-Trent. Through our academies, we offer support to students and staff, including access to resources, high-quality governors, work experience, placements, training and leadership development. The creation of a central Trust is helping to develop and deliver our vision for the academies: 'To inspire a new generation of high-achieving, aspirational, skilled and confident young people who fully understand and appreciate how a co-operative approach will prepare and enable them to play their part in a changing global society'. We also provided curriculum resources through our Green Schools Revolution initiative during 2014.

Ebola appeal

We have supported various Disasters Emergency Committee (DEC) appeals in past years. In 2014, we leveraged the support of customers, Members and colleagues to raise £28,760◊ for the DEC Ebola appeal.

A better way of doing business

We aim to be commercially successful, building a sustainable way of doing business that benefits our Members and customers, while continuing to position the Group among the top performing businesses in terms of delivering on sustainability.

Social responsibility lies at the heart of the co-operative approach. We recognise that we have both a responsibility and an opportunity to have a positive social impact throughout our value chain. Our work to achieve this includes our contribution to international development through Fairtrade and ethical trade, promotion of healthy choices and UK sourcing, as detailed below. Our approach to protecting the environment acknowledges that there are limits to the natural resources that we rely on to operate our business, and that, as a sustainable business, we need to operate within those limits. Addressing climate change and reducing waste are key areas of focus. Our work to build a diverse workforce that is representative of the communities in which we operate, is covered in the 'Our People' section on page 21 of this report.

Healthy choices

Within our Food business, we believe that healthy and ethical options should be accessible to everyone. We aim to help customers to make healthy and informed choices and continue to target salt, saturated fat and sugar reductions in key products. We ensure that products in our own-brand 'low fat' and 'reduced' ranges are no more expensive than standard equivalent lines and in 2014 over 40% of products carrying traffic-light labelling were 'healthy [8]' lines (2013: 40%). We are also committed to providing customers with open and honest food labelling and, in 2014, 32% of promotions were for healthier [9] products (2013: 32%). Reformulation of products and healthy promotions will remain key elements of our Food business's strategy going forward.

8 Healthy is defined as a product that carries no red 'traffic lights', is a healthier alternative, or meets the Food Standards Agency nutrient profiling criteria used by Ofcom.

9 Healthier products are defined as: produce, bread, pure fruit juice, canned fruit and vegetables in water or fruit juice, lean protein, plain pasta, rice and noodles, products meeting the Food Standards Agency nutrient profiling criteria used by Ofcom, or any products from the low fat and reduced range. Food promotions exclude non-food grocery and beers, wines and spirits.

Sustainability Review continued

UK sourcing and animal welfare

We are proud to support British farmers. In 2014, 100%◊ of our fresh beef, chicken, ham, pork, sausage, turkey, salmon, milk and eggs were sourced from UK farmers, as was meat in some prepared foods including ready meals.

We are committed to providing products that have been produced to good animal welfare standards. We support animal welfare through schemes such as Red Tractor, RSPCA Freedom Food and our own-brand animal welfare standards, as delivered through six dedicated farming groups.

Through our dedicated farming groups, which supply 63% [10] of our own-brand fresh meat and poultry, we have been developing long-term relationships with carefully selected meat and dairy suppliers. Using key performance indicators and annual audits of all farms in the groups, we want to help drive continuous improvement. Farms are rated according to their performance across five agricultural pillars: 'Health, welfare and quality'; 'Co-operative brand'; 'Sustainability'; 'Environmental impact'; and 'Ethical and training'. In August 2014, suppliers received premiums totalling £5m based on the levels of achievement against these pillars.

None of our own-brand toiletry or household products or their ingredients have been tested on animals since 1985 and 1997 respectively. All own-brand products continue to carry Cruelty Free International's rabbit and stars logo.

Food safety and quality control

We are actively working with suppliers to simplify our supply chains and strengthen our risk management, traceability and quality assurance processes. All own-brand suppliers are certified against British Retail Consortium (BRC) Global Food Safety or BRC Consumer Products standards (or equivalents), and we work with our suppliers to ensure all products are compliant with relevant legislation and our own standards, which often exceed regulatory requirements.

Climate change

We recognised the need to act on climate change long before most businesses and have reported our climate impacts annually since 2005, with an ambition to reduce our direct greenhouse gas (GHG) emissions by 50% by 2020, compared to 2006.

Our overall strategy for addressing climate change focuses on reducing consumption, increasing efficiency, generating and using renewable energy, and offsetting carbon.

We measure our direct GHG emissions in tonnes of carbon dioxide equivalent (tCO_2e), using the latest UK government guidance [11]. Our direct GHG footprint measure encompasses energy and fuel consumption, food store refrigerant leakages and all business travel (road, air, and rail). We are also responsible for significant indirect emissions across our global supply chains, as well as being exposed to the impacts of climate change globally.

Since 2006, our total direct GHG emissions have reduced by 39%◊ as detailed in the table below, with strong emissions reductions in energy (38%◊), refrigerant leakages (44%◊) and transport (35%◊). Overall, total direct GHG emissions increased in 2014, due to a significant increase in the GHG intensity [12] of electricity supply, together with greatly improved data recording for food store refrigerant leakages.

Direct greenhouse gas emissions	Total emissions (tCO_2e)[13] ◊
2006	1,204,760
2011	755,504
2012	715,278
2013	694,725
2014	**737,263**
	39% decrease since 2006 6.1% increase since 2013

In 2014, energy consumption reduced by 9%◊, due primarily to behaviour change initiatives and a targeted Food store improvement programme. This equates to a £61m◊ cost saving compared to 2006 consumption. We also reduced fleet mileage by almost six million miles within our Food business in 2014. Over 7,000 tCO_2e◊ was saved through fleet improvements, better planning and switching some routes to rail freight. Greenhouse gas emissions by source are detailed in the table below.

Total greenhouse gas emissions by source

	Total emissions (tCO_2e)◊	
Source of emissions	**2014**	2013 [r]
Fuel combustion	**35,170**	42,237
Electricity consumption [14]	**403,386**	392,528
Refrigerant leakages [15]	**167,136**	120,752
Transport [16]	**131,571**	139,208
Total	**737,263**	694,725
Carbon intensity (tCO_2e/£m gross income)	**72.18**	66.06 [r]

10 June 2013 – June 2014.

11 Department for Environment, Food and Rural Affairs (Defra), Environmental Reporting Guidelines: Including Mandatory greenhouse gas emissions reporting guidance, June 2013 (www.gov.uk/government/uploads/system/uploads/attachment_data/file/206392/pb13944-env-reporting-guidance.pdf).

12 GHG emissions per unit of electricity are calculated by Defra and updated annually. Due to changes in the UK energy mix Defra increased this metric from 0.44548 kgCO2e/kWh for electricity purchased in 2013 to 0.49426 kgCO2e/kWh for electricity purchased in 2014.

13 All figures restated to account for the Group's separation from The Co-operative Bank and the sale of the Pharmacy, Farms and Sunwin Services businesses - emissions from these businesses are not included in figures. Emissions associated with the Group's 20% equity share in The Co-operative Bank are also excluded from reporting.

14 If electricity from renewable sources is accounted as zero carbon, then emissions from electricity would be 7,799 tCO_2e.

15 Refrigerant data is reported from our Food store estate and home delivery vehicles only, and excludes distribution centres and distribution fleet.

16 Distribution data is reported for all Group businesses except Co-operative Electricals, which utilises third-party distribution.

Sustainability Review continued

We sourced 98%◊ of electricity from renewables in 2014 (2013: 98%), including 100GWhs from our own renewable energy projects (12%◊ of total). The latest addition to our portfolio is Biggleswade windfarm in Bedfordshire, a ten-turbine project that in 2014 generated enough electricity to power 9,700 homes.

In 2014, the indirect emissions associated with our operations [17] were 263,634 tCO_2e◊. We avoided 37,350 tCO_2e◊ through recycling waste rather than landfilling it, and we continue to work with suppliers to help them manage their own GHG emissions, such as through a carbon reduction project in our Fairtrade tea supply chain in Kenya.

Funeralcare sourced 100%◊ of its electricity from renewables in 2014 and also maintained its carbon neutral policy◊ for the fourth consecutive year by offsetting its operational greenhouse gas (GHG) emissions [18]. It does this by supporting a rigorously selected portfolio of carbon reduction projects, which provide additional benefits for people and the environment.

Sales of General Insurance's innovative motor product 'ecoinsurance' reduces customers' environmental impacts by offsetting 20% of an average car's carbon dioxide emissions for every policy held. The offsets work by supporting carbon reduction projects in developing countries and in 2014 we purchased offsets equivalent to 100,224◊ tonnes of carbon dioxide.

Waste

Our waste management follows the well-established waste hierarchy of reduce, reuse and recycle. We have reduced the volume of waste produced by 41%◊ since 2006, while increasing the proportion of waste that is reused or recycled by 37%◊ over the same period, as detailed in the table below. Reported waste production in 2014 is slightly higher than the previous year (3%◊ increase) due to improved accounting as a result of consolidating waste contracts. Reuse/recycling rates have increased significantly over the last two years, reaching 95%◊ in 2014. Improvements have largely been due to backhauling waste from our Food stores to regional depots. By removing waste collections from stores and collecting from depots instead, we reduce the number of skip collections and are able to segregate waste more effectively to ensure we are maximising the environmental benefit.

	Total waste (tonnes)◊	Percentage recycled/reused◊
2006 [19]	156,568	58%
2011	97,580	59%
2012	95,161	60%
2013	89,866	74%
2014	**92,385**	**95%**
	41% reduction since 2006 3% increase since 2013	

Food waste has negative environmental and social impacts. We are engaged in an industry-wide process to agree a standardised approach for measuring food waste within the food retail sector. While only a relatively small proportion of overall food waste in the UK arises directly from food retailers [20], we have a responsibility to reduce our impacts. We are engaged in initiatives that include redistributing surplus food from our operations to people and communities suffering from food poverty through charities such as Fareshare. We are also supporting the reduction of food waste from households, for example through printing storage instructions for fruit and vegetables on fresh produce bags.

We have gained recognition for our actions to reduce waste and carbon emissions, winning the Transport Project of the Year at the Business Green Leaders Awards and the Environmental Improvement award at the European Supply Chain Excellence Awards.

Sustainable sourcing

We are one of the UK's leading retailers on forest and marine stewardship. We are committed to sourcing wood and paper products from sustainable sources and continue to be guided by our Responsible Fish Sourcing Policy. In addition, we have market-leading commitments on the sustainable procurement of high-risk products such as palm oil and we have in place supplier policies on pesticides and chemicals for priority action.

17 'Operations' relates to: the transmission and distribution of electricity, supply of fuel, recycling and disposal of waste and the supply and treatment of water. Indirect emissions across our entire value chain are likely to be far larger than this.

18 Remaining emissions from gas, non-renewable electricity, and business travel, once green electricity supply is discounted.

19 All figures restated to account for the Group's separation from The Co-operative Bank and the sale of its Pharmacy, Farms and Sunwin Services businesses. Data from these businesses is excluded from the figures.

20 British Retail Consortium, January 2015: food waste from seven major food retailers estimated to account for only 1% (200,000 tonnes) of total annual food waste in UK.

Sustainability Review continued

Fairtrade

We believe that, when undertaken fairly, trade has an unparalleled capacity to improve quality of life and empower communities. In 2014, as a result of Fairtrade sales in our stores, the Fairtrade premium received by producers was an estimated £2.6m◊ (2013: £3.1m◊ [r]). We sold 218◊ Fairtrade ranges (2013: 272 [r]), of which 132◊ were own brand (2013: 170 [r]) and overall sales of Fairtrade products were £133m◊ (2013: £140m [r]). Fairtrade Premium has declined as a consequence of reduced sales. This was largely due to declining sales in core categories, reflecting a reduction in store space for grocery lines as we began to focus on our core convenience store format and changes in wider consumer behaviour. Despite this, we continued to be recognised as the top UK supermarket for Fairtrade retail share relative to our size and we have the widest Fairtrade range and highest Fairtrade sales of any UK convenience retailer.

With increasing recognition of the role of smallholder farmers in global food security, we have gone 'beyond Fairtrade', investing £1.8m between 2009 and 2014 in 17 supply-chain co-operatives (2014: £226,000 to support five co-operatives) to strengthen their capacity and resilience, for example in carbon offsetting, which, in turn helps us to secure sustainability of future supply.

As we celebrated 20 years of championing Fairtrade, during Fairtrade Fortnight we hosted our annual producer tour and arranged events across the UK. Our Members and customers heard first-hand the positive impact of making the Fairtrade choice.

Ethical Trade

Given that we source products for sale in Food stores from 1,628◊ sites in 69◊ countries around the world, which employ over half a million◊ workers, suppliers are a key stakeholder. This presents a challenge and an opportunity in terms of minimising environmental and social impacts along the supply chain.

Our Sound Sourcing Code of Conduct identifies the labour standards we expect to be applied across suppliers of our own-brand products and we are a member of the Ethical Trading Initiative. Our approach to managing labour standards in our supply chain combines: a robust monitoring programme to help ensure fair treatment of workers in our supply chains around the world; working in partnership and building capacity with suppliers to achieve continuous improvement; and employee training to improve awareness and understanding of our own impacts on workers and communities. Approved third-party bodies have carried out 460◊ supplier site audits to monitor compliance with our Sound Sourcing criteria in the past two years and all tier-one [21] suppliers identified as high risk have either had an audit in the past two years or are scheduled for audit in 2015. In 2014, 16◊ supplier events were carried out in five countries, amounting to over 3,300◊ hours of supplier training and engagement.

We recognise that some supply chain issues, such as modern slavery, are complex, and to help develop long term solutions we need to work in partnership with suppliers, other retailers, NGOs, Trade Unions and the Government. Through the Stronger Together programme, we are working to reduce forced labour and human trafficking in the UK, providing pragmatic guidance, tools and training for suppliers. We are also partners in an intiative with Anti-Slavery International and other retailers and suppliers to address trafficking in the seafood supply chain in Thailand, which includes delivering mechanisms to increase visibility of issues through worker hotlines.

General Insurance ethical screening

Our General Insurance business screens its investments against its Ethical Policy, which includes issues of human rights, the environment, international development and animal welfare. Seven fixed income investment opportunities were screened in 2014, of which one was declined. A further seven investment opportunities were declined without the need for referral.

Sustainability Management

Sustainability policies

Our Group-wide Sustainable Development Policy sets out how we seek to deliver value to our stakeholders in an ecologically sustainable and socially responsible manner. It guides the approach to sustainability across our businesses. A range of bespoke policies exist at business level, and are embedded within the businesses. Other policies, such as the Sound Sourcing Code of Conduct and Human Rights and Trade Policy, extend across all operations.

Introduced in 2009, the Human Rights and Trade Policy identifies the extreme conditions under which we will suspend trade with a nation state or designated region. We believe that trade can bring positive change, but also recognise that in exceptional circumstances the benefits of trade can be undermined. Implementation of the Policy remains the same as reported for 2013.

Stakeholder engagement

Engagement with stakeholders is key to achieving an accountable and strategic response to sustainability issues. During 2014, our stakeholder engagement activities have included our 'Have Your Say' survey, run by YouGov, to which over 180,000 people responded, feeding into the development of our new Purpose. Our Let's Talk discussion forum was a key means of engagement with Members and customers, while Members continued to exercise democratic participation via the tabling of motions to our Annual General Meeting, which, in 2014, included sustainability issues of local sourcing and pay ratios. We also engaged with specific groups, for example, the Co-operative Young Members' Board, an advisory panel of 15 Members aged 16 – 25, established to encourage our young Members to be actively involved in our business.

21 A tier-one site is a production site at which goods are finished, ready for supply to, or sale by, the end company.

Sustainability Review continued

Accounting, reporting and audit

The process of accounting, auditing and reporting on our material social, ethical and environmental issues is important to drive performance and it provides crucial information to our stakeholders. We are taking an interim approach to reporting on our sustainability activities and performance this year, as we progress towards integrated reporting. In addition to information presented within this report, we will launch an online datacentre to track performance trends and present more detailed information and data for stakeholders.

Performance benchmarking and recognition

We continued to report performance in the Business in the Community (BitC) Corporate Responsibility (CR) Index, as one of five key performance indicators (page 11), measuring the degree to which the Group is viewed as a leading champion of corporate responsibility in the UK. The index challenges businesses to demonstrate the degree to which CR is embedded in business strategy and performance. The Group achieved a Platinum Plus ranking in 2013, re-accredited in 2014 [22].

A Queen's Award for Enterprise in Sustainable Development was conferred upon the Group in 2012 and runs for five years.

22 Our 2015 score was not available at the time of publication.

Directors' report

Executive Biographies

Richard Pennycook

Chief Executive Officer

Appointed as permanent CEO of the Group in September 2014, after having taken up the role on an interim basis in March 2014. Joined the Group as Chief Financial Officer in 2013 after nearly eight years with Wm Morrison Supermarkets plc (Morrisons). Previously held similar roles at RAC and JD Wetherspoon.

Sam Walker

Chief HR Officer

Joined the Group in 2013 from Britvic Soft Drinks. Has over 26 years' experience in HR across a number of sectors including media, FMCG, pharmaceuticals and utilities. She has also worked within marketing, sales and operations.

Nick Folland

Chief External Affairs Officer

Joined the Group in 2013 from Kingfisher where he led the Net Positive sustainability agenda having also been the General Counsel and Company Secretary.

Steve Murrells

Chief Executive, Retail

Joined as Chief Executive of The Co-operative Food in 2012. Previously CEO of Danish meat company, Tulip. Has a long history in fresh food retailing, having held a number of senior positions with Tesco, including CEO for One Stop Stores and Commercial Director of Fresh Foods. Has also worked within buying and trading for Sainsbury's.

Alistair Asher

Group General Counsel

Joined the Group in 2013 from Allen & Overy where he was a senior partner. Alistair has had a 34 year career with Allen & Overy, 26 of them as a partner.

Paula Kerrigan

Group Chief Strategy Officer

Joined the Group in 2013 from Kingfisher where she was responsible for finance for Central Support functions having also held strategy and finance roles across Europe and Asia.

Pippa Wicks

Chief Operating Officer

Working with the Group since 2014 from the business consultants AlixPartners where she co-founded the firm's Europe wide operations. Prior to joining AlixPartners, she was group CEO of FT Knowledge, group CFO of Courtaulds Textiles plc and a senior manager with Bain & Company strategy consultants. While at AlixPartners she has taken on a number of Interim CEO and COO positions at UK and European companies.

Rod Bulmer

Chief Executive, Consumer Services

Joined the Group Executive in 2014, after seven years at the Co-operative Financial Services and the Co-operative Banking Group. Before joining the Group, held roles including Managing Director of Retail within the UK operation at Santander Group and Director of Branch Network at Abbey National Group.

Claire Davies

Group Secretary

Joined the Group in 2014 from Lloyds Banking Group. Claire is a solicitor and has more than 28 years' experience in a variety of legal, compliance and company secretarial positions.

Board Biographies

Allan Leighton

Appointed as Independent Chair on 19 February 2015

Committee Membership

Transitional Search

Skills and Experience

Allan has held a series of high profile roles, including Chief Executive of Asda, from 1996 to 2000, Non-Executive Chairman of Royal Mail from 2002 to 2009 and President of Loblaw, the largest food retailer in Canada, from 2008 to 2011.

Allan is currently the the Chairman of Matalan Limited, Office Limited, Entertainment One plc, Pace plc and Deputy Chairman of Pandora A/S.

Sir Christopher Kelly

Appointed on 14 November 2014 as Senior Independent Non-Executive Director

Committee Membership

Transitional Remuneration, Transitional Search

Skills and Experience

Sir Christopher chaired the independent review which considered the events leading up to the re-capitalisation plan for The Co-operative Bank plc in 2013. Prior to this he was a senior public servant for many years. He currently chairs the King's Fund and the Responsible Gambling Strategy Board and previously chaired the Committee on Standards in Public Life, the Financial Ombudsman Service and the NSPCC. He has also been a senior official in HM Treasury and was permanent Secretary of the Department of Health.

Sir Christopher is a director of TPOF Limited, The TPO Foundation and Brookfield Mansions (Freehold) Limited.

Simon Burke*

Appointed on 14 November 2014 as an Independent Non-Executive Director for the transitional period (ending May 2015)

Committee Membership

Transitional Risk and Audit, Transitional Search

Skills and Experience

Simon is a Chartered Accountant and, as an Independent Non-Executive Director, sat on the Board of the Group's principal subsidiary, Co-operative Food Holdings Ltd. Simon was previously Chair of both BathStore and Hobbycraft, and CEO for Virgin Retail, Virgin Cinemas and Virgin Entertainment Group.

Simon is currently a non-executive director for the BBC and a director of Kensington Hall Management Limited, Cestbourne Limited, 51/53 Ossington Street Freehold Limited, Johnson Burke & Co Limited, The Light Cinemas (Holdings) Limited and Blue Diamond Limited.

Richard Pennycook

Appointed as a director on 13 January 2015

Skills and Experience

Richard was appointed as permanent CEO of the Group in September 2014, after having taken up the role on an interim basis in March 2014. Richard joined the Group as Chief Financial Officer in 2013 after nearly eight years with Wm Morrison Supermarkets plc (Morrisons). Richard previously held similar roles at RAC and JD Wetherspoon.

Richard is a director of Persimmon plc, Howden Joinery Group plc, The Hut Group plc and the Institute of Turnaround.

Frank Nelson*

Appointed as a director on 17 May 2014

Committee Membership

Transitional Remuneration, Transitional Search

Skills and Experience

Frank is a retired Bank Marketing Manager with over 30 years' experience in the banking sector. Frank has been a Pension Fund Trustee since 1988 and is also a Magistrate. He is a member of the Merseyside Area Committee of the Group and served on the Group's North West and North Midlands Regional Board for five years.

Frank is a director of the Knowsley Mutual Credit Union.

Marc Bicknell*

Appointed as a director on 7 October 2013

Committee Membership

Transitional Remuneration, Transitional Search, Transitional Risk and Audit

Skills and Experience

Marc is a Chartered Accountant and Local Authority Chief Internal Auditor. Marc was a member of the Group's North Regional Board for six years and serves on the Leeds and Wakefield Area Committee of the Group.

Marc is a director of the Druids Sheffield Friendly Society amd a trustee of the Leeds Forester Investment Association.

Board Biographies continued

Martyn Cheatle*

Appointed as a director on 22 May 2010

Committee Membership

Transitional Risk and Audit – Chair, Transitional Search

Skills and Experience

Martyn is Chief Executive of Central England Co-operative Society and previously held the role of Head of Finance and Deputy Chief Executive since joining the society in 2001. Martyn has previously worked as Finance Director for Gala Leisure and Financial Controller of Bass Brewers.

Martyn is a director and Chair of Federal Retail and Trading Services Limited and a director of TCCT Holdings Limited. He also holds a number of directorships on subsidiaries of Central England Co-operative Society.

Duncan Bowdler*

Appointed as a director on 29 July 2007

Committee membership

Transitional Risk and Audit, Transitional Search

Skills and Experience

Duncan is the Trade and Legislation Manager of the Group. Duncan previously served on the Board of United Co-operatives Limited since 2002 prior to its merger with the Co-operative Group in 2007, where he continued on as a Co-operative Group Board Director. Duncan is a member of the Manchester Area Committee of the Group and served on a Regional Board for 12 years.

Michael Harriott*

Appointed as a director on 19 May 2013

Committee membership

Transitional Remuneration, Transitional Search

Skills and Experience

Michael is Finance Manager of Ashburton Family Services, a registered charity helping to support families within the local community. He is a member of the Group's North, East, West Devon and Somerset Area Committee and served on the South and West Regional Board of the Group for four years.

Michael is a director of Plymouth Energy Co-operative and Plymouth Energy Co-operative Renewables.

Eric Calderwood*

Appointed as a director on 21 May 2006

Committee Membership

Transitional Remuneration – Chair, Transitional Search

Skills and Experience

Eric is a Lecturer at the University of Stirling, and is also a Retail Consultant. He is a member of the Central Scotland Area Committee of the Group and served on the Group's Scotland and Northern Ireland Regional Board for ten years. Eric is also Chair of The Manx Co-operative Society.

* Director is a member of the Transitional Board and will step down on the conclusion of the 2015 Annual General Meeting.

Governance Review

Introduction from the Chair

After a year in which the Group's governance structures and framework have been radically reformed, I am pleased to present the Group's annual corporate governance report for 2014.

As a Member you will be well aware of the difficult issues that the Group has faced in recent years. The damage caused to the Group's reputation through a series of high profile governance failings in 2013 will take time to repair. In 2014, in direct response to those events, the Group embarked on the urgent task of rebuilding trust in our Group for our Members.

The process of reform began with two independent reviews commissioned by the Group to ensure a clear understanding of what went wrong and the lessons to be learnt:

a. The Kelly Review was commissioned jointly by the Co-operative Group and The Co-operative Bank plc to look into the events which led to the capital shortfall announced by The Co-operative Bank plc in June 2013. The independent review, chaired by Sir Christopher Kelly, reported in April 2014. A summary of the findings can be found in the report below; the full report is available on the following website: www.thekellyreview.co.uk.

b. The Myners Review. In December 2013, Lord Myners was commissioned by the Group Board to conduct an independent review of the Group's governance framework. The Myners Review was published in May 2014. A summary of the findings can be found in the report below; the full report is available on the Group's website: www.co-operative.coop/MynersReview.

The Group is grateful to both Sir Christopher Kelly and to Lord Myners for their significant contribution to its recovery both in their capacity as independent reviewers and as Senior Independent Directors on our board. Their insight has been instrumental in helping us to identify and address the deficiencies in our former structures.

Both reviews made uncomfortable reading, drawing attention, in a very public way, to the fact that the Group's corporate governance arrangements were not fit for purpose. Against that background, we set about reforming and modernising our governance framework.

At the Group's Special General Meeting (SGM) in May 2014, Members unanimously voted in favour of the four principles that would underpin our new governance framework. These are set out in the report below. In the 100 or so days that followed, working together at pace in a wide ranging consultation process, we set about designing our new constitution. The new Rulebook which defined the new governance structure was approved by Members at an SGM held on 30 August 2014. Following registration, these new Rules came into effect on 30 September 2014.

Since 1 October 2014, we have been in transition, working to create the new Board, to establish the structure and ways of working for our Members' Council and to implement new processes to support One Member, One Vote. There is still much to do to ensure that we are ready to move out of transition and adopt our new constitution following the Annual General Meeting (AGM) in May 2015. Further detail on the progress to date is contained in the pages that follow.

This last year has been one of the most painful in the Group's history, forcing us to face up to our failings. However, as we near the end of the transitional phase, we believe we have turned a corner in our journey of governance reform. Whatever your contribution, I would like to thank everyone who has participated in the reform process. The combined efforts of the Group and the wider movement have been a great example of the true spirit and benefits of co-operation. Special thanks go to the International Co-operatives Alliance (ICA) and Co-operatives UK for their invaluable support and for their commitment to helping us to deliver a new governance framework.

Once implemented, we believe that these reforms, together with the rebuilding of our business, will help us to restore the Group to its rightful place at the heart of communities across the UK.

Allan Leighton
Chair, The Co-operative Group

Governance Review continued

Compliance with the UK Corporate Governance Code

The Group is registered under the Co-operative and Community Benefit Societies Act 2014. As such it is not mandatory for the Group to comply with the UK Corporate Governance Code ('the Code') published by the Financial Reporting Council. In fact, the democratic nature of the Group and its ownership by Members makes certain provisions of the Code difficult to apply. However, where possible and appropriate, the Group aims to conform to the Code's key principles to ensure alignment with good practice, transparency and openness.

The format of this report follows the Code's key themes of leadership, effectiveness, accountability, engagement and relations with our Members. The required regulatory and governance assurances are provided in this report. Where we have not complied, we have endeavoured to provide a supporting explanation.

The Group also adheres to the spirit of the Corporate Governance Code for Consumer Co-operatives in respect of which we report directly to Co-operatives UK which publishes this Code.

Effectiveness

The Group has undertaken an extensive reform programme during the year to remedy deficiencies in its governance arrangements and to ensure that these are effective going forward.

The Route to Reform

Background

This section summarises the work of the Governance Reform Project ('the Project') which was set up in May 2014 to deliver radical reform of our governance arrangements and structures. The Project is ongoing and is expected to complete its work at the end of the transitional phase at the AGM 2015.

The Project was set up in direct response to the adverse impacts on the Group's business and reputation of high profile governance failings. In particular, its work was informed by the findings of the independent reviews conducted by Sir Christopher Kelly and Lord Myners. Both reports were highly critical of the practices and behaviours that had been allowed to develop within the Group's management and governance structures.

Both reviews were made available via the Group's website on publication and remain accessible to Members and to the public at large.

Following the AGM in May 2014, Sir Christopher and Lord Myners attended a meeting with Members to deliver their findings in person and to take questions.

The Kelly Review

In August 2013, Sir Christopher Kelly was commissioned jointly by the Group and The Co-operative Bank ('the Bank') to conduct an independent review of the events which led to the capital shortfall of £1.5bn announced by the Bank in June 2013. The Kelly Review was published in April 2014. It concluded that a number of factors had led to the capital shortfall, including a system of governance which led to serious failures of oversight by the Board of the Co-operative Group. In summarising his findings, Sir Christopher stated:

"I am conscious that member control by democratically elected representatives is a fundamental part of the co-operative ideal. But there is more than one way to implement this principle. I have no doubt at all that the methods used over the last few years to appoint members to the Board of the Co-operative Group and its subsidiaries have led to serious failures in relation to oversight and governance of the Bank. The existing governance structure has badly let down the Co-operative Group's members".

A full copy of the Kelly Review is available on the following website: www.thekellyreview.co.uk.

Sir Christopher Kelly was appointed to the Group Board as Senior Independent Director in November 2014.

The Myners Review

In December 2013, Lord Paul Myners was appointed to the Group Board as Senior Independent Director to chair a comprehensive, independent review of the Group's governance arrangements. The aim of the review was to create a co-operative with 'best in class' structures and working practices that were fit for its scale and complexity. The terms of reference called for particular attention to be paid to the effectiveness of the Group Board and on ensuring that the interests of the entire membership were properly served.

It was originally intended to be a two stage reporting process: initial proposals were due to be delivered at the AGM 2014 with a final report and recommendations being published later in the year. However, in response to the adverse impact of continuing scrutiny on the Group's commercial interests, Lord Myners was asked to bring forward the timetable for publication of his report. Preliminary findings were published in April 2014 and the full report published on 7 May 2014.

The Myners report identified a number of failings in the Group's governance arrangements including serious weaknesses in relation to the Group Board.

In summarising his findings, Lord Myners reported that:

"The inescapable conclusion of this Review's analysis is that the present governance architecture and allocation of responsibilities is not fit for purpose. It places individuals who do not possess the requisite skills and experience into positions where their lack of understanding prevents them from exercising the necessary oversight of the Executive."

On 10 April 2014, Lord Myners announced that he would step down from the Board following delivery of his report at the 2014 AGM.

Governance Review continued

SGM 17 May 2014 – vote on the Four Principles

In response to these reviews, the Board convened an SGM on 17 May 2014 seeking the support of Elected Members to fundamental reforms. At the SGM, Members voted unanimously in favour of a resolution which established the following four key principles of reform:

- the creation of a Board of Directors, elected by Members, that is individually and collectively qualified to lead an organisation of the size and complexity of the Co-operative Group;
- the establishment of a structure that gives the Co-operative Group's Members appropriate powers to hold the Board properly to account for the performance of the business, and adherence to co-operative Values and Principles;
- a move to the concept of One Member One Vote, with appropriate representation for independent co-operative societies;
- the inclusion of necessary provisions in the Rules of the Co-operative Group to protect against de-mutualisation.

The Group's Governance Reform Project was set up immediately following the SGM to design a new constitution and Rulebook built around these four principles.

Governance Reform Project structure

The Project was led by the Group Secretary, Claire Davies, reporting to the Group Chair, Ursula Lidbetter. The Project team comprised a small number of specialists with access to advisers as appropriate. Initially working closely with the Myners Review team and drawing on the recommendations set out in the Myners Report, the Project team had the following key objectives:

- delivering a governance structure that is compatible with the highest standards of corporate governance and withstands the scrutiny of competitors and critics;
- enshrining the Values and Principles of the co-operative movement; and
- allowing the Co-operative Group, as the UK's largest consumer co-operative, to be held up as an exemplar of the co-operative model, both in the UK and worldwide.

Reporting to the Board, the Project was overseen by a Steering Committee comprising:

- Ursula Lidbetter, Group Chair
- Claire Davies, Group Secretary
- Herbert Daybell, Chair of the Values and Principles Board
- Michael Harriott, Group Board Director
- Richard Pennycook, Interim CEO.

Nick Folland, Chief External Affairs Officer, was a regular attendee at this Committee and, in addition, members of the Project team, the Executive and other advisers attended as required. Ian Snaith, a consultant with law firm, DWF LLP and a specialist in the law relating to co-operatives, acted as an adviser to the Steering Committee. The wider Project has been advised throughout by its corporate legal advisers, Allen & Overy LLP.

From May to October 2014, the Committee met weekly or more frequently as required. This was a period of intense Member engagement involving ongoing and wide ranging consultation including:

- weekly meetings between the Steering Committee and Regional Board Chairs
- rolling production and review of documentation and proposals
- drafting and review of new Rulebook, including Transitional Provisions
- a legal workshop held jointly between the Project team and Elected Members to address technical points in the Rules
- additional and extended Group Board, Regional Board and Area Committee meetings
- special meetings for Elected Members to review proposals including two joint meetings with the Project team and Elected Members
- consultation with Independent Society Members facilitated by Co-operatives UK
- regular communications including webinars, videos and articles
- support and engagement with the wider movement including the ICA and Co-operatives UK.

SGM 30 August 2014 – vote on the new Rulebook

In just over 100 days after the vote on the governance principles, a second SGM was held, this time to vote on the new Rulebook which proposed an entirely new constitution. At the SGM held on 30 August 2014, Elected Members voted overwhelmingly in favour of adopting the new Rulebook.

Following registration by the Financial Conduct Authority on 30 September 2014, the new Rules came into effect. This marked the start of the transitional period which is ongoing. During this period we are devising new structures and terms of engagement as we prepare for the implementation of the new governance arrangements. Transition is due to end at the AGM 2015.

Transition

Since 30 September 2014, the Group has been operating under Transitional Provisions contained in the Rulebook. The Transitional Provisions set out the steps to be undertaken to move to the new governance pillars. Certain new Rules have been suspended pending completion of transition.

During transition, the emphasis is on establishing new ways of working to deliver the new structure which comprises three core pillars of governance.

Governance Review continued

The new structure reflects the three constitutional pillars

Group Board

- **Composition:** 1 Independent Chair, 2 Executive Directors, 5 Independent Non-Executive Directors (INEDs) and 3 Member Nominated Directors
- **Requirements:** All Directors are expected to meet the high standards of competence commensurate with the needs of a business of the scale and complexity of the Group. Additionally, all Directors must demonstrate a commitment to Co-operative Values and Principles
- **All elected:** MNDs elected by Members via competitive elections, INEDs and Exec Directors appointed by Board/NomCo and approved by Members at the first AGM following their appointment

The Council

- **Purpose:** the representative body elected by and from Members to promote their interests and to hold the Board to account
- **Roles and responsibilities to include:**
  – Guardian of the Group's Purpose, Values and Principles
  – Holding the Group Board to account and influencing strategic and operational issues
  – Acting as a consultative body and a body for making representations on behalf of the Council's constituencies
  – Making decisions on those matters reserved to the Council by the rules
- **Size:** up to 100 members
- **Other representation:** elected Senate and President

Members

- Move to **One Member One Vote** seeks to reaffirm the importance of direct member participation in the affairs of the Society
- **Dramatic extension of Member control:** decision-making, voice, elections, representation
- Appropriate representation of **Independent Society Members** including new federal structure to formalise the commercial and organisational relationship with the Group

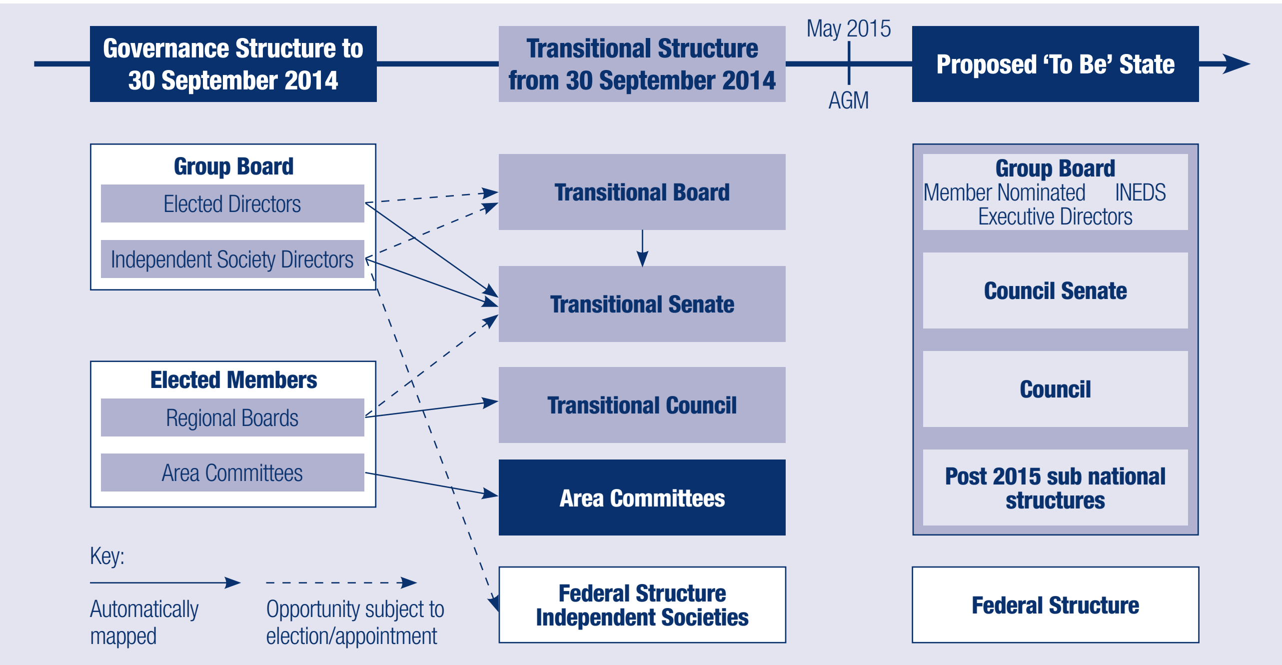
All of the above require detailed secondary regulations and procedures to implement the new governance structures post-transition.

As a result of the reforms, the Regional Boards and Regional Values and Principles Committees were disbanded on 31 December 2014. All Elected Members on those Boards and Committees transferred to the Transitional Council.

The Transitional Council has been tasked with implementing new sub-national structures to replace the Area Committees which are expected to be in place with effect from the 2015 AGM.

The diagrams below show the Group's transitional governance structure and the 'to be' governance structure which will come into effect at the end of transition in May 2015.

Transition Plan To Reform



Governance Review continued

New Governance Structure (post transition)

Summary of key changes

1. A new Group Board
- Reduced from 20 to 11 seats
- Majority of independent directors and an independent chair, rather than a majority of elected member representatives
- Two Executive Directors on the Board (one of whom will be CEO) – previously none
- High levels of experience and qualifications required for all Directors

2. Revised Sub Committees
- New sub-committees for Board and Council

3. Creation of a Council
- Council to represent members and to act as guardian of the Group's Purpose, Values and Principles and the Society's Constitution, with the power to hold the Group Board to account

4. Removal of existing Regional Structures
- Regional Boards (and Regional Values and Principles Committees) ceased to operate on 31 December 2014
- Area Commitees to be replaced by new structures (from May 2015)

5. One Member One Vote
- Representative democracy replaced with direct 'OMOV' participation for ordinary Members

6. Focus of Independent Societies
- No longer have seats on Group Board, but have appropriate representation as:
  – Independent Society Members on the Council/Senate and
  – through a new Federal Structure

Reflecting the considerable changes made to our governance structures, the Steering Committee was disbanded following the adoption of the new Rules. Working closely with the Board, the Council and the Executive, the Project team managed by the Group Secretary, continues to oversee implementation of the new arrangements, reporting directly to the Board.

The new Rulebook

The new Rulebook will come into force following the AGM 2015. At that time, the Transitional Provisions will fall away and the new structure will take effect.

The Governance Reform Project has required significant commitment and contribution from huge numbers of people both within the Group and the wider movement. Everyone involved can be proud of their contribution to this crucial Project.

Governance Review continued

Leadership

Following the events of the last few years, the Board is acutely aware of the importance of good corporate governance and, in particular, of ensuring that it keeps pace with the size and complexity of the business as it evolves. The Board recognises the vital role it plays in maintaining the integrity of decision making, efficient execution of the strategy and of performing for our Members.

The Board understands its responsibility to Members for the long-term success of the Group. After a difficult year in 2013, the focus for 2014 has been on redefining and communicating the Group's strategy and Purpose at the same time as fundamentally reviewing its governance arrangements. The Board monitors performance against the strategy using key financial and non-financial indicators including risks. Throughout the year, the Board strived to adhere to the International Co-operative Alliance Values and Principles, by actively engaging and listening to its Members, employees and customers, and other stakeholders.

Where possible, we have taken the views of stakeholders into account when making significant changes, most notably the views of Members were actively sought in relation to the Governance Reform Project, the work of which is described above.

What decisions can the Board take?

The Group's Rules reserve certain matters to the Board which cannot be delegated to management. They include the following responsibilities:

- determining a strategy for the Group, consistent with its Purpose and the Values and Principles and meeting the needs of Members;
- overseeing the Group's business in accordance with the strategy;
- motivating and retaining an Executive qualified to deliver the strategy;
- holding the Executive to account in the performance of its duties, taking into account the Council's views; and
- overseeing a risk and internal audit framework designed to provide adequate assurance regarding the protection of the Group's assets; the health, safety and welfare of customers, Members and staff; compliance with all relevant laws and regulations; and the maintenance of the reputation of the Group.

To ensure the smooth running of the business, the Board may delegate specific powers, duties, discretions and authorities relating to the Group's business to one or more directors, Board Committees, officers or employees, or any subsidiary. Delegated authorities are laid down in a delegated authorities framework approved by the Board and which is subject to review. The framework was substantially reviewed and rolled out across the business during 2014.

Board Committees

The Group Board governs through clearly identified Board Committees, which are detailed in this report. Each Committee has a role in ensuring the effectiveness of the Group. The Board ensures that its Committees have sufficient resources to undertake their duties. The Board has access to all Committee minutes and receives a report from the relevant Committee Chair at each Board meeting as appropriate.

Transitional Risk and Audit Committee – The formal report of the Transitional Risk and Audit Committee is given on page 51.

Transitional Remuneration Committee – Information on the Transitional Remuneration Committee is in the Committee's report on page 58.

Transitional Search Committee – Information on the Transitional Search Committee is in the Committee's report on page 79.

The terms of reference for the Board Committees can be found on the Group's website www.co-operative.coop/corporate/investors/governance.

The Values and Principles Board was established by resolution of the Group Board on 13 June 2013 to consider matters relating to the Group's co-operative objectives and, where appropriate, make recommendations to the Group Board. It operated in accordance with its terms of reference up until 30 September 2014.
Its responsibilities were superseded by the formation of the Members' Council on the adoption of the new Rules. A statement from the Council which is the guardian of the Group's Values and Principles can be found on page 82.

Governance through our subsidiaries

Throughout the period, the Group Board has operated through three principal trading subsidiaries, all of which are registered societies:

- Co-operative Food Holdings Ltd ('Food')
- Co-operative Specialist Businesses Limited ('Specialist Businesses' which includes Funeralcare and Legal Services)
- Co-operative Banking Group which has responsibility for oversight of the General Insurance business, the Reclaim Fund and CFS Management Services. It also holds the Group's equity stake (currently 20.2%) in The Co-operative Bank.

For most of the period under review, operational performance of Food and Specialist Businesses was overseen and monitored by the Board of the relevant trading entity with matters of strategic importance being escalated to the Group Board. The reduction of the Group's business portfolio following the disposal of Farms and Pharmacies provided an opportunity, as part of the Governance Reform Project, to review how these businesses were governed.

Governance Review continued

With effect from 31 December 2014, responsibility for overseeing and monitoring the strategic and operational performance of Food and Specialist Businesses transferred back to the Group Board. At entity level, the Boards of both these businesses now operate as management boards. Consequently, the following independent non-executive directors resigned from their respective boards on 31 December 2014: Simon Burke and John Longworth (Food) and Penny Coates and Mike Cutt (Specialist Businesses). We thank them for their considerable contribution to their respective boards and for the support offered to the Group Board, particularly in relation to the Governance Reform Project.

Board meeting attendance throughout the period

The table below sets out the frequency and attendance of directors at:

i. Board meetings to 30 September 2014 when the new Rules were registered; and

ii. Transitional Board meetings from 1 October 2014 to the end of the period.

The original 2014 Board schedule comprised nine Board meetings and one Strategy Planning day. However, events during 2014, including the Governance Reform Project described on page 35, gave rise to the need for a number of additional or extended Board meetings. Often these were called at short notice in response to external pressures or events; accordingly this resulted in some directors being unable to attend.

If a director is unable to attend a meeting, it is the Chair's practice to seek a satisfactory reason for absence. All directors, including those that are not able to attend, receive papers for Board and Committee meetings via a Board Portal which is accessed via iPad. Those unable to attend are invited to submit their views to the Chair in advance of the meeting.

Private sessions of the Board are scheduled for each Board meeting and take place as required. All non-executive directors have open access to the Chair and may request a private meeting.

Director attendance at Board meetings

		Group Board Attendance to 30 September 2014			Transitional Group Board from 30 September to 3 January 2015		
Current directors who served during the period	**Date of Appointment**	**Date of Resignation**	**Actual meetings attended**	**Total meetings held or eligible to attend**	**Date of Appointment**	**Actual meetings attended**	**Total meetings held or eligible to attend**
Ursula Lidbetter	07/06/2009	30/09/2014	20	20	30/09/2014	3	3
Marc Bicknell	07/10/2013	30/09/2014	20	20	30/09/2014	3	3
Duncan Bowdler (i)	29/07/2007	30/09/2014	18	20	30/09/2014	3	3
Simon Burke	-	-	-	-	14/11/2014	1	1
Eric Calderwood (i)	21/05/2006	30/09/2014	18	20	30/09/2014	3	3
Martyn Cheatle (i)	22/05/2010	30/09/2014	14	20	30/09/2014	3	3
Michael Harriott (i)	19/05/2013	30/09/2014	19	20	30/09/2014	3	3
Sir Christopher Kelly	-	-	-	-	14/11/2014	1	1
Frank Nelson	17/05/2014	30/09/2014	9	9	30/09/2014	3	3

(i) Reflects inability to attend due to changes to the original Board schedule and/or additional meetings arranged at short notice

Governance Review continued

Former directors who served during the period	Date of Appointment	Date of Resignation	Actual meetings attended	Total meetings held or eligible to attend
	Group Board Attendance to 30 September 2014			
Jenny Barnes	07/06/2009	30/09/2014	20	20
Steven Bayes (i)	11/09/2013	17/05/2014	11	11
John Brodie (i) (ii)	26/05/2012	30/09/2014	13	20
Herbert Daybell	07/06/2009	30/09/2014	20	20
Jenny de Villiers	19/05/2013	30/09/2014	20	20
Andrew Donkin	17/05/2014	30/09/2014	9	9
Patrick Grange	29/07/2007	17/05/2014	11	11
Bob Harber (i)	17/05/2014	30/09/2014	8	9
Ray Henderson (iii)	07/06/2009	30/09/2014	19	20
Munir Malik	19/05/2013	13/05/2014	6	6
David Morrow	17/05/2014	30/09/2014	9	9
Liz Moyle	21/05/2011	17/05/2014	11	11
Lord Myners (ii)	10/12/2013	17/05/2014	9	11
David Pownall	29/07/2007	30/09/2014	20	20
Stuart Ramsay	07/06/2009	29/04/2014	9	9
Ben Reid (i)	28/05/2000	19/05/2014	10	11
David Smith (i)	30/05/2014	30/09/2014	6	8
Mark Smith (i) (ii) (iv)	22/05/2010	30/09/2014	14	20

(i) Non-attendance was due to changes to the original Board schedule and/or additional meetings arranged at short notice
(ii) Non-attendance was due to other business commitments
(iii) Non-attendance was due to illness
(iv) Non-attendance was due to holiday

The roles of the Group Chair and the Chief Executive Officer (CEO)

Ursula Lidbetter chaired the Board throughout the period and led the Group through the Governance Reform activities described above (see 'The Route to Reform' on page 35). She retired from the Board on 19 February 2015, following the appointment of Allan Leighton. She had been a non-executive director on the Group Board since 2009 and was previously a Deputy Chair of the Group and Chair of the Food Board.

Ursula was elected to the Board from the Independent Society Members' constituency. She was appointed Chair in November 2013 following the resignation of Len Wardle, the Board having concluded that she was the right person to lead the Group through the critical stages of reform. She was not considered independent on her appointment as Chair. The composition of the Board at the time made it difficult to appoint a Chair who was completely independent of the Group. It was therefore not required by the Group's Rules.

On 19 February 2015, Allan Leighton was appointed as the Group's first independent Chair. This reflects changes made to the Group's Board composition during 2014 as a result of the Governance Reform Project.

The role of the Group Chair is clearly defined and set out in the terms of appointment. The Group Chair is responsible for leading the Group Board and setting the Board's agenda together with the Group Secretary (primarily focused on strategy, performance, value creation and accountability), while ensuring that adequate time is available for discussion of all agenda items.

The Chair is expected to promote a culture of mutual respect, openness and debate by facilitating the effective contribution of all directors, as well as ensuring effective communication with Members and other stakeholders. Ethical leadership and promotion of the highest standards of integrity, probity and corporate governance throughout the Group, particularly at Board level, is a fundamental responsibility.

The Chair has no involvement in the day-to-day running of the Group's businesses which is formally delegated to the Group Chief Executive.

During the period, the role of Group Chief Executive was held by Euan Sutherland until his resignation on 11 March 2014. Richard Pennycook was appointed Interim Group Chief Executive with effect from 11 March 2014 until 4 September 2014 when he was formally appointed to the role.

Governance Review continued

The Group's constitution did not previously allow Executives to sit on the Group Board. Neither the Group Chief Executive nor any other member of the Group Executive was a board director during the period. Following changes to the Group's governance arrangements, the Group Chief Executive is now a board member by virtue of his office. Richard Pennycook was appointed to the Group Board on 13 January 2015.

The Group Chief Executive has direct responsibility for the Group on a day-to-day basis and is accountable to the Board for the Group's financial and operational performance. He is responsible for the appointment of the executive team, with the exception of the Group Secretary who is appointed by the Board.

The key responsibilities of the Group Chief Executive, the Group Executive and of the Group Secretary are set out in the Group's Rules.

Senior Independent Director

Lord Myners, appointed in December 2013, was the first director to hold the position of Senior Independent Director of the Group. He stepped down from that position and as a Board director following the AGM in May 2014.

Sir Christopher Kelly was the first independent non-executive director to be appointed to the Group Board on 14 November 2014 under the new Rules agreed as part of the Governance Reforms. On appointment to the Board, he took on the role of Senior Independent Director (SID).

The primary role of the SID is to provide a sounding board for the Chair and for other directors, serving as an intermediary when necessary. The SID is available to directors wishing to raise or escalate issues relating to the Group's governance, the Board or Chair's performance and any other issues which cannot conveniently be raised with the Chair of the Board. One important responsibility is to be available to the Members of the Group and other stakeholders, to obtain a balanced understanding of the issues and concerns of such Members and to ensure that the Board is made aware of these views.

The SID conducts the annual appraisal of the performance of the Chair of the Group Board. He will meet with other Group Board directors in private at least once a year (and on such other occasions as are deemed appropriate) in order to appraise the Chair's performance.

The Secretary to the Board

The Group Secretary is responsible for advising the Chair and the Group Board on all governance matters. All directors have access to the advice and services of the Group Secretary.

Under the Group's Rules, the appointment and removal of the Group Secretary is a matter for the Group Board. The Rules also reserve certain powers and discretions to the Group Secretary.

The Group Secretary reports to the Chair and is a member of the Executive by virtue of his or her office.

Claire Davies was appointed Group Secretary in March 2014. Reporting to the Group Chair and working closely with the Board and the Council, Claire led the Governance Reform Project, the detail of which is explained in 'The Route to Reform' on page 35.

Insurance and indemnities

The Group maintains appropriate directors' and officers' liability insurance cover in respect of legal action against its directors and officers in relation to Group business. The insurance cover was reviewed and renewed in 2014.

The Group has agreed to grant to Board directors and the Group Secretary in office from time to time an indemnity in respect of certain liabilities that may be incurred in the discharge of their function.

Group Board composition and independence to 30 September 2014

Prior to the adoption of the new Rules on 30 September 2014, the Group's Rules provided for a Group Board of up to 23 directors. This comprised:

- Up to 20 elected directors of which 15 were elected from the Group's regional Member constituencies and five from Independent Co-operative Society members. At the start of 2014, all 20 seats were filled. In the course of the year, a number of casual vacancies arose.
- Up to three Independent Professional Non-Executive Directors (IPNED) appointed from outside the Group (i.e. non-elected positions).

Lord Myners was appointed to one of the IPNED roles in December 2013. He retired from the Board following the 2014 AGM.

Prior to 30 September 2014, the Board size ranged between 17 and 21. In view of the impending Governance Reforms, it was not practicable to fill casual vacancies as they arose.

The composition of the Transitional Board is explained below.

Independence

Under the old Rules (pre-30 September 2014), all Board directors were non-executive. The method of selection to the Group's Board historically meant that it was difficult to appoint directors who were completely independent of the Group.

Of the directors in place prior to 30 September 2014, only Lord Myners was believed to meet the full test of independence.

Governance Review continued

Appointment and resignation of directors

In the course of the year, a number of changes to the Board took place.

Resignations:

- 29 April 2014 – following an independent report, Stuart Ramsay left the Board with immediate effect at the request of fellow directors
- 13 May 2014 – at the request of the Board, Munir Malik left with immediate effect
- 17 May 2014 – having failed to be re-elected, Steven Bayes, Patrick Grange and Liz Moyle ceased to be Board Members following the 2014 AGM
- 17 May 2014 – Lord Myners stood down from the Board following the AGM
- 19 May 2014 – Ben Reid (Independent Society Member) resigned from the Board with immediate effect
- 30 September 2014 – on adoption of the new Rulebook and pursuant to the Transitional Provisions, the following directors stood down from the Board and joined the Senate of the Transitional Council:
  - Jenny Barnes
  - John Brodie
  - Herbert Daybell
  - Jenny de Villiers
  - Andrew Donkin
  - Bob Harber
  - Ray Henderson
  - David Morrow
  - David Pownall
  - David Smith
  - Mark Smith

Appointments:

- 17 May 2014 – following the 2014 directors' elections, the following directors were appointed to the Board:
  - Andrew Donkin
  - Bob Harber
  - David Morrow
  - Frank Nelson
- 30 May 2014 – David Smith was appointed to the Board having also been successful in the 2014 directors' elections

So How Are We Changing?

A summary of the key governance changes introduced in the course of the year is set out under 'The Route to Reform' on page 35.

Composition of the Transitional Board

The Transitional Board has adopted a Board Composition Charter which has been approved by the Transitional Council. The Charter sets out how the new Board plans to meet the principle of creating a Board that is individually and collectively qualified to lead an organisation of the Group's size and complexity.

The Transitional Provisions provide for an initial Board of nine directors, rising to 11 as new directors are appointed preparing the way for the new Board.

On 30 September 2014, a number of Board directors as shown above stood down from the Group Board. The following remained on the Transitional Board:

- Ursula Lidbetter (Group Chair and Chair of the Transitional Search Committee)
- Marc Bicknell
- Duncan Bowdler
- Eric Calderwood (Chair of the Transitional Remuneration Committee)
- Martyn Cheatle (Chair of the Transitional Risk and Audit Committee)
- Michael Harriott
- Frank Nelson

Simon Burke, an Independent Non-Executive Director (INED), who previously sat on the Food Board, was appointed to the Transitional Board on 14 November 2014.

Appointments to the Transitional Board are temporary pending recruitment of the new Board. Members of the Transitional Board will stand down at the AGM 2015, or earlier as members of the new (i.e. post transition) Board are appointed to replace them.

Ursula Lidbetter stepped down as a director and Group Chair on 19 February 2015 following the appointment of Allan Leighton as Independent Chair of the Group.

The biographies of directors serving on the Board are set out on page 32.

Governance Review continued

New Board

The Board Composition Charter provides for a new Board of 11 directors composed as follows:

- an independent Group Chair;
- five Independent Non-Executive Directors (including the SID);
- two executive directors (of whom one will be the CEO); and
- three Member Nominated Directors (MNDs).

The Board will only exceed 11 directors in circumstances where the Group Chair considers there are good reasons (for example, to facilitate succession planning or to address the need for particular skills).

Those directors who are currently serving on the Transitional Board and who will remain in office post-transition are:

- Allan Leighton – Chair, appointed 19 February 2015
- Sir Christopher Kelly – SID, appointed 14 November 2014
- Richard Pennycook – Group Chief Executive, appointed 13 January 2015.

Three MNDs are expected to be elected to the Board at the 2015 AGM.

All directors are expected to meet eligibility criteria, including a strong commitment to Co-operative Values and Principles, possessing the skills and experience necessary to oversee a complex business as well as minimum membership and trading requirements.

Succession planning

Emphasis during the period has been on creating effective governance structures. In building the new Board, the following principles will apply as set out in the Board Composition Charter. These principles will also apply to succession planning in due course.

- The collective experience and skills of the directors is broad enough to enable the Board to provide effective oversight of the Group and its various businesses as a whole.
- It reflects a diverse range of backgrounds, views and perspectives.
- It provides an effective voice for Members.
- It allows all directors to participate effectively in meetings.
- Changes to the composition of the Board can be managed without undue disruption.
- Committees can function without placing over reliance on particular individuals.

Appointment of directors to the new Board

The recruitment of the new Board is overseen by the Transitional Search Committee. A report of the work of the Transitional Search Committee can be found on page 79.

To ensure an objective review all Board appointments are subject to review by the Council's Scrutiny Committee.

Elections in 2015 – Transitional Provisions

In accordance with the Transitional Provisions, as the new Board was not in place 60 days in advance of the 2015 AGM, the Transitional Search Committee has determined that the following directors shall stand for election at the 2015 AGM:

- the Group Chair – Allan Leighton;
- the Senior Independent Director – Sir Christopher Kelly; and
- the Group Chief Executive in his capacity as an Executive Director – Richard Pennycook.

Election of the Member Nominated Directors

In relation to Member Nominated Directors, and in accordance with the new Rules, elections will be held annually in time to fill vacancies arising on retirement, unless the Council and the Board agree otherwise. Each MND may serve a maximum of three terms of two years.

The MND Election Regulations set out the procedure for nominating and electing MNDs to the Board. Eligibility requirements for MNDs are set out in the Rules, the Board Composition Charter, the Membership Regulations and the MND Election Regulations.

The wider membership is invited to step forward for MND election, and in 2015 were encouraged to do so through advertising in the media.

Candidates in the MND elections are shortlisted and considered on the Council's behalf by a sub-committee of the Council. The sub-committee is supported in this process by an external Executive Search firm. The purpose of the shortlisting process is to ensure that candidates meet the criteria detailed in the Board Composition Charter. The shortlist is then approved by the Transitional Search Committee on behalf of the Group Board.

The Transitional Council

The composition of the Transitional Council is explained in the Council's Annual Statement on page 82.

Governance Review continued

Composition and key responsibilities of the Council, Senate and Council sub-committees

Role	Composition	Key responsibilities
Presidency	• One President • Vice Presidents may be elected by the Council	• Preside over both the Council and the Senate • Have a key role within the Group both internally (e.g. the role played in Board scrutiny) and externally (e.g. the role played in representing the views of the Council and Senate to Members and other stakeholders) • Vice Presidents – duties delegated to them by the President
Council	• Maximum 100 members • Up to 85 Council Members will represent Individual Members • Up to 15 Council Members will represent Independent Society Members • Employee Members may occupy up to 18 seats.	• Act as guardian of the Group's Purpose, the Values and Principles and the constitution • Hold Board to account and influence strategic and operational initiatives • Act as a consultative body and a body for making representations on behalf of the constituencies represented by the Council • Approve matters reserved by the Rules for approval by the Council • Make decisions on those matters reserved to the Council by the Rules
Council Senate	• Elected by the Council • 10 to 15 members	• Represent the Council within the Group and within the co-operative movement • In consultation with the Executive, prepare a three year Council plan for approval by the Council and Board • Determine allocation of the Council's annual budget • Prepare agenda for each Council meeting • Liaise with the Board and Executive on any relevant matters/issues • Prepare the Council Annual Statement
Council Scrutiny Committee	• 5 members	• Oversee adequacy of checks and due diligence on directors and prospective directors • Scrutinise the objectivity of the selection/appointment process of INEDs • Assist the Council in the shortlisting and screening of the Member Nominated Directors
NED Fees Committee	• 5 members	• Set the compensation for Group Chair, SID, INEDs and Member Nominated Directors

Engagement and Relations with Our Members

Governance reforms introduced during the year have provided a significant extension of Member influence, decision-making, voice, elections and representation.

The Board and the Transitional Council has approved a General Meetings Manual, which includes the Voting Representative regulations. Members entitled to attend Group General Meetings may vote, or appoint a voting representative to vote on their behalf, on motions for resolution at Group General Meetings. This move to One Member One Vote seeks to reaffirm the importance of direct Member participation in the affairs of the Group.

Motions can be put to an AGM or Half Yearly Meeting by the Board, the Council or 100 Qualified Members in accordance with the Rules. The Council may decide to submit motions on behalf of other bodies, for example Independent Society Members.

The new arrangements also provide for appropriate representation of Independent Society Members, including a new federal structure to formalise the commercial and organisational relationship with the Group.

Board statement on diversity

Following the move to the Transitional Board in the course of 2014, the Group has not met its previously published aspirations in respect of gender diversity. In the course of 2015, the Board intends to prepare a more detailed diversity policy with appropriate targets, reflecting best practice.

In building a new Board, diversity is a key consideration. The Transitional Search Committee is well aware of the importance of ensuring a diversity of views and backgrounds that is representative of its membership. This is consistent with the Co-operative Values and Principles of honesty, openness, equality and equity.

The Board Composition Charter provides that: 'The Board will be appropriately balanced and diverse in its broadest sense including diversity of gender, ethnicity, age and geography and will seek to ensure an appropriate balance.'

The Search Committee's professional advisers, Odgers Berndtson, have been tasked with ensuring that all short lists include an appropriate gender balance and that the final composition of the Board reflects broader aspects of diversity.

Odgers Berndtson are signatories of the Executive Search Voluntary Code of Conduct and actively embrace the provisions and recommendations it sets out.

Governance Review continued

Induction and continuing professional development

Consistent with Co-operative Values and Principles, the Group is committed to ongoing learning and development for all its directors.

All directors undergo a comprehensive and timely induction on appointment to the Board. This induction is designed to help the new director to contribute within an appropriately short timeframe to the Board, and to maximise the quality of his or her contributions.

Induction comprises three core components:

- corporate induction focusing on the Group's Purpose and strategy, business and organisational structure, financials, the markets in which it operates and the individual businesses;
- legal duties and responsibilities include statutory duties of a director, Board policies and procedures, Board Code of Conduct, governance structures and Codes including Co-operative Values and Principles;
- bespoke induction tailored to each individual director's needs.

The Group Secretary will evaluate the adequacy of any training (including, but not limited to, any induction training) for directors from time to time, and shall be responsible for ensuring it fulfils the requirements contemplated by the Group Rules.

Conflicts of interest

The Board has adopted a Conflicts of Interests Policy, which is contained within the Code of Conduct for directors and the Group Rules.

The aim of the policy is to ensure that conflicts of interest are appropriately managed through effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent actions that are either contrary to the interests of the Group, its Members and customers, or could cause reputational damage or the appearance of impropriety.

Consistent with his or her legal obligations, a director has a duty to avoid conflicts of interests. Prior to appointment, potential conflicts of interest are disclosed and assessed to ensure that there are no matters which would prevent that person from taking on the appointment. The Board has considered the current external appointments of all directors which may give rise to a situational conflict and has authorised potential conflicts where appropriate.

Conflicts are actively managed at and in advance of Board meetings. Actions include: directors being excluded for certain items and/or not being entitled to vote. If directors have an interest in a matter, they receive redacted copies of minutes relating to that item.

Professional advice and Board support

A number of external consultants provide professional advice to the Boards of the constituent parts of the Group. Directors may also take independent professional advice, at the Group's expense, when furthering their duties under appropriate procedures and guidelines set from time to time.

Principal Risks and Uncertainties

Background

Whilst 2013 was a difficult year for the Co-operative Group, with issues relating predominantly to the Bank widely publicised, 2014 has been a critical year in the subsequent rescue phase. Weaknesses in governance, highlighted by independent reports from Sir Christopher Kelly and Lord Myners, have led to the implementation of significant governance reforms.

External advisors were appointed during the year to undertake an independent review of the control environment, recommending the need to strengthen the Group's Risk Management Framework. The findings from this review were considered by the Transitional Risk and Audit Committee, and consequently an improvement plan has been developed and is now being implemented under the leadership of the new Chief Risk Officer.

Process and Approach to Risk

In 2014 work began on developing the new Risk Management Framework, and the Group Executive began a process to identify the Group's principal risks against its strategy. In 2015 this process will continue where both the Board and the Group Risk and Audit Committee will further review the principal risks for the Group and fully evaluate the Group's risk appetite. Executive members will be assigned an oversight role for each principal risk, to include responsibility for implementing a robust and effective action plan to reduce or mitigate the risk. Assurance on principal risks shall be provided to the Board, who have responsibility for ensuring the Group operates within its associated levels of risk, on a regular basis.

The new Group-wide Risk Management Framework will encompass policies, standards, systems and processes. It will provide assurance that strategic decisions are underpinned by effective risk management methodology and an embedded Group-wide risk culture, with the aim of safeguarding the interests of our Members, stakeholders and Group assets and reputation. The three lines of defence risk model will be adopted, with the business units providing the first line of defence, Group Risk Management and corporate functions providing the second line, and Internal Audit providing independent third line assurance.

Controls

The results of the 2014 annual control self-assessment undertaken by the Group Executive validated the need for establishing greater control within the organisation, which will be addressed with an extensive training and awareness programme to be rolled out in 2015. Implementation of the new framework will ensure a comprehensive and appropriate set of controls are assigned to all risks to reduce the probability or impact of risk materialisation, with regular review of control effectiveness. Independent third party assurance will also be sought where appropriate.

Compliance with national laws and regulation is maintained by implementation of appropriate policies and procedures by dedicated specialists, to ensure our business activities and processes comply with the necessary standards, such as in the areas of health and safety, food safety and staff welfare.

The principal risks most relevant to the Group are as follows:

Risk Area	Description	What are we doing to manage and/or reduce the risk
Business Strategy and Transformation	Ensuring effective implementation of our strategic plan to secure a sustainable future	Group strategy and new Purpose developed to rebuild the Group. Adoption of disciplined, comprehensive programme management to govern anticipated benefits. Group-wide communication of strategy to ensure colleague understanding, which will extend to other key stakeholders and opinion formers.
	Achieving real sustained benefits for our Members and the community	Revised membership proposition in development to support the Group's strategic intent and Rebuild programme. Results of major survey used to underpin strategy and Rebuild.
	Stabilising and strengthening governance model	Significant governance reform underway including establishment of a new Board (composed of a majority of independent directors), a Council and Senate. Defined roles and responsibilities, inductions and training for new personnel and Board.
	Improving our operating efficiency	Group-wide cost saving programme in place across all divisions. A sustainable target operating model is being delivered for the longer term based on external benchmarks.

Principal Risks and Uncertainties continued

Risk Area	Description	What are we doing to manage and/or reduce the risk
Brand and Reputation	Rebuilding the Group's reputation as a trusted corporate citizen	Key media, political and financial opinion formers/investors regularly engaged on progress on the Rebuild journey so they understand strategic actions being taken and why.
	Delivering the Group's Purpose of 'championing a better way of doing business for you and your community'	Proactive engagement on local issues, which align with the Group's Purpose and needs of our Members.
	Delivering on our customer promise and securing excellent value for money for our customers	Price positions and range reviews on products undertaken and are constantly adapted to reflect changing customer demands. Regular benchmarking against competition.
People Capability	Enhancing the safety, security and wellbeing of our colleagues	Investment in physical security on premises to reduce the risk of violence to colleagues. Development of bespoke safety awareness and education programmes are to be delivered throughout 2015.
	Developing our colleagues to have the right capabilities at all levels	Up-skill our people to meet the changing needs of our businesses and meet different challenges.
	Sustaining a motivated and engaged workforce	Detailed colleague engagement plans exist to inform and keep momentum during Rebuild of the Group. Surveys undertaken to understand and respond to colleague concerns.
	Building strong leadership to drive the Co-operative Purpose	Significant investment and restructuring undertaken to invest in capable leadership.
	Retaining top talent and critical role holders	Identification of top talent and critical role holders with individual retention plans in place.
Financial and Treasury	Meeting our banking covenants	Robust action taken to return the Group to a sustainable position, including major disposals to significantly reduce debt. Continual engagement with banks and bondholders on business performance and development. The Group satisfied its requirement to make a capital contribution to the Bank of £333m by 31 December 2014.
	Maintaining sufficient headroom	Tracking metrics used to manage and maintain debt levels, and monitor maturity of borrowings.
	Managing our supply chain (including procurement)	A Group-wide Value Improvement Programme is underway being led by Group Procurement, which includes demand and specification challenge, supplier rationalisation and re-tendering due for completion December 2015.
	Achieving operating cashflow targets	Short, medium and long term cash flow forecasts are monitored, and debtor terms monitored.
	Managing our liquidity and interest-rates	Rigorous Treasury policies adopted to monitor and oversee all financial market risks.
	Pension scheme funding	Continual monitoring of volatility in pensions risk exposure. Pensions offer under review following separation of Bank from Group. Trustees are required to perform triennial valuations and target full funding on an actuarial basis.
Market and Economy	Market changes and weakened UK economy	Financial forecasts are frequently updated to reflect economic indicators and monitor trading conditions.
	Delivering on the financial objectives of Food's True North strategy in the face of continuing volatility in the UK grocery market	Tracking performance against financial targets on regular basis to ensure that corrective action is taken if market conditions have an adverse impact on Food business cashflows.

Principal Risks and Uncertainties continued

Risk Area	Description	What are we doing to manage and/or reduce the risk
IT Operations and Data Security	Providing a stable, resilient IT platform from which the Group's strategic objectives can be met	Target operating model implemented to improve IT risk governance and operational capability.
	Protecting the IT environment from external threats, cyber risk and electronic data loss	Investment in underlying IT infrastructure and systems to address PCI compliance and maintain Barclaycard Risk Reduction Programme (BRRP) acceptance. Initiation of programmes and procedures to address ongoing cyber risk.
Ethical Sourcing and Food Fraud	Maintaining excellent standards in food hygiene and customer safety	Robust technical quality assurance policies, auditing and monitoring to ensure ongoing compliance with standards, both ethical and technical.
	Ethical sourcing	Clear sourcing policies in place, comprehensively reviewed and communicated. Widespread communication of our commitment to Fairtrade. Fair, transparent relationships developed through the supply chain.
	Food fraud in the supply chain and ingredient sourcing	Rigorous due diligence, risk assessments and technical/social auditing on all new suppliers. Specific safeguards in relation to meat sourcing, increased testing, and technical resource within the supply chain, approved primary and secondary supplier listings.
Assurance and Compliance	Acting responsibly and ethically towards colleagues, customers, or business partners ensuring compliance with the Code of Conduct	Social responsibility lies at the heart of the co-operative approach. Alignment of all activities throughout the organisation to our ethical values and principles.
	Fraud, financial crime or material misstatement	Regular financial controls testing, including annual self-assessment exercises, and compliance with standard Group accounting policies. Independent testing by external auditors. Confidential whistle blowing hotline in operation.
	Health and Safety or Environmental breach resulting in loss of life, litigation, financial penalties or reputation damage	Compulsory e-learning training. Employment of suitably qualified and experienced compliance and risk officers. Group-wide project underway to review all policies and procedures. Full and continuous engagement with relevant authorities.
	Data Protection or PCI breach	Compulsory e-learning training. Employment of suitably qualified and experienced compliance and risk officers. Group-wide project underway to review all policies and procedures. Full and continuous engagement with relevant authorities.
	Breach of laws or regulations, including competition and anti-bribery	Appropriate policies in place, requirement to discuss possible breaches, with Group Legal and Group Risk monitoring compliance.
	Loss of capability due to major incident e.g. fire, flood, terrorism, war, political or civil unrest	Group Business Continuity Management Policy refined in 2014 to reflect changing business needs. Incident management strategies are tested on a regular basis. Programme in place to enhance the resilience of critical IT infrastructure.
Bank Separation	Following the LME transaction, plans are in place to separate the Bank from the Group. Risks to the Group exist in the delivery and implementation of the separation programme within agreed time, cost and quality criteria with no impact to our customers.	A dedicated Separation Programme capability has been set up to work within a defined delivery and governance framework that interlocks with executive management, the three lines of defence model, and key suppliers. HR representation on the separation programme support the attraction and retention of high calibre people and monitor adequate staffing levels. Agreed IT plans and contracts in place with suppliers and critical third parties.
General Insurance	Uncertainties as to the occurrence, amount and timing of insurance liabilities	Achieve acceptable profits and return on equity, by ensuring insurance risks are carefully selected in accordance with the risk appetite, risk strategy and priced to reflect the underlying risk. Minimise reserve risk volatility through robust reserving and modelling approaches. Ensure all claims are properly scrutinised and paid where they fall within the terms and conditions of the policy. Use of reinsurance to mitigate the cost of catastrophe events such as storms and floods, and the cost of large claims arising within its motor account.

Principal Risks and Uncertainties continued

Risk Area	Description	What are we doing to manage and/or reduce the risk
General Insurance Market Risk	Loss or adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and volatility of market risk drivers e.g. interest rates, market prices of assets and liabilities	Invest primarily in high-quality fixed and variable interest bonds issued by corporations. Achieve acceptable returns while minimising volatility through minimal exposure to equities and other volatile instruments. Interest-rate risk is largely mitigated through investing in fixed interest securities with a similar duration profile to insurance liabilities. Changes in credit-spreads, over and above risk-free interest rates, upon corporate bonds, are managed through limits for exposure to credit-ratings and individual counterparties.
General Insurance Conduct Risk	The General Insurance business's behaviours, offerings or interactions result in unfair outcomes for customers	Implementation of a robust Conduct Risk Strategy to maintain the highest standards in conduct, customer experience and treatment of our customers. Improvements to controls made in 2014 include improved MI Reporting, conduct risk training and a risks and issues register. New Product Governance Forum established to govern the product through its lifecycle. Executive Conduct Risk Steering Committee held monthly to ensure timely identification and management of all conduct risks.
General Insurance Strategic Risk	Risks to earnings and capital as a result of strategic/management decisions, business choices or lack of responsiveness to changes in the business environment	Capital position managed on a stand-alone basis with capital retained in the business. Maintain a sufficient capital buffer in excess of minimum regulatory capital requirements to cover projected risks and maintain market confidence. Obtain a sufficient, stable and sustainable return on equity. Implementation of a strategic transformation programme to ensure the business model can respond to the technology-driven changing insurance market.

Report of the Transitional Risk and Audit Committee

Introduction from the Committee Chair, Martyn Cheatle

I am pleased to present the report of the Transitional Risk and Audit Committee for the 2014 financial year.

The Transitional Risk and Audit Committee (TRAC) came into being on 30 September 2014, following the registration of the new Group Rules. Prior to this, the Committee which undertook the audit and risk role was known as the Group Audit and Risk Committee (GARC).

This report details the activities of both the GARC and the TRAC during the year. Throughout this report, I will refer to the work of both these Committees over the period by reference to 'the Committee' unless otherwise specifically stated.

As mentioned throughout this Annual Report, the Group has faced some difficult issues over the last few years. 2014 has been a year of radical governance reform and, for the Committee, has involved a re-focus from its traditional 'audit' role to a more risk-based approach.

In response to the findings detailed in the Kelly Review and the Myners Review, an independent review into the effectiveness of the internal control within the Group was undertaken. The Committee considered the results of this report in detail and agreed the Risk Improvement Plan which has been drawn up in response.

Throughout the year, the Committee supported the Rebuild of the Group and closely monitored the impact of the governance reforms on the risk and controls across the business. Detailed consideration was given to the impact of the legal separation of The Co-operative Bank from the rest of the Group, together with the impact of the key disposals – Pharmacy, Farms and Sunwin Services. This work has continued into 2015.

The role of the Committee is to undertake an independent assessment of the financial affairs of the Group. This includes reviewing the Group's financial statements and ensuring that there is a sound system of financial control and risk management throughout the Group. Whilst the Group Board is ultimately responsible for approving the financial results, the Committee undertakes the detailed analysis to support the Board's decision. You will find details of the key activities and areas of judgement of the Committee set out in this report.

The Committee also maintains oversight for the Co-operative Banking Group, which includes CIS General Insurance Limited (CISGIL). CISGIL has its own separate Audit and Risk Committees, both of which report regularly to the Committee.

Finally, Patrick Grange stepped down as a member of the Committee in May 2014 and also, following the registration of the new Rules and the establishment of the TRAC, Mark Smith and John Brodie stepped down from the Committee. I would like to place on record my thanks to them all for their contribution.

Martyn Cheatle
Chair of the Transitional Risk and Audit Committee

Report of the Transitional Risk and Audit Committee continued

Membership

The following table sets out the membership, dates of appointment and attendance of both the GARC and the TRAC during the year:

	Group Audit and Risk Committee			Transitional Risk and Audit Committee	
Committee Member	**Date of Appointment**	**Date of Resignation**	**Number of meetings attended**	**Date of Appointment**	**Number of meetings attended**
Martyn Cheatle	02/06/2011	30/09/2014	5 (5)	15/10/2014	1 (1)
Marc Bicknell	10/12/2013	30/09/2014	5 (5)	15/10/2014	1 (1)
Duncan Bowdler	17/06/2009	30/09/2014	5 (5)	15/10/2014	1 (1)
Patrick Grange	17/06/2009	17/05/2014	3 (3)	N/A	N/A
Mark Smith	16/06/2010	30/09/2014	4 (5)	N/A	N/A
John Brodie	11/06/2014	30/09/2014	2 (2)	N/A	N/A
Simon Burke	N/A	N/A	N/A	09/12/2014	N/A

The number in brackets denotes the number of meetings the individual was entitled to attend.

During the year, the Committee membership did not comply with the recommendations of the UK Code on Corporate Governance in relation to having at least three independent directors serving as members. However, the Group Board believes that the varied background of all members of the Committee, and their skills, knowledge and experience of the Group, allows them collectively to fulfil the Committee's remit and to oversee the relationship with the Group's auditors. In particular, Marc Bicknell, who is a chartered accountant and an internal auditor, is viewed by the Board as the member possessing recent and relevant financial experience.

In addition to directors, the Chief Executive Officer, Chief Financial Officer, Director of Group Internal Audit, Chief Risk Officer, Finance Director, Corporate and Head of Financial Control, together with other key colleagues also attended Committee meetings by invitation. The external auditors attended all Committee meetings and private meetings were held with the internal and external auditors to allow them the opportunity for discussions without the presence of management.

Key managers from CISGIL Audit and CISGIL Risk areas also attended meetings of the Committee.

Summary Responsibilities of the Committee

The Terms of Reference for the Committee describe the role and responsibilities of the Committee in more detail and are available on the Group's website: www.co-operative.coop. Whilst the role of the Committee is very similar to the role of the former GARC, increased time is currently being given to considering the risk management and associated internal audit framework to ensure there is greater protection over the Group's assets.

In summary, the responsibilities of the Committee fall into the following six areas:

Financial and Regulatory Reporting

- Monitoring the integrity of the financial statements of the Group and any other formal announcements relating to the Group's financial performance or prospects, including annual results and half-yearly statements.
- Reviewing significant financial reporting issues and judgements.
- Ensuring the Group's Annual Report and Accounts are fair, balanced and understandable and recommending their adoption by the Group Board.
- Reviewing compliance with applicable accounting policies and practices and compliance with regulatory responsibilities.
- Having oversight of the Group's compliance with the Grocery Supply Code of Practice (GSCOP).

Internal Controls

- Reviewing the adequacy and effectiveness of the Group's internal and financial controls system, together with the processes for monitoring their effectiveness.
- Monitoring significant deficiencies or material weaknesses in the Group's controls and the implementation of appropriate remedial action.
- Reviewing and approving the statement on internal controls in the Annual Report and Accounts.

Internal Audit

- Monitoring and evaluating the performance of Group Internal Audit and the Director of Group Internal Audit, including obtaining an independent external assessment of the Group's Internal Audit function.
- Approving the Internal Audit plans and ensuring the Internal Audit function has sufficient resource.
- Reviewing and monitoring reports and findings on significant investigations, including management's responses and implementation of any remedial actions.

Report of the Transitional Risk and Audit Committee continued

External Audit

- Monitoring and reviewing the independence of the external auditor and evaluating their effectiveness.
- Approving the annual external audit plan and external audit fees.
- Tendering the Group's external audit and overseeing the selection process of the tender.
- Recommending to the Group Board the appointment and removal of the Group's external auditor.

Risk

- Overseeing the development, implementation and maintenance of the Group's risk management framework, its risk appetite and the control environment.
- Providing input into the Group Remuneration Committee (as requested) to ensure the alignment of remuneration to risk performance.
- Reviewing the adequacy of the resources of the Group's Risk function and its authority and standing within the Group and ensuring that action is taken to any material policy breaches.

Other

- Reviewing the adequacy of the whistle-blowing procedure, the Group's process for detecting fraud and the controls for the prevention of bribery.
- Establishing a 'Risk and Audit Committee Charter' for the effective operation of the Committee, including its interaction with management.
- Receiving and reviewing an annual report of the management of the Group's pension schemes.
- Undertaking similar duties for any relevant subsidiaries of the Group, including CISGIL, but acknowledging that CISGIL has its own Audit Committee and Risk Committee.

Key activities of the Committee during the year

The activities of the Committee during the year principally related to financial reporting, the external audit, internal control and risk management. The Director of Group Internal Audit left the Group on 4 July 2014. The position was held by an Interim Director of Group Internal Audit while recruitment for a replacement took place. The Chair of the Committee was involved in the recruitment process and a new Director of Group Internal Audit joined the Group on 19 January 2015.

The following key issues were also focused on by the Committee during the year:

- reviewing the published financial information, including the Annual and Interim reports which included accounting for the Co-operative Bank and the Liability Management Exercise. To assist with consideration of these, reports were received from management and the external auditor
- consideration of the Independent Governance Review undertaken by Lord Myners, which was published in May 2014
- reports on the impact and progress of the Group and the Co-operative Bank separation exercise
- regular reports on the internal controls and risk within the Group and the Co-operative Banking Group
- consideration of the independent report into governance and risk undertaken by Grant Thornton and the review of the Risk Improvement Plan which had been undertaken subsequently
- the impact on internal controls of Project Orion, which was initiated in 2013 and designed to address the immediate need for cost reduction across the Group, together with the impact of the superseding review of the Group's target operating model
- the Committee received regular reports from KPMG and representatives from KPMG were consulted throughout the debates during meetings
- an annual review of the Group's pension schemes and reports on whistleblowing and anti-bribery.

Report of the Transitional Risk and Audit Committee continued

Significant issues relating to the financial statements

In relation to the 2014 financial statements, the Committee considered the following key areas of judgement. In all cases these were discussed with management and the external auditor:

Area of focus	Committee Action
Going Concern The ability of the Group to remain within its facilities and banking covenants continue to be areas of focus, given the level of external debt, commitments to The Co-operative Bank under the Liability Management Exercise and ongoing strategies to improve performance. The Group's insurance business is separately funded and has to comply with a number of regulatory capital requirements.	The Committee reviewed a paper and discussed with management the Group's current and projected financial performance and cash flow against its banking covenants and available facilities together with key assumptions and sensitivities. This data has been monitored closely by the Committee throughout the year. The Committee reviewed forecasts showing the insurance business should be able to operate within its regulatory capital requirements for the foreseeable future, including a number of stress tests on capital, none of which results in a breach of existing externally imposed capital requirements. This paper was also reviewed in detail and approved by the CISGIL Audit Committee.
Investment in The Co-operative Bank ('the Bank') The Group's investment in the Bank was initially recorded using a provisional estimate of the Group's share of the fair value of the Bank's assets and liabilities at recognition. The investment has been equity accounted in 2014 and adjusted to reflect: (i) the Group's share of the Bank's losses; (ii) the unwind of fair value differences created when the Group lost control of the Bank and (iii) the impairment of the Bank to its carrying value.	Over the year, the Committee considered reports which illustrated the sensitivity of assumptions around the accounting judgements made by management on the fair values and the accounting treatment of the Bank associate.
Accounting for disposals (Farms, Pharmacy, Sunwin Services) (see notes 3 and 9 in the financial statements) The Group disposed of key businesses during the year – Farms (2 August 2014), Pharmacy (6 October 2014), Sunwin Services (3 November 2014).	The Committee reviewed the application of the complex accounting judgements, assumptions and methodologies which had been applied to these disposals to ensure that the financial information had been accurately and correctly treated, measured and disclosed.
Impairment – carrying value of investments, goodwill, tangible and intangible assets A formal annual impairment review was conducted by management. This involved an assessment of the underlying future cash flows expected to be derived from the net book value of assets held in the balance sheet.	The Committee reviewed the results of management's annual impairment review and discussed the key judgements and assumptions underpinning the calculations. The data was based on the three year plan as approved by the Board and assessed in the light of current reported trading performance.
Provisions (see note 26 in the financial statements) The Group makes provisions where it is likely that settlement of liabilities will result in a cash outflow. Key areas where significant management judgements have had to be applied include (i) onerous leases; (ii) litigation; (iii) self insurance and (iv) separation from the Bank.	Key management judgements in respect of material provisions were reviewed by the Committee. Reports were also received from external experts which supported the judgements taken by management. The provisions were assessed for consistency of approach year on year and against the Group accounting policies.
Pensions (see note 16 in the financial statements) The Group has a number of defined benefit pension schemes which require extensive disclosure. The assumptions applied take into account the accounting consequences for the Pace scheme on the separation of the Bank.	The Committee assessed the key assumptions which underpinned the pensions calculations. Advice provided by internal and external actuaries was also reviewed to give confidence that the assumptions adopted had been consistently applied year on year.
Supplier Income Ensuring that income from suppliers has been recognised in line with supplier agreements, at an appropriate level and in the relevant period.	A detailed paper on the policy and application of the recognition of supplier income was received by the Committee. The Committee also gained further assurance from the work undertaken by Internal Audit on the treatment of supplier income.

Report of the Transitional Risk and Audit Committee continued

Area of focus	Committee Action
Inventory Judgement is involved in assessing the amount of inventory held, including estimates of the level of stock leakage and wastage arising. Judgement also exists in assessing the valuation of inventory at the year end at the lower of cost and net realisable value.	The Committee received a paper that outlined the methodology for the calculation of inventory and noted refinements to the process. The process for verifying stock including cyclical counts of physical stock throughout the year was also considered.
Insurance Contract Liabilities CISGIL holds significant insurance liabilities for the estimated cost of settling all claims incurred but unpaid at the balance sheet date, whether reported or not. This is a judgemental and complex area due to the inherent uncertainty of estimating claims not yet reported, future costs of settling claims, discount rates and whether customers will be awarded a lump sum claim or periodic payment order.	The Committee received reports from the CISGIL Audit Committee which detailed the key judgements and conclusions surrounding the appropriateness and consistency of estimates which had been applied to CISGIL reserving. The relative levels of prudence year on year were also considered.

Review of Effectiveness of the Committee

During the year, the Committee conducted a review of its effectiveness. This was done through a series of questionnaires and was co-ordinated by Group Secretariat. The review concluded that the Committee was considered to be operating effectively and in accordance with the guidance included in the UK Corporate Governance Code.

The Committee considered a number of areas in relation to the impact of the Group's Governance Reforms on resources and internal controls. Although members did not undertake any specific training sessions, detailed discussions were held during Committee meetings on key areas such as the governance and risk within the Co-operative Banking Group (in particular, CISGIL), and the impact of the Kelly Review, the Myners Report and the report by Grant Thornton into governance and risk. The Committee also received reports in relation to regulatory changes and changes in best practice/emerging issues.

External Auditor

The UK Corporate Governance Code states that the Audit Committee should have primary responsibility for making a recommendation on the appointment, re-appointment and removal of the external auditor and to assess the effectiveness of the external audit process.

Independence, Objectivity and Fees

The independence of the external auditor is critical for the independence of the audit. The Group therefore has an External Auditor Independence Policy which is designed to maintain the independence and objectivity of the external auditor. There is also a policy on the appointment by the Group of former employees of KPMG and the approach to be taken when using the external auditors for non-audit work.

The Committee regularly reviews the other services being provided to the Group by the external auditor and has in place a formal policy to ensure that this does not impair their independence or objectivity. The policy on the provision of non-audit services and the employment of the external auditor was last reviewed by the Committee in 2013.

Details of the amounts paid to the external auditors during the year for audit and other services are set out in the note 3 to the financial statements.

The external auditors are permitted to provide some non-audit services that do not conflict with their independence and at each meeting; the Committee receives a report providing details of assignments (including fees) carried out by the external auditors, in addition to their statutory audit work. Pre-approval of the Committee is required for services above certain thresholds determined by the Committee. In addition, the following are prohibited from being performed by the external auditors:

- bookkeeping or other services related to the accounting records or financial statements
- financial information systems design and implementation
- actuarial services
- internal audit outsourcing services
- management functions or human resources
- any other services that the Committee may determine.

Effectiveness and Reappointment

The Committee has undertaken a formal assessment of the effectiveness of the external audit process. This was conducted through a series of targeted questionnaires to TRAC members, senior Group Executives and finance leaders across the business, together with members of Internal Audit.

KPMG have continued to provide excellent support and invaluable advice to the Group through what has been a difficult period. Following a recommendation from the Committee and the Group Board, at the 2014 Annual General Meeting Members agreed to re-appoint KPMG as auditors of the Group.

The Group's policy is to tender the external audit every five years and the external audit was last put out to tender in 2011. As reported to Members at the 2014 Annual General Meeting, the re-tender process will commence towards the end of 2015 for the year ending 31 December 2016.

Report of the Transitional Risk and Audit Committee continued

In line with the ASB's Ethical Standard 3, the external audit partner, Jonathan Hurst, stepped down following the signing of the 2013 statutory financial statements and was replaced by Chris Hearld. To prepare for this succession, Chris was introduced to the external audit team at the beginning of 2014.

The Committee has recommended to the Board that KPMG LLP be re-appointed as the Group's external auditor.

Internal Audit

Internal Audit is an independent appraisal function that derives its authority from the Group Board through the Committee. Its primary role is to provide reasonable and objective assurance about the adequacy and effectiveness of the Group's financial control framework and risk management.

Internal Audit seeks to discharge the responsibilities set out in its charter by reviewing the processes that ensure business risks are effectively managed; reviewing the financial and operational controls that help to ensure compliance with corporate objectives, policies and procedures.

Internal Audit also acts as and is a source of constructive advice and best practice, assisting senior management with its responsibility to improve the process by which business risks are identified and managed.

The Committee has reviewed the effectiveness of the Internal Audit function by considering regular reports on audit planning, strategy and resource within the function.

Internal control

The Group Board has overall responsibility for the system of internal controls, which aims to safeguard the Group's assets and to ensure that proper accounting records are maintained and that the financial information used within the business and for publication is accurate, reliable and fairly presents the financial position of the Group and the results of its business operations.

The Group Board is also responsible for reviewing the effectiveness of the system of internal controls. This has been in place for the year under review and is regularly reviewed by the Group Board. The key elements of the system of internal control within the Group are aligned to the recommendation of The Committee of Sponsoring Organisation of the Treadway Commission (COSO). The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against misstatement or loss. There is an equivalent system within the CISGIL regulated business which is aligned to industry best practice.

Assisted by the Committee, the Group Board formally reviews the effectiveness of the system of internal control annually. The internal control framework contains the following key elements.

Control environment

The Group's control environment is designed to create an attitude of taking acceptable business risk within clearly defined limits. The control environment includes:

- An organisational structure with clear lines for responsibility, delegation of authority and reporting requirements.
- Co-ordinated activity across the whole Group through executive management meetings.
- Defined policies for capital and revenue expenditure. Larger capital and revenue expenditure requires Group Board authorisation.
- Comprehensive systems of financial reporting. The annual budget and long-term plans of the Group and of each division are reviewed and approved by the Group Board. Results are reported against budget and previous year and action taken where appropriate.
- A Code of Business Conduct covering relations with customers, Members, employees, suppliers, community and competitors. The Code provides procedures to allow any employee to report, in confidence, suspected serious malpractice. An anti-fraud policy with guidance further supports this Code.
- Internal audit, compliance and operational functions that review the system of internal control, including a financial control self-assessment process.

Risk assessment

The Group Board and executive management teams have the primary responsibility for identifying the key business risks facing the Group. Management is responsible for identifying the risks facing the business and for establishing controls and procedures to monitor and mitigate those risks. The Group Board is responsible for ensuring there is a robust risk management process and for regularly reviewing the identified key risks. Details of the Group key risks can be found on pages 47 to 50.

Each business has a risk register that identifies the likelihood and impact of risks within their area and the actions being taken to manage them. Risk assessments are updated on a quarterly basis and reported to the appropriate Risk Management Committee and Board Committee. The information is consolidated for the Group Risk Management Committee, which provides reports on how these risks are being managed to the Committee.

The Group's Risk Management Committee has responsibility for establishing a coherent framework for the Group to manage risks. The objective of the Committee is to assist the Group Board in carrying out its responsibility to ensure effective risk management and a system of control.

Report of the Transitional Risk and Audit Committee continued

The risk management framework within the Group is currently being reviewed and a Group Chief Risk Officer was appointed on 26 January 2015. This is a new position and demonstrates the commitment of the Group to having effective risk management in place. This review also includes confirming the relevant Committee and meeting structures needed to oversee risk management in the future. These structures will continue to include representation from senior executives within the Group.

Control activities

The Group's control procedures are designed to ensure completeness and accuracy in respect of accounting for financial transactions and to limit the potential exposure to loss of assets or fraud. Procedures and reference information are maintained in relation to the Group's Rules, accounting policies and procedures, insurance, employees and Code of Business Conduct. These are issued to appropriate management.

Information and communication

Communication takes place with all key stakeholders through a variety of media. Employees receive and provide information on strategy and objectives through their reporting lines and a formal performance measurement process. Colleagues also receive regular business updates from Group Executives and senior managers electronically via the internal intranet site, by conference calls and through face to face briefings.

Monitoring

The operation of the system of internal control is the responsibility of line management. It is subject to independent internal audit review and, where appropriate, by the Group's external auditors and external regulators.

The Committee, on behalf of the Group Board, reviews the reports of the Group on internal control.

A key part of the process of assessing internal control within the Group, by the Committee, is an annual 'letter of assurance' process. In this Executive Management confirm they have assessed the effectiveness of the systems of internal controls they are responsible for. This includes a review of compliance with Group policies, local laws and regulations and any key control improvements required. The outcome of these assurances are reported to the Committee for their review. This annual process has included additional rigour for the 2014 financial year end by setting out an internal benchmark of internal control standards expected and by instigating a review and challenge of each letter of assurance through the Chief Operating Officer and Managing Director, Group Operations.

Within the CISGIL regulated business, an annual attestation is provided to the CISGIL Audit Committee in advance of submission to the Committee.

The Committee considers that there have been no material losses or contingencies that have not been disclosed.

Whistle-Blowing procedure

In line with best practice and to ensure that the Group operates within the highest ethical standards and its Values and Principles, a whistle-blowing procedure, known as 'Speak Up', has been in operation during the year. The policy is managed by an external independent provider and allows colleagues to raise concerns about business practices confidentially. This operation has also been extended to include all third party organisations which trade with the Group to ensure any malpractice or misconduct of Group colleagues can also be reported as part of the Group's Anti-Bribery controls.

The whistle-blowing policy is included in the Code of Business Conduct which is available on the Group's Intranet site and is also on the Group's corporate web site. There are plans to re-launch 'Speak Up' across the Group in 2015.

The Committee considers the whistle-blowing procedures to be appropriate for the size and scale of the Group.

Remuneration Report

Committee Chair's statement

Introduction

I am pleased to present the Remuneration Report for 2014 on behalf of the Transitional Remuneration Committee (the Committee). Although the Group is not subject to the remuneration disclosure regulations that apply to FTSE-listed PLCs, the Committee has chosen to structure its report in accordance with these regulations. The report is in two parts:

- the Executive Remuneration Policy, which describes the policy the Committee has developed for the structure, performance conditions and levels of executive pay;
- the Annual Report on Remuneration, which describes how the policy has been applied in 2014, and how the Committee intends to apply it in 2015.

Changes made during 2014

In 2013, the Committee put in place exceptional, interim remuneration arrangements. These were necessary to enable the Group to address the profound and immediate business challenges confronting it. In particular, the annual bonus plan was suspended so that a Retention Programme could be put in place, designed to retain the management team during the period of crisis, by offering fixed payments following the end of 2013 and 2014. In the first quarter of 2014, as the challenges continued, together with the uncertainty arising from the resignation of Euan Sutherland, further changes in remuneration were made to retain the critical skills imperative to sustain the rescue of the Group.

The business transformation process has been proceeding at pace during 2014. Many significant challenges remain. However, the Committee has taken initial steps during 2014 to normalise Executive remuneration. Some key points are:

- Previously, for 2013 and 2014, the Executives were not eligible to participate in the Annual Incentive Plan as they participated in the Retention Programme. For 2014, the Retention Programme was changed so that the Executives participated in a variable pay scheme such that the entitlements be subject to both the original conditions and additional performance conditions, agreed by the current Executives. From 2015 onwards, Executives will return to a more usual policy where any remuneration in excess of salary, pension and benefits is conditional on performance, and is also subject to clawback mechanisms in the event of misstatement of performance or misconduct.
- There was a substantial reduction in the cost of the Retention Programme when Euan Sutherland resigned from the CEO role in March 2014, as he has not received any payments under the Programme.
- Richard Pennycook initially became Interim CEO, following Euan Sutherland's departure. During this period, between March and August 2014, as Interim CEO, Richard Pennycook continued to receive his previous base salary, plus an Interim CEO allowance. However, at Richard Pennycook's request, this Interim CEO allowance was not pensionable and not included in the calculation of the 2014 performance related programme or the 2014-2016 Long-Term Incentive Plan awards. This was a significant cost saving for the Group during this interim period.
- In September 2014 Richard Pennycook was appointed as CEO. The Committee set his remuneration package for the CEO role at the middle of the market, taking account of the Group's size and business profile. Richard Pennycook's base salary as CEO is significantly less than his predecessor's salary.
- Base salaries for other Executives were last reviewed in March 2014. The Committee has decided not to apply any increase to executive salaries for 2015.
- The Committee has assessed the performance outcome for the Long-Term Incentive Plan awards for the period 2012-2014. The performance measures included financial, customer and colleague engagement components measured over the whole three years. Having assessed the performance, the Committee has determined that no payments are due under these plan awards.

Future policy

The Committee intends to continue moving to a market-aligned and sustainable remuneration structure for executives of the Group. Key aspects of this policy are as follows:

- We shall pay at the middle of the market for companies of the Group's size and business profile for fully competent performance. This enables the Group to compete in the employment market for the people we need to run the business successfully.
- The Committee will operate an Annual Incentive Plan and a Long-Term Incentive Plan, with stretching and challenging performance metrics that are directly linked to our strategy.
- The Committee is reviewing the current balance of fixed versus variable remuneration for the Executives, with a view to a more substantial proportion of executive remuneration being conditional on achieving performance targets. This work is on-going and we will provide an update next year.
- Annual Incentive Plan awards will also depend on the individual performance of Executives, as we seek to build a stronger performance culture within the Group.

Remuneration Report continued

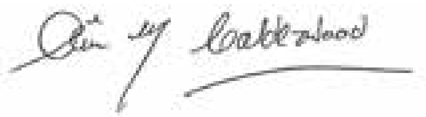
- If Executives depart, our aim will be to minimise the costs to the Group. We will limit any salary or benefits payments to the employee's legal entitlements. We will not pay additional discretionary redundancy or severance payments. Any incentive plan awards that are due will not be paid unless the individual is deemed a 'good leaver' by the Committee, and will be subject to performance conditions and to reduction to take account of the curtailment of their employment. Leavers will continue to be subject to the clawback provisions in incentive plan rules.

Members' views and voting

We are committed to openness and transparency on remuneration matters, taking views of members into account. The whole Remuneration Report is subject to a vote of members at the forthcoming Annual General Meeting (AGM).

Conclusions

I hope you will find the Remuneration Report clear and informative. The Committee would welcome your support in the vote at the AGM.



Eric Calderwood
Chair of the Transitional Remuneration Committee

Remuneration Report continued

Transitional Remuneration Committee

The previous Remuneration and Appointments Committee of the Board was superseded from 30 September 2014 by the Committee (a committee of the Transitional Board), in accordance with the Transitional Provisions of the new Rules of the Society.

Role of the Committee

The Committee is responsible for determining and overseeing the remuneration policy for the Group to ensure a consistent approach across the Group and its subsidiaries.

Terms of reference

The Committee's terms of reference for the transitional period were approved by the Board on 9 December 2014. The principal terms of reference are to:

- oversee the Group's reward policies for all employees, oversee any material changes in benefit structures, and maintain an awareness of the Group's pension policy and how this fits within the overall reward arrangements;
- approve the design of any Group-wide incentive schemes. Approve the design of any long-term incentive schemes including eligibility, award levels, performance measures and payments under the schemes;
- in respect of the Executives:
  - determine policy on remuneration, ensuring that overall levels of reward or remuneration are sufficient to attract, retain and motivate individuals of the quality necessary to manage the Group effectively and successfully, but that the overall levels are not excessive in comparison to the relevant external market;
  - determine remuneration and contractual arrangements including:
    - set base salaries and agree any base salary increases;
    - approve awards under incentive schemes, set performance measures and targets and determine any payouts due;
    - approve benefits available;
    - approve the individual pension arrangements;
    - review and approve any other remuneration arrangements; and
    - approve the policy applicable to and approve any payments, terms or other commitments to be entered into on the retirement, resignation, dismissal or other exit arrangement of members of the Group Executive;
- in respect of the non-executive directors:
  - determine the approach to be adopted in relation to fees for the Group Chair, Independent Non-Executive Directors and Member Nominated Directors who are members of the Group Board, within the Group's remuneration policy, and in consultation with the Non-Executive Directors' Fees Committee and Transitional Search Committee as required; and
  - consider the contractual arrangements, including remuneration, applicable to non-executive directors (if any) on the boards of the Group's subsidiaries.

The terms of reference of the Committee are available on the Group's website.

Members of the Committee

The Committee's membership is in accordance with the Transitional Provisions of the new Rules of the Society. The Committee comprises six members, including Eric Calderwood, who was the Chair of the Group Remuneration and Appointments Committee immediately prior to commencement of the Transitional Period.

The members of the Committee and the previous Group Remuneration and Appointments Committee and attendance during the 2014 year were as follows:

1. Transitional Remuneration Committee

Committee member	Date of appointment	Meeting attendance during 2014
Eric Calderwood, Committee Chair	30 September 2014	4/4
Marc Bicknell	15 October 2014	4/4
Michael Harriott	15 October 2014	3/4
Ursula Lidbetter	15 October 2014	3/4
Frank Nelson	15 October 2014	4/4
Sir Christopher Kelly	9 December 2014	1/1

2. Previous Remuneration and Appointments Committee

Committee member	Date of appointment	Date of resignation from this Committee	Meeting attendance during 2014
Eric Calderwood, Committee Chair	20 June 2012 17 July 2013 appointed Chair	30 September 2014	11/11
Ursula Lidbetter	16 June 2010	30 September 2014	10/11
Frank Nelson	11 June 2014	30 September 2014	3/3
Michael Harriott	11 June 2014	30 September 2014	3/3
Marc Bicknell	11 June 2014	30 September 2014	3/3
Jenny de Villiers	11 June 2014	30 September 2014	3/3
Steven Bayes	9 April 2013	17 May 2014	8/8
Patrick Grange	17 July 2013	17 May 2014	8/8
Liz Moyle	17 July 2013	17 May 2014	7/8

Remuneration Report continued

The Group Chief Executive, the Group Secretary and the Group Chief HR Officer are also invited to attend the meetings of the Committee, but are not present when their own remuneration or terms and conditions are being considered. Other individuals are invited to attend for specific agenda items when necessary.

The Committee members are all non-executive. They have no personal financial interests in the Committee's decisions and they have no involvement in the day-to-day management of the Group. The Group Board believes that all members of the Committee are independent for the purpose of reviewing remuneration matters.

The number of meetings of the Committee and the previous Remuneration and Appointments Committee was 15 during 2014.

Independent advice

In carrying out its responsibilities, the Committee has access to independent advice as required. During 2014, the Committee retained New Bridge Street (an Aon Hewitt company) as its independent remuneration adviser. New Bridge Street supplied survey data and advised on market trends and other general remuneration issues. Other than specialist advice in relation to the Group's remuneration issues, New Bridge Street does not provide other services to the Group and on this basis, the Committee considers New Bridge Street to be operating in an independent manner. The fees paid to New Bridge Street during this period totalled £82,749 excluding VAT.

New Bridge Street is a signatory of the Remuneration Consultants' Code of Conduct which requires its advice to be objective and impartial.

Hogan Lovells provided independent legal advice to the Committee as required. The total fee paid to Hogan Lovells was £8,619 excluding VAT.

Remuneration Report continued

Remuneration Policy

This section sets out the Group's policy on remuneration for members of the Executive and non-executive directors.

As set out above, the Committee intends to continue moving to a market-aligned and sustainable remuneration structure for the Executives of the Group and we believe the new policy will be fair, appropriate and transparent and will help promote the success of the Group. It will seek to follow the Society's values of openness and transparency.

As a commitment to putting a clear and fair policy in place and to enable the Committee to agree the remuneration packages of the Executive during the year, steps have been taken during 2014 to adopt some parts of the policy, for example going forward the Committee will seek to set total remuneration at around the middle of the relevant external market for target performance (being when all business and personal objectives have been met at the target level). This means that you will hear terms such as at the middle of the market or at the market median for fully competent performance being used.

We will ask Members to vote on the Executive remuneration policy at the 2016 AGM.

Executive remuneration policy table

The table below shows the current Executive remuneration policy including the new elements of the policy which have been approved during 2014.

	Element	Link to strategy	Summary and operation	Maximum Opportunity	Change since previous policy?
Fixed elements	Base salary	To set a level of reward for performing the core role.	The aim is for total target compensation to be at the middle of the market which the Committee considers relevant for fully competent performance.	There is no formal maximum salary. Typically, salaries are reviewed annually. When reviewing salaries, the Committee will take account of: – experience and personal and business performance – appropriate market data with the aim of total remuneration being at the middle of the most appropriate and relevant market for fully competent performance – increases for the wider employee population, unless there are exceptional circumstances.	Yes, the Committee's aim is that total target compensation should be at the middle of the relevant market for fully competent performance.
Fixed elements	Benefits	To offer a benefits proposition to attract and retain talented leaders.	The benefits provided to the Executive will be in line with normal market practice and could include a car or car allowance, fuel in certain cases, healthcare cover and life cover. Executives are also able to take advantage of benefits offered to all colleagues for example childcare vouchers and discounts on certain products and services.	There is no formal cap on the level of benefits that can be provided however this will represent a small proportion of the total compensation. All Executives will receive the same level of benefits offer. The benefits offering for all colleagues including the Executives is currently being reviewed. This review will ensure that benefits offered are appropriate and affordable.	No
Fixed elements	Pension [1]	To provide competitive pension benefits to attract and retain talented leaders.	The Executives are able to join the Group's Defined Benefit or Defined Contribution pension plans on the same basis as applies to all other colleagues in the Group and/or receive a cash allowance in lieu of pension provision.	The following options are available: – Defined Contribution employer pension contributions of up to 16% of salary. – Defined Benefit pension plan accrual (when eligible). – Cash alternative of up to 16% of salary.	No

Remuneration Report continued

	Element	Link to strategy	Summary and operation	Maximum Opportunity	Change since previous policy?
Variable elements	Annual Incentive Plan (AIP)	To motivate and incentivise achievement of performance measures.	The Executive will be eligible for a payment under a new AIP which has recently been agreed by the Committee. The performance measures and targets for each annual AIP cycle will be set at the start of each year. Payments will be based on a combination of business and individual performance. Payments made under the AIP are subject to the clawback provisions set out on page 64.	For 2015, the AIP opportunity for the Executive has been agreed by the Committee as 50% of salary at target performance (maximum payout will be 100% of salary at stretch performance). The Committee is reviewing the current balance of fixed to variable remuneration. The policy of total remuneration being at the middle of the market for fully competent performance will continue. We will update Members as this review work is carried out.	Yes, for 2013 and 2014 Executives were not eligible to participate in the AIP as they participated in the Retention Programme. For 2014 the Retention Programme was changed so that the Executives participated in a variable pay scheme such that the entitlements be subject to both the original conditions and additional performance conditions, agreed by the current Executives.
Variable elements	Long Term Incentive Plan (LTIP)	To incentivise senior management towards the achievement of long term specific performance targets and results, and promote the behaviours considered by the Committee to be key to the success of the Group.	The Executive will be eligible to participate in a new LTIP which has recently been agreed by the Committee. Key terms of the new plan: • All LTIP awards are cash based, have a three year performance period, and will be subject to performance measures and targets set at the start of each three year award cycle. • LTIP awards will be made annually although awards may be granted where an eligible colleague has joined the Group after the grant date. • The Committee has the discretion to determine the performance measures for each LTIP award, including the weighting, ensuring that they support the long term strategy of the business. • At the end of each LTIP performance period, the Committee will assess the overall performance of the Group and can reduce any payments under the award as it determines appropriate. • Payments made under the LTIP are subject to the clawback provisions set out on page 64.	For 2015, the LTIP opportunity for the Executive has been agreed by the Committee as 50% of salary at target performance (maximum payout will be 100% of salary at stretch performance). As above, the Committee is reviewing the current balance of fixed to variable remuneration. The policy of total remuneration being at the middle of the market for fully competent performance will continue. We will update Members as this review work is carried out.	Yes, eligibility for LTIP will be clear under the new policy and levels of award will be defined by grade and therefore consistent across a grade.

Remuneration Report continued

Notes to the table:

1 Pensions

The Group offers every employee the opportunity to join a pension scheme.
Executives have the option to join The Co-operative Pension Scheme ('Pace') or take a cash allowance instead of pension.
Pace includes the defined benefit section (Pace Complete) and the defined contribution sections (Pace Essential and Pace Extra). All employees can choose to join Pace Complete once they have completed two or more consecutive years' service.

- Pace Complete provides defined benefit pensions based on 1/60th of average pensionable earnings, revalued by inflation for each year of pensionable service. Benefits accrued as at 5 April 2006, in respect of membership of the scheme preceding Pace Complete, continue to be linked to final pensionable salary at a member's date of leaving pensionable service in Pace Complete or retirement, whichever is earlier. Benefits accrued as at 6 October 2012 in respect of the closed United Norwest Co-operatives Employees' Pension Fund ('the United Scheme') also continue to be linked to final pensionable salary in the same way as above. Both schemes also provide pensions to dependants on death.
- Members of Pace Essential, into which all eligible employees will be automatically enrolled, currently pay 1% of pay and the Group pays 2%. Members of Pace Extra, which is available to all employees, currently pay 4% of pay and the Group pays 8%.
- Under all sections a lump sum is payable if death occurs in service.
- All members of Pace have the choice of making pension contributions by salary sacrifice.

Executives who are members of Pace Complete currently contribute 8% of their pensionable salary. The Group pays the balance of the cost of providing defined benefits.
Where an Executive may be impacted by the Lifetime Allowance or the Annual Allowance they have the facility of opting out of future pension accrual in favour of a pension allowance or opting for restricted pension accrual based on a capped pensionable salary of £187,500 (£150,000 from 6 April 2014) and receiving a restricted pension allowance in lieu of pension provision based on salary above the capped salary. Where paid, the rate of pension allowance is currently 16% of pensionable salary which is broadly equivalent to the employer contribution rate to Pace Complete.
Executives who join Pace Extra are provided with an additional 8% of pensionable salary as a pension contribution or pension allowance. Executives who join Pace Essential are provided with an additional 14% of pensionable salary as a pension allowance.
Supplementary life cover is provided to Executives in order to provide total life cover of 4 x salary when aggregated with benefits from Pace, as appropriate.

Additional information/footnotes

Clawback

Clawback provisions apply to the new AIP and LTIP plans recently agreed by the Committee. This enables the Committee to seek to recoup part or all of a payment under these arrangements if the Group's results were materially misstated, should have been assessed materially differently, or where an individual ceases to be employed by the Group as a result of misconduct.

Any differences in policy of the Executives and the wider employees

- The Committee now has a stated philosophy that total remuneration for fully competent performance should be at the middle of the relevant external market. 2015 will see the launch of new remuneration policies that help the Group to move towards achieving this aim for all colleagues.
- For base salary, benefits and pension, the same policies apply to all colleagues though the type and level of benefits and pension available to the Executive is different and in line with the middle of the market.
- The Group is on a journey towards all colleagues being eligible to participate in an incentive scheme.
- Those eligible for LTIP awards are at senior management grades to ensure participants have a line of sight and can influence the long term performance measures; the level of opportunity varies by grade.

What could Executives earn under this policy?

The chart below illustrates the **potential** remuneration package for the Executive who sits on the Board under the new remuneration policy set out above. In future years, this section will show the remuneration packages for all members of the Executive who are appointed to the Board. Currently, only Richard Pennycook is appointed to the Board.

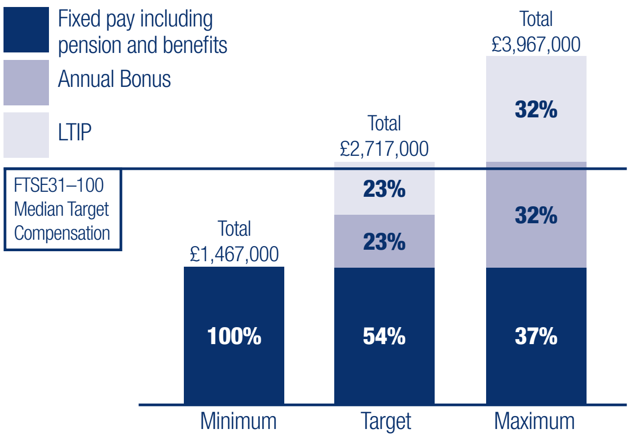
The chart shows the following performance scenarios:

- 'Minimum' is the remuneration due if none of the performance based elements payout.
- 'Target' shows the total package where the AIP and LTIP awards both pay at the target level, being the amount payable for target performance. The target AIP payment is 50% of salary and the target LTIP opportunity is 50% of salary.
- 'Maximum' shows the total package where the AIP and LTIP both pay at the maximum level which is twice the target opportunities, being 100% of salary for both.

The chart does not include any one-off arrangements or temporary allowances, for example relocation or compensation for forfeited awards at a previous employer.

Chief Executive Officer – Richard Pennycook

Richard Pennycook's total potential compensation at target, including incentives, is £2,717,000 (as shown in the 'Target' column below):



Fixed pay is made up of:	Annual value	% of Total Target Compensation
Base salary	£1,250,000	
Pension contribution (16%)	£200,000	
Car allowance	£16,000	
Healthcare benefit (approximate P11D value)	£1,000	
Total fixed pay	**£1,467,000**	54%
Annual Bonus Target – 50% of Base Salary	£625,000	23%
LTIP Target – 50% of Base Salary	£625,000	23%
Total Target Compensation	**£2,717,000**	**100%**

Remuneration Report continued

How this compares to market

Richard Pennycook's total potential compensation at target, including incentives, is £2,717,000 (as shown in the 'target' column above). The Committee considered a variety of data sources when agreeing the package, including median data for chief executive roles within various comparator groups. For example, the median total package for chief executives in companies within the FTSE 31-100 is around £2.7m (this increases to around £3m in FTSE 100 companies). The Committee also considered data from a Retail group of companies which also showed total target packages for chief executives was around £3m.

What would we pay to recruit a new member of the Executive?

The remuneration package for a new Executive is currently set using the same policies that apply to current Executives. This means that the Committee would seek to set the total package at the middle of the market for fully competent performance. AIP and LTIP awards would be at the same level and have the same performance measures as the current Executive.

The following additional items of remuneration would be considered when recruiting an Executive:

- Relocation – The Committee will consider contributing towards relocation costs for an Executive who would need to move home to be closer to their place of work or would stay close to their place of work during the working week. During the year, the Committee oversaw the development of a new Group-wide relocation policy and has recently agreed that this should apply to the Executives. This policy seeks to provide appropriate financial assistance based on the nature of the move and individual circumstances, without encouraging people to spend extended periods away from family.
- Forfeiture of previous awards – The Committee will consider compensating a new Executive for variable remuneration awards lost from a previous employer. During the year, the Committee oversaw the development of a new Group-wide buyout policy and has recently agreed that this should apply to the Executives which confirms the circumstances in which a buyout is considered appropriate and details the approach to calculating this. The exact type and amount of compensation will vary depending on the variable remuneration plans operated by the previous employer. Any payments agreed under this policy will not be more generous than, and will mirror as far as possible, the terms of the forfeited awards.

What would an Executive get on leaving the Group?

In the event of termination, the Committee would review and approve all payments due to an Executive with the aim of minimising the costs to the Group. Payments will be based on contractual obligations plus an element to compensate for statutory employment obligations and legal fees where necessary. Where negotiated, a contribution towards career support is made.

It is the Committee's policy that the notice period in Executives' service contracts should not exceed one year and all Executive contracts can be terminated by one year's notice. Where it is deemed commercially beneficial for an individual to remain under a contract of employment with the Group but not to work their notice, they are placed on garden leave and only contractual payments are made.

During 2014 the Committee introduced a new policy under which:

- During the notice period, the Group is only obliged to pay base salary. Notice pay does not include any benefits or incentives.
- The Committee can agree that the salary in lieu of the whole or part of the notice period can be paid in instalments in which case the departing Executive is obliged to mitigate their loss. The Society has the right to reduce the payments of salary in lieu of notice by the amount of income from a new role.

The Committee has discretion to determine whether, and to what extent, a leaver is allowed to retain LTIP awards they hold and their eligibility for AIP in respect of the period they have served. In exercising its discretion the Committee will take account of the reasons for leaving, performance and contractual commitments.

What is the Group's policy on Executives taking non-executive roles with other organisations?

It is the Group's policy that, subject to the Board's approval, Executives may accept one external, non-executive appointment, where this does not conflict with the performance of their duties with the Co-operative Group, and where the appointment further develops the individual's skills and experience for the benefit of the Group.

It is not unusual for the Executives we have been recruiting to the Group to hold outside appointments already. Where this is the case, the Board will review the appointments to ensure they are appropriate, usually limiting the Executive to one appointment but in exceptional circumstances, the Board may permit an Executive to hold more than one. This exception was applied to Richard Pennycook who holds three external directorships and also chairs a professional body. It has been agreed that Richard Pennycook will step down from one of these appointments thereby reducing his external appointments to three.

Remuneration Report continued

Provided the external appointment is not related to the Executive's role with the Group, they are normally permitted to retain the non-executive fees they may earn for the appointment.

Does the Committee take account of employment conditions elsewhere in the Group?

In setting remuneration policy for the Executives, the Committee will continue to ensure that pay arrangements for all colleagues are taken into account. The new philosophy of setting remuneration at the middle of the market for fully competent performance will apply to all colleagues and is considered fair and appropriate. As above, the Group is on a journey towards all colleagues being eligible to participate in an incentive scheme.

What would the non-executive directors be paid?

The policy for the new Group Chair, Senior Independent Director, non-executive directors and Member Nominated Directors who are/have been appointed to the new Board and who will remain on the Group Board after the May 2015 AGM - referred to in this report as NEDs - is set out below.

The policy and the fees for NEDs have been approved by the Transitional Council acting through the Non-Executive Directors' Fees Committee ('NED Fees Committee').

Element	Link to strategy	Summary and operation	Maximum Opportunity	Change since previous policy?
Fee	To recruit and retain the right people to contribute to the success of the Group.	The Group Chair will be paid an annual fee and will not receive any additional fees. The NEDs will receive an annual base fee. Additional fees will be paid to the Senior Independent Director and the Chairs of the Remuneration Committee and Risk and Audit Committee. No additional fees will be paid for the Chair of Nominations Committee or for being a member of any committee. The members of the Group Executive who sit on the Group Board will not receive a fee or any additional remuneration.	The fees will not be reviewed again until 2017. As set out in the terms of reference, when reviewing fees, the NED Fees Committee will take account of: – Appropriate market data – The Group's remuneration policy as set by the Remuneration Committee – Recommendations from the Transitional Search Committee	Yes, the previous non-executive directors who served on the Group Board were paid separate fees for their various roles within the Group or the wider co-operative interests.

No benefits are to be provided to the new NEDs, although the Group Chair will have access to a pool car and driver for Group business if required.

NEDs are not entitled to participate in any of the Group's incentive plans (including the AIP and the LTIP) or in any Group pension arrangements. They are not entitled to any payment in compensation for any early termination of their appointment.

Remuneration Report continued

Annual Report on Remuneration

What did the Executives earn in total during the year?

The tables below show the remuneration received by the Executives whilst appointed to the Group Executive during the 2014 financial year. Pippa Wicks was a member of the Group Executive during 2014 on an interim basis and is therefore not included in table 1a. Pippa Wicks has been engaged by the Group through AlixPartners and the total fees paid in respect of her services during 2014 were £949,000 excluding VAT. This is within the total remuneration parameters anticipated for the Chief Operating Officer role at the median of the external market.

Table 1a – 2014 remuneration for Executives in post at 3 January 2015

	Notes	Date of appointment to the Executive (Note 1)	Date of stepping down from Executive (Note 1)	**Basic salary 2014 £'000**	**Taxable benefits (Note 2) 2014 £'000**	**2014 Performance related payment (Note 3) 2014 £'000**	**2012-2014 LTIP (Note 4) 2014 £'000**	**Pension benefits (Note 5) 2014 £'000**	**Other (Note 6) 2014 £'000**	**Total 2014 £'000**	Basic salary 2013 £'000	Taxable benefits (Note 2) 2013 £'000	2013 Performance related payment 2013 £'000	2011-2013 LTIP (Note 4) 2013 £'000	Pension benefits (Note 5) 2013 £'000	2013 Retention programme (Note 7) 2013 £'000	Other (Note 6) 2013 £'000	Total 2013 £'000
Richard Pennycook	8	1 Jul 2013		**1,164**	**26**	**900**	**–**	**160**	**265**	**2,515**	429	16	–	–	72	750	–	1,267
Alistair Asher		1 Jul 2013		**534**	**17**	**550**	**–**	**85**	**–**	**1,186**	245	9	–	–	39	475	–	768
Rod Bulmer		9 Jun 2014		**363**	**10**	**650**	**–**	**51**	**–**	**1,074**	–	–	–	–	–	–	–	–
Claire Davies		12 May 2014		**167**	**10**	**265**	**–**	**26**	**–**	**468**	–	–	–	–	–	–	–	–
Nick Folland		11 May 2013		**524**	**17**	**550**	**–**	**84**	**132**	**1,307**	265	11	–	–	44	425	165	910
Paula Kerrigan		17 Mar 2014		**315**	**14**	**400**	**–**	**51**	**–**	**780**	–	–	–	–	–	–	–	–
Steve Murrells		16 Jul 2012		**729**	**33**	**750**	**–**	**117**	**138**	**1,767**	642	32	–	–	103	650	188	1,615
Sam Walker		17 Mar 2014		**335**	**14**	**425**	**–**	**54**	**–**	**828**	–	–	–	–	–	–	–	–

Remuneration Report continued

Table 1b – 2014 remuneration for Executives who left or stepped down from the Executive during the 2014 financial year

	Notes	Date of appointment to the Executive (Note 1)	Date of stepping down from Executive (Note 1)	**Basic salary 2014 £'000**	**Taxable benefits (Note 2) 2014 £'000**	**2014 Performance related payment 2014 £'000**	**2012-2014 LTIP (Note 4) 2014 £'000**	**Pension benefits (Note 5) 2014 £'000**	**2014 Retention programme (Note 7) 2014 £'000**	**Other (Note 6) 2014 £'000**	**Total 2014 £'000**	Basic salary 2013 £'000	Taxable benefits (Note 2) 2013 £'000	2013 Performance related payment 2013 £'000	2011-2013 LTIP (Note 4) 2013 £'000	Pension benefits (Note 5) 2013 £'000	2013 Retention programme (Note 7) 2013 £'000	Other (Note 6) 2013 £'000	Total 2013 £'000
Euan Sutherland	9	1 May 2013	11 Mar 2014	**301**	**–**	**–**	**–**	**48**	**–**	**–**	**349**	1,000	1	–	–	161	–	1,000	2,162
Gill Barr	10	31 Jan 2011	17 Mar 2014	**68**	**4**	**–**	**–**	**11**	**68**	**–**	**151**	314	17	–	–	67	314	–	712
Mark Craig	11	4 Jan 2012	1 Apr 2014	**41**	**6**	**–**	**–**	**1**	**–**	**–**	**48**	188	23	–	–	41	188	–	440
Andy Haywood	12	4 Jan 2012	17 Mar 2014	**76**	**4**	**–**	**–**	**9**	**–**	**–**	**89**	334	17	–	–	74	350	–	775
Martyn Hulme	13	1 Sep 2010	17 Mar 2014	**65**	**4**	**–**	**–**	**10**	**65**	**–**	**144**	287	17	–	–	81	300	–	685
Rebecca Skitt	14	11 Mar 2013	28 Feb 2014	**111**	**–**	**–**	**–**	**18**	**111**	**–**	**240**	489	6	–	–	79	650	–	1,224

Notes to Tables 1a and 1b

1. The date of appointment to or stepping down from the Executive may differ from the date service commenced or terminated with the Group.
2. **Taxable benefits** include car, fuel, car cash allowance and healthcare (where applicable).
3. **2014 Performance related payments:**
   - The current Executives agreed that the terms of their participation in the Retention Programme should be changed for 2014 and their 2014 entitlements be subject to both the original conditions and additional performance conditions.
   - The original conditions were being employed and not having given notice of resignation by 31 December 2014.
   - The additional conditions to be met by 31 December 2014 were ensuring the Group's capital contribution to the Bank for 2014 was made on time and in full, ensuring the Group did not enter administration in 2014, and the Executive's employment contract not being terminated without notice in accordance with their employment contract, for example due to gross misconduct or being deemed by the Board to be negligent and incompetent in the performance of their duties.
   - These performance measures were met at the year end and the payments will be made to the Executives during early 2015.
   - The additional performance measures did not apply to the Retention Payments made to the former Executives.
4. **2012-2014 LTIP:** The Committee used its discretion to decide that no part of the 2012-2014 LTIP should vest. See page 69 for more detail.
   2011-2013 LTIP: The performance measures were met in part though the Committee used its discretion last year to reduce the payments due under this LTIP to zero in light of the events of 2013.
5. **Pension** includes benefits accrued in the year from participation in pension schemes (using new disclosure calculation rules and factor of 20) and cash allowances in lieu of retirement benefit.
6. **Other payments in 2014** include:
   - a payment of £265,000 to Richard Pennycook as compensation for incentive scheme awards that he forfeited on resignation from his previous employer
   - a payment of £132,000 to Nick Folland as compensation for incentive scheme awards that he forfeited on resignation from his previous employer
   - payments totalling £138,000 to Steve Murrells, comprising £75,000 as compensation for incentive scheme awards that he forfeited on resignation from his previous employer and £63,000 as part of continuing obligations under the relocation arrangements agreed on his recruitment which are due to end in 2015.

   Other payments in 2013 include:
   - payments totalling £165,000 to Nick Folland as compensation for incentive scheme awards that he forfeited on resignation from his previous employer
   - payments totalling £188,000 to Steve Murrells, comprising £100,000 as compensation for incentive scheme awards that he forfeited on resignation from his previous employer and £88,000 as part of continuing obligations under the relocation arrangements agreed on his recruitment
   - a payment of £1m to Euan Sutherland as compensation for incentive scheme awards that he forfeited on resignation from his previous employer.
7. **2013 and 2014 Retention Programme**: payments were not subject to performance conditions for participants who are not currently members of the Executive.
8. From 12 March 2014 to 3 September 2014 Richard Pennycook was Interim CEO and received an interim CEO allowance of £400,000 per annum. The allowance for the relevant period is included in the basic salary figure. At Richard Pennycook's request, this interim CEO allowance was not pensionable and not included in the calculation of the 2014 performance related programme or the 2014-2016 Long Term Incentive Plan awards.
9. Euan Sutherland was placed on garden leave on 11 March 2014. The figures in the table above represent his earnings for services provided to the Group until this date. Payments made since 11 March 2014 are shown on page 71.
10. Gill Barr stepped down from the Executive on 17 March 2014. The figures in the table above represent her earnings for services provided to the Group whilst on the Executive until this date. The full amount of the 2014 Retention Programme payment due to Gill is £314,000. Gill's role has since been made redundant and the details of her exit arrangements are shown on page 71.
11. Mark Craig's role was made redundant on 1 April 2014. The figures in the table above represent his earnings for services provided to the Group until this date. Payments made during 2014 under the terms of his settlement agreement are shown on page 72.
12. Andy Haywood stepped down from the Executive on 17 March 2014. The figures in the table above represent his earnings for services provided to the Group whilst on the Executive until this date. Andy has since left the Group and the details of his exit arrangements are shown on page 72.
13. Martyn Hulme stepped down from the Executive on 17 March 2014. The figures in the table above represent his earnings for services provided to the Group whilst on the Executive until this date. The full amount of the 2014 Retention Programme payment due to Martyn is £300,000. Martyn is still employed with the Group.
14. Rebecca Skitt was placed on garden leave on 28 February 2014. The figures in the table above represent her earnings for services provided to the Group until this date. Payments made since 28 February 2014 are shown on page 72. The Committee obtained independent legal advice regarding Rebecca Skitt's contractual entitlement.

Remuneration Report continued

Will the Executives receive a salary increase in 2015?

As part of the annual salary review for the Executives, the Committee has agreed that the Executive salaries would not be increased in 2015.

What LTIP scheme interests do the Executives hold?

Awards are made annually under the Long Term Incentive Plan, and any payments due are made in cash, subject to the achievement of performance conditions over a three year period. Table 2a shows the maximum potential LTIP awards held by Executives in post at 3 January 2015. Table 2b shows the maximum potential award under each plan held by former Executives.

Table 2a – LTIP awards held by Executives in post at 3 January 2015

Name of Executive	Award	Notes	Maximum award opportunity at start of the year £	Maximum 2014-2016 award opportunity granted £	Awards vested in year £	Awards lapsed in year £	Maximum award opportunity at the year-end £
Richard Pennycook	2014-2016	1	–	900,000	–	–	900,000
	2013-2015	2	750,000	–	–	–	750,000
Alistair Asher	2014-2016	1	–	550,000	–	–	550,000
	2013-2015	2	475,000	–	–	–	475,000
Rod Bulmer	2014-2016	1	–	650,000	–	–	650,000
Claire Davies	2014-2016	1	–	265,000	–	–	265,000
Nick Folland	2014-2016	1	–	550,000	–	–	550,000
	2013-2015	2	425,000	–	–	–	425,000
Paula Kerrigan	2014-2016	1	–	400,000	–	–	400,000
	2013-2015	2, 3	107,500	–	–	–	107,500
Steve Murrells	2014-2016	1	–	750,000	–	–	750,000
	2013-2015	2	650,000	–	–	–	650,000
	2012-2014	4	615,000	–	–	615,000	–
Sam Walker	2014-2016	1	–	425,000	–	–	425,000
	2013-2015	2, 3	107,500	–	–	–	107,500

Notes to Table 2a

1. 2014-2016 awards are subject to performance conditions which are deemed key business objectives over the three financial years ending with the 2016 financial year. The performance conditions for the 2014-2016 LTIP awards are a net debt to EBITDA ratio, a cumulative cashflow measure and a reputation measure. These measures are equally weighted.
2. The 2013-2015 LTIP awards are subject to performance conditions which were deemed to be critical turnaround objectives. These are:
   - to re-capitalise the Bank
   - to successfully rebalance the cost base of the Group and achieve cost saving targets
   - to establish a revised senior leadership structure and populate this to the satisfaction of the Committee and operate a revised performance management process for the whole Group by the end of 2015
   - to have defined, communicated and embedded in the financial plan a new Group strategy and Purpose
   - to safeguard the reputation of the Group throughout the turnaround.
3. The 2013-2015 LTIP awards held by Paula Kerrigan and Sam Walker were granted before they were appointed to the Group Executive.
4. The 2012-2014 LTIP performance period has ended. The performance conditions were:
   - Group cumulative profit
   - corporate responsibility
   - colleague engagement
   - customer satisfaction.

   The only measure that was achieved was corporate responsibility. This measure accounted for 10% of an individual's LTIP award. The Committee used its discretion to decide no part of the 2012-2014 LTIP should vest.

Remuneration Report continued

Table 2b – LTIP awards for Executives who left or stepped down from the Executive during the 2014 financial year

Name of Executive	Award	Notes	Maximum award opportunity at start of the year £	Maximum 2014-2016 award opportunity granted £	Awards vested in year £	Awards lapsed in year £	Maximum award opportunity at the year-end £
Euan Sutherland	2013-2015	1, 3	1,500,000	–	–	1,500,000	–
Gill Barr	2013-2015	1, 4	314,000	–	–	157,000	157,000
	2012-2014	2, 4	230,625	–	–	230,625	–
Mark Craig	2013-2015	1, 5	188,000	–	–	109,710	78,290
	2012-2014	2, 5	138,375	–	–	138,375	–
Andy Haywood	2013-2015	1	350,000	–	–	350,000	–
	2012-2014	2	225,000	–	–	225,000	–
Martyn Hulme	2013-2015	1, 6	300,000	–	–	–	300,000
	2012-2014	2, 6	195,000	–	–	195,000	–
Rebecca Skitt	2013-2015	1, 7	650,000	–	–	433,333	216,667

Notes to Table 2b

1. The 2013-2015 LTIP awards are subject to performance conditions which were deemed to be critical turnaround objectives and are set out above.
2. The 2012-2014 LTIP performance period has ended and the performance conditions are set above. The Committee used its discretion to decide that no part of the 2012-2014 LTIP should vest.
3. Euan Sutherland resigned on 11 March 2014 and all of his LTIP awards lapsed.
4. The Committee used its discretion to allow Gill Barr good leaver status following her departure from the Group and she therefore retains part of her LTIP awards.
5. Mark Craig retained part of his LTIP awards under the terms of his settlement agreement.
6. Martyn Hulme stepped down from the Executive on 17 March 2014. He is still employed with the Group and retains his LTIP awards.
7. Rebecca Skitt retained part of her LTIP award under the terms of her settlement agreement.

What pension benefits are the Executives entitled to?

The table below shows the pension entitlements for the Executive. The figures shown below reflect the period that the individuals were appointed to the Group Executive including any pension benefits transferred into the scheme.

Comparative figures for 2013 are shown in brackets.

Table 3a – Pension entitlements for Executives in post at 3 January 2015

Name of Executive	Notes	Date of appointment to the Executive	Years of Service (Note 1)	Total Defined Benefit Pension accrued at 3 January 2015 (Note 2) £'000	Increase in Defined Benefit Pension during year (gross of inflation) £	Increase in Defined Benefit Pension during year (net of inflation) £	Value of previous column x 20 (net of members contributions) (Note 3) £'000	Employer Contributions to Defined Contribution Pension £'000	Payment in lieu of Pension Benefit £'000	Total Pension Benefits £'000	Defined Benefit Pension Normal Retirement Date (Age)
Richard Pennycook	4	1 Jul 2013	1	–	–	–	–	–	160 (72)	160 (72)	–
Alistair Asher	4	1 Jul 2013	1	–	–	–	–	–	85 (39)	85 (39)	–
Rod Bulmer	5	9 Jun 2014	–	32	1,442	621	6	–	45	51	65
Claire Davies	7	12 May 2014	–	–	–	–	–	13	13	26	–
Nick Folland	8	11 May 2013	1	–	–	–	–	9 (37)	75 (7)	84 (44)	–
Paula Kerrigan	9	17 Mar 2014	1	–	–	–	–	51	–	51	–
Steve Murrells	4	16 Jul 2012	2	–	–	–	–	–	117 (103)	117 (103)	–
Sam Walker	4	17 Mar 2014	1	–	–	–	–	–	54	54	–

Remuneration Report continued

Table 3b – Pension entitlements for Executives who left or stepped down from the Executive during the 2014 financial year

Name of Executive	Notes	Date of appointment to the Executive	Date of stepping down from Executive	Years of Service (Note 1)	Total Defined Benefit Pension accrued at 3 January 2015 (Note 2) £'000	Increase in Defined Benefit Pension during year (gross of inflation) £	Increase in Defined Benefit Pension during year (net of inflation) £	Value of previous column x 20 (net of members contributions) (Note 3) £'000	Employer Contributions to Defined Contribution Pension £'000	Payment in lieu of Pension Benefit £'000	Total Pension Benefits £'000	Defined Benefit Pension Normal Retirement Date (Age)
Euan Sutherland	4	1 May 2013	11 Mar 2014	–	–	–	–	–	–	48 (161)	48 (161)	–
Gill Barr	6	31 Jan 2011	17 Mar 2014	3	7	661	490	7 (47)	–	4 (20)	11 (67)	65
Mark Craig	10	4 Jan 2012	1 Apr 2014	20	82	1,966	–	– (41)	–	1 (–)	1 (41)	65
Andy Haywood	6	4 Jan 2012	17 Mar 2014	2	8	509	313	3 (55)	–	6 (19)	9 (74)	65
Martyn Hulme	11	1 Sep 2010	17 Mar 2014	24	92	–	–	– (35)	–	10 (46)	10 (81)	65
Rebecca Skitt	4	11 Mar 2013	28 Feb 2014	–	–	–	–	–	–	18 (79)	18 (79)	–

General notes to Tables 3a and 3b

1. Years of Group service include, where appropriate, pre-merger service with United Co-operatives.
2. Total Defined Pension Benefit is that which would be paid annually on retirement at normal retirement age based on service to 3 January 2015 and includes any transferred-in benefits as appropriate. There is no additional pension benefit payable in the event of an Executive's early retirement.
3. Pension scheme members have the option of paying additional voluntary contributions to their respective pension scheme. Neither any contributions paid nor any benefits arising from them are shown in the above table.

Individual notes to Tables 3a and 3b

4. Indicates that this Executive was paid a cash allowance in lieu of pension provision.
5. Rod Bulmer has a restricted pension accrual and was paid a restricted pension allowance. His Defined Benefit Pension at the end of the year includes pension built up in Pace whilst previously employed by The Co-operative Bank (which participates in the Pace scheme).
6. Indicates that this Executive has a restricted pension accrual and was paid a restricted pension allowance.
7. Claire Davies joined the Defined Contribution Pension (Pace Extra) and the balance of her pension benefit after the Group's contribution was paid as a pension allowance.
8. Nick Folland joined the Defined Contribution Pension (Pace Essential) and the balance of his pension benefit after the Group's contribution was paid as a pension allowance.
9. Paula Kerrigan joined the Defined Contribution Pension (Pace Extra) and was provided with an additional pension contribution.
10. Mark Craig joined United Co-operatives on 24 January 1994 and transferred-in benefits built up in other co-operative schemes in respect of service from 4 October 1982 and his years of service are counted from this date. Mark opted out of pension provision from 22 March 2014 and became entitled to an early retirement pension from Pace Complete and a deferred pension from the United Scheme. From 22 March 2014 until he left the Group, he was paid a pension allowance in lieu of pension provision.
11. Martyn Hulme opted out of Pace from 6 April 2012 and became entitled to a deferred pension from Pace when he left the scheme. He was paid a pension allowance in lieu of pension provision. Deferred pensions are revalued under the Pace rules and account has been taken of this in the above table.

What payments have been agreed for former Executives?

Details of the settlement agreements for Executives who have left the Group during 2014 are shown below.

Euan Sutherland	Euan Sutherland was placed on garden leave on 11 March 2014 and his employment terminated on 11 October 2014. His earnings whilst he was an active member of the Executive up to 11 March 2014 are shown in Table 1b. Whilst he was on garden leave up to the date his employment terminated on 11 October 2014, Euan Sutherland was entitled to continue to receive his contractual base salary and benefits. The total amounts for this period were base salary £882,000, benefits £12,000 and pension £141,000. Under the terms of Euan Sutherland's settlement agreement, for the remainder of the notice period after termination of employment on 11 October 2014, the Society was only obliged to pay Euan Sutherland the difference between his base salary and contractual benefits from the Society and the earnings from his new employer. If he had remained on garden leave for his entire notice period he would have been paid a total of £733,000 (comprising base salary, benefits and pension for the period), but instead this overall cost was reduced to £421,000 which will be paid in instalments until 10 March 2015. This mitigated the cost to the Society by £312,000. Euan Sutherland waived his right to a payment of £1.5m under the Retention Programme and his 2013-2015 LTIP award has lapsed, under which he could have received a maximum value of £1.5m.
Gill Barr	Gill Barr's role was made redundant on 4 July 2014. Her earnings whilst she was an active member of the Executive are shown in Table 1b. The terms of her settlement agreement included £383,000 being her contractual entitlement to salary and benefits for her notice period, a payment of £48,000 in accordance with the Group's redundancy policy, a total payment of £314,000 equivalent to the 2014 Retention Programme payment which is payable early 2015, and £20,000 towards career advice.

Remuneration Report continued

Mark Craig	Mark Craig's role was made redundant on 1 April 2014. His earnings whilst he was an active member of the Executive until 1 April 2014 are shown in Table 1b. The terms of his settlement agreement included an amount of £228,000 being his contractual entitlement to salary and benefits for his notice period, a payment of £238,000 based on the Group's redundancy policy and a statutory redundancy payment of £13,000. Mark Craig retains the parts of the 2012-2014 LTIP and 2013-2015 LTIP that relate to the period of time he was in employment and these remain subject to the original performance measures and the original performance periods.
Andy Haywood	Andy Haywood's employment was terminated on 31 May 2014. His earnings whilst he was an active member of the Executive are shown in Table 1b. The terms of his settlement agreement included £425,000 being his contractual entitlement to salary and benefits for his notice period.
Rebecca Skitt	Rebecca Skitt was placed on garden leave on 28 February 2014 and her employment terminated on 1 September 2014. Her earnings whilst she was an active member of the Executive are shown on Table 1b. Whilst she was on garden leave, Rebecca Skitt continued to receive her contractual base salary and benefits totalling base salary of £329,000, benefits £6,000 and pension £54,000. Following the end of the garden leave period, the following payments were made to Rebecca Skitt in accordance with her settlement agreement: • an amount of £385,000 which relates to base salary and contractual benefits for the remaining six months of her notice period. • a payment of £650,000 under the 2014 Retention Programme which is payable in early 2015 (of which £111,000 relates to the time she was an active member of the Executive and is therefore shown in Table 1b). Rebecca Skitt retains one third of the 2013-2015 LTIP award which remains subject to the original perfomance measures and the orginal perfomance period (any payment due under the 2013-2015 LTIP is payable early 2016). The Committee obtained independent legal advice regarding Rebecca Skitt's contractual entitlement.

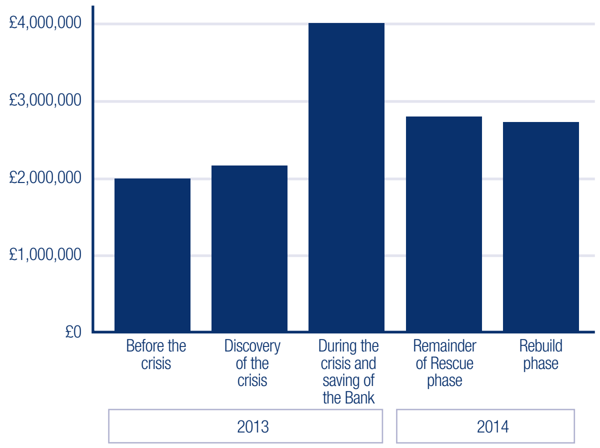
What was the change in remuneration of the CEO and other employees?

Listed companies are required to show the change in remuneration for the CEO and wider employees. As the Group has had three CEOs over the past two years, this disclosure is not considered relevant for 2014. Reviewing the year on year change in remuneration of the CEO will be more relevant going forward.

We have included a table which shows how the annual remuneration package for the Group's CEO has changed over time and has reflected the need to retain individuals in the time of crisis and appoint the right calibre of individual to lead the Group through Rebuild.

The figures in the chart opposite illustrate the total annual packages including base salary, car allowance, healthcare benefit, AIP and LTIP values that would be payable if target performance was achieved. Amounts agreed under the Retention Programme are included where relevant.

Total on-target remuneration for the CEO (annualised)



There is no one single increase that applies to all colleagues across the Group due to the number of collective agreements in place. In 2014 customer facing staff in Food stores received a 2.5% increase; customer facing staff in General Insurance received a 2.2% increase and the majority of remaining staff received a salary increase of 1.2%.

Remuneration Report continued

How much does the Group spend on pay compared with other major items of expenditure?

The chart below illustrates the amount spent on remuneration paid to all employees compared with different elements of expenditure.

	2014	2013
Total wages (including pension and social security costs and excluding Pharmacy employees as this was a discontinued business)	**£1,287m**	£1,367m
Distributions (including payments to individual Members, employee Members and corporate Members)	**£nil** ***Paid in 2014 relating to 2013 profits***	£49m *Paid in 2013 relating to 2012 profits*
Community distribution	**£nil**	£6m

Although no community distribution was paid out of dividend, the Group did make payments to charities and communities during the year and these are discussed on page 23.

Highest to lowest ratio relating to the 2014 financial year

We have carried out an analysis of the CEO's pay as a multiple of the lowest paid (full-time employee) for the Co-operative Group and, for comparison, the median of other large retailers.

We have used the pay figures net of income tax and employee's national insurance (based on 2014/15 rates). Market information for the CEO has been sourced from Report and Accounts and for the lowest paid employees from Incomes Data Services.

We have carried out the analysis on two bases: (i) looking at the target opportunities for the roles; and (ii) looking at the amounts actually paid and awarded in 2014.

- When looking at the total amount payable if target performance is achieved, the CEO's total pay as a multiple of the lowest paid (full time) employee is 110 for the Co-operative Group versus a median of 143 for other large retailers (Co-operative Group 140 versus median of 145 if calculated at the same point last year). Highest total pay for this purpose is based on current salary, target bonus, target value of long term incentives at grant, pension and benefits.
- When looking at the total amount actually paid and awarded in the year, the CEO's total pay for the financial year 2014 as a multiple of the lowest paid (full time) employee was 109 for the Co-operative Group versus a median of 110 for other large retailers (Co-operative Group 106 versus median of 131 for 2013). Highest total pay for this purpose is based on salary and bonus paid in relation to the 2014 financial year, target value of long term incentives awarded, pension and benefits. The Co-operative Group data for 2014 includes pro-rata information for both Euan Sutherland (until the date of stepping down as CEO) and Richard Pennycook (from the date of assuming the role of Interim CEO and then the ongoing role).

How did Members vote on the 2013 Remuneration Report at the last AGM?

In respect of the resolution to approve the 2013 Remuneration Report at the AGM held on 17 May 2014, 62% of votes cast were for the Remuneration Report. 38% of votes cast were against the Remuneration Report. Abstentions were not counted.

An introduction to the non-executive directors

Earlier in the Governance Review pages of this Annual Report, we introduced you to our Board of Directors. This section of the report discusses the different elements of remuneration we pay to attract and retain our non-executive directors. For the purposes of this report, the non-executive directors fall into two groups:

1. Prior to the Transitional Period, the Group Board was made up of elected non-executive directors ('Elected Directors'). Some of the Elected Directors continued to sit on the Transitional Board. This group also includes the Independent Non-Executive Director ('INED – Transitional Board') who was appointed to the Transitional Board for the Transitional Period only.
2. The new Group Chair, Senior Independent Director, Independent Non-Executive Directors and Member Nominated Directors - together referred to as NEDs - who have been/will be appointed to the Board and who will continue to serve on the new Board after the 2015 AGM, subject to their election by Members.

The policy on setting fees for the new NEDs is on page 66. This policy was set by the Transitional Council acting independently through the NED Fees Committee. The Terms of Reference for the NED Fees Committee were agreed between the Transitional Council and this Committee can be found on http://www.co-operative.coop/corporate/investors/governance/.

The previous fee policy will continue to apply to all Elected Directors, including those who are part of the Transitional Board and those who stepped down from 30 September 2014, until the 16 May 2015 AGM unless an individual resigns before this date.

No element of remuneration for NEDs or Elected Directors is subject to performance conditions.

Remuneration Report continued

What do the non-executive directors earn?

This section is split into two parts, the first being the fees that apply to Elected Directors and secondly the fees for the new NEDs.

1. What are the fees for the Elected Directors?

Role	Fees
Group Chair	• The basic fee for the Chair was £120,368 per annum. No additional fees were paid.
Elected Directors	• The basic remuneration for a Group director was £11,574 per annum. • In addition, the members of the Co-operative Food and Specialist Businesses Boards received an additional fee of £11,574 per annum (the Chairs of these Boards received a total of £23,148 per annum which includes their membership fee). • Additional fees for membership of and for chairing other committees varied depending on the duties/committee and range from £1,157 to £5,787 per annum. • An Elected Director sitting on the Co-operative Banking Group Board received an additional fee of £17,361 per annum.
INED – Transitional Board	• The INED on the Transitional Board is Simon Burke who was previously a member of the Co-operative Food Board. His fee arrangements from his role on the Food Board continue during the Transitional Period. This fee is £53,560 per annum.
Pension Trustees	• Additional fees for membership of a Pension Fund Board were £3,472 per annum. • The total fee for chairing a Pension Fund Board was £5,787 per annum.

Only the Group Chair was eligible for a car benefit though this was not taken up by the current Group Chair.

None of the Elected Directors, by virtue of their Board position, participated in any of the Group's incentive plans or pension schemes, nor did they receive performance related payments during the period.

The Elected Directors do not have service contracts but instead receive letters of appointment. The letters of appointment are available for inspection on request.

2. What are the fees agreed for the new NEDs?

The NED Fees Committee approved the fees in the table below at their meeting on 7 November 2014, and took account of:

- appropriate market data provided by New Bridge Street,
- recommendations from the Search Committee,
- the time commitment expected from the incumbents,
- the overarching need to attract the right calibre of person for governance reform and the Rebuild phase of the Group's strategy, and
- the Group's remuneration policy as set by this Committee.

The NED Fees Committee also considered the important role of the Senior Independent Director (SID), which will focus on stakeholder relationships. It is expected that the SID will be a key point of contact for the Senate and the Council as well as the specific responsibilities under the rules for the evaluation of the Group Chair.

These fees will apply to the new NEDs who are appointed to the Transitional Board and who will continue to serve on the new Board after the May 2015 AGM.

Due to the intensive levels of activity required during the Rebuild phase it is envisaged that the new Group Chair and NEDs appointed to the Board will initially have to commit above average time and energy into driving the agenda. Whilst this was considered by the NED Fees Committee, it did not result in increased fees.

Role	Fees
New Group Chair	• The basic fee for the Group Chair is £250,000 per annum. No additional fees are paid. • It is anticipated that the time commitment in respect of the role of the Chair will be around 2 days per week, though might exceed this initially.
New independent non-executive directors ('INEDs')	• The basic fee for an INED is £60,000 per annum. • The following additional fees will apply: ○ SID £15,000 ○ Chair of Risk and Audit Committee £15,000 ○ Chair of Remuneration Committee £15,000. • There is no additional fee for the Chair of Nominations Committee or for being a member of any committee. • It is anticipated that the time commitment will initially be: ○ SID around 1.5-2 days per week or 75-100 days per year. ○ INEDs (including Committee membership), around 2.5 – 3 days per month or 30 -36 days per year. Committee Chairs are expected to spend around 3-4 days per month or a total (including their NED responsibilities) of 36-48 days per year.
New member nominated directors ('MNDs')	• The basic fee for an MND is £60,000 per annum. • The same additional fees for the INEDs apply to MNDs who are members of or chairs of a committee.

The new Group Chair will have access to a pool car and driver for Group business if required. No other benefits will be provided for the Group Chair or any other member of the Group Board.

All NEDs are entitled to reimbursement of all reasonable and properly documented travelling, hotel and other expenses incurred in performing their duties, in accordance with the terms of the Society's expenses policy.

No additional fees will be paid to an Executive who sits on the Group Board.

The NEDs and the Executives' letters of appointment are available for inspection on request.

Remuneration Report continued

How long are non-executive directors and Executives appointed to the new Board for?

Going forward, appointments to the new Board will be for the following periods:

- The Group Chair, INEDs and Executives will be appointed for an initial two year term at which point they will be put forward for re-election. They will retire from office at the second AGM following his/her election/re-election. The Group Board and the Council have the right to agree otherwise in order to avoid a situation where more than half of these roles would be retiring from office at the same AGM.

  A Group Chair or an INED who has been in office for a continuous period of six years or more at the date of an AGM will be required to retire from office and they will not be eligible to put themselves forward for election again.
- An MND may serve a maximum of three terms of two years each, subject to the Member Nominated Director Election Regulations.

What did the Elected Directors earn during the year?

The fees shown in tables 4-5 are rounded to the nearest £1,000 and do not include fees of less than £500.

In the tables the following applies, where relevant:

- Group Board fees include fees for sitting on the Transitional Board.
- Group Audit and Risk Committee fees include fees for sitting on the Transitional Risk and Audit Committee.
- Group Remuneration and Appointments Committee fees include fees for sitting on the Transitional Remuneration Committee.
- There are no additional fees paid for sitting on the Transitional Search Committee.

Table 4a – Members of the Transitional Board at 3 January 2015

	Notes	Year/ date first appointed/ elected to the Group Board	Term expires	2014 Group Board £000	2014 Group Audit & Risk Comm £000	2014 Group Rem & App Comm £000	2014 Other committees and boards (see Table 4b) £000	2014 Benefits £000	2014 Total £000	2013 Total £000
Ursula Lidbetter (Former Chair)	10, 11	2009	2015	120	-	-	-	-	120	51
Marc Bicknell	11	2013	2015	12	3	1	27	-	43	7
Duncan Bowdler	11	2007	2015	12	3	-	24	-	39	43
Simon Burke (INED)	1, 11	14 Nov 2014	2015	7	-	-	45	-	52	-
Eric Calderwood	11	2006	2015	12	-	5	26	-	43	41
Martyn Cheatle	10, 11	2010	2015	12	6	-	12	-	30	29
Michael Harriott	11	2013	2015	12	-	1	25	-	38	18
Sir Christopher Kelly (SID)	2, 11	14 Nov 2014	2017	10	-	-	-	-	10	-
Frank Nelson	3, 11	17 May 2014	2015	7	-	1	16	-	24	-

Remuneration Report continued

Table 4b – Members of the Transitional Board at 3 January 2015 – Breakdown of Other Fees

	Notes	Co-operative Food Holdings Limited Board £000	Co-operative Specialist Businesses Limited Board £000	Co-operative Banking Group Limited and its committees £000	Regional Board and Area Committee £000	Co-operatives UK and Co-operative Press Board £000	Pension Fund Trustee £000	2014 Total of other fees £000
Ursula Lidbetter (Former Chair)		-	-	-	-	-	-	-
Marc Bicknell	4, 5	18	-	-	7	-	2	27
Duncan Bowdler		-	-	17	7	-	-	24
Simon Burke (INED)	1	45	-	-	-	-	-	45
Eric Calderwood	6	12	-	-	7	1	6	26
Martyn Cheatle		12	-	-	-	-	-	12
Michael Harriott	7	-	18	-	7	-	-	25
Sir Christopher Kelly (SID)		-	-	-	-	-	-	-
Frank Nelson	8, 9	6	-	-	7	1	2	16

Notes to Tables 4a and 4b
1. Simon Burke was appointed to the Co-operative Food Holdings Limited Board on 14 January 2014. He stepped down from Co-operative Food Holdings Limited when he was appointed to the Group Board for the Transitional Period with effect from 14 November 2014 as a Transitional Director.
2. Sir Christopher Kelly was appointed to the Group Board as Senior Independent Director on 14 November 2014.
3. Frank Nelson was elected to the Group Board on 17 May 2014.
4. Marc Bicknell was appointed Chair of Co-operative Food Holdings Limited with effect from 11 June 2014.
5. Marc Bicknell was appointed to the Board of Co-operative Group Pension Trustees (Northern) Limited with effect from 12 June 2014 and stepped down from that Board on 1 December 2014.
6. Eric Calderwood stepped down from the Board of Co-operatives UK with effect from 11 June 2014.
7. Michael Harriott was appointed Chair of Co-operative Specialist Business Limited with effect from 11 June 2014.
8. Frank Nelson was appointed to Co-operative Food Holdings Limited with effect from 11 June 2014. He stepped down from the Board of Co-operatives UK with effect from 1 August 2014.
9. Frank Nelson was appointed to the Board of Co-operative Group Pension Trustees (North West) Limited with effect from 12 June 2014 and stepped down from that Board on 1 December 2014.
10. The remuneration of some directors is paid, at their request, direct to their employers who release them to act as directors of the Group.
11. Details of appointments to the Transitional Search Committee, the Transitional Remuneration Committee and the Transitional Risk and Audit Committees (and their former bodies, where relevant) can be found in the respective reports of those committees.

For details of fees paid to Independent Professional Non-Executive Directors on the boards of subsidiary businesses, please see the relevant accounts which are available on request from the Group Secretary.

Remuneration Report continued

Table 5a – Former Elected Directors who resigned during the year

	Notes	Year/ date first elected	Resignation date	2014 Group Board £000	2014 Group Audit & Risk Comm £000	2014 Group Rem & App Comm £000	2014 Group V&P Comm/ Board £000	2014 Other committees and Board (see Table 4b) £000	2014 Benefits £000	2014 Total £000	2013 Total £000
Jenny Barnes	7	2009	30 Sep 2014	12	-	-	1	20	-	33	34
Steven Bayes	1	2009	17 May 2014	4	-	1	-	16	-	21	40
John Brodie	7	2012	30 Sep 2014	12	2	-	-	12	-	26	24
Herbert Daybell	7	2009	30 Sep 2014	12	-	-	1	24	-	37	38
Andrew Donkin	2, 8	17 May 2014	30 Sep 2014	7	-	-	1	14	-	22	-
Patrick Grange	1	2007	17 May 2014	4	1	1	-	19	-	25	44
Bob Harber	2, 7	17 May 2014	30 Sep 2014	7	-	-	1	13	-	21	-
Ray Henderson	7	2009	30 Sep 2014	12	-	-	-	22	-	34	31
Munir Malik	5	2013	13 May 2014	4	-	-	1	11	-	16	19
David Morrow	2, 8	17 May 2014	30 Sep 2014	7	-	-	1	14	-	22	-
Liz Moyle	1	2011	17 May 2014	4	-	1	-	11	-	16	34
David Pownall	8	2007	30 Sep 2014	12	-	-	1	24	-	37	37
Stuart Ramsay	4	2009	29 Apr 2014	4	-	-	1	6	-	11	33
Ben Reid	6	2000	19 May 2014	4	-	-	-	-	-	4	40
David Smith	2, 8	30 May 2014	30 Sep 2014	7	-	-	1	13	-	21	-
Mark Smith	8	2010	30 Sep 2014	12	3	-	-	12	-	27	27
Jenny de Villiers	8	2013	30 Sep 2014	12	-	1	-	20	-	33	19
Lord Myners (INED)	3	2013	17 May 2014	-	-	-	-	-	-	-	-

Remuneration Report continued

Table 5b – Former Elected Directors - Breakdown of Other Fees

	Co-operative Food Holdings Limited Board £000	Co-operative Specialist Businesses Limited Board £000	Co-operative Banking Group Limited and its committees £000	Regional Board and Area Committee £000	Co-operatives UK and Co-operative Press Boards £000	Pension Fund Trustee £000	2014 Total of other fees £000
Jenny Barnes	12	-	-	7	1	-	20
Steven Bayes	-	8	-	7	-	1	16
John Brodie	12	-	-	-	-	-	12
Herbert Daybell	12	-	-	7	-	5	24
Andrew Donkin	-	6	-	8	-	-	14
Patrick Grange	5	-	-	7	-	7	19
Bob Harber	6	-	-	7	-	-	13
Ray Henderson	12	-	-	7	1	2	22
Munir Malik	-	4	-	7	-	-	11
David Morrow	-	6	-	8	-	-	14
Liz Moyle	-	4	-	7	-	-	11
David Pownall	-	12	-	7	2	3	24
Stuart Ramsay	-	4	-	2	-	-	6
Ben Reid	-	-	-	-	-	-	-
David Smith	-	6	-	7	-	-	13
Mark Smith	-	12	-	-	-	-	12
Jenny de Villiers	-	12	-	7	1	-	20
Lord Myners (INED)	-	-	-	-	-	-	-

Notes to Tables 5a and 5b:

1. Steven Bayes, Patrick Grange and Liz Moyle stood down from the Board at the conclusion of the 2014 AGM.
2. Andrew Donkin, Bob Harber and David Morrow were elected to sit on the Group Board with effect from 17 May 2014, and David Smith was elected to sit on the Group Board with effect from 30 May 2014.
3. Lord Myners stood down from the Board at the conclusion of the 2014 AGM. He had agreed to serve for a nominal fee of £1 per annum. He did not sit on any other Boards or Committees or associated entities.
4. Stuart Ramsay stood down from the Board on 29 April 2014.
5. Munir Malik stood down from the Board on 13 May 2014.
6. Ben Reid stood down from the Board on 19 May 2014.
7. The director stood down from the Group Board and the Board of Co-operative Food Holdings Limited with effect from 30 September 2014 to join the Senate of the Council.
8. The director stood down from the Group Board and the Board of Co-operative Specialist Business Limited with effect from 30 September 2014 to join the Senate of the Council.

Report of the Transitional Search Committee

The Committee was established on 30 September 2014 under the Transitional Provisions with a limited remit to oversee and co-ordinate the appointment of Independent Non-Executive Directors to the new Board. Following the Annual General Meeting 2015, the Rules provide that the Transitional Search Committee will be replaced by a Nominations Committee with wider powers.

The Transitional Search Committee oversees the search and selection process for prospective board directors, conducts due diligence and makes recommendations to the Board regarding suitable candidates. To ensure that all views and perspectives are taken into account, the Transitional Rules provide that:

- by virtue of his/her office, the President of the Council is a member of the Committee; and
- any recommendation made by the Committee to the Board regarding the appointment of a director must be unanimous.

Committee Composition

Membership of the Committee is set out below.

Member	Date of Appointment	Attended	Held
Ursula Lidbetter (Chair)	30 September 2014	3	3
Marc Bicknell	30 September 2014	2	3
Duncan Bowdler	30 September 2014	3	3
Simon Burke	14 November 2014	1	1
Eric Calderwood	30 September 2014	2	3
Martyn Cheatle	30 September 2014	1	3
Michael Harriott	30 September 2014	3	3
Sir Christopher Kelly	14 November 2014	1	1
Frank Nelson	30 September 2014	3	3
Lesley Reznicek (President of the Council)[1]	6 December 2014	-	1

1 Lesley Reznicek was appointed President at the Council meeting held on 6 December 2014 which was too short notice for her attendance at the Committee meeting scheduled for 9 December 2014. Prior to the appointment of the President, Jenny de Villiers (Senate member) attended as an observer at two of the three meetings.

The Committee has been supported by professional search firm, Odgers Berndtson, in its search for a new Chair and Independent Non-Executive Directors. The Committee also engaged the services of Peter Jackson, an independent adviser with substantial Board experience, to assist in the interview and selection process of the Chair.

Transitional Search Committee activities

During the period the Committee has overseen a robust interview and due diligence process leading to recommendations in respect of the following appointments:

- November 2014 – Simon Burke appointed as Independent Non-Executive Director on the Transitional Board and Sir Christopher Kelly appointed Senior Independent Director on the new Board
- February 2015 – Allan Leighton appointed Independent Group Chair.

In addition, the Committee has undertaken the following activities:

- conducted a competitive process resulting in the appointment of Odgers Berndtson as its professional advisers to support the recruitment of the new independent Board members;
- approved the proposed approach to assessment of skills and competency including Co-operative Values and Principles, for new Board members
- prepared proposals based on benchmarking data, to the Non-Executive Directors' Fees Committee, a Committee of the Council, in respect of the fees to be paid to the new Board;
- approved the due diligence checks to be completed in respect of all prospective appointments, including additional enquiries in respect of individual candidates as applicable;
- drafted and agreed individual role specifications for each of the independent Board positions;
- reviewed long lists and selection of short lists of candidates for each of the roles being recruited; and
- prepared reports for the Scrutiny Committee, a Committee of the Council, to enable the Committee to scrutinise the appropriateness of the appointment process.

Other Statutory Disclosures

Results and distributions

The profit before taxation was £124m (2013: loss of £310m). The directors do not recommend a final dividend. The Group Board determined not to pay an interim dividend in 2014.

Going concern

The financial statements are prepared on a going concern basis as the directors have a reasonable expectation that the Society and the Group has access to adequate resources to enable it to continue in operational existence for the foreseeable future.

In assessing the appropriateness of the going concern basis of preparation, the directors have firstly considered the going concern position and outlook of the Trading Group, and the Co-operative Banking Group (which includes the General Insurance business) separately, as they are independently funded. The directors have then, taking these individual assessments into account, considered the overall going concern position of the Group.

In making their assessment, the directors have considered a wide range of information relating to present and future conditions, including future forecasts of profitability, cash flow and covenant compliance, and available capital resources.

Further information relevant to the directors' assessment is provided within the basis of preparation section of the financial statements (page 100).

Post balance sheet events

There have been no material post balance sheet events.

Corporate governance report

The corporate governance report is contained on page 34. This includes the appointment and retirement of directors, directors' conflicts of interest and directors' indemnities.

Employees and employment of disabled persons

Information on the Group's approach to the employment, development and engagement of colleagues can be found in the Our People section on page 21.

Corporate responsibility and the environment

The Sustainability Review can be found on page 23. This section also describes how the Group manages its social, ethical and environmental impact and includes the disclosure of greenhouse gas emissions.

Political donations

Like many other businesses of a comparable size, the Group undertakes an engagement programme with a wide range of political opinion formers and decision-makers, designed to protect, promote and enhance the Group's corporate reputation. During the course of 2014, much of this activity has inevitably focused on 'protection', with significant engagement about key business issues, particularly in Whitehall and Westminster. In addition, on issues of sectoral relevance, the Group is an active participant in the work of business trade associations.

Quite separately to this corporate activity, the Group is a member of The Co-operative Party, which was created in 1917 by the UK co-operative movement in order to promote its values and principles. The Co-operative Party works to raise awareness of the benefits of co-operative and mutual models.

A motion was approved by Members at the Half Yearly Meeting on 9 November 2013 to permit political expenditure, including donations to political parties, up to a maximum ceiling of £1m for 2014. During the course of 2014, two donations were made by the Group to The Co-operative Party; the first to cover 2014 was £625,600 (2013: £810,000) and the second of £374,200 to cover the first half of 2015. The Co-operative Party reports donations to the Electoral Commission in accordance with its reporting obligations as a registered political party under the Political Parties, Elections and Referendums Act 2000. In addition, use of a meeting room by a local Labour Party branch represented a small 'in kind' donation.

A motion will be tabled at the forthcoming 2015 Annual General Meeting regarding future political donations and expenditure.

Compliance with Grocery Supplier Code of Practice ('the Code')

The Code was introduced on 4 February 2010 following a Competition Commission investigation of the market for the supply of groceries in the UK. The Code applies to all grocery retailers with a turnover greater than £1bn and aims to address a number of findings of the investigation by placing those retailers under specific obligations regarding their supplier relationships, including a requirement to deliver an annual compliance report (of which this is a summary) to the Office of Fair Trading.

We expect to work purposefully and collaboratively with our suppliers in the long term interests of our customers and Members, and believe this approach has served us well in the past and will continue to do so in the future. Naturally, we take our responsibilities under the Code seriously.

Other Statutory Disclosures continued

Consequently, a significant investment has continued to be made in robust compliance processes and systems. This includes work commissioned by our appointed Code Compliance Officer, a sample of compliance reviews undertaken by Group Risk Services, a comprehensive training programme for all employees involved in dealings with our suppliers, an online supplier portal, and the provision of an annual report to the Group's Risk and Audit Committee to ensure that the Committee retains effective oversight of Code compliance generally.

A modest number of alleged breaches of the Code have been asserted by suppliers, but all have been found, on examination, not to breach the provisions of the Code. Engagement with the Grocery Suppliers Code of Practice Adjudicator has been ongoing since her appointment in 2013 and a quarterly meeting is held to discuss any issues and to share best practice.

Statement of Co-operative Group Board responsibilities in respect of the Annual Report and financial statements

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

Co-operative and Community Benefit Society 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 International Financial Reporting Standards as adopted by the EU (IFRSs as adopted by the EU).

The Group financial statements are required by law to give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period.

In preparing the Group financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the Society and enable them to ensure that its financial statements comply with the Co-operative and Community Benefit Societies Act 2014. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and the Society and to prevent and detect fraud and other irregularities.

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

Financial statements

So far as the directors are aware, there is no relevant information that has not been disclosed to the Group's auditor, and the directors believe that all steps have been taken that ought to have been taken to make them aware of any relevant audit information and to establish that the Group's auditor has been made aware of that information.

Auditors

As recommended by the Transitional Risk and Audit Committee, a resolution to appoint KPMG LLP as auditor of the Group and to authorise the directors to fix their remuneration will be proposed at the 2015 Annual General Meeting.

By Order of the Board

Claire Davies, Group Secretary

8 April 2015

Council's Annual Statement

The Co-operative Group's new constitutional model took effect upon the registration of the new Rule Book, which was adopted at a Special General Meeting on 30 August 2014.

The creation of the Members' Council – as one of the three pillars of the Group's constitution (along with the Board and the Group's membership) – brought a significant change to the Group's governance. Those Members (who meet the required eligibility criteria) can play an extremely important role in the Group's democracy by standing for election to the Members' Council or, for the first time, standing for direct election to the Group Board as a Member Nominated Director.

The Members' Council's roles and responsibilities can be summarised as '.. a structure that gives Members appropriate powers to hold the Board properly to account for the performance of the business and adherence to co-operative values and principles', which is outlined in detail in the new Rule Book:

- to act as the guardian of the Society's Purpose, the Values and Principles and the constitution (the Guardian Role)
- to hold the Board to account and influence strategic and operational initiatives (the Holding to Account role)
- to act as a consultative body and a body for making representations on behalf of the constituencies represented on the Council (the Consultation and Representation Role)
- to approve matters reserved by the Rules for approval by the Council (the Approvals Role)
- to make decisions on those matters reserved to the Council by the Rules (the Decisions Role).

In the interim, a Transitional Members' Council was created until the election of a new Members' Council which will take up office following the Group Annual General Meeting (AGM) in May 2015. The Transitional Council comprises members of the Group who were not members of the Transitional Group Board, members of the seven Regional Boards, the Chairs of the seven Regional Values and Principles Committees and a small number of representatives from Independent Co-operative Societies. Regional Boards continued to operate in parallel to the Transitional Council until 31 December 2014.

The Transitional Council met in November and December 2014 (and also had two meetings by teleconference) and conducted a range of business, in order to meet the deadlines of having the new Council formed and fully operational from May 2015. Three further meetings of the full Council will take place prior to the Group AGM in May 2015, after which it's envisaged that the Council will meet quarterly, with members fulfilling other duties between meetings.

President and Vice-Presidents

Bob Harber, Transitional Council member, was appointed Interim Chair of the Council and Senate. At the December Council meeting, elections took place in which Council members elected Lesley Reznicek as President and three Vice-Presidents: Tricia Davies, Jenny de Villiers and Robin Stewart. The President and Vice-Presidents will hold office until further elections are held after the new Council is formed in May 2015.

The President and Vice-Presidents have regular meetings with the Board and Group Chief Executive on a range of business matters, including future information exchange between the Board and Council, the interaction between the Council and the Board and Executive, resourcing of the Council and a range of other matters. Regular dialogue will continue into 2015, to ensure that the Council has the information and resources to enable it to fulfil its role on behalf of the Group's Members: to establish new ways of working to enable the Council to fulfil its role of holding the Board to account

Transitional Senate

The new Rules provide for the establishment of a Senate, elected by and from the Council. The Senate's prime role is to help co-ordinate the activities of the Council and to serve as a nexus for interactions between the Council, the Board, the Executive and Members.

Pending the election of a new Senate, the Transitional Senate comprises of the former Regional Board Chairs, former Group Board members and representatives from Independent Co-operative Societies and the elected President.

Council Committees

The Council has two standing committees which each have an important role in the Group's governance:

- The Non-Executive Directors' Fees Committee, whose role is to determine the fees payable to the Group Chair and other members of the Group Board.
- The Scrutiny Committee, whose role is to verify the screening process for the Group Chair, Independent Non-Executive Directors and Member-Nominated Directors after their appointment. It also scrutinises the decisions made by the Transitional Search Committee in respect of Group Chair and Independent Non-Executive Director candidates.

Members of the Council were elected to sit on these until further elections are held following the Group AGM in May 2015.

In addition, working groups have been established in order to focus on specific areas of work, including proposed amendments to the Group's Rules at the 2015 AGM and a group focusing on social responsibility issues.

Council's Annual Statement continued

The Group's 2014 Annual Report incorporates a summarised report on progress on the Group's ethical and sustainability targets. A separate Sustainability Report will not be produced in 2015. The Council will be advocating fully integrated reporting by the Group in future years as part of its role in holding the Board to account for the Group's sustainability performance.

Project workstreams

In addition to the Council committees and the working groups referred to above, eight project workstreams were created – each comprising Council members from across the UK, together with a number of representatives from Independent Co-operative Societies. These have focused on the Council and Member Nominated Director elections, the information required by the Council in order to fulfil its role and Council communications. The workstreams have been reporting back to the full Council in order that decisions could be made and acted upon. The workstreams' roles will continue into spring 2015.

Key activities to date

Although the Council only came into existence in the autumn of 2014, a considerable amount has been achieved. In addition to the extensive work of the workstreams, highlights have included the Council's input to the development of the Board Composition Charter, which is a key element of the new constitution, and working with area committees to develop sub-national structures and local membership activity.

The Council has also engaged in a range of 'business as usual' activities, such as discussions with Executive management regarding the Group's strategic priorities and the future focus on 'meaningful membership'. It is envisaged that holding the Board to account on such matters will be a major focus for each meeting once the Council set-up has been completed.

Group AGM

The Council has also engaged in discussions about the arrangements for the introduction of One Member One Vote. In future, all Members who meet a modest trading requirement will have the opportunity to vote in the election of Member Nominated Directors and Council members, as well as voting on the business of the Group AGM and attending in person, should they wish to do so.

This significant change in the Group's governance arrangements presents an excellent opportunity for Members to help make The Co-operative a business of which all Members and other stakeholders can be proud.

Another area of activity which has been a particular source of attention in recent months is Member communications, including the development of 'Let's Talk'. Since its introduction in mid-2014, Let's Talk has gone from strength to strength, enabling Members to engage in online conversation with the Group. After inviting input into the development of new Social Goals themes and promoting the Half-Yearly Members' Meetings, the Group's businesses are now using the platform to hold discussion with Members on subjects such as how Co-operative Insurance can contribute to the community, ideas for Fairtrade Fortnight 2015 and a debate on wills. The President also used Let's Talk as a mechanism to hear from Members about their views and aspirations for the new Council.

If the Council is to effectively represent the Group's Members, Council members clearly need to be aware of Members' views. Member engagement will continue to be a key area of attention for the Council in the coming months, consistent with the Group's commitment to 'meaningful membership' as central to its strategic priorities.

Copies of the various Regulations, Terms of Reference of Council Committees and other information relating to the Council or Transitional Council can be provided on request to karen.froggatt@co-operative.coop.

Independent Auditor's Report to the Members of Co-operative Group Limited Only

Opinions and conclusions arising from our audit

1. Our opinion on the Group financial statements is unmodified

We have audited the Group financial statements of the Co-operative Group Limited ('the Society' or 'the Group') for the period ended 3 January 2015 set out on pages 92 to 197.

In our opinion the Group financial statements:

- give a true and fair view, in accordance with International Financial Reporting Standards as adopted by the EU, of the Group's affairs as at 3 January 2015 and of the income and expenditure of the Group for the period then ended; and
- comply with the requirements of the Co-operative and Community Benefit Societies Act 2014.

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement that had the greatest effect on our audit were as follows:

Going concern

Refer to page 54 (Report of the Transitional Risk and Audit Committee) and page 100 (accounting policy).

The risk:

The Group's financial statements are prepared on a going concern basis: the directors have explained in the General Accounting Policies on page 100 of the financial statements how, after consideration of the factors set out, and after making all appropriate enquiries, they have a reasonable expectation that this is appropriate.

The Group has a high level of external borrowings which require ongoing compliance with certain financial and other covenants. In addition the Group's insurance business, CIS General Insurance Limited (CISGIL), which is separately funded from the rest of the Group's trading activities ('the Trading Group'), is required to comply with a number of regulatory capital requirements set by the Prudential Regulation Authority (PRA). The Group has strategies in place to ensure it meets its financial covenants, and regulatory capital requirements.

The ability of the Group, including both CISGIL and the Co-operative Banking Group (CBG), the holding company that owns the Group's investment in The Co-operative Bank plc which is also separately funded from the Trading Group, to remain within their borrowing facilities and to meet their financial covenants and regulatory requirements, is one of the key judgemental areas on which our audit is concentrated. The directors' assessment of this ability is based on forecast trading performance and cash flows for the period under review, and consideration of potential risks to those forecasts. Such risks include uncertainties in relation to future trading performance, in particular in respect of growth targets for the Food business, the amount of forecast capital expenditure, the success of central cost saving initiatives and the timing of expected cash flows (including for CBG and CISGIL in relation to separation costs and transformation costs respectively). The directors have concluded that the range of possible outcomes in relation to these risks is not sufficient to give rise to a material uncertainty regarding the Group's ability to continue as a going concern. As this assessment involves consideration of future events, there is a risk that the judgement is inappropriate and the uncertainty should have been assessed as material, in which case additional disclosures would have been required.

Our response:

Our audit procedures are driven by the nature of funding within each part of the Group, and included:

In relation to the Trading Group, we held detailed discussions with the Head of Group Planning and Reporting, and senior members of the Group Finance management team, to fully evaluate the funding position. We obtained external confirmations of the Group's banking agreements and covenant requirements and we assessed the Group's forecast funding requirements under these agreements, together with their compliance with covenants both during the year ended 3 January 2015 and forecast for the periods ending 2 January 2016 and 2 July 2016. We critically assessed the cash flow forecasts on which these forecast funding requirements were based, and we evaluated the key assumptions within the forecasts, including relevant growth rates, cost inflation, expected disposals, timing of cash flows, capital expenditure and central cost initiatives. We considered these assumptions with reference to our knowledge of the Group and experience of the wider economic market in which it operates, and we challenged the Group's sensitivity analysis to assess the impact of changes in these assumptions on the available headroom for the Group's forecast funding requirements and covenant compliance.

In relation to CBG, we considered, by reference to external information, the forecast timing of cash flows in relation to separation commitments, and critically assessed the likelihood of CBG meeting those commitments from its available resources.

In relation to CISGIL, we assessed the regulatory capital position of the business in the context of both the regulatory requirements and CISGIL's latest strategic plan, by testing the underlying information used in the model. This testing involved an assessment of the forecasts used in the plan versus actual results, and stress testing and challenge of the key assumptions within the model by reference to our understanding of the business and its key risks and sensitivities. We subsequently evaluated the impact of changes in key assumptions in these risk areas on the regulatory position. We considered the likelihood of success of the planned capital raising within the going concern assessment period and the impact of the expected outcome on the regulatory requirements using our understanding of the business and the wider market.

Independent Auditor's Report to the Members of Co-operative Group Limited Only continued

We also assessed whether the disclosures provided in respect of the Group's assessment of the going concern position, and the impact of changes in assumptions on the Group's funding and regulatory position, appropriately reflected the related uncertainties and judgements.

Classification and carrying value of the Group's investment in The Co-operative Bank plc (£224m) ('the Bank')

Refer to page 54 (Report of the Transitional Risk and Audit Committee) and note 13 (accounting policy and financial disclosures).

The risk:

Following the disposal of a significant proportion of the Group's investment in The Co-operative Bank plc in December 2013, the Group initially recorded its remaining investment (of 30% of the share capital of the Bank) at fair value and classified the investment as an associate. On 30 May 2014, the Bank completed a rights issue to secure additional funding. The Group did not take up its full rights under the Bank's offer, and as a result its shareholding in the Bank reduced, from 30.0% to 20.2%, and the Group's Board representation reduced from two directors to one director. The Bank continues to be accounted for as an associate following the dilution in the shareholding.

The classification of the investment in the Bank as an associate or financial investment is based on whether the Group is determined to have significant influence over the Bank, which, following the dilution of the Group's shareholding to 20.2%, involves judgement. Inappropriate classification, either on initial recognition or when circumstances change, would have a material effect on the financial statements.

The Group's investment in the Bank was initially recorded using a provisional estimate of the Group's share of the fair value of the Bank's net assets and liabilities at the date of recognition. That provisional estimate was finalised during the year ended 3 January 2015.

As the Group's investment in the Bank was initially recorded at fair value, which involved an estimation of the fair value of the Bank's assets and liabilities, in particular the fair value of loan assets which are measured at amortised cost in the financial statements of the Bank, the Group's share of the Bank's operating result for each period must be adjusted from the result as recorded in the Bank's own financial statements, to reflect the effect of the fair value exercise.

For loan assets, the estimation of the appropriate fair value adjustments, and the unwind of these adjustments in each period, is complex, owing to the number of individual loans and the judgement required in respect of the expected performance of those loans and/or their settlement. These adjustments are particularly significant to the Group's reported share of the Bank's result for the period.

In addition, on 16 December 2014 the Bank announced that it had failed a stress test required by the Bank of England, which acted as a trigger for the Group to perform an impairment test on the carrying value of its investment in the Bank. There is subjectivity in determining the recoverable amount of the Bank, which is material to the Group.

Our response:

Our procedures in this area included the following:

We evaluated the appropriateness, in line with relevant accounting standards, of the Group's classification of its investment in the Bank as an associate, by reading the shareholder agreements to assess the nature and level of influence that the Group exercises over the Bank. In making our assessment, we considered the reduction in the Group's percentage shareholding in the Bank following the rights issue undertaken by the Bank during the year, and the level of Board representation held.

In respect of the finalisation of the fair value of the initial investment in the Bank, we assessed the fair value of individual assets and liabilities, by reference to the audited information included in the Bank's Annual Report.

In respect of the unwind of the fair value adjustments during the year, we used our Financial Services specialists to assist us in critically assessing the Group's calculation of the movements in fair value adjustments, and the assumptions impacting the unwind of those adjustments. With respect to the fair value of loans and advances to customers, we challenged the Group on their assumptions in respect of the lives of assets and liabilities, by reference to their expected maturity, based on underlying information provided by the Bank and information included in the Bank's Annual Report.

We held detailed discussions with senior members of the Group Finance management team, to critically assess their assessment of the recoverable amount of the Bank and challenged the Group's impairment assessment. Our valuation specialists assisted us in critically evaluating the valuation methodologies used by the Group and the key assumptions underlying each method, including the Group's share of the net assets of the Bank, recent Bank share trades on the grey market, a multiple analysis based on price to book ratio and a discounted cash flow method. This included assessing the appropriate multiple, relevant growth rates, timing of cash flows and the performance of the Bank against its forecast strategy. We considered these assumptions with reference to our knowledge of the Bank and experience of the wider economic market in which it operates.

We also assessed whether the Group's disclosures in respect of its share of the Bank's result and the carrying value of its investment in the Bank properly reflected the methodology applied. We considered whether the Group's disclosures about the recoverable amount, and the impact of changes in key assumptions, properly reflected the risks inherent in the determination of the recoverable amount.

Independent Auditor's Report to the Members of Co-operative Group Limited Only continued

Recoverable amount of goodwill (£925m) and property, plant and equipment (£1,998m)

Refer to page 54 (Report of the Transitional Risk and Audit Committee) and notes 10 and 11 (accounting policies and financial disclosures).

The risk:

The Group's balance sheet includes significant goodwill and property, plant and equipment balances, principally in relation to its Food store estate. The directors have assessed the carrying value of goodwill, and of property, plant and equipment for which there are impairment indicators, for potential impairment. Market conditions within the grocery industry, and the current trading performance of the Group, mean that the Group's forecasts of future performance, which are used to derive a value in use for the assets are inherently uncertain. As a result, this is one of the key judgemental areas on which our audit is concentrated.

Our response:

Our audit procedures included testing of the Group's budgeting procedures upon which the forecasts are based, and the principles and integrity of the Group's discounted cash flow model, including consideration of the accuracy of previous forecasts. We evaluated the Group's key assumptions within the cash flow forecasts used as a basis for determining value in use, such as specific projected growth rates for each Food store location, cost inflation and discount rate. Our evaluation included comparing the growth rates used to a composite regional rate from externally available data and sensitising key inputs to the model to determine the likely impact on the impairment calculation. We critically evaluated the discount rates used to discount the forecast cash flows by comparing the rates used to market data, and we performed our own sensitivity analysis of the impact on the impairment charge to changes in the rate used. We also critically evaluated any changes in the assumptions used to assess the level of impairment compared to previous years to ensure that changes were appropriate and supportable.

We assessed whether the Group's disclosures in respect of the approach adopted for its impairment assessment properly reflected the methodology used. We also considered whether the Group's disclosures about the key assumptions and sensitivities within the impairment calculation, and its assessment of the impact of changes in key assumptions, properly reflected the risks inherent in the determination of the recoverable amount.

Provisions (£521m)

Refer to page 54 (Report of the Transitional Risk and Audit Committee), and note 26 (accounting policy and financial disclosures).

The risk:

The Group has recorded a number of provisions for anticipated expenditure, including in relation to uninsured claims, onerous lease commitments, restructuring and integration activities, litigation exposures and regulatory/other cost commitments (principally related to the costs arising from the separation of the Bank and the Group's former Life and Savings business).

Determining the completeness of, and expected cash flows in relation to, the Group's potential liabilities in these areas requires the application of assumptions, including in respect of the value and timing of expected cash flows in each area and the rates used to discount future cash flows to account for the time value of money. As such, and due to the significant value of provisions held, both individually and in aggregate, this is one of the most significant issues on which our audit is focused.

Our response:

Our procedures included specific testing dependent on the nature and size of each potential liability and our assessment of the risk of misstatement. In each area tested we assessed the key assumptions adopted in respect of the expected cash flows underlying each provision, through critically evaluating the estimates and forecasts prepared by the directors. Our evaluation included a comparison of the estimates made by the directors with available internal and external data, including with the assistance of relevant internal real estate, actuarial and valuation specialists where appropriate. We compared the assumptions with the Group's current circumstances and the directors' expectations going forward, and challenged the directors on the specific assumptions made in relation to elements of each provision, based on our knowledge and expectations in respect of each provision and experience of the impact of the wider economic market.

We critically evaluated the discount rates used to discount forecast cash flows associated with the provisions by comparing the specific rates used for each provision to market data relevant to that liability, and we performed our own sensitivity analysis of the impact on the provision to changes in the rates used.

We evaluated the adequacy of the Group's disclosures in respect of provisions in accordance with relevant accounting standards.

Insurance contract liabilities (£738m)

Refer to page 55 (Report of the Transitional Risk and Audit Committee), and note 22 (accounting policy and financial disclosures).

The risk:

The Group's balance sheet includes significant insurance liabilities in relation to CISGIL. These liabilities relate to the estimated cost of settling insurance claims incurred but unpaid at the balance sheet date, whether reported or not. Provisioning for insurance claims is a judgemental and complex area due to the inherent uncertainty involved in estimating claims not yet reported, the future costs of settling claims, the application of appropriate discount rates and whether customers will be awarded a lump sum claim or a periodic payment order. The directors set the insurance liabilities at a level which they consider includes an appropriate margin over the actuarial best estimate, in order to take account of current uncertainties in relation to factors that may influence the value of reserves. The appropriateness of this margin is also subjective.

Independent Auditor's Report to the Members of Co-operative Group Limited Only continued

Our response:

Our procedures included testing the overall governance and key controls in place in respect of the reserving process, including controls over the setting of reserves for reported claims and over the completeness and accuracy of data used to perform the actuarial projections used to set the reserve for claims incurred but not reported.

We evaluated the competence, capability and objectivity of the actuarial team employed by the Group, based on discussions with them, our experience with their previous work, our knowledge of the actuaries' qualifications and the professional standards that their work is subject to, and by providing challenge to their analysis through the procedures described below.

Through observation, enquiry and through following transactions through the reserving process, we obtained an understanding of the reserving methodology and the key assumptions used (including the propensity for claims to become periodic payment orders and past experience used in calculating large loss reserves), and we critically assessed these for appropriateness, and for consistency with prior periods. We considered the movement in reserves relating to claims incurred in prior years to assess the appropriateness of the Group's past assumptions and the methodology used to estimate claims outstanding. Where there were changes in the methodology or key assumptions, we challenged whether these are reasonable based on our knowledge of changes in the industry and on the Group's historical claims experience, and considered whether all the changes we would expect to see have been made. In addition, with the assistance of our internal actuarial specialists, we benchmarked the methodology applied, key assumptions and projected results (such as the ultimate loss ratios) used in determining the provisions against our knowledge of the insurance sector.

In respect of the margin held above the actuarial best estimate, we assessed the rationale for this margin, including consideration of consistency of the basis for the margin applied to the actuarial estimate year-on-year. This included an assessment of the potential uncertainties that have been reserved for within the margin.

We also considered the adequacy of the Group's disclosures about the degree of estimation and sensitivity of recognised amounts to changes in assumptions.

Valuation of, and accounting for, the Group's largest post-retirement defined benefit pension scheme, Pace (Pension assets at 3 January 2015 of £9,154m, liabilities of £8,025m and a net accounting surplus of £1,129m)

Refer to page 54 (Report of the Transitional Risk and Audit Committee), and note 16 (accounting policy and financial disclosures).

The risk:

The Group has eleven post-retirement defined benefit pension schemes, which are each subject to separate valuation for accounting purposes at the year end. The Pace scheme is the most significant of the Group's schemes, which is recognised as an asset. Significant estimates are made in valuing the scheme's liabilities and small changes in assumptions and estimates used to value those liabilities could have a significant effect on the results and financial position of the Group.

Following the Group's disposal of its majority shareholding in The Co-operative Bank plc in December 2013, the Pace scheme is required to be accounted for as a multi-employer scheme. This requires an assessment to be made of whether sufficient information exists to be able to determine the Group's proportionate share of the defined benefit obligation, plan assets and costs associated with the scheme and, if so, what that share is. Changes in the assessment of the Group's share, which is complex and subject to interpretation, and of the potential impact on the Group and other scheme employers of any asset ceiling restrictions, would have a significant impact on the Group's reported financial position.

Our response:

Our audit procedures included the following:

In respect of the valuation of the Pace scheme they included testing the controls over the maintenance of the scheme's membership data, as well as sample testing from that source data to the source documentation, establishing the obligation to members, and vice versa. With the support of our own actuarial specialists, we then challenged the key assumptions applied to that data in determining the scheme's liabilities, being the discount rate, inflation rate and mortality/life expectancy. This included a comparison of these key assumptions against externally derived data.

We evaluated the appropriateness of the Group's recognition of the Pace scheme surplus as an asset by reading the respective scheme documentation to assess the Group's sole right to refund of that surplus at the end of the scheme's life.

In relation to the basis of accounting as a multi-employer scheme, we determined and formed our own view as to the appropriateness of the Group's assessment of its proportionate share of the scheme obligations, assets and costs, by evaluating the underlying agreements between the Group and the scheme trustees, and the Group and the Bank, and by critical assessment of the underlying data available to support the valuation of the scheme obligations, assets and costs. We then evaluated the appropriateness of the Group's recognition of both its and the Bank's share of the scheme surplus, following adjustment to reflect the impact of the asset ceiling adjustment.

We also considered the adequacy of the Group's disclosures in respect of the Pace scheme, and in particular the disclosures in respect of the sensitivity of the surplus to each of the key assumptions.

Independent Auditor's Report to the Members of Co-operative Group Limited Only continued

Inventory (£434m)

Refer to page 55 (Report of the Transitional Risk and Audit Committee), and note 18 (accounting policy and financial disclosures).

The risk:

The Group holds a significant level of inventory at the year end, principally in the Food business, which is held at both distribution warehouses and within the large number of individual retail stores. Since the Group has a system of continuous inventory records, tested by cyclical counts of physical inventory throughout the year, rather than inventory counts at all locations on the year end date, the determination of the quantity of inventory held at the year end involves judgement, including in relation to the estimation of the level of inventory leakage and wastage arising since the date of the previous cyclical count.

Judgement is exercised also in assessing the carrying value of inventory at the year end at the lower of cost and net realisable value. The carrying value of inventory held in the stores is based on estimates of gross margin applied to the retail price of inventory held in each location and across different product categories. The cost of warehouse stock is based on weighted average cost.

Our response:

Our audit procedures included the following:

In relation to the quantity of inventory held, they included testing the design and effectiveness of the Group's controls over inventory counts. This included the upload of count results to the general ledger, which is the basis of the Group's internal data on its past experience of leakage and wastage. We attended a number of counts carried out during the year at both individual stores and distribution warehouses, and compared the year end leakage and wastage results to historical results, to assess the reasonableness of the year end adjustments.

In relation to the carrying value of inventory, in critically assessing the level of adjustment required to record the value of inventory held in retail stores at the lower of cost and net realisable value, we evaluated the process for calculating the cost of inventory and challenged the accuracy of the calculations made to adjust the retail price of inventory for the estimate of gross margin. We agreed a sample of the data used within this calculation back to underlying stock reports. In addition, we evaluated the design and implementation, and tested the operating effectiveness of, the automated calculation of weighted average cost of warehouse stock by the IT system.

We also evaluated the adequacy of the Group's disclosures in respect of inventory in accordance with relevant accounting standards.

Supplier income (£612m)

Refer to page 54 (Report of the Transitional Risk and Audit Committee) and note 3 (accounting policy).

The risk:

The Group receives significant amounts of supplier incentives, rebates and discounts (collectively referred to as Supplier income), which are recognised as a deduction from operating expenses. There are a large number of agreements with different suppliers and the terms of each agreement vary, and can be complex. Interpreting these contractual arrangements involves making judgements about the extent to which the Group has met certain performance conditions, which often span the end of the reporting period, resulting in a risk surrounding the appropriate recognition of Supplier income in the correct period. The process for calculating and recording Supplier income often involves manual processes, which are more susceptible to error.

Our response:

Our audit procedures included testing the design and operating effectiveness of controls put in place by the Group to ensure that Supplier income is calculated correctly and recognised in the appropriate period; corroborating the Group's assertion that performance conditions had been met by, on a statistical sample of contracts, recalculating the amount of Supplier income by reference to the terms and conditions of the related Supplier income agreement; agreeing accrued Supplier income to subsequent invoicing and cash receipts; inspecting post year end credit notes for evidence of amounts being refunded; and comparing income trends by period, product category and supplier to historical data, adjusted for the current trading performance of the Group.

We evaluated the adequacy of the Group's disclosures in respect of supplier income in accordance with relevant accounting standards.

Accounting for, and disclosure of, business disposals (Profit on disposal of businesses included in both continuing and discontinued profit: £256m)

Refer to page 54 (Report of the Transitional Risk and Audit Committee) and notes 3 and 9 (accounting policies and financial disclosures)

The risk:

The Group disposed of its Pharmacy, Farms and Sunwin Services businesses during the year. The measurement of consideration at fair value, including recognition and valuation of contingent or deferred proceeds, the appropriateness of accounting for, and valuation of, linked contracts and therefore the calculation of the profit arising on disposal, can be complex and is dependent on the individual terms set out within the respective sale and purchase agreements.

Independent Auditor's Report to the Members of Co-operative Group Limited Only continued

In addition, the assessment of appropriateness, and timing, of the classification, and resulting appropriate disclosure, of disposed businesses as discontinued operations and/or held for sale assets/liabilities involves judgement as to whether, and when (due to the cessation of depreciation/amortisation from the point of classification), the disposals meet the criteria for presentation as such within relevant accounting standards. The judgement as to whether each disposal is classified as discontinued or held for sale has a significant impact on the Group's continuing profit before tax, and is therefore a focus for our audit.

Our response:

Our audit procedures included:

Critically assessing the measurement of proceeds on disposal for each business, including by reading each sale and purchase agreement to understand the relevant terms and conditions of disposal, assessing the fair value of disposal proceeds by reference to external evidence where available, obtaining an understanding and assessing the value of linked contracts, understanding the nature and likely cash outflow in relation to any warranties and indemnities provided and assessing whether costs included as part of the profit or loss on disposal were directly attributable to the transaction.

We assessed the appropriate classification of revenue and costs for each business between trading activities in the period immediately prior to disposal within the current year, and the profit on disposal calculation, with reference to the relevant chronology of the disposals and the terms of the individual sale and purchase agreements.

We formed our own view on the appropriateness and timing of the classification of the Pharmacy business as a discontinued operation, and the Farms and Sunwin Services businesses as part of continuing operations, based on the criteria set out within relevant accounting standards, and our knowledge of the business, and agreed the inclusion of the significant results of each business, within the relevant section of the consolidated income statement.

We also considered the adequacy of the Group's disclosures in relation to discontinued operations.

3. Our application of materiality and an overview of the scope of our audit

The materiality for the Group financial statements as a whole was set at £14m, determined with reference to a benchmark of the Group's profit before taxation, net finance costs and member payments, including profits from discontinued operations, net of tax, but before inclusion of the Group's share of the result of The Co-operative Bank plc, normalised to exclude one-off items and profits and losses on property and business disposals, being £243m, of which it represents 5.8%.

We report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.5m, in addition to identified misstatements below that threshold that warranted reporting on qualitative grounds.

Audits for group reporting purposes were performed at all of the Group's sixteen reporting components. These audits covered 100% of total Group revenue and total Group assets and 100% of the Group's profit before tax. The work on two of the components was completed by the Group audit team and the remaining 14 components were audited by component auditors.

The Group audit strategy and detailed audit instructions were sent to all component auditors. These instructions covered the significant audit areas that should be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported to the Group audit team.

Two of the components in scope for the Group audit are not controlled by the Group, including the Bank. We were provided with sufficient access to the component's auditors in order to satisfy ourselves that appropriate audit procedures had been completed by them on the relevant component's financial statements.

The Group audit team approved the component materialities, which ranged from £4m to £10m, having regard to the mix of size and risk profile of the Group across the components.

The Group audit team attended closing meetings or held telephone meetings with each of the component teams and further update meetings were held where appropriate. At these meetings, the findings reported to the Group audit team were discussed in more detail, and any further work required by the Group audit team was then performed by the component auditor.

4. We have nothing to report in respect of the matters on which we are required to report by exception

Under the Co-operative and Community Benefit Societies Act 2014 we are required to report to you if, in our opinion:

- the Society has not kept proper books of account; or
- the Society has not maintained a satisfactory system of control over its transactions; or
- the financial statements are not in agreement with the Society's books of account; or
- we have not received all the information and explanations we need for our audit.

In addition to our audit of the financial statements, the directors have engaged us to review their Corporate Governance Statement on pages 34 to 46 as regards the Society's compliance with provisions 43, 123 to 130, and 135 to 152 of Co-operatives UK Limited's Corporate Governance Code for Consumer Co-operative Societies issued in November 2013 ('the Code'). Under the terms of our engagement, we are required to review whether the Corporate Governance Statement reflects the Society's compliance with the provisions of the Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Independent Auditor's Report to the Members of Co-operative Group Limited Only continued

Respective responsibilities of directors and auditor

As more fully explained in the Statement of Directors' Responsibilities set out on page 81 the Society's directors are responsible for the preparation of Group financial statements which give a true and fair view. Our responsibility is to audit, and express an opinion on, the Group financial statements in accordance with the terms of our engagement, applicable law, and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of an audit of financial statements performed in accordance with ISAs (UK and Ireland)

A description of the scope of an audit of financial statements is provided on our website at www.kpmg.com/uk/auditscopeother2014.

This report is made subject to important explanations regarding our responsibilities, as published on that website, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Society's members, as a body, in accordance with section 87 of the Co-operative and Community Benefit Societies Act 2014 and, in respect of the reporting on corporate governance and in sections 2 and 3 of this report, on terms that have been agreed. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and, in respect of the reporting on corporate governance and in sections 2 and 3 of this report, those matters we have agreed to state to them in our 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.

Chris Hearld

for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
1 St. Peter's Square,
Manchester, M2 3AE

Financial accounts

Consolidated Income Statement

for the period ended 3 January 2015

	Notes	2014 £m	2013 (restated*) £m
Revenue	2	**9,433**	9,746
Operating expenses - normal	3	**(9,253)**	(9,784)
Operating expenses - impairment of goodwill	11	**-**	(239)
Other income	4	**47**	96
Operating profit/(loss)	1	**227**	(181)
Finance income	5	**69**	15
Finance costs	6	**(169)**	(89)
Share of losses of associates and joint ventures	13	**(3)**	-
Profit/(loss) before member payments		**124**	(255)
Member payments	7	**-**	(55)
Profit/(loss) before tax	1	**124**	(310)
Taxation	8	**(17)**	40
Profit/(loss) after tax but before profit/(loss) on discontinued operations		**107**	(270)
Profit/(loss) on discontinued operations, net of tax	9	**109**	(2,031)
Profit/(loss) for the period		**216**	(2,301)
Attributable to:			
Equity holders of the parent		**216**	(2,267)
Non-controlling interests		**-**	(34)
Profit/(loss) for the period		**216**	(2,301)

Non-GAAP measure: underlying profit before member payments**

	Notes	2014 £m	2013 (restated*) £m
Analysed as:			
Profit/(loss) before member payments (as above)		**124**	(255)
Add back losses/(deduct gains):			
One-off items	1	**68**	311
Property and business disposals	1	**(107)**	29
Change in value of investment properties	1	**(16)**	18
Finance income	1	**(69)**	(15)
Non-cash finance costs	1	**30**	(11)
Accelerated interest due to the early repayment of debt	1	**26**	-
Share of profit of associates and joint ventures	1	**3**	-
Underlying profit before member payments		**59**	77

*See general accounting policies section on page 98 for more details of the restatement.

**For a definition of underlying profit before member payments, refer to note 1.

Consolidated Statement of Comprehensive Income

for the period ended 3 January 2015

	Notes	2014 £m	2013 £m
Profit/(loss) for the period		**216**	(2,301)
Other comprehensive income/(losses):			
Items that will never be reclassified to the income statement:			
Remeasurement gains/(losses) on employee pension schemes	16	**707**	(82)
Restriction of pension surplus under IFRIC 14	16	**-**	(11)
Revaluation of property, plant and equipment	10	**11**	-
Related tax on items	8	**(145)**	20
		573	(73)
Items that are or may be reclassified to the income statement:			
Changes in available for sale assets		**26**	(70)
Changes in cash flow hedges		**-**	(82)
Share of other comprehensive income from associates	13	**14**	-
Related tax on items		**-**	39
		40	(113)
Other comprehensive income/(losses) for the period net of tax		**613**	(186)
Total comprehensive income/(losses) for the period		**829**	(2,487)
Total comprehensive income/(losses) attributable to:			
Equity holders of the parent		**829**	(2,453)
Non-controlling interests		**-**	(34)
		829	(2,487)

Of the above, £nil (2013: £43m debit) of the changes in available for sale assets and £nil (2013: £82m debit) of the changes in cash flow hedges relate to discontinued operations. £nil of the tax credit (2013: £31m credit) that was or may be reclassified to the income statement related to discontinued operations. Of the total loss on discontinued operations, including other comprehensive income, £nil (2013: £34m) related to non-controlling interests.

Consolidated Balance Sheet

as at 3 January 2015

	Notes	2014 £m	2013 (restated*) £m
Non-current assets			
Property, plant and equipment	10	**1,998**	2,311
Goodwill and intangible assets	11	**925**	1,281
Investment properties	12	**99**	98
Investments in associates and joint ventures	13	**316**	285
Investments in funeral plans	14	**608**	517
Investments from insurance activities	21	**661**	670
Reinsurance contracts	22	**67**	53
Derivatives	15	**67**	29
Pension assets	16	**1,247**	410
Trade and other receivables	19	**24**	38
Deferred tax assets	17	**263**	257
Reclaim fund assets	32	**73**	69
Total non-current assets		**6,348**	6,018
Current assets			
Inventories and biological assets	18	**434**	526
Trade and other receivables	19	**566**	1,069
Cash and cash equivalents		**380**	264
Assets held for sale	20	**85**	59
Investments from insurance activities	21	**260**	301
Reinsurance contracts	22	**5**	4
Reclaim fund assets	32	**407**	382
Total current assets		**2,137**	2,605
Total assets		**8,485**	8,623
Non-current liabilities			
Interest-bearing loans and borrowings	24	**993**	6
Trade and other payables	25	**841**	894
Derivatives	15	**48**	67
Provisions	26	**375**	311
Pension liabilities	16	**258**	237
Deferred tax liabilities	17	**344**	189
Insurance contracts	22	**334**	396
Reclaim fund liabilities	32	**406**	377
Total non-current liabilities		**3,599**	2,477
Current liabilities			
Overdrafts		**8**	9
Interest-bearing loans and borrowings	24	**69**	1,544
Income tax payable		**13**	8
Trade and other payables	25	**1,381**	1,889
Provisions	26	**146**	189
Insurance contracts	22	**404**	470
Total current liabilities		**2,021**	4,109
Total liabilities		**5,620**	6,586
Equity			
Members' share capital	23	**70**	70
Retained earnings		**2,691**	1,804
Other reserves		**104**	162
Non-controlling interests		**-**	1
Total equity		**2,865**	2,037
Total equity and liabilities		**8,485**	8,623

Board's certification

The financial statements on pages 92 to 197 are hereby signed on behalf of the Board pursuant to Section 80 (1) (a) of the Co-operative and Community Benefit Societies Act.

Allan Leighton Chair
8 April 2015

Richard Pennycook Executive Director

Claire Davies Group Secretary

Consolidated Statement of Changes in Equity

for the period ended 3 January 2015

	Notes	Members' share capital £m	Retained earnings £m	Other reserves £m	Total shareholder interest £m	Non-controlling interests £m	Total equity £m
Balance at 4 January 2014		70	1,804	162	2,036	1	2,037
Profit for the period		-	216	-	216	-	216
Other comprehensive income:							
Gains less losses on available for sale assets		-	-	29	29	-	29
Available for sale cumulative gains transferred to the income statement		-	-	(3)	(3)	-	(3)
Re-measurement gains on employee pension schemes	16	-	707	-	707	-	707
Pace pension surplus attributable to non Group entities	16	-	(226)	-	(226)	-	(226)
Restriction of pension surplus under IFRIC 14	16	-	226	-	226	-	226
Revaluation of property, plant and equipment	10	-	-	11	11	-	11
Revaluation reserve recycled to retained earnings		-	95	(95)	-	-	-
Share of other comprehensive income from associates		-	14	-	14	-	14
Tax on items taken directly to other comprehensive income	8	-	(145)	-	(145)	-	(145)
Total other comprehensive income/(expense)		-	671	(58)	613	-	613
Distributions to members:							
Members' share interest		-	-	-	-	-	-
Dividend – non-controlling interests		-	-	-	-	(1)	(1)
Distributions to members		-	-	-	-	(1)	(1)
Balance at 3 January 2015		70	2,691	104	2,865	-	2,865

Other reserves

Other reserves comprise the following:

Reclaim Fund capital reserve

This reserve comprises the surplus held within the Reclaim Fund Limited. The surplus has not been transferred to retained earnings because the profits are ultimately payable to the Big Lottery Fund and are therefore not available for distribution by the Group. The period end balance is £74m (2013: £74m) following the surplus created in other income in 2010. Further details of the balance sheet items can be found in note 32.

Revaluation reserve – property, plant and equipment

This reserve relates to the surplus created following the revaluation of certain assets in the Trading Group in previous periods. The balance at the start of the period all related to farmland and, following the sale of the Farms business, all £95m has been transferred to retained earnings. The revaluation uplift of £11m (2013: £nil) relates to several discreet parcels of land that were revalued during the period. The period end balance was therefore £11m.

Available for sale investments reserve

CISGIL mainly holds debt securities as available for sale investments. Subsequent valuation is at fair value with differences between fair value and carrying value recognised in equity as they arise. The period end balance is a £19m credit (2013: £7m debit). There has been a £29m gain (2013: £14m loss) following the revaluation of available for sale assets during the period. £3m of losses (2013: £56m of losses) were transferred to the income statement during the period. A tax debit of £nil (2013: £20m credit) has also affected this reserve.

Consolidated Statement of Changes in Equity (continued)

for the period ended 4 January 2014

	Notes	Members' share capital £m	Retained earnings £m	Other reserves £m	Total shareholder interest £m	Non-controlling interests £m	Total equity £m
Balance at 5 January 2013		70	4,145	275	4,490	35	4,525
Loss for the period		-	(2,267)	-	(2,267)	(34)	(2,301)
Other comprehensive income/(expense):							
Gains less losses on available for sale assets		-	-	(14)	(14)	-	(14)
Available for sale cumulative gains transferred to the income statement		-	-	(56)	(56)	-	(56)
Net cashflow hedge gains transferred to the income statement		-	-	(82)	(82)	-	(82)
Pace pension surplus attributable to non Group entities	16	-	(145)	-	(145)	-	(145)
Restriction of pension surplus under IFRIC 14 - Pace	16	-	145	-	145	-	145
Re-measurement losses on employee pension schemes	16	-	(82)	-	(82)	-	(82)
Restriction of pension surplus under IFRIC 14 - Britannia	16	-	(11)	-	(11)	-	(11)
Tax on items taken directly to other comprehensive income	8	-	20	39	59	-	59
Total other comprehensive expense		-	(73)	(113)	(186)	-	(186)
Distributions to members:							
Members' share interest		-	(1)	-	(1)	-	(1)
Distributions to members		-	(1)	-	(1)	-	(1)
Balance at 4 January 2014		70	1,804	162	2,036	1	2,037

Consolidated Statement of Cash Flows

for the period ended 3 January 2015

	Notes	2014 £m	2013 (restated*) £m
Net cash used in operating activities*	27	**(13)**	(2,496)
Cash flows from investing activities			
Acquisition of property, plant and equipment		**(279)**	(283)
Proceeds from sale of property, plant and equipment		**341**	375
Purchase of intangible assets		**(15)**	(28)
Proceeds from sale of investments		**4**	(349)
Disposal of businesses, net of cash disposed		**796**	(5,153)
Income from investments		**-**	51
Proceeds from sale and maturity of investment securities		**-**	6,681
Purchase of investment securities		**-**	(4,495)
Dividends received from investments	13	**5**	-
Net cash from investing activities		**852**	(3,201)
Cash flows from financing activities			
Interest paid on borrowings	24	**(150)**	(100)
Payment of corporate investor shares		**(13)**	(20)
Preference dividends paid		**-**	(47)
Member payments		**-**	(64)
Additional payments into pension schemes		**(48)**	(56)
Repayment of borrowings, net of derivatives	24	**(484)**	(437)
Issue of borrowings, net of derivatives	24	**-**	129
Dividents paid to non-controlling interests		**(1)**	-
Finance leases (repaid)/issued		**(1)**	1
Net cash used in financing activities		**(697)**	(594)
Net increase/(decrease) in cash and cash equivalents		**142**	(6,291)
Cash and cash equivalents at beginning of period		**637**	6,928
Cash and cash equivalents at end of period		**779**	637
Analysis of cash and cash equivalents			
Overdrafts		**(8)**	(9)
Cash held in Reclaim fund	32	**407**	382
Cash and cash equivalents per balance sheet		**380**	264
		779	637

*Net cash used in operating activities includes £313m (2013: £nil) capital contribution to Co-operative Bank Plc. Excluding this payment, cash flows from operating activities were £300m (2013: cash used in operating activities of £2,496m).

Cash and cash equivalents include deposits of £53m (2013: £50m) held in trustee-administered bank accounts of the Society, which can only be utilised to meet liabilities in respect of funeral plans. These liabilities are included in trade and other payables (see note 25). Prior year cash and cash equivalents included £1m of cash proceeds relating to property sales which were within the Group's solicitors' bank facilities, but were accessible to the Group to exclusively repay debt facilities. The cash held in the Reclaim Fund of £407m (2013: £382m) is not available for use by the Group.

Included in the above are cash flows from discontinued operations. An analysis of these can be found in note 9.

General Accounting Policies

This section sets out details of the general Group accounting policies that relate to the financial statements as a whole. Details of other accounting policies are included within the notes to the financial statements to which they relate. This allows readers quick and easy access to the relevant policy. This section also sets out new accounting standards, amendments and interpretations endorsed by the EU and their potential future impact on the Group financial statements.

General information

The Co-operative Group Limited is a registered co-operative society domiciled in England and Wales. The address of the Society's registered office is 1 Angel Square, Manchester, M60 0AG.

Basis of preparation

The Group accounts have been prepared in accordance with the Co-operative and Communities Benefit Act 2014 and applicable International Financial Reporting Standards as endorsed by the EU (IFRS) for the period ended 3 January 2015. As permitted by statute and by IAS 1, the financial statement formats have been adapted as necessary to give a fair presentation of the state of affairs and result of the Group. As permitted by statute, a separate set of financial statements for the Society are not included.

The financial statements also follow the provisions of the Revised Statement of Recommended Practice on Accounting for Insurance Business (SORP) issued by the Association of British Insurers in 2005 (as amended in December 2006), insofar as these are compatible with the requirements of IFRS.

The accounts are presented in pounds sterling and are principally prepared on the basis of historical cost. Areas where other basis are applied are identified in the relevant accounting policy in the notes. Amounts have been rounded to the nearest £m.

The accounting policies set out in the notes have been applied consistently to all periods presented in these financial statements, except where stated otherwise.

Basis of consolidation

The financial statements consolidate Co-operative Group Limited ('the Society'), which is the ultimate parent society, and its subsidiary undertakings (see note 30 for details of the composition of the Group). The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total comprehensive income of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

A joint venture is an arrangement whereby the Group has joint control and has rights to the net assets of the arrangement, rather than rights to its assets and obligations for its liabilities.

General Accounting Policies (continued)

Mixed presentation and definitions of Trading Group and Financial Services

Previously, a mixed presentation has been applied to the Group's consolidated balance sheet to separately present the Group's Financial Services activities (formerly referred to as the Co-operative Banking Group) from its Trading Group entities (the Trading Group). However, following the disposal of the Co-operative Life and Savings business and 70% of the Group's shareholding in the Co-operative Bank plc during 2013, the current and prior year balance sheets of the Financial Services Group only includes CIS General Insurance Limited (CISGIL), other smaller entities (mainly holding, ancillary companies and the Reclaim Fund Limited) and the Group's remaining 20.2% investment in the Bank plc. Therefore, following this significant change in the nature of the entity's operations, it is now deemed more appropriate that the balance sheet is presented singularly, with both Financial Services and Trading Group balances consolidated into a current and non-current presentation. This is deemed to be more relevant to a user of the financial statements than a presentation in order of liquidity which is mainly used in banking entities. A third balance sheet at 4 January 2014 has not been presented on the basis this would not be comparable as it would include the assets and liabilities of the Bank (which were still controlled by the Group at this date). The prior year comparatives of the consolidated balance sheet have been restated to reflect the reclassification as shown below:

	Prior year figure reported (£m)	Non-current restated (£m)	Current restated (£m)
Cash and balances at central banks	64	-	64
Investments	971	670	301
Investments in associates and joint ventures	221	221	-
Reinsurance contracts	57	53	4
Intangible assets	47	47	-
Property, plant and equipment	34	34	-
Deferred tax assets	73	73	-
Prepayments and other receivables	620	15	605
Reclaim Fund assets	451	69	382
Amounts owed to credit institutions (overdrafts)	(9)	-	(9)
Insurance contracts	(866)	(396)	(470)
Income tax payable	(90)	-	(90)
Trade and other payables	(517)	(1)	(516)
Deferred tax liabilities	(6)	(6)	-
Pension liabilities	(8)	(8)	-
Provisions	(75)	(19)	(56)
Reclaim Fund liabilities	(377)	(377)	-

Accounting dates

The financial statements are prepared for the 52 weeks ended 3 January 2015. Comparative information is presented for the 52 weeks ended 4 January 2014. Since the financial periods are virtually co-terminus with the calendar years, the current period figures are headed 2014 and the comparative figures are headed 2013.

The Financial Services subsidiaries of the Group have prepared accounts for the period ended 31 December. This differs from the parent of the Group and other Trading Group subsidiaries which have accounting periods ended on the first Saturday on or after 31 December (please refer to note 30 to see which entities are Financial Services and Trading Group subsidiaries). For the period ending 3 January 2015, there are no significant transactions or events which need to be adjusted to reflect the difference in reporting dates.

One-off costs and non-GAAP measures

One off costs include costs relating to activities such as large restructuring programmes, one-off impairments not relating to individual stores and costs or income which would not normally be seen as costs or income relating to the underlying principal activities of the Group.

To help the reader make a more informed judgement on the underlying profitability of the Group, a non-GAAP measure: underlying profit before member payments has been presented. This is shown at the bottom of the income statement and is reconciled back to the statutory measure of profit before member payments. In calculating this non-GAAP measure, property and business disposals, the change in value of investment properties, one off costs and non-underlying interest are added back.

General Accounting Policies (continued)

Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to do so and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Going concern

The Directors have considered the Group's business activities, together with the factors likely to affect its future development, performance and position (as set out in the Business Review on pages 16 to 20). The Directors have also assessed the financial risks facing the Group, its liquidity position and available borrowing facilities. These are principally described in note 24 to the accounts. In addition, notes 24 and 31 also include details of the Group's objectives, policies and processes for managing its capital, its financial risk management objectives and its financial instruments and hedging activities.

In assessing the appropriateness of the going concern basis of preparation, the Directors have firstly considered the going concern position and outlook of the Trading Group, Co-operative Banking Group Limited ('CBG') and CISGIL separately, as they are independently funded. Details of the relevant factors in relation to the going concern position of each of these businesses are set out below. The Directors have then, taking these individual assessments into account, considered the overall going concern position of the Group.

The Trading Group

The Trading Group meets its working capital requirements through a number of separate funding arrangements, as set out in detail in note 24, certain of which are provided subject to continued compliance with certain covenants (Debt Covenants). Profitability and cash flow forecasts for the Trading Group, prepared for the period to July 2016 (the forecast period), and adjusted for sensitivities considered by the Board to be reasonably possible in relation to both trading performance and cash flow requirements, indicate that the Trading Group will have sufficient resources available within its current funding arrangements to meet its working capital needs, and to meet its obligations as they fall due.

CBG

CBG is the holding company that owns the Group's ongoing investment in the Co-operative Bank plc, the General Insurance business and other less material financial services subsidiaries. CBG is self-funding. Profitability and cash flow forecasts for CBG, prepared for the period to July 2016 (the forecast period), and adjusted for sensitivities considered by the Board to be reasonably possible in relation to both trading performance and cash flow requirements, indicate that CBG will have sufficient resources to meet its working capital needs, and to meet its obligations as they fall due.

The key risk for CBG is its ability to fund the costs of separating CBG from Co-operative Bank plc. Based on the information available to the Board at the current time, including taking external advice, CBG is highly confident in its ability to fund the separation costs.

CISGIL

CISGIL has significant deposits with credit institutions of £156.3m, considerably in excess of the Board's target minimum liquidity requirement.

CISGIL is required to comply with a number of regulatory capital requirements. Total regulatory capital was £344.1m at 31 December 2014, which is in excess of all externally imposed regulatory capital requirements. Current forecasts show that CISGIL's available capital will remain above all these regulatory capital requirements for the foreseeable future, including when Solvency II comes into force with effect from 1 January 2016.

Whilst CISGIL has maintained capital above all its regulatory requirements throughout the period, since September 2014 CISGIL has fallen below its 1-in-6 year risk appetite buffer capital requirement. In assessing capital resilience for the period under review, CISGIL has considered a number of stress and reverse stress tests on capital both in the context of restoring capital above risk appetite and maintaining capital above all regulatory requirements. In considering these scenarios, management has identified potential actions that could be taken to improve the capital position if overall solvency is threatened.

CISGIL reported a statutory loss for the year of £6.9m. Moving forward the business forecasts a period of underperformance as costs in relation to CISGIL's planned strategic transformation programme are incurred. CISGIL plan to raise additional capital in 2015 in order to finance this transformation.

The key risks to CISGIL's transformation programme are CISGIL's ability to raise the finance required to fund transformation, and execution risk. Based on the information available to the Board at the current time, including taking external advice, CISGIL is highly confident in its ability to raise additional finance. Until completion however, there remains a risk that events not wholly within the Board's control could impact on the capital being secured. In this eventuality, and CISGIL remains on its existing operating model in the immediate future, CISGIL is forecast to continue to meet all of its capital requirements over the going concern assessment period.

General Accounting Policies (continued)

A designated Solvency II programme and plans are in place, targeting compliance with the new regime from 1 January 2016. Forecast solvency projections show that CISGIL maintains its capital buffer when the new regulation comes into force although this makes no allowance for any capital add-ons that the regulator may apply under the new regime. Whilst the size of a potential add-on cannot be predicted, an add-on of similar magnitude to that currently applied under Solvency I would not affect CISGIL's going concern status.

Group summary

After consideration of the factors set out above, and, after making all appropriate enquiries, the Directors have a reasonable expectation that the Society and the Group has access to adequate resources to enable it to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Group's financial statements.

Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements and estimates made by management in the application of IFRSs that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are described in the following notes stated below:

- Supplier income (note 3)
- Classification of discontinued operations (note 9)
- Non-current asset impairment (notes 10 and 11)
- Accounting for the Group's investment in Co-operative Bank Plc (note 13)
- Pensions (note 16)
- Inventories (note 18)
- Provisions (note 26)
- General Insurance claims and reserves (note 22)

The Group has applied all endorsed IFRSs that are effective on a European basis for the Group's financial statements for the period ended 3 January 2015 and the comparative period.

Restatement and changes in accounting policies

The Group adopted IFRS 10 Consolidated financial statements, IFRS 11 Joint arrangements, IFRS 12 Disclosure of Interests in Other Entities, amended IAS 27 Consolidated and separate financial statements and amended IAS 28 Investments in associates and joint ventures on 5 January 2014. There was no material effect on the income statement or balance sheet as a result of the adoption of these standards, however disclosures have significantly increased with regards to associates and joint ventures (see note 13).

The Group adopted IFRIC 21 Levies (2013) on 5 January 2014. As the Bank was disposed of in 2013 and is therefore a discontinued operation, the only restatement from the adoption of the IFRIC has been to transfer £26m from results from operating activities in discontinued operations to loss on sale of discontinued operations. The income statement and balance sheet have not, therefore, been restated. The Bank has also restated a number of other items in its 2013 balance sheet within its 2014 annual report. These items have not been adjusted in the Group financial statements as the net effect is not material.

The following standards also became effective for the Group on 5 January 2014, but had no material effect on the Group's financial statements:

- IAS 32 Financial instruments: presentation – Amendments relating to the offsetting of assets and liabilities
- IAS 39 Financial instruments: recognition and measurement – Amendments for novation of derivatives

The Group early adopted IAS 36 Recoverable Amount Disclosures for Non-Financial Assets on 6 January 2013.

General Accounting Policies (continued)

The restatement of the comparative period consolidated income statement reflects the following:

- Following the Group's disposal of the Pharmacy business, the results of this business for the comparative period have been reclassified to discontinued operations.
- Other income in the prior year has been increased by £28m (with a corresponding reduction in revenue) to reclassify rental income from non-investment properties which was included within revenue for the Estates division within the 2013 Annual Report. As the activities of the Estates division are now considered to be incidental to the running of the Group's main operating activities, it is considered more appropriate to include its revenue in other income.
- Fair value credits of £2m, which were netted off within finance costs in the 2013 Annual Report, have now been included gross within finance income.

Standards, amendments and interpretations issued but not yet effective

The Group has not early adopted the following standards and statements. The adoption of these standards is not expected to have a material impact on the Group's accounts when adopted.

- Amendments to IAS 19 Defined benefit plans: employee contributions;
- IFRS 14 Regulatory Deferral Accounts;
- IAS 16 Property, Plant and Equipment – Amendments regarding the clarification of acceptable methods of depreciation and amortisation and Amendments bringing bearer plants into the scope of IAS 16;
- IAS 38 Intangible assets – Amendments regarding the clarification of acceptable methods of depreciation and amortisation

The adoption of the following standards will or may have a material impact on the Group's accounts when adopted:

- IFRS 9 (Financial Instruments: Classification and Measurement (2013))*

This new standard, issued in July 2014 replaces IAS 39 (Financial Instruments: Recognition and Measurement (2009)). IFRS 9 Financial Instruments includes requirements for the recognition and measurement, de-recognition and hedge accounting for financial instruments. IFRS 9 was originally issued in November 2009, reissued in October 2010, and then amended in November 2013. The standard will be effective for annual periods beginning on or after 1 January 2018. Management are assessing the impact of this standard on its financial statements.

- IFRS 15 Revenue from Contracts with Customers*

This new standard, issued in July 2014 replaces a number of standards and interpretations, including IAS 11, 18 and IFRIC 13, 15 and 18. It will be effective for annual periods beginning on or after 1 January 2017. As the Group's operations are mainly in retail and not in long term contracts, the effects of this standard will be minimal, except with regards to member payments. As a member will usually expect a discount in the form of a dividend on the point of sale, the Group will need to recognise a liability at the point of sale rather than when the dividend is approved at the Annual General Meeting. In addition, the amount recognised as a liability will be presented as a reduction in revenue rather than as a charge to the Income Statement after operating profit. As the Group is still developing its future dividend strategy, the numerical impact of these changes is uncertain.

*Not yet endorsed by the European Union.

Notes to the Financial Statements

1. Operating segments

The segmental information presented below reflects the key components of the Group, the operating results of which are regularly reviewed by the Chief Operating Decision Maker (CODM), which is considered to be the Group's Management Executive.

A summary of the operations of the businesses and further financial information on all segments can be found in the business reviews on pages 16 to 20.

	2014				
	Revenue from external customers[f] £m	**Underlying segment operating profit[a] £m**	**Operating profit £m**	**Additions to non-current assets[e, f] £m**	**Depreciation and amortisation[e] £m**
Food	**7,085**	**251**	**358**	**235**	**(206)**
Funeralcare	**363**	**66**	**66**	**19**	**(21)**
General Insurance	**371**	**(7)**	**(7)**	**48**	**(63)**
Other businesses	**135**	**8**	**20**	**4**	**(4)**
Federal[g]	**1,479**	**-**	**-**	**-**	**-**
Corporate costs	**-**	**(146)**	**(210)**	**22**	**(35)**
Total	**9,433**	**172**	**227**	**328**	**(329)**

	2013 (restated)				
	Revenue from external customers[f] £m	Underlying segment operating profit[a] £m	Operating loss £m	Additions to non-current assets[e, f] £m	Depreciation and amortisation[e] £m
Food	7,237	247	(35)	170	(211)
Funeralcare	370	62	50	26	(20)
General Insurance	476	36	36	70	(65)
Other businesses	201	8	9	6	(5)
Federal[g]	1,462	-	-	-	-
Corporate costs	-	(176)	(241)	24	(13)
Total	9,746	177	(181)	296	(314)

a) Underlying segment operating profit is a non-GAAP measure of segment operating profit before property disposals, change in value of investment properties and one-off costs.

b) Each segment derives its revenue and profits from the sale of goods and provision of services, mainly from retail and insurance activities.

c) The Group identifies its operating segments based on its divisions, which are organised according to the differing products and services it offers its customers. The reportable operating segments (and the captions) reported above are based on the monthly accounts reported into the CODM and whether the respective division's results meet the IFRS 8 minimum reporting thresholds. The significant constituent parts of 'Other businesses' are the Group's Legal Services, Electricals and, prior to its disposal, the Sunwin Services business and their results have been combined as allowed by IFRS 8. The Farms business is included with Food. Other Financial Services entities (mainly holding, ancillary companies and the Reclaim Fund Ltd) are included within Corporate costs.

d) The operating segments are restated from the prior year following the sale of the Pharmacy business. Pharmacy's results are now reported within discontinued operations (see note 9). The Group's operating segments have also been restated since the previous year end to separate out 'Other businesses' and 'Corporate costs' whilst the results of the Estates division are now also included within Corporate costs (see general accounting policies section).

e) Additions to non-current assets is derived on a cashflow basis. Depreciation and amortisation excludes £9m amortisation of deferred income relating to the use of the Co-operative Travel brand by the Group's associate: TCCT Holdings UK Limited. Amortisation of £63m (2013: £65m) and additions of £46m (2013: £70m) on deferred acquisition costs are included within General Insurance.

Notes to the Financial Statements continued

1. **Operating segments** continued

f) The Group's external revenue and non-current assets arise primarily within the United Kingdom. The Group does not have a major customer who accounts for 10% or more of revenue. There are no material transactions between the main operating segments stated above.

g) Federal relates to the activities of a joint buying group that is operated by the Group for itself and other independent co-operative societies. This is run on a cost recovery basis and therefore no profit is derived from its activities.

h) Transactions between operating segments excluded in the above are £20m (2013: £24m) of sales by Sunwin Services Group (prior to the sale of this business), £9m (2013: £9m) sales by Co-op Electrical, £2m (2013: £nil) sales by Legal Services and £2m (2013: £3m) of sales by the General Insurance business.

i) A reconciliation between underlying segment operating profit and operating profit/(loss) is as follows:

	2014					
	Food £m	**Funeralcare £m**	**General Insurance £m**	**Other businesses £m**	**Corporate costs £m**	**Total £m**
Underlying segment operating profit	**251**	**66**	**(7)**	**8**	**(146)**	**172**
One off items:						
– Restructuring costs	**(21)**	**-**	**-**	**-**	**(58)**	**(79)**
– Past service pension credit	**-**	**-**	**-**	**-**	**11**	**11**
One off items	**(21)**	**-**	**-**	**-**	**(47)**	**(68)**
Property and business disposals	**128**	**-**	**-**	**12**	**(33)**	**107**
Change in value of investment properties	**-**	**-**	**-**	**-**	**16**	**16**
Operating profit/(loss)	**358**	**66**	**(7)**	**20**	**(210)**	**227**

	2013 (restated)					
	Food £m	**Funeralcare £m**	**General Insurance £m**	**Other businesses £m**	**Corporate costs £m**	**Total £m**
Underlying segment operating profit	247	62	36	8	(176)	177
One off items:						
– Restructuring costs	(6)	-	-	-	(54)	(60)
– Impairment of goodwill	(226)	-	-	(13)	-	(239)
– Change in accounting estimate regarding funeral benefit options	-	(12)	-	-	-	(12)
One off items	(232)	(12)	-	(13)	(54)	(311)
Property and business disposals	(50)	-	-	14	7	(29)
Change in value of investment properties	-	-	-	-	(18)	(18)
Operating profit/(loss)	(35)	50	36	9	(241)	(181)

Restructuring costs in 2014 mainly related to costs incurred in the restructuring of the Food distribution network, the executive restructure and establishment of the Target Operating Model for the Group's support centres.

During 2014, certain United Co-operative pension funds changed its rules decreasing retirement benefits for early retirees. This reduced estimated future liabilities by £11m and therefore created a one-off benefit.

Restructuring costs in 2013 mainly related to costs incurred in modernising our corporate central operating model and the food distribution network. For more details on the impairment of goodwill refer to note 11 and for the change in accounting estimate in relation to funeral benefit options, refer to note 25.

Notes to the Financial Statements continued

1. Operating segments continued

j) A reconciliation between underlying segment operating profit and profit/(loss) before tax is provided below:

	Note	2014 £m	2013 (restated) £m
Underlying segment operating profit		**172**	177
Underlying interest payable	6	**(113)**	(100)
Underlying profit before payments to members		**59**	77
One-off items (see above)		**(68)**	(311)
Property and business disposals	3	**107**	(29)
Change in value of investment properties	3	**16**	(18)
Finance income	5	**69**	15
Non-cash finance income/(costs)	6	**(30)**	11
Accelerated interest due to the early repayment of debt	6	**(26)**	-
Share of profit of associates and joint ventures	13	**(3)**	-
Profit/(loss) before member payments		**124**	(255)
Member payments	7	**-**	(55)
Profit/(loss) before tax		**124**	(310)

2. Revenue

	2014 £m	2013 (restated) £m
Sale of goods	**7,170**	7,386
Provision of services	**412**	422
Federal sales	**1,479**	1,462
Gross earned premiums	**400**	509
Premiums ceded to reinsurers	**(28)**	(33)
Net revenue	**9,433**	9,746
Value Added Tax	**789**	806
Gross sales	**10,222**	10,552

Notes to the Financial Statements continued

2. Revenue continued

Accounting policies

Gross sales

A non-GAAP measure representing the amounts receivable by the Group for goods and services supplied to customers, net of discounts but including VAT.

Sale of goods

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received. Customer discounts including any member loyalty schemes not approved at the Annual General Meeting (see note 7) are deducted from revenue. Also deducted from revenue are rebates, VAT and other sales tax or duty. Staff discounts are included within operating expenses. For the sale of goods, revenue is recognised at the point of sale.

Provision of services

Provision of services relates to activities in Funeralcare, Legal Services and, prior to its disposal, Sunwin Services Group. Revenue is recognised when the service is rendered and the revenue can be reliably measured. See note 25 for further details of the accounting policies relating to prepaid funeral plans and funeral benefit options (FBO's).

Gross earned premiums

Gross earned premiums relate to the General Insurance business and are gross written premiums adjusted for any change in the unearned premium provision (see note 22 for an explanation of this provision).

Gross written premiums comprise receivables on those contracts which were incepted during the period, irrespective of whether they relate in whole or in part to a later accounting period, together with any necessary adjustments to amounts reported in prior periods. They are:

- stated gross of commission and exclude any taxes or levies based on premiums; and
- include an estimate of the premiums receivable on those contracts which incepted prior to the period end but which have not been notified by the balance sheet date ('pipeline premium'). When calculating pipeline premiums it is assumed, where appropriate, that options to renew contracts automatically will be exercised.

Gross written premiums (whether paid in advance or by instalments) are earned evenly over the period of the contract (usually 12 months). The treatment of outward reinsurance premiums is similar to gross premiums written.

3. Operating expenses

Operating profit/(loss) is stated after (charging)/crediting the following:

	2014 £m	2013 (restated) £m
Cost of sales		
– Trading activities	**(6,251)**	(6,368)
– Claims incurred, net of claims recovered from reinsurers	**(249)**	(331)
– Fee and commission expense	**(7)**	(20)
Employee benefits expense (see below)	**(1,287)**	(1,367)
Net gain/(loss) on property and business disposals (see below)	**107**	(29)
Change in value of investment properties	**16**	(18)
Operating lease rentals	**(196)**	(194)
Impairment of non-current assets	**(20)**	(262)
Depreciation	**(257)**	(269)
Amortisation	**(71)**	(115)
Subscriptions and donations	**(5)**	(3)

Depreciation, amortisation and impairment of non-current assets relate to continuing businesses. The figures in notes 10 and 11 also include charges relating to discontinued operations.

Notes to the Financial Statements continued

3. Operating expenses continued

Employee benefits expense

	2014 £m	2013 (restated) £m
Wages and salaries	**(1,139)**	(1,197)
Social security costs	**(64)**	(69)
Pension costs – defined benefit schemes	**(58)**	(79)
Pension costs – defined contribution schemes	**(26)**	(22)
	(1,287)	(1,367)

The average number of people employed by the Group in the UK (excluding discontinued businesses) was:

	2014	2013 (restated)
Full-time	**27,237**	28,258
Part-time	**53,720**	52,762
	80,957	81,020

For details regarding remuneration of the Group Board and the Management Executive refer to pages 58 to 78.

Net gain/(loss) on property and business disposals

	2014 £m	2013 (restated) £m
Property disposals	**(26)**	(43)
Disposal of Farmcare	**121**	-
Disposal of Sunwin Services Group	**13**	-
Disposal of Motor Group dealerships	**(1)**	14
	107	(29)

The total consideration received for Farmcare and Sunwin Services Group was £281m of which £268m was received in cash and cash equivalents by year end and £13m is deferred and will be paid in cash in 2015. As Pharmacy is a discontinued operation, the gain on disposal of Pharmacy and other disclosures relating to the sale are included within discontinued operations in note 9.

A summary of the assets and liabilities relating to Farmcare and Sunwin Services Group at the point of disposal is below:

	2014 £m
Property, plant and equipment	**99**
Goodwill and intangible assets	**2**
Deferred tax	**1**
Biological assets	**11**
Inventories	**6**
Trade and other receivables	**20**
Cash and cash equivalents	**3**
Trade and other payables	**(11)**
Net assets	**131**

Notes to the Financial Statements continued

3. Operating expenses continued

Auditors' remuneration and expenses	2014 £m	2013 £m
Audit of these financial statements	**0.4**	0.9
Amounts receivable by the Society's auditor in respect of:		
– Audit of financial statements of subsidiaries in respect of the Society	**0.3**	0.5
– Other services pursuant to such legislation	**0.2**	0.2
Services relating to:		
– Other tax advisory services	**-**	-
– Corporate finance services	**-**	3.9
– Information technology services	**-**	-
– Pensions services	**-**	-
– All other services	**0.3**	0.2
Total	**1.2**	5.7

In both the current and prior period, the above figures include auditors' remuneration and expenses in respect of discontinued operations. Of the total amounts presented, £1.1m relates to continuing operations in 2014 (2013: £1.5m). In the prior year, fees relating to discontinued operations included £3.9m relating to services provided to the Co-operative Bank plc (audit fees of £0.6m and non-audit fees of £3.3m). No costs in relation to services performed by the auditors were capitalised during the current or prior period.

Non audit fees incurred with the Group's auditor by the Co-operative Bank plc during 2014 were £0.2m (2013: £3.3m).

Accounting policies

Operating expenses

Operating expenses are analysed by nature, as defined by IAS 1.

Fees and commission expense mainly relates to commission payable to broker intermediaries that is incurred over the lifetime of the related policy. All other fee and commission payable is recognised on an accruals basis as the service is provided.

Supplier income

Supplier income is recognised as a deduction from cost of sales on an accruals basis, based on the expected entitlement that has been earned up to the balance sheet date for each relevant supplier contract. The accrued incentives, rebates and discounts receivable at year end are included within trade and other receivables. Where amounts received are in the expectation of future business, these are recognised in the income statement in line with that future business.

There are three main types of income:

1. Long term agreements: These relate largely to volumetric rebates based on agreements with suppliers. They include overriders, advertising allowances and targeted income. The income accrued is based on the joint buying group's latest forecast volumes and the latest contract agreed with the supplier. Income is not recognised until confirmation of the agreement has been received from the supplier.

2. Bonus income: These are typically unique payments made by the supplier and are not based on volume. They include payments for marketing support, range promotion and product development. These amounts are recognised when the income is earned and confirmed by suppliers. An element of the income is deferred if it relates to a future period.

3. Promotional income: Volumetric rebates relating to promotional activity agreed with the supplier. These are retrospective rebates based on sales volumes or purchased volumes.

In 2014, the supplier income deducted from cost of sales in Food was £612m (2013: £545m), of which £137m (2013: £132m) related to long term agreements, £160m (2013: £129m) related to bonus income and £316m (2013: 284m) related to promotional income. This represented 2.1%, 2.4% and 4.8% respectively (2013: 2.0%, 1.9% and 4.3%) of Food's cost of sales before these deductions. These figures do not include any income or purchases made as part of the Federal joint buying group.

Notes to the Financial Statements continued

4. Other income

Income earned from activities outside of the normal trading activities of the Group include:

	2014 £m	2013 (restated) £m
Investment income	**21**	28
Gains less losses arising from financial instruments	**3**	13
Rental income from non-investment property	**11**	28
Rental income from investment property	**2**	13
Fee and commission income	**10**	14
	47	96

The prior period figure has been restated to reclassify rental income from non-investment property within the Estates division to other income, as the activities of the Estates division are now considered to be incidental to the running of the Group's main operating activities.

Accounting policies

Investment income

Interest income on CISGIL financial assets designated as available for sale and loans and receivables are recognised within investment income on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees, and discounts and premiums where appropriate. This income is treated as other income rather than as a finance income or cost as it relates to a Financial Services entity.

The EIR basis spreads the interest income over the expected life of the instrument. The EIR is the rate that, at inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating EIR, CISGIL estimates cash flows considering all contractual terms of the instrument (for example prepayment options) but does not consider future credit losses.

Interest income on assets designated as fair value through income and expense is recognised within investment income in the income statement as it accrues on an effective interest basis.

Gains less losses arising from financial instruments

Investments in CISGIL, other than those in debt securities, are classified as financial assets at fair value through the income statement. Gains less losses arising from these assets are included within other income as they are not part of the normal funding arrangements of the Group.

Rental income from investment and non-investment properties

Rental income arising from operating leases on both investment and non-investment properties is accounted for on a straight-line basis over the lease term. For accounting policies relating to investment property, refer to note 12.

Fee and commission income

Fees and commission receivable mainly relates to sundry fee/commission income from CISGIL's aggregator partner and is earned over the lifetime of the related policy or when services are provided, as deemed appropriate. All other fee and commission income is recognised on an accruals basis.

5. Finance income

	2014 £m	2013 (restated) £m
Net pension finance income	**12**	13
Fair value movement on interest rate swaps	**57**	2
Total finance income	**69**	15

The prior period figure has been restated by £2m to reclassify credits on fair value movements to finance income. These were previously reported within finance costs.

Notes to the Financial Statements continued

6. Finance costs

	2014 £m	2013 (restated) £m
Loans repayable within five years	**(99)**	(87)
Loans repayable wholly or in part after five years	**(14)**	(12)
Corporate investor share interest	**-**	(1)
Underlying interest payable	**(113)**	(100)
Accelerated interest due to the early repayment of debt	**(26)**	-
Accelerated fee amortisation due to the early repayment of debt	**(4)**	-
Fair value movement on quoted Group debt	**(15)**	21
Discount unwind of provisions (note 26)	**(11)**	(10)
Other finance costs	**(56)**	11
Total finance costs	**(169)**	(89)

Fair value movements on forward currency transactions were immaterial in the current and prior period. Total interest expense on financial liabilities that are not at fair value through profit or loss was £18m in 2014 (2013: £4m).

As explained in note 5, the prior period figure has been restated to reclassify credits arising on fair value movements to finance income.

7. Member payments

	2014 £m	2013 £m
To individual members	**-**	(26)
To employees who are members	**-**	(13)
To corporate members	**-**	(10)
Community distribution	**-**	(6)
	-	(55)

Further details of member payments are shown in the Finance Review on page 12.

Accounting policies

Payments to holders of Members' share capital ('members', see note 23) in their capacity as equity shareholders of the Society, such as share interest, are accounted for as an appropriation of profit.

Payments to Members in their capacity as customers or employees are treated as charges to the income statement. Additionally members are allocated funds to distribute to charitable and co-operative organisations which are also treated as charges to the income statement. Where such payments are non-contractual, are distinguishable from the operating activities of the business and payment is dependent on, and subject to, member approval in a general meeting and the Society making a profit within the year, these payments are termed 'Member payments', are charged below operating profit (where material) and are recognised when such payments are approved by the membership. Certain costs relating to supporting member activity which were formerly treated as part of member payments are now treated as an operating expense.

All payments to Corporate members in respect of their holding of Corporate Investor Shares (see note 24), are charged to the income statement when the Society incurs the obligation to make such payments, and are classified as finance costs (see note 6).

Notes to the Financial Statements continued

8. Taxation

	2014 £m	2013 £m
Current tax charge – current year	-	(66)
Current tax charge – adjustments in respect of prior years	-	(5)
Deferred tax charge – current year	(5)	(75)
Deferred tax credit – adjustments in respect of prior years	1	33
Total tax charge	(4)	(113)
Deduct tax (credit)/charge on discontinued businesses	(13)	153
Total tax (charge)/credit on continuing businesses	(17)	40

The tax on the Group's net profit before tax differs from the theoretical amount that would arise using the standard applicable blended rate of corporation tax of 21.5% (2013: 23.25%) as follows:

	2014 £m	2013 £m
Profit/(loss) before tax	124	(310)
Current tax (charge)/credit at 21.5% (2013: 23.25%)	(27)	72
Expenses not deductible for tax (including one-off costs)	(4)	(17)
Depreciation and amortisation on non-qualifying assets	(5)	(72)
Non-taxable profits arising on share disposals	29	-
Non-deductible costs of investments	(13)	(8)
Adjustment in respect of previous periods	1	28
Losses taxed at lower rate/utilisation of losses	2	17
Restatement of deferred tax to 20% (2012: 23%)	-	20
Tax (charge)/credit on continuing business	(17)	40

Tax (expense)/benefit items taken directly to consolidated statement of comprehensive income

	2014 Tax (expense)/ benefit £m	2013 Tax (expense)/ benefit £m
Changes in available for sale assets	-	20
Actuarial gains and losses on employee pension scheme	(145)	20
Effective portion of cash flow hedges transferred to the cash flow hedging reserve	-	19
	(145)	59

Of the tax taken directly to the consolidated statement of comprehensive income, £145m charge (2013: £37m credit) relates to deferred taxation. See note 17 on deferred tax.

The 2013 Budget on 20 March 2013 announced that the UK corporation tax rate will reduce to 20% with effect from 1 April 2015. This was substantively enacted on 2 July 2013. This will reduce the company's future current tax charge accordingly. The deferred tax liability at 3 January 2015 has been calculated based on the rate of 20% substantively enacted at the balance sheet date.

Accounting policies

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in reserves, in which case it is recognised in other comprehensive income. Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Notes to the Financial Statements continued

9. Profit/(loss) on discontinued operations, net of tax

On 6 October 2014 the Group announced the completion of the sale of its Pharmacy business to Bestway Group for consideration of £640m.

During the year, the Group also disposed of its Farms division (Farmcare) and the Sunwin Services Group. As these businesses were not considered to be separate, major operating activities of the Group, the results of these businesses have not been disclosed as discontinued operations as defined by IFRS 5.

In the prior period, the Group announced the completion of a Liability Management Exercise (LME) in respect of the Co-operative Bank plc ('the Bank') following which the Group's shareholding in the Bank reduced to 30%. As a result the Group now accounts for its investment in the Bank as an associate (see note 13 for more information). The results of the Bank up to 20 December 2013 were included in discontinued operations in the prior period.

The cost to the Group of completing the LME was £527m, which consisted of a discounted deferred cash consideration of £320m, the issue of new debt to bondholders of £129m (see note 24) and disposal and separation costs of £78m. The deferred cash consideration was £333m (discounted to £320m) on the date of the LME, of which £313m remained payable during 2014 comprising several tranches: £50m payable no later than 31 January 2014, £100m payable by 30 June 2014 and £163m payable by 31 December 2014. These amounts were all paid in accordance with the agreed schedule.

Following the adoption of IFRIC 21 from 1 January 2014, in its own published financial statements the Bank restated its results for the 2013 comparative periods. This adjustment has also been reflected in the Group's comparatives for the prior year and had the impact of reducing the loss from operating activities in discontinued operations and increasing the loss on discontinued operations by £26m.

In August 2013 the Group announced the sale of CIS Limited (the entity responsible for the Life Insurance business) to Royal London Group. This sale included a number of its wholly owned subsidiaries and TCAM Limited (whose principal activity was the management of the life fund investment portfolio). The results of both of these entities were included in discontinued operations in 2013.

Results of discontinued operations	2014 £m	2013 (restated) £m
Revenue	**578**	2,225
Expenses*	**(528)**	(3,984)
Other income	**-**	559
Results from operating activities	**50**	(1,200)
Profit/(loss) on sale of discontinued operations (see below)	**61**	(662)
Profit/(loss) before tax	**111**	(1,862)
Tax – relating to operating activities**	**(2)**	(174)
Tax – relating to the loss on sale of discontinued operations	**-**	5
Profit/(loss) for the period	**109**	(2,031)

*The Pharmacy business was classified as held for sale from 26 February 2014. Its assets were therefore not depreciated or amortised from this date to the date of completion of the disposal. Expenses in the current year therefore do not include depreciation and amortisation charges of £20m which would have been included in the operating result if Pharmacy had not become an asset held for sale at that date.

**Included within tax relating to operating activities is income tax attributable to policyholder returns of £nil (2013: £16m).

Further details of income and expenses relating to the Co-operative Bank plc, the Life and Savings business and TCAM Limited can be found in note 33.

Notes to the Financial Statements continued

9. Loss on discontinued operations, net of tax continued

Profit/(loss) on sale of discontinued operations	Note	2014 Pharmacy £m	2013 (restated) Bank £m	Life and Savings (including TCAM) £m	Total £m
Investment in associate recognised at fair value	13	**-**	221	-	221
Cash consideration received		**640**	-	90	90
Net assets derecognised		**(490)**	(357)	(217)	(574)
Deferred cash consideration (payable)/receivable	25, 19	**-**	(320)	168	(152)
Interest-bearing loans and borrowings issued as part of LME transaction	24	**-**	(129)	-	(129)
Disposal and separation costs		**(28)**	(78)	(52)	(130)
Recycle of available for sale and cashflow hedge reserves		**-**	12	-	12
Profit/(loss) on sale		**122**	(651)	(11)	(662)
Further disposal and separation costs in respect of the Co-operative Bank		**(49)**	-	-	-
Further disposal costs in respect of the Life and Savings business and TCAM Limited		**(12)**	-	-	-
Profit/(loss) on sale of discontinued operations		**61**	(651)	(11)	(662)

Following a review of the Group's separation of the Bank in 2014, and in light of better information, the Group has reassessed the estimated costs on separation and a further £49m charge has been recognised to separate certain IT systems and processes from the Bank.

Pharmacy segmental analysis

	Revenue from external customers £m	Underlying segment operating profit £m	Operating profit £m	Additions to non-current assets £m	Depreciation and amortisation £m
52 weeks ended 3 January 2015	**578**	**30**	**30**	**7**	**26**
52 weeks ended 4 January 2014	760	33	33	13	35

The amounts in the table above do not include the IFRS 5 adjustment to cease depreciation and amortisation from 26 February 2014 when the Pharmacy business became an asset held for sale. This is because the information given to the Executive (Chief Operating Decision Maker) did not include this adjustment.

Notes to the Financial Statements continued

9. Loss on discontinued operations, net of tax continued

A summary of the assets and liabilities held by the Pharmacy business at the point of disposal is shown below:

	£m
Non current assets	
Property, plant and equipment	**74**
Goodwill and intangible assets	**345**
Investments in associates and joint ventures	**1**
Trade and other receivables	**13**
Current assets	
Inventory	**51**
Trade and other receivables	**89**
Cash and cash equivalents	**29**
Total assets disposed of	**602**
Non current liabilities – deferred tax provision	**15**
Current liabilities – trade and other payables	**97**
Total liabilities disposed of	**112**
Net assets disposed of	**490**

A summary of the cash flows used in discontinued operations is below:

	2014 £m	2013 £m
Cash flows used in discontinued operations:		
Net cash from operating activities	**49**	(2,215)
Net cash from investing activities	**(21)**	(3,996)
Net cash used in financing activities	**-**	(131)
Net cash used in discontinued operations	**28**	(6,342)

Notes to the Financial Statements continued

9. Loss on discontinued operations, net of tax continued

A summary of the assets and liabilities held by the Bank and the Life and Savings business (including TCAM Limited) as at the point of their disposal in the prior year is shown below together with Group's assessment of the fair value of the Bank's assets and liabilities at the disposal date, including the impact of the LME.

	2013		
	Bank (restated) £m	Bank at fair value £m	Life & Savings £m
Assets			
Cash and balances at central banks	5,274	5,399	155
Insurance receivables	-	-	3,859
Derivatives	556	556	-
Loans and advances to banks	1,594	1,594	-
Loans and advances to customers	30,322	27,947	-
Fair value adjustments for hedged risk	108	108	-
Investments	4,669	4,667	19,729
Investments in associates and joint ventures	5	5	-
Intangible assets	111	111	10
Income tax	-	-	6
Property, plant and equipment	115	115	-
Deferred tax assets	-	-	-
Prepayments and other receivables	256	576	-
Total assets disposed of	43,010	41,078	23,759
Liabilities			
Amounts owed to credit institutions	2,758	2,758	-
Customer accounts	32,463	32,488	-
Capital bonds	538	538	-
Derivatives	539	539	1,503
Insurance and participation contracts	-	-	18,065
Debt securities in issue	4,195	4,702	-
Other borrowed funds	1,256	234	-
Income tax payable	-	-	-
Trade and other payables	261	323	-
Deferred tax liabilities	93	93	54
Pension liabilities (see note 16)	-	-	-
Provisions	550	550	9
Insurance payables	-	-	2,624
Net asset value attributable to unit holders	-	-	76
Unallocated divisible surplus	-	-	1,211
Total liabilities disposed of	42,653	42,225	23,542
Net assets/(liabilities) disposed of	357	(1,147)	217
Fair value of assets and liabilities of Bank post disposal at 30%		(344)	

The £357m of net assets disposed of included non-controlling interests of £34m.

Accounting policies

Discontinued operations are those operations that can be clearly distinguished from the rest of the Group, both operationally and for financial reporting purposes, that have either been disposed of or classified as held for sale and which represent a separate major line of business or geographical area or a subsidiary purchased exclusively with a view to resale.

Notes to the Financial Statements continued

10. Property, plant and equipment

For the period ended 3 January 2015

	Property £m	Plant and equipment £m	Total £m
Cost or valuation:			
At 4 January 2014 (restated)	1,805	2,489	4,294
Additions	60	257	317
Reclassified as assets held for sale (see note 20)	(110)	(50)	(160)
Disposals	(107)	(80)	(187)
Disposal of subsidiary undertakings	(113)	(143)	(256)
Transfer to intangible assets	-	(22)	(22)
Transfer from Investment Property	2	-	2
Revaluation	11	-	11
At 3 January 2015	1,548	2,451	3,999
Depreciation:			
At 4 January 2014 (restated)	539	1,444	1,983
Charge for the period	26	233	259
Impairment	9	11	20
Reclassified as assets held for sale (see note 20)	(37)	(38)	(75)
Disposals	(31)	(70)	(101)
Disposal of subsidiary undertakings	(14)	(77)	(91)
Transfer to intangible assets	-	(8)	(8)
Transfer to Investment Property	(1)	-	(1)
Transfer from provisions	15	-	15
At 3 January 2015	506	1,495	2,001
Net book value:			
At 3 January 2015	1,042	956	1,998
At 4 January 2014	1,266	1,045	2,311
Capital work in progress included above	1	9	10

Amounts in relation to cost and accumulated depreciation have been re-stated in the prior year to more accurately represent the appropriate accounting entries that are required to record historic store disposals (primarily in the Food business). There is no impact on the overall net book value in the current or any previous years as a result of these adjustments.

The impairment charge of £20m (2013: £34m) primarily relates to charges against loss making stores in Food of £8m (2013: £20m) and has been recognised to the extent that the carrying value of individual stores exceeds their recoverable amount. The recoverable amount is assessed as the greater of fair value less costs to sell and value in use. For these loss making stores the fair value has been assessed as their estimated disposal proceeds (less costs to sell) as at 3 January 2015 using internal valuations based upon the expected rental yield of the property. A £6m impairment charge has also been made in relation to computer software and hardware assets within CISGIL. The charge reflects accelerated depreciation to write off the assets to the end of 2015, after which a new operating platform is planned to be implemented and the assets will no longer be able to be used as intended.

The disposal of subsidiary undertakings relates to the sale of our Pharmacy, Farms and Sunwin Services businesses during the year. In the prior year the disposals from loss of control of subsidiaries related to the reduction of the Group's investment in the Bank from 100% to 30% on 20 December 2013.

Assets held for sale at 3 January 2015 relate to a number of foodstores. For further details see note 20.

Notes to the Financial Statements continued

10. Property, plant and equipment continued

Assets with a cost of £6m and accumulated depreciation of £1m in relation to a website in the Funerals business have been transferred to Intangibles. Computer software assets with a cost of £16m and accumulated depreciation of £7m in CFSMS have also been transferred to Intangibles (see note 11).

Included in accumulated depreciation is an impairment provision of £15m which was previously held within provisions.

The revaluation uplift of £11m (2013: £nil) relates to several discreet parcels of land that were revalued during the period following the sale of our Farms business and consequent change in use of the assets. The land had been held at historical cost and was mostly tenanted by external parties (or was vacant) but was adjacent to land farmed by our Farms business. The historical cost carrying value was £4m and the surplus on revaluation has been recognised in the statement of other comprehensive income. The properties were fair valued as at 4 August 2014 (IFRS 13 level 3 hierarchy) and then transferred to Investment Properties. The valuation was carried out by a number of external chartered surveyors: CBRE and Smiths Gore; as well as in-house valuers, on the basis of open market value in accordance with the RICS Appraisal and Valuation Manual (see note 12 for further details as to the accounting policies for investment properties).

For the period ended 4 January 2014

	Property £m	Plant and equipment £m	Total £m
Cost or valuation:			
At 5 January 2013 (restated)	1,951	2,558	4,509
Additions	73	210	283
Reclassified as assets held for sale (see note 20)	(50)	(10)	(60)
Disposals (restated)	(60)	(114)	(174)
Disposals arising from loss of control of subsidiary	(109)	(155)	(264)
At 4 January 2014	1,805	2,489	4,294
Depreciation:			
At 5 January 2013 (restated)	543	1,363	1,906
Charge for the period	32	257	289
Impairment	15	19	34
Reclassified as assets held for sale (see note 20)	(1)	-	(1)
Disposals (restated)	(9)	(87)	(96)
Disposals arising from loss of control of subsidiary	(41)	(108)	(149)
At 4 January 2014	539	1,444	1,983
Net book value:			
At 4 January 2014	1,266	1,045	2,311
At 5 January 2013	1,408	1,195	2,603
Capital work in progress included above	1	47	48

Within property, land of £nil (2013: £49m) is held at valuation (IFRS 13 level 3 hierarchy). The historical cost equivalent is £nil (2013: £1m). In the prior year, this related to agricultural land held for development purposes, but farmed by the Group whilst the development potential was explored. The £49m land held at valuation has now been sold following the disposal of the Farms business. The carrying amount was previously tested annually for impairment in line with the Group's approach to all property, plant and equipment. Valuations were based on rental yields in an active market at similar sites.

In the prior year the disposals from loss of control of subsidiaries related to the reduction of the Group's investment in the Bank from 100% to 30% on 20 December 2013.

Notes to the Financial Statements continued

10. Property, plant and equipment continued

	2014 £m	2013 £m
Plant and equipment includes assets held under finance leases as follows:		
Cost	**39**	35
Accumulated depreciation	**(27)**	(21)
Net book value	**12**	14

No other assets of the Group are held under finance lease.

Critical accounting estimates and judgements

Impairment

The carrying amount of property, plant and equipment is reviewed at each balance sheet date and if there is any indication of impairment, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any associated goodwill allocated to cash-generating units, and then to reduce the carrying value of other fixed assets.

The recoverable amount is the greater of the fair value less costs to sell and value in use. The value in use of an asset is estimated by taking the relevant business' five year plan and discounting the cash flows associated with that asset at a post tax rate of between 8-10% dependent on the business. Certain central corporate costs and tax are also allocated to the asset on a reasonable basis. Cash flows beyond five years use a steady or declining growth rate dependent on the business. Fair value less costs to sell are measured using internal valuations based on the rental yield of the property.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent of the asset's carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Accounting policies

Where parts of an item of property, plant and equipment have materially different useful economic lives, they are accounted for as separate items of property, plant and equipment.

Cost includes purchase price plus any costs directly attributable to bringing the assets to the location and condition necessary for it to be capable of operating in the manner intended by management.

Depreciation is provided on the cost or valuation less estimated residual value (excluding freehold land) on a straight-line basis over the anticipated working lives of the assets.

The estimated useful lives are as follows:

Property

Freehold buildings – 50 years

Leasehold property – shorter of period of lease or 50 years

Plant and equipment

Plant and machinery – 3 to 13 years

Vehicles – 3 to 9 years

The residual value, if significant, is reassessed annually.

All properties are measured at cost less accumulated amortisation and impairment losses, except £nil (2013: £49m) of freehold land that is subject to potential development which is carried at fair value. Movements in fair value are recognised in the statement of comprehensive income.

The derecognition of property, plant and equipment occurs when the entity loses the future economic benefits associated with the asset. For a property disposal, this usually relates to when the property is unconditionally exchanged.

Leased assets

Leases where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and vehicles

Notes to the Financial Statements continued

10. Property, plant and equipment continued

acquired under finance leases are stated at an amount equal to the lower of fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and any impairment losses.

Depreciation is provided on the same basis as for owned assets. Minimum finance lease payments are apportioned between the finance charge and the redemption of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Property held under operating leases that would otherwise meet the definition of investment property may be classified as investment property on a property by property basis. Where such leases are treated as investment properties, the assets are held at fair value and the leases are accounted for as finance leases.

Lease payments in respect of operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense and the aggregate benefit is recognised as a reduction of rental expense over the lease term on a straight-line basis.

For any leases where the Group is the lessor, the aggregate cost of incentives is recognised as a reduction of rental income over the lease term on a straight-line basis.

Sale and leaseback

A sale and leaseback transaction is one where a vendor sells an asset and immediately reacquires the use of that asset by entering into a lease with the buyer. The accounting treatment of the sale and leaseback depends upon the substance of the transaction and whether or not the sale was made at the asset's fair value. For sale and finance leasebacks, any apparent profit or loss from the sale is deferred and amortised over the lease term. For sale and operating leasebacks, generally the assets are sold at fair value, and accordingly the profit or loss from the sale is recognised immediately in the income statement. Following initial recognition, the lease treatment is consistent with those principles described above.

Notes to the Financial Statements continued

11. Goodwill and intangible assets

For period ended 3 January 2015

	Goodwill £m	Licences £m	Computer software £m	Deferred acquisition costs £m	Other £m	Assets in course of construction £m	Total £m
Cost:							
At 4 January 2014	1,276	504	48	308	-	2	2,138
Additions – acquired separately	12	-	2	46	-	2	62
Transfers from property, plant and equipment	-	-	22	-	-	-	22
Disposals	(3)	-	(9)	-	-	(2)	(14)
Disposals of subsidiaries	(23)	(504)	-	-	-	-	(527)
At 3 January 2015	1,262	-	63	354	-	2	1,681
Amortisation:							
At 4 January 2014	371	176	39	271	-	-	857
Charge for the period	-	4	8	63	-	-	75
Impairment	2	-	-	-	-	-	2
Transfer from property, plant and equipment	-	-	8	-	-	-	8
Disposals	-	-	(6)	-	-	-	(6)
Disposals of subsidiaries	-	(180)	-	-	-	-	(180)
At 3 January 2015	373	-	49	334	-	-	756
Net book value:							
At 3 January 2015	889	-	14	20	-	2	925
At 4 January 2014	905	328	9	37	-	2	1,281

Notes to the Financial Statements continued

11. Goodwill and intangible assets continued

For period ended 4 January 2014

	Goodwill £m	Licences £m	Computer software £m	Deferred acquisition costs £m	Other £m	Assets in course of construction £m	Total £m
Cost:							
At 5 January 2013	1,296	503	202	238	46	284	2,569
Additions – acquired separately	1	1	20	70	-	6	98
Transfers	-	-	138	-	-	(138)	-
Disposals	(21)	-	(8)	-	-	-	(29)
Disposals arising from loss of control of subsidiary	-	-	(304)	-	(46)	(150)	(500)
At 4 January 2014	1,276	504	48	308	-	2	2,138
Amortisation:							
At 5 January 2013	132	150	93	206	17	150	748
Charge for the period	-	25	31	65	4	-	125
Impairment	239	1	140	-	2	-	382
Transfer to assets held for sale	-	-	-	-	-	-	-
Disposals	-	-	(9)	-	-	-	(9)
Disposals arising from loss of control of subsidiary	-	-	(216)	-	(23)	(150)	(389)
At 4 January 2014	371	176	39	271	-	-	857
Net book value:							
At 4 January 2014	905	328	9	37	-	2	1,281
At 5 January 2013	1,164	353	109	32	29	134	1,821

Balances categorised under licences related exclusively to Pharmacy licences that were held prior to the sale of the business and were being amortised over 20 years. The current year charge (£4m) represents amortisation in respect of the period prior to the announcement of the sale on 26 February 2014. No further amortisation has been charged on these assets after that date in-line with IFRS 5. Assets with a cost of £6m and accumulated depreciation of £1m in our Funerals business have been transferred to computer software from property, plant and equipment as have computer software assets with a cost of £16m and accumulated depreciation of £7m in CFSMS (see note 10).

Goodwill

The components of goodwill are as follows:

	2014 £m	2013 £m
Food	**862**	856
Other businesses	**27**	49
	889	905

The components of Food goodwill include £627m (2013: £621m) that is allocated to the group of cash generating units (CGUs) that is Food as a whole; £86m (2013: £86m) allocated to stores acquired with the Alldays group and £149m (2013: £149m) assessed against other specific components of the Food business, none of which is individually significant.

Within other businesses is goodwill largely relating to the Funerals business. The prior period also included goodwill relating to the Pharmacy business which was disposed of during the year and Legal Services which was partially impaired in the prior period.

Notes to the Financial Statements continued

11. Goodwill and intangible assets continued

Impairment

The components of the impairment charge are as follows:

	2014 £m	2013 £m
Included in operating expenses within continuing operations:		
Goodwill in Food	**2**	226
Goodwill in Legal Services	**-**	13
Included in discontinued operations		
Finacle asset in Financial Services	**-**	140
Brand in Financial Services	**-**	2
Licences in Pharmacy	**-**	1
	2	382

The £2m impairment of goodwill relates to foodstores transferred to assets held for sale at the end of 2014. The prior year impairment of £140m in Financial Services occurred prior to the LME transaction on 20 December 2013 and was therefore included as part of the loss from discontinued operations in the income statement. The prior year impairment in Food of £226m primarily related to larger stores intended for disposal following the implementation of True North.

In 2013, the True North strategy was implemented which shifted the focus of Food onto smaller convenience stores. As a result, a significant portion of the Food estate, including larger stores, were identified for closure or sale, with the proceeds reinvested in smaller stores, often in different catchment areas. This represented a significant restructuring of the Food business, and as such the goodwill of £236m associated with the stores intended for disposal was separately identified from that remaining within the wider Food business and assessed for impairment. Within this group of CGUs, impairment testing was carried out using discounted post tax cash flows from the business' four year plan up to the date of disposal (including an allocation of central corporate costs) and estimated disposal proceeds, at a discount rate of 7.3%. The NPV of the disposal group calculated on that basis was £354m, resulting in an impairment of £226m. The key assumption within the estimate of value in use was the estimated disposal proceeds, which were based on contracts or latest negotiations at the year end date where available, and otherwise were estimated by RICS qualified property specialists employed by the Group.

Critical accounting estimates and judgements

Goodwill

A cash generating unit (CGU) is the smallest identifiable group of assets that generates cash inflows which are largely independent of the cash inflows from other assets of the Group. Goodwill is allocated to CGUs or groups of CGUs as explained in the policy below. It is reallocated where appropriate based on relative values to reflect changes in the way goodwill is reported.

In the Food business, the CGUs' recoverable amounts are based on value in use estimates, using projections of the Group's performance based on the four-year plans approved by the Board. The discount rate is based on the cost of capital for each business and calculations range from 8-10% (2013: 7-10%). Business-specific growth rates are used to extrapolate cash flows beyond the four year plan. The cash flows for each business are risk adjusted as appropriate to their respective industry. Certain central corporate costs have been allocated as appropriate to each CGU.

The goodwill that arose on the acquisition of Somerfield is allocated to Food as a whole to reflect the synergies (principally buying benefits) that benefit the whole estate. Accordingly, impairment testing is carried out using the whole estate as the group of CGUs. The key assumption used in the review for potential impairment of this goodwill is cash flows from operation of stores (projecting growth at 1-3% (2013: 1-3%) based on management's best estimate based on the profile of the stores, and including an allocation of corporate central costs) taken into perpetuity and discounted to present value at a rate of 8.1% (2013: 8%). In each of the current and comparative year, sensitivity analysis has been performed on this, testing for a 1% increase in discount rate and a decrease in growth to 1%; within both these sensitivites the cash flows remain well in excess of the current carrying value.

For other Food individual stores/smaller groups such as Alldays, annual cashflows have been inflated for growth by between 1% and 3% (2013: 1-3%) per annum (dependent on the size of the acquisition group) taken into perpetuity and discounted to present value also using a 8.1% (2013: 8%) discount rate and after allocating Corporate costs.

Notes to the Financial Statements continued

11. Goodwill and intangible assets continued

For Funeralcare, average selling price increases and wage and cost inflation have been applied as per the assumptions in the four year plan. Cash flows have been projected based on the four year plan and into perpetuity from year five and discounted back to present value using a discount rate of 8.2% (2013: 8.5%). Sensitivity analysis has been performed with both the growth rate and discount rate adjusted by +/- 1%, and under these sensitivities significant headroom is maintained.

Accounting policies

Goodwill

Goodwill represents amounts arising on business combinations. In respect of business acquisitions that have occurred since 11 January 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired. In respect of acquisitions prior to 11 January 2004, goodwill is included on the basis of its deemed cost, which represents the amount recorded under previous UK GAAP.

Assets and liabilities accepted under a transfer of engagements are restated at fair value, including any adjustments necessary to comply with the accounting policies of the Group.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortised but is tested annually for impairment. In respect of associates, the carrying value of goodwill is included in the carrying amount of the investment in the associate. Where impairment is required the amount is recognised in the income statement and cannot be written back.

Negative goodwill arising on an acquisition is recognised directly in the income statement.

For transfers of engagements on or after 3 January 2010, considerations transferred have been valued by reference to the fair value of the Group's interest in the aquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting to perpetuity using a discount rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Acquisition costs since 3 January 2010 are now expensed to the income statement when incurred.

Computer software

Stated at cost less cumulative amortisation and impairment. In Financial Services, all costs directly attributable in the development of computer software for internal use are capitalised and classified as intangible assets where they are not an integral part of the related hardware and amortised over their useful life up to a maximum of ten years.

Other intangible assets

These include pharmacy licences and Deferred Acquisition Cost (DAC) assets that are acquired by the Group and are stated at cost less accumulated amortisation (see below) and impairment losses. Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

Assets in the course of construction

Include directly attributable software development costs and purchased software that are not an integral part of the related hardware, as part of strategic projects that meet the capitalisation requirements under IAS 38 but have not been brought into use. The costs are held within assets in the course of construction until the project has gone live or the related asset is brought into use. At that point it will be transferred out of this classification and will be amortised based on the useful economic life as defined by the intangible asset accounting policy specified above.

Subsequent expenditure

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill with an indefinite useful life is systematically tested for impairment at each balance sheet date. Other intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

- software development costs: 3-7 years (Core systems – maximum of 10 years)
- pharmacy licences: 20 years
- general insurance deferred acquisition cost assets: Up to 1 year

Notes to the Financial Statements continued

11. Goodwill and intangible assets continued

Impairment

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount (the greater of the fair value less costs to sell and value in use). Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units, and then to reduce the carrying value of other fixed assets.

The carrying amounts of the Group's intangibles are reviewed at each balance sheet date and whenever there is any indication of impairment. For goodwill, and for assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. If any such indication of impairment exists, the assets' recoverable amount is estimated.

For the purpose of impairment testing of goodwill, the Group is regarded as several cash-generating units. Components of goodwill range from individual cash generating units, where stores were acquired individually, to groups of cash generating units, where groups of stores/branches were acquired as part of one transaction. Impairment testing is carried out at the level at which management monitor these components of goodwill.

Deferred acquisition costs

Costs directly associated with the acquisition of new business in the General Insurance business, including commission, are capitalised and amortised in accordance with the rate at which the gross written premiums associated with the underlying contract are earned.

12. Investment properties

	2014 £m	2013 £m
Valuation at beginning of period	**98**	273
Additions	**2**	2
Disposals	**(14)**	(154)
Transfers (net) to property, plant and equipment	**(3)**	-
Transfers to investments in joint ventures (see note 13)	**-**	(5)
Revaluation gain/(deficit) recognised in income statement	**16**	(18)
Valuation at end of period	**99**	98

Investment properties have been valued as at 3 January 2015 (IFRS 13 level 3 hierarchy). The valuation was carried out by a number of external chartered surveyors: CBRE and Smiths Gore; as well as in-house valuers, on the basis of open market value in accordance with the RICS Appraisal and Valuation Manual.

In the case of investment properties, it is assumed that uplifts on valuation principally reflect future rentals.

The mean ERV (Estimated Rental Value) yield over the whole estate at the period end is 2.2% (2013: 3.4%).

Direct operating expenses of investment property are not considered material to the Group in either the current or prior period. Rental income is disclosed in note 4.

Transfers (net) to property, plant and equipment comprises transfers in of £18m (including £16m in relation to fifteen agricultural properties that were not sold as part of the sale of the Farms business and now meet the requirements for recognition as investment properties). Transfers out includes nine sites (£21m) that were previously held as investment properties and were disposed of by the Group as part of the sale of the Farms business. The transfer to investments in joint ventures in the prior period represents the transfer of Biggleswade wind farm to a joint venture.

Notes to the Financial Statements continued

12. Investment properties continued

Accounting policies

Properties held for long term rental yields that are not occupied by the Group or property held for capital appreciation are classified as investment property. Investment property comprises freehold land and buildings and are carried at fair value. Fair value is based on current prices in an active market for similar properties in the same location and condition, using the work of independent valuers. No depreciation is provided on these properties. Any gain or loss arising from a change in fair value is recognised in the income statement. ERV is the Group's external valuers' opinion as to the open market rent, which on the date of valuation, could reasonably be expected to be obtained on a new letting or rent review.

On disposal of an investment property, the gain or loss on the disposal is recognised within the change in value of investment property line within the income statement.

Properties are valued individually, and yields therefore vary on a property-by-property basis. If an investment property becomes owner-occupied, it is reclassified as property, plant and equipment, and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes. Similarly, transfers to the investment property portfolio are made when owner-occupancy ceases in full and the property meets the criteria of an investment property under IAS 40. Separate portions of an owner occupied property which are not occupied by employees are transferred to investment property if these portions can be sold separately or leased out separately under a finance lease. Prior to such a transfer the property is measured at fair value with any uplift recognised in the income statement.

13. Investments in associates and joint ventures

A breakdown of the investments held and income received is disclosed below:

	2014		2013	
	Income/ (losses) £m	**Investments £m**	Income/ (losses) £m	Investments £m
The Co-operative Bank plc	**(10)**	**224**	-	221
TCCT Holdings UK Limited (Travel)	**6**	**48**	-	46
NOMA	**1**	**31**	-	-
Windfarm joint ventures	**-**	**11**	-	12
Pharmacy associates and joint ventures	**-**	**-**	-	1
Other investments	**-**	**2**	-	5
	(3)	**316**	-	285

The movements in investments in associates, joint ventures and other investments are as follows:

	2014			2013		
	Associates and joint ventures £m	**Other investments £m**	**Total £m**	Associates and joint ventures £m	Other investments £m	Total £m
At beginning of period	**280**	**5**	**285**	58	5	63
Additions	**31**	**-**	**31**	221	-	221
Transfer from investment property	**-**	**-**	**-**	5	-	5
Share of losses – continuing businesses	**(3)**	**-**	**(3)**	-	-	-
Share of other comprehensive income	**14**	**-**	**14**	-	-	-
Dividends received	**(5)**	**-**	**(5)**	-	-	-
Disposals	**(3)**	**(3)**	**(6)**	(4)	-	(4)
At end of period	**314**	**2**	**316**	280	5	285

Notes to the Financial Statements continued

13. Investments in associates and joint ventures continued

The Co-operative Bank Plc (the Bank)

Following the Group's loss of control of the Bank in December 2013, the Group retained a 30% shareholding and also retained the right to appoint two directors to the Board. Based on these continued rights, the Group was deemed to have retained a significant influence over the Bank, and as a result, the Group accounted for their investment as an associate. On 30 May 2014, the Group's percentage shareholding in the Bank was diluted from 30% to 20.2% as the Group did not fully participate in a rights issue undertaken by the Bank on that date. Before the rights issue, the carrying value of the Group's investment in the Bank as an associate was recorded at £244m. This reduced to £242m following the rights issue as the Group effectively disposed of £2m of its investment for nil consideration and consequently recorded a loss of £2m. Following the disposal, the Group's right to appoint directors fell from being able to appoint two directors to only one. It nevertheless still equity accounts for the investment as an associate because it still has the right to appoint a director, which is deemed to give the Group significant influence over the Bank.

The principal activity of the Co-operative Bank Plc is banking and its principal place of business is the United Kingdom. By retaining the right to appoint a director to the Bank Board, the Bank is still considered to be strategic to the Group's activities as the Group can still continue to promote the adoption of the Co-operative's ethical agenda into the Bank's activities and strategy. The Bank's year end date is 31 December as the Bank works to a monthly reporting cycle. For further information on the Bank's commitments and contingent liabilities, see below.

The Bank has the following significant restrictions to transfer funds to the Group in the form of cash dividends, or to repay loans or advances made by the Group. The Bank may, by ordinary resolution, declare a dividend to be paid to the members, according to their respective rights and interests in the profits. When considering whether or not to pay an interim dividend or to recommend the payment of a final dividend, the Bank Board shall take into account such factors as the Bank's capital and financial position, cash requirements and liquidity and profits available as well as the Bank's regulatory outlook, capital position, investment needs and principal relevant risk factors subsisting at the time.

The Group's risk associated with its interest in the Bank arises if the Bank were to suffer unexpected losses that adversely impacted its net assets and therefore the valuation of the Group's investment. The Bank splits its risks into three main areas: credit risk, liquidity risk and market risk which could all affect the Group's valuation of its investment in the Bank and lead to the risk of further impairment in the Group financial statements. Credit risk is the current or prospective risk to earnings and/or capital arising from a borrower's failure to meet the terms of any contract with the Bank or the various subsidiaries of the Bank or such borrower's failure to perform as agreed. Liquidity risk is the risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in a stress. It arises from the mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives). Should additional liquidity be required during a time of stress this is likely to result in higher than anticipated funding costs which will negatively impact on retained earnings and therefore capital resources. Market risk is the risk that the value of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates which is managed and hedged in line with the market risk policy to minimise earnings volatility. For more specific information on the Bank's own risks, refer to the Bank's own 2014 annual financial statements.

TCCT Holdings UK Limited (Travel)

The principal activity of TCCT Holdings UK Limited is the provision of travel agency services. Its principal place of business is the United Kingdom. The Group held an investment of 30% in TCCT Holdings during the entirety of 2013 and 2014 and has the right to appoint two directors to the Board. As a result the Group has equity accounted for Travel as an associate in both periods. The 30% shareholding and the right to appoint two directors to the Board means that Travel is still strategic to the Group's activities as the Group can closely align Travel's strategy to the overall Group strategy. Travel's year end date is 30 September which is in line with its majority shareholder, Thomas Cook Group plc. Travel does not have any material commitments or contingent liabilities. The Group's risk associated with its interest in Travel arises if the business were to significantly underperform leading to losses in the associate and risk of impairment. Underperformance could arise from a worsening in the economic conditions of the UK, terrorist plots or severe weather restrictions.

Travel has the following significant restrictions to transfer funds to the Group in the form of cash dividends, or to repay loans or advances made by the entity. The aggregate dividend to which the holders of the B Shares (which the Group owns) shall be entitled to in a given financial year is based on a formula dependent on the number of other shares in issue at the relevant time. Travel is also restricted in the raising of any indebtedness other than by way of trade credit on normal commercial terms which must have approval of a resolution of the Board of Directors.

Notes to the Financial Statements continued

13. Investments in associates and joint ventures continued

NOMA

On 5 June 2014, the Group completed its joint venture with Hermes Real Estate to develop the £800m NOMA scheme in Manchester city centre via a joint venture. The partnership will develop the buildings and land within NOMA to deliver a new mixed use district in the Northern part of Manchester City Centre. NOMA is strategic to the Group's activities as it is developing the Group support centre's surroundings. As decisions about the relevant activities of NOMA can only take place with unanimous consent of both parties, NOMA is considered to be a joint arrangement. As the Group has rights to the net assets of the arrangement, NOMA is a joint venture and the Group therefore equity accounts for its investment in its financial statements. The Group's risk associated with its interest in NOMA arises if property values were to fall in Manchester leading to impairments of property in the joint venture and therefore a potential impairment in the value of the Group's investment. There are no restrictions to transfer funds to the entity in the form of cash dividends or repay loans or advances made by the entity.

Summary financial information of the Group's material joint ventures and associates is as follows:

	Co-operative Bank Plc		TCCT Holdings UK Ltd		NOMA	
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Current assets	**-**	-	**188**	114	**10**	-
Non-current assets	**-**	-	**227**	241	**81**	-
Current liabilities	**-**	-	**(394)**	(344)	**(7)**	-
Non-current liabilities	**-**	-	**-**	-	**-**	-
Financial Services – Assets*	**37,583**	43,384	**-**	-	**-**	
Financial Services – Liabilities*	**(35,568)**	(41,615)	**-**	-	**-**	
Net assets (100%)	**2,015**	1,769	**21**	11	**84**	-
Group's share of net assets	**407**	531	**6**	3	**42**	-
Elimination of unrealised profits	**-**	-	**-**	-	**(11)**	-
Fair value adjustments	**(476)**	(885)	**-**	-	**-**	-
Goodwill	**385**	575	**42**	43	**-**	-
Accumulated impairment	**(92)**	-	**-**	-	**-**	
Carrying amount in Group balance sheet	**224**	221	**48**	46	**31**	-
Revenue	**1,249**	1,465	**316**	316	**3**	-
Profit or loss from continuing operations	**(225)**	(777)	**38**	-	**2**	-
Post-tax profit or loss from discontinued operations	**-**	-	**(10)**	-	**-**	-
Other comprehensive income	**84**	(86)	**-**	-	**-**	-
Interest expense	**(707)**	(931)	**5**	5	**-**	-
Income tax income/(expense)	**39**	(145)	**(9)**	-	**-**	-

*Due to the Bank ordering their balance sheet in order of liquidity, the current/non-current split is not available. The balance sheet amounts have not been restated as they are not material to net assets for the purposes of this disclosure.

NOMA had cash and cash equivalents of £9m at 3 January 2015 (2013: £nil). Balances relating to other individually immaterial joint ventures and associates were immaterial in both periods.

Notes to the Financial Statements continued

13. Investments in associates and joint ventures continued

Critical accounting estimates and judgements

The unwind of the fair value adjustments arising on the recognition of the Group's investment in the Bank during 2014 increase the carrying value of the investment to a value that was considered to be in excess of its recoverable value. As a result, the Group has recorded an impairment at the year end to reduce its investment to fair value. The fair value recorded (IFRS 13 fair value heirachy level 3) is based on the value of the Group's 20.2% holding in the Bank. The valuation was derived and confirmed by a range of methodologies based on the Bank's business plan and using appropriate market multiples for the banking industry, adjusted for the risks appropriate to the Bank's circumstance and risk profile. The investment in the Bank was initially recorded based on a valuation of the Group's equity holding of 30% of the ordinary share capital of the Bank using similar methodologies as above.

The key assumptions within the valuations related to the Bank's 5 year plan profit growth and the extent to which any value was ascribed to the Bank's non-core businesses. The valuation methodologies taken included a price to book value multiple applied to 2014 closing equity, a dividend discount model and a price earnings multiple applied to 2017 equity. The multiples used were considered consistent with competitor banks, adjusted for the appropriate risk and capital structure of the Bank. This discount rate was higher than used in other Group businesses due to the additional business risk the Bank faces in the future.

The Group adopted a prudent approach within the overall range of possible valuations which indicated a range between £1,005m to £1,218m (2013: £674m to £807m). The valuation of the Bank as a whole is higher at the end of 2014 due to the Bank's rights issue which created additional equity of £387m. The key valuation methodology used within that range was a price to book value ratio based on the Bank's capital at year end, using a multiple of 0.55 to arrive at a valuation of £1,109m of which the Group's 20.2% share was £224m.

The Group assessed the valuation of the Bank implied from the market trading in the Bank's shares as at year end. The Group considered there were insufficient trading volumes for these to be considered a reliable valuation basis, without significant adjustment for market imperfections.

Contingent liabilities and commitments of associates and joint ventures

The table below gives the contract amounts and risk weighted amounts of contingent liabilities and commitments within the Co-operative Bank plc. The contract amounts indicate the volume of business outstanding at the Bank's balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the PRA rules.

The contingent liabilities of the Bank as detailed below arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	2014		2013	
Unaudited	**Contract amount £m**	**Risk-weighted amount £m**	Contract amount £m	Risk-weighted amount £m
i) Contingent liabilities				
Guarantees and irrevocable letters of credit	**43**	**18**	86	45
	43	**18**	86	45
ii) Other commitments:				
Documentary credits and short term trade related transactions	**-**	**-**	-	-
Forward assets purchases and forward deposit placed (a)	**155**	**78**	570	152
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments) (b)	**2,863**	**449**	3,433	684
	3,018	**527**	4,003	836

Notes

(a) Forward asset purchases have significantly reduced during the year as a result of lower funding requirements and the maturity of repos.

(b) Undrawn loan commitments include revocable commitments in respect of unused credit card limits of £1,787m (2013: £1,968m).

Notes to the Financial Statements continued

13. Investments in associates and joint ventures continued

The following sections (Conduct Issues, Consumer Credit Act issues, Regulatory and other investigations, Legal proceedings, Mortgage securitisation representations and warranties, Pensions, Former Britannia Building Society pension scheme guarantee and Tax treatment of separation) specifically represent the considerations documented in the accounts of the Co-operative Bank plc in respect of contingent liabilities.

Conduct Issues

Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain aspects of the Bank's current or historic business, including, amongst other things, mortgages and relationship banking, may be determined by the FCA and other regulatory bodies or the courts as, in their opinion, not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment.

In particular, there is currently a significant regulatory focus on the sale practices and reward structures that financial institutions have used when selling financial products. There is a risk that there may be other regulatory investigations and action against the Bank in relation to conduct and other issues that the Bank is not presently aware of, including investigations and actions against it resulting from alleged mis-selling of financial products or the ongoing servicing of those financial products. The nature of any future disputes and legal, regulatory or other investigations or proceedings into such matters cannot be predicted in advance. Furthermore, the outcome of any on-going disputes and legal, regulatory or other investigations or proceedings is difficult to predict.

Consumer Credit Act issues

The Consumer Credit Act regulates consumer lending and governs the way in which entities, including banks providing consumer credit to retail customers, carry out business. From 1 April 2014 the Financial Services and Markets Act 2000 also applies alongside certain retained provisions of the Consumer Credit Act. The Consumer Credit Act includes very detailed, prescriptive and highly technical requirements for lenders affecting customer documentation and which, in turn, impact how operational processes and IT systems are configured. While the Bank has undertaken a detailed analysis to identify certain instances where its documentation or processes have not been fully compliant with the technical requirements and has provided accordingly, it is not possible to rule out the possibility of other instances which have not yet been identified. Breaches may have the effect of triggering periods of non-compliance during which an affected customer is not liable to pay interest.

Debit interest refunds would therefore need to be made in certain cases where a period of non-compliance has been previously triggered, in the same way the Bank will be making such refunds as a consequence of the issues already identified (and provided for). During the year the Bank provided £65.0m (2013: £109.5m) for identified issues. As part of the process of identification, detailed and technical legal analysis has been carried out as to whether breaches of the technical requirements have in fact occurred. Such legal analysis by its nature involves judgement and assessment of the facts of particular circumstances. In the event that such legal analysis and judgements are determined to be wrong, the Bank could be exposed to a material additional liability. The amount of £174.5m which has been provided is the best estimate of the liability based on the legal analysis.

Notes to the Financial Statements continued

13. Investments in associates and joint ventures continued

Regulatory and other investigations

The Bank is the subject of multiple regulatory and other investigations and enquiries into events at the Bank and circumstances surrounding them including:

- The Treasury announced by press release on 22 November 2013 that it intends to conduct an independent investigation into events at the Bank and the circumstances surrounding them from 2008, including the Verde transaction and Britannia merger. The investigation will review the conduct of Regulators and the Government but is not anticipated to commence until it is clear that it will not prejudice the outcome of the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) enforcement investigations.
- The PRA is undertaking an enforcement investigation in relation to the Bank and as part of that investigation will consider the role of former senior managers.
- The FCA is undertaking enforcement investigations into events and decisions at the Bank up to June 2013.
- The Financial Reporting Council has launched an investigation under its Accountancy Scheme into the preparation, approval and audit of the Bank's accounts up to and including its 2012 annual accounts.

The Bank is co-operating with the investigating authorities. It is not possible to estimate the financial impact upon the Bank should any adverse findings be made.

Legal proceedings

The Bank is engaged in various other legal proceedings in the United Kingdom involving claims by and against it which arise in the ordinary course of business, including debt collection, mortgage enforcement, consumer claims and contractual disputes. The Bank does not expect the ultimate resolution of any of these proceedings to which the Bank is party to have a material adverse effect on its results of operations, cash flows or the financial position of the Bank and has not disclosed the contingent liabilities associated with these claims. Provisions have been recognised for those cases where the Bank is able reliably to estimate the probable loss where the probable loss is not de minimis.

Mortgage securitisation representations and warranties

In connection with the Bank's mortgage securitisations and covered bond transactions, the Bank makes various representations and warranties relating to the mortgage loans, including in relation to ownership, compliance with legislation and origination procedures. If the representations and warranties are breached subject to any applicable materiality determination, the Bank may be required to repurchase the affected mortgage loans or in some circumstances pay compensation to the securitisation vehicle. There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions could have given rise to breaches of such representations and warranties. Accordingly there is a risk that the Bank may be required to pay compensation or repurchase affected mortgage loans in amounts that may reduce the Bank's liquidity. The Bank is unable to estimate the extent to which, the matters described above will impact it or how future developments may have a material adverse impact on the Bank's net assets, operating results or cash flows in any particular period.

Pensions

There is uncertainty over the amount that the Bank will have to pay while it continues to participate in Pace. The Bank's obligations to contribute to Pace would increase significantly if another large employer in Pace becomes insolvent while the Bank continues to participate. If the Bank seeks to address these risks by terminating its participation, the default position is that material liabilities in respect of the deficit in Pace will arise. The Co-operative Group and the Bank have entered good faith discussions to manage this by reaching agreement so that the liabilities properly attributable to the Bank (and an equivalent proportion of assets) would be transferred to a separate scheme, or a segregated section of Pace, on the Bank's exit but, no arrangements have yet been agreed. There is therefore uncertainty over the amount that the Bank will have to pay in the event that it exits Pace. Separation of Pace will also require the co-operation of the Pace Trustees which may not be forthcoming. The Pace scheme is not sectionalised and operates on a 'last man standing' basis. In the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Bank would become liable for the remaining liabilities.

Other pensions risks and uncertainties include the risk to the Bank's capital and funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets), risks inherent in the valuation of scheme liabilities and assets, risks regarding the split of liabilities between the Bank and other participating employers while the Bank continues to participate in Pace and on exit from Pace and, in respect of the Britannia Scheme, risks on separation from the Co-operative Group.

In respect of the Britannia scheme, the Bank will need to manage the liabilities that could arise on separation from the Co-operative Group. This will require the co-operation of the Trustees of the Britannia scheme, which may not be forthcoming. It is not practicable to provide an estimate of the financial impact of these matters or what effect if any that these matters may have upon the Bank's operative revenues, cash flows or financial position in any period.

Notes to the Financial Statements continued

13. Investments in associates and joint ventures continued

Former Britannia Building Society pension scheme guarantee

Following the transfer of engagements of Britannia Building Society, in 2009 the Britannia pension scheme transferred to CFSMS. Under the terms of this transfer the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the scheme should CFSMS be unable to pay its obligations as they fall due. However, the Co-operative Group has undertaken to ensure that, CFSMS will not take or omit to take any action without the Bank's prior agreement if the result would be to increase the Bank's liabilities or contributions in respect of the Britannia Scheme. The most recent actuarial report indicated that the funding deficit in the Britannia Scheme as at 5 April 2013 was £61.0m. The scheme was recognised in 2014.

Tax treatment of separation

Until separation of the Bank from the Co-operative Group is complete, the Bank will continue to be responsible for indemnifying CFSMS under the CFSMS-Bank Services Agreement. During 2013, the Directors reviewed and reconsidered the accounting treatment of the intangible asset in development and all other assets held on the balance sheet of CFSMS which were used solely by the Bank. The Directors concluded that the Bank was substantially exposed to the risks and rewards of these assets and after considering the funding of the asset and CFSMS's lack of assets to absorb losses, the appropriate accounting treatment would be to hold these assets on the balance sheet of the Bank. The Bank applied an approach to the tax and accounting treatment of the Bank exclusive assets. However, if, and that to the extent that, there is a change to this treatment, there may be an additional tax charge. In November 2014 the Bank became the legal owner of the assets held by CFSMS for the provision of services exclusively to the Bank.

There will continue to be VAT charges incurred in respect of any assets that are supplied to the Bank under the CFSMS-Bank Services Agreement that are not owned by the Bank, until separation is fully effected.

There were no contingent liabilities or capital commitments in respect of the Group's other joint ventures or associates as at 3 January 2015 (2013: £nil).

Significant transactions and outstanding balances with the Bank, NOMA and the Travel investments at the period end can be found in note 29.

Accounting policies

The Group's interests in equity accounted investees comprise a number of joint ventures and associates as mentioned above. Associates are those entities in which the Group has significant influence, but not control or joint control over the financial and operating policies. A joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement, rather than rights to the assets and obligations for its liabilities. The Group records its share of the associate's post tax profit or loss within the income statement and its share of the net assets within investments. In accordance with IAS 28, the Group's share of any associate and joint venture result is adjusted for any fair value adjustments made on initial recognition.

Investments which have originated from the Group losing control of a subsidiary such as the Bank and the Travel business, are originally recorded at fair value on the date the Group lost control.

Other investments include investments where the Group does not have significant influence over the respective business. These investments are accounted for at cost.

14. Investments in funeral plans

The Group holds investments in respect of funeral plan policies which are invested in either Individual Whole of Life Policies, Trusts or life assurance products.

Funeral plan investments:

	2014 £m	2013 £m
At start of period	**517**	-
Transferred in following sale of Life and Savings business (as above)	**-**	452
New plan purchases	**87**	85
Plans redeemed or cancelled	**(43)**	(37)
Interest and bonus applied	**47**	17
At end of period	**608**	517

Refer to note 25 for accounting policy.

Notes to the Financial Statements continued

15. Derivatives

Derivatives held for non-trading purposes for which hedge accounting has not been applied are as follows:

	2014			2013		
	Contractual/ notional amount £m	**Fair value assets £m**	**Fair value liabilities £m**	Contractual/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Interest rate swaps	**895**	**67**	**(48)**	1,201	29	(67)
Forward currency transactions	**-**	**-**	**-**	-	-	-
Total recognised derivative assets/(liabilities)	**895**	**67**	**(48)**	1,201	29	(67)

Interest rate swaps and forward currency transactions are measured at fair value (IFRS 13 level 2 hierarchy) through the income statement (see note 5).

Accounting policies

The Trading Group uses derivative financial instruments to provide an economic hedge to its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its treasury policy, the Trading Group does not hold or issue derivative financial instruments for trading purposes.

Derivatives entered into include swaps and forward rate agreements. Derivative financial instruments are measured at fair value and any gains or losses are included in the income statement.

Fair values are based on quoted prices and where these are not available, using valuation techniques such as discounted cash flow models. For further details refer to note 31.

Interest payments or receipts arising from interest rate swaps are recognised within net financial income/(expenses) in the period in which the interest is incurred or earned.

Notes to the Financial Statements continued

16. Pensions

The pension assets and liabilities in the balance sheet comprise:

	Assets 2014 £m	Assets 2013 £m	Liabilities 2014 £m	Liabilities 2013 £m	Net 2014 £m	Net 2013 £m
Schemes in surplus						
The Co-operative Group Pension Scheme (Pace)	**9,154**	7,487	**(8,025)**	(7,126)	**1,129**	361
20% (2013: 40%) of Pace attributable to non-Group entities	**(1,831)**	(2,995)	**1,605**	2,850	**(226)**	(145)
Asset limitation on non-Group portion (IFRIC14)	**1,831**	2,995	**(1,605)**	(2,850)	**226**	145
Somerfield Pension Scheme	**958**	804	**(845)**	(759)	**113**	45
Britannia Pension Scheme	**-**	631	**-**	(604)	**-**	27
Lothian Borders & Angus Co-operative Society Limited Employees' Pension Fund	**69**	61	**(64)**	(57)	**5**	4
Total schemes in surplus	**10,181**	8,983	**(8,934)**	(8,546)	**1,247**	437
Schemes in deficit						
United Norwest Co-operatives Employees' Pension Fund	**492**	455	**(641)**	(584)	**(149)**	(129)
Other former United Co-operatives Funds	**159**	148	**(203)**	(189)	**(44)**	(41)
Plymouth and South West and Brixham Funds	**89**	79	**(151)**	(138)	**(62)**	(59)
Britannia unfunded obligations	**-**	-	**(3)**	(3)	**(3)**	(3)
EFRBS liabilities from the Pace scheme (unfunded)	**-**	-	**-**	(5)	**-**	(5)
Total schemes in deficit	**740**	682	**(998)**	(919)	**(258)**	(237)
Total schemes excluding asset limitation (IFRIC 14)	**10,921**	9,665	**(9,932)**	(9,465)	**989**	200
Less asset limitation (IFRIC 14)	**-**	(27)	**-**	-	**-**	(27)
Total schemes	**10,921**	9,638	**(9,932)**	(9,465)	**989**	173

Retirement benefit obligations

The Group operates a number of defined benefit (DB) pension schemes, the assets of which are held in separate trustee-administered funds to meet future benefit payments. The Group also provides defined contribution (DC) pension benefits.

The main Group pension scheme is the Co-operative Group Pension Scheme ('Pace'). The Group also operates nine other funded pension schemes which are closed to future accrual. These are listed below by size of DB obligation.

Under the scheme specific funding regime established by the Pensions Act 2004, trustees of DB pension schemes have to undertake a full actuarial valuation at least every three years. The purpose of the valuation is to determine if the scheme has sufficient assets to pay the scheme's benefits when these fall due. The valuation targets full funding (scheme assets equal to the value of pension liabilities) against a basis that prudently reflects the scheme's risk exposure.

The basis on which Defined Benefit (DB) pension liabilities are valued for funding purposes differs to the basis required under IAS19. The Group may therefore be required to pay contributions to eliminate a funding shortfall even when a surplus is reported in the IAS19 disclosure.

Any net pension asset disclosed represents the maximum economic benefit available to the Group in respect of its pension obligations. The Group has been able to recognise the entire net pension asset in respect of Pace and the Somerfield Scheme since it can recoup a surplus via a combination of refunds and reductions in contributions. There is no requirement in Pace that a surplus has to be shared amongst participating employers.

The net pension asset disclosed in the Group accounts for Pace and the Somerfield Scheme has increased substantially since last year. While the value of pension liabilities measured in accordance with IAS19 and the value of scheme assets have both increased, the asset values have increased more significantly. This is partly attributable to the relative increases in the price of government and corporate bonds. The schemes hold both types of bonds as investments.

The measurement of the pension liabilities under IAS19 is based on the price of corporate bonds since this affects their yields. Therefore, the increase in price of corporate bonds has increased both liabilities and assets. However the more significant increase in government bond prices has only increased the asset values. Therefore overall under IAS19 the increase in scheme asset values has exceeded the increase in pension liabilities.

Notes to the Financial Statements continued

16. Pensions continued

The investment income earned on scheme assets over the year has been greater than the level expected under IAS19 and this is recognised under the Other Comprehensive Income section of the accounts.

Although the value of pension scheme assets has increased, there remains a funding shortfall and a requirement to pay contributions to remove the shortfall. This is predominantly because under the scheme funding regime the liabilities are measured with reference to government bond prices and a very prudent funding objective. The substantial increase in government bond prices has meant that scheme funding liabilities have increased by more than the scheme assets.

The effective date of the last full valuations of the schemes are shown below:

The Co-operative Pension Scheme ('Pace')	5 April 2013
Somerfield Pension Scheme ('Somerfield Scheme')	31 March 2013
Britannia Pension Scheme ('Britannia Scheme')	5 April 2011
United Norwest Co-operatives Employees' Pension Fund ('United Fund')	31 January 2011
Plymouth and South West Co-operative Society Limited Employees' Superannuation Fund ('Plymouth Fund')	31 March 2013
Yorkshire Co-operatives Limited Employees' Superannuation Fund ('Yorkshire Fund')*	31 January 2011
Lothian Borders & Angus Co-operative Society Limited Employees' Pension Fund ('Lothian Fund')	24 January 2012
Sheffield Co-operative Society Limited Employees' Superannuation Fund ('Sheffield Fund')*	31 January 2011
Leeds Co-operative Society Limited Employee Pension Fund ('Leeds Fund')*	31 January 2011
Brixham Co-operative Society Limited Employees' Superannuation Fund ('Brixham Fund')	31 March 2011

*Other former United Co-operatives Funds.

Full actuarial valuations for Pace, the Somerfield Scheme and the Plymouth Fund were concluded during 2014. Any shortfall in the assets directly held by the schemes, relative to their funding target, is financed over a period that ensures the contributions are reasonably affordable to the Group. The expected employer related contributions to all pension schemes over the 2015 financial year is £115m. This includes contributions in respect of all DB and DC sections and scheme expenses where these are payable by the Group. Additional contributions due in respect of Bank's participation in Pace, are paid directly or reimbursed by Bank.

For IAS19 (2011) disclosure purposes, DB obligations are determined following actuarial advice and are calculated using the projected unit method. The IAS19 (2011) valuations of the schemes are carried out by independent qualified actuaries. The assumptions used by the actuaries are the best estimates chosen from a range of possible actuarial assumptions which may not necessarily be borne out in practice.

Retirement benefit risks

Pension risk may be defined as the risk of exposure to pension scheme liabilities and risks inherent in the valuation of scheme liabilities and assets. The liability associated with the pension schemes is material to the Group, as is the cash funding required. The contributions that the Group is required to make to its pension schemes may change over time and the Group may be obliged to make large one-off payments to the pension schemes if certain events occur.

Retirement benefit governance

Group considers and manages its pension risks through the Pensions Strategy Committee and the Transitional Risk and Audit Committee. Where appropriate, recommendations are made by these forums to Group Board for approval. The key objective is to ensure that the Group's pension strategy continues to be appropriate and within acceptable cost and risk parameters.

Notes to the Financial Statements continued

16. Pensions continued

Retirement benefit scheme information

Closed schemes

All pension schemes, apart from Pace, were closed to new accrual in 2012. Employees who were accruing benefits linked to final salary retained this link in respect of pension accrued through service before closure.

Employer Financed Retirement Benefit Schemes (EFRBS)

There are unfunded pension arrangements in place for certain former Group executives. In addition to these, the Britannia Supplementary Pension and Life Assurance Plan is a no charge supplementary arrangement for certain executive directors. Benefits provided by these unfunded arrangements are valued using the same assumptions as the funded DB schemes and are disclosed as unfunded obligations.

The United Norwest Co-operatives Limited 1989 Discretionary Early Retirement Benefits Scheme was set up to provide additional early retirement benefits to eligible members. The scheme closed to new entrants from 5 November 1995 and benefits are granted at the discretion of the Group. However, given Group's financial commitments to meet guaranteed pension obligations, recent applications for these discretionary benefits have not been approved.

Insured Money Purchase Scheme

The Leeds Co-operative Society Limited Managerial Staff Pensions Scheme is an insured money purchase scheme, providing benefits through Royal London (CIS) Ltd. There are no active members.

Material schemes

The Group's three largest DB pension schemes (Pace, the Somerfield Scheme and the Britannia Scheme) make up over 90% of total DB obligations and therefore represent the greatest risk to the Group. Additional information regarding the nature of, and risks associated with, these schemes is provided below. The other funded Group schemes are all UK registered pension schemes and as such meet the same regulatory and reporting requirements. All schemes have not been disaggregated as their characteristics (other than those noted above) do not represent materially different risks to those discussed below for Pace, the Somerfield Scheme and the Britannia Scheme. In previous years, the Britannia Scheme assets and liabilities were recognised on the Group's consolidated balance sheet. However, the share of scheme obligations attributable to Group can no longer be reliably and consistently measured. Therefore, in accordance with IAS19 (2011), the Group will now account for the scheme as though it were a defined contribution scheme.

Pace

Nature of Scheme

Pace is a non-segregated, multi-employer, hybrid pension scheme consisting of a DB section ('Pace Complete') and two DC sections ('Pace Extra' and 'Pace Essential').

Qualifying employees are automatically enrolled into membership of Pace Essential three months after joining the Group. All employees also have the option of joining the Pace Extra section. Once they have completed two or more consecutive years' service, employees can choose to join the DB section, Pace Complete.

Pace Extra and Pace Essential provide benefits based on the value of a member's fund which can be used to purchase an annuity at retirement. Members of Pace Essential make contributions of 1% with participating employers contributing 2% of pensionable salary. Members of Pace Extra make contributions of 4% with participating employers contributing 8% of pensionable salary.

Pace Complete provides benefits based on a member's average career salary and length of contributory membership. Benefits accrued on a DB basis prior to 6 April 2006 will continue to be linked to final salary until members' cease pensionable service.

The weighted average duration of the DB obligation is approximately 25 years.

Multi-employer provisions

The Co-operative Bank ('the Bank') and Co-operative Financial Services Management Services Limited ('CFSMS'), a Co-operative Financial Services subsidiary undertaking of the Group, both participate in Pace with a material share of accrued DB obligations. Other participating employers include Group subsidiaries and associated entities.

Prior to the completion of the Bank's Liability Management Exercise (LME) in 2013 Pace was recognised under IAS19 (2011) as a scheme that shared risks between entities under the common control of the Group. Following the Bank's LME in 2013, and the subsequent reduction in the Group's investment in the Bank to a minority stake holding, Pace is now recognised as a multi-employer scheme in accordance with IAS 19 (2011).

Notes to the Financial Statements continued

16. **Pensions** continued

As a multi-employer pension scheme, Pace exposes the participating employers to the risk of funding the pension obligations associated with the current and former employees of other participating employers. When Pace was a group scheme, there was no contractual agreement or stated Group policy for charging the net DB obligation, or surplus, to participating employers. Therefore, the Group had not previously disclosed an IAS19 surplus attributable to participating employers.

There is no contractually agreed share of pension liabilities between the Group and the Bank. However, following the Bank's LME in 2013, the Group notionally and approximately attributed a 40% share (2013: £145m) of the net pension asset to the Bank in the 2013 accounts, although this was restricted to zero as explained below. This share was based on the share of contributions the Bank paid towards the funding shortfall as at the year end. After the completion of the most recent full actuarial valuation in 2014, the Bank has agreed to pay £5m of the £25m contributions per annum due in respect of the funding shortfall identified. Therefore, in the 2014 financial statements the Group has used this to approximate a notional 20% share (2014: £226m) of the net DB pension asset attributable to the Bank, again restricted to zero.

Pace currently shows a net DB pension asset of £1,129m and no participating employers are entitled to a share of the surplus under the rules of the scheme. The net DB pension asset is therefore recognised fully by the Group since the Group is the Principal Employer. The statement of Other Comprehensive Income shows a net zero adjustment in respect of the Bank's participation in Pace. This adjustment first of all excludes the portion of the scheme no longer attributable to the Group, but then adds this back based on the principles of IFRIC 14.

The Group therefore includes a net pension asset of £226m in respect of Pace on its balance sheet which is notionally attributable to Bank. This asset, or some other amount to be determined following the formal separation of the Bank's pension liabilities, may be recognised as a loss (or gain depending on the terms of separation) in its income statement in a future period when the Bank's share is removed from the Group's balance sheet.

Other participating employers in Pace, account for pension contributions in respect of the scheme on a DC basis. This means their pension costs are recognised as an expense in the income statement as incurred.

On 4 November 2013, the Group and the Bank entered into an undertaking pursuant to which the Group agreed with the Bank, subject to certain exceptions, not to require the Bank to cease to participate in Pace in connection with the LME or any subsequent reduction in the Group's shareholding in the Bank (including to nil). Should either the Group or the Bank so request, the parties will enter into good faith discussions to agree on the separation of Pace, so that the scheme liability properly attributable to the Bank and a proportion of the scheme's assets would be transferred to a separate tax registered pension scheme, or a segregated section of Pace. Neither party shall be under an obligation to agree to any separation of the scheme that would result in a requirement to make material payments to or in respect of the scheme. Separation of Pace will require agreement with the Pace Trustee and agreement of the basis on which any separation would be measured.

Funding objective

The Group's primary objective is for Pace Complete to target 100% funding on a basis that should ensure that benefits can be paid as they fall due in accordance with the Statutory Funding Objective.

Funding the liabilities

In 2014, the Scheme Actuary completed a full actuarial valuation of Pace Complete as at 5 April 2013, in accordance with the scheme specific funding requirements of the Pensions Act 2004. The results of the valuation showed that Pace Complete had a shortfall of £600m. Following the valuation date, changes in market conditions and the performance of the scheme's assets both acted to improve the funding level. The Scheme Actuary's updated calculations at 31 May 2014 showed that the shortfall had reduced to £104m.

The Group agreed that annual contributions of £25m would be paid from 1 July 2014 until 30 June 2019 to eliminate the funding shortfall. This is an increase of £5m per annum compared to the previous contribution agreement. The Group determines the contributions payable by each participating employer in accordance with the scheme rules. The Bank has agreed to pay £5m of the annual contributions each year over the period of the recovery plan. The share of deficit contributions paid by the Bank is used as the basis for determining a notional share of net DB pension asset and DB pension cost for IAS19 (2011) disclosures.

Each participating employer pays the agreed employer contributions in relation to their employed members. In the year up to 1 July 2014, participating employers contributed 16% of pensionable earnings towards the cost of DB accrual for current employed members of Pace Complete. Following completion of the actuarial valuation in 2014, the Group has agreed an increase in the employer contribution to 18% of pensionable salaries from 1 July 2014. In addition, employer contributions will increase to 23.3% from 5 April 2016. The increases in the contributions for future DB accrual are reflective of increases in life expectancy and lower expected investment returns. Member contributions have remained at 8% of pensionable salaries.

The Group may terminate the scheme at any time by giving written notice to the Trustee. On termination, no further contributions would become payable unless required to meet any funding shortfall.

Notes to the Financial Statements continued

16. Pensions continued

Governance

Pace Trustees Ltd acts as 'Trustee' of the Pace scheme. Following changes taken within the Group to improve corporate governance, a similar approach has been taken with the Trustee Board ('the Board') to strengthen Pace's governance and enhance the level and range of expertise on the Board.

The Chair of Trustees is appointed by the Trustee Directors. The Board comprises 10 Trustee Directors: three professional independent Trustee Directors, three Group appointed Trustee Directors, and four Member Nominated Directors (MNDs) elected by scheme members.

The Trustee is responsible for the development and implementation of appropriate policies for the investment of the assets of Pace. The Trustee consults with the Group in developing investment strategy and delegates the responsibility for implementing and monitoring the strategy to an Investment Committee.

Investment strategy

The Trustee recognises the specialist technical nature of investment management and the Investment Committee provides a greater focus and appropriate level of expertise to manage investment strategy. Some risk arises from Pace Complete because the value of the asset portfolio and returns from it may be less than expected. There is also a risk that a change in scheme asset values does not match corresponding changes in pension liabilities.

The Trustee, following investment advice and in consultation with the Group, has implemented a change in investment strategy for Pace Complete during 2014. The change in strategy means fewer investments are held in higher-risk return-seeking assets. The leverage used to fund lower-risk assets that better match the scheme liabilities has also been reduced. The objective of holding 'liability matching' assets is to reduce volatility in the funding level due to changes in inflation and interest rates. The liability matching assets are invested to hedge 75% of interest rate and inflation exposure.

Other risks

The introduction of the automatic enrolment legislation requires qualifying employees to be automatically enrolled into a workplace pension scheme and that a minimum level of contributions is paid (which are due to increase in 2017 and 2018). Pace Essential was designed with this legislation in mind. The Group's contributions exceed the minimum level required and are planned to increase to 3% of pensionable salary in October 2017 and 5% of pensionable salary in October 2018.

Actions taken by the Pensions Regulator, changes to European legislation, or changes in the financial strength of the Group could result in increased funding requirements. This could materially affect the Group's cash flow. However, because the Group has a right to a refund of any surplus assets, subject to the requirements of section 37 of the Pensions Act 1995, there would be no further balance sheet effect.

There is also a risk that changes in the assumptions for life expectancy, interest rates or in price inflation could result in a deficit in the scheme. The sensitivity of defined benefit obligations to changes in these assumptions is discussed below. Other assumptions used to value the DB obligation are also uncertain, although their effect is less material.

Guarantees

With effect from April 2006, CFSMS became a participating employer in Pace and employees were seconded to work for CIS General Insurance Ltd ('CISGIL'), a separate Group subsidiary business. CISGIL provides a guarantee to the Pace Trustee to pay any amount due to Pace arising from employees seconded to CISGIL should CFSMS default on its pension funding responsibilities.

Winding up

Although currently there are no plans to do so, with Group approval, the Trustee could choose to wind up Pace (following termination by the Group). In this case, unless otherwise transferred to an approved pension arrangement or paid as a lump sum to the member, the benefits would be secured with insurance policies and annuity contracts. The cost of securing benefits with an insurance company would be significantly more than the defined benefit obligation calculated in accordance with IAS 19 (2011).

Liabilities may also arise for the Group as an employer participating in a Pace in certain circumstances set out in legislation, for example on ceasing to participate in the pension scheme or becoming insolvent. The liability would be the value of the employer's share of the defined benefit funding deficit at the time, calculated by reference to the cost of buying out the scheme's liabilities in the insurance market. Pace is not sectionalised and operates on a 'last man standing' basis. In the event that other participating employers became insolvent and the full statutory debt was not recovered on insolvency, the Group would become liable for the remaining liabilities.

Notes to the Financial Statements continued

16. **Pensions** continued

Somerfield Pension Scheme

Nature of Scheme

The Somerfield Scheme is a sectionalised, hybrid pension scheme consisting of DB sections and a DC section, both of which closed to future accrual in November 2012. Following closure of the Somerfield Scheme, all active DB and DC members at the date of closure started to accrue benefits in Pace, unless they elected not to join Pace.

In January 2013, the funds of members of the DC section who were actively contributing at the date of closure were also transferred to Pace. The funds of members of the DC section who were no longer making contributions when the scheme closed were transferred to a Legal & General master trust in March 2014, unless they elected to transfer to another arrangement of their choice. The DC section is due to complete winding-up during 2015. There are currently no assets (or liabilities) held in the DC section.

The weighted average duration of the defined benefit obligation is approximately 19 years.

Funding objective

The Group's objective is for the Somerfield Scheme to target 100% funding on a basis that should ensure that benefits can be paid as they fall due in accordance with the Statutory Funding Objective.

Funding the liabilities

In 2014, the Scheme Actuary completed a full actuarial valuation of the Somerfield Scheme as at 31 March 2013, in accordance with the scheme specific funding requirements of the Pensions Act 2004. The results of the valuation showed that the Somerfield Scheme had a shortfall of £77.3m. The Group paid deficit contributions of £18.4m during the year following the valuation date, and agreed to pay annual contributions of £2.6m from 1 July 2014 until 30 June 2023 to eliminate this funding shortfall.

Governance

Somerfield Pension Trustees Limited is the corporate body that acts as 'Trustee' of the Somerfield Scheme. The Chair of the Trustee Board is appointed by and from the Trustee Directors and the Board comprises nominees of the Group, including an Independent Trustee, and elected scheme members.

The Trustee, in consultation with the Group, is responsible for the risk management arrangements for the Somerfield Scheme, agreeing suitable contribution rates, setting the investment strategy and for taking professional advice as appropriate. The Trustee consults with the Group in developing investment strategy and delegates the responsibility for implementing and monitoring the strategy to an Investment Committee.

Investment strategy

Some risk arises from the Somerfield Scheme because the value of the asset portfolio and returns from it may be less than expected. There is also a risk that a change in scheme assets values does not match corresponding changes in pension liabilities.

The Trustee's overall objective is to invest the scheme's assets in the best interest of the members and beneficiaries. Within this framework the Trustee has agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Somerfield Scheme is exposed.

The Trustee's strategy, following investment advice and in consultation with Group, aims to hedge interest rate and inflation risk equal to 90% of the scheme's assets. The Trustee continues to develop the investment strategy and review opportunities for further reduction in, or re-balancing of, expected risks when these arise.

Other risks

Actions taken by the Pensions Regulator, changes to European legislation, or changes in the financial strength of the Group could result in increased funding requirements. This could materially affect the Group's cash flow. However, because the Group has a right to a refund of any surplus assets, subject to the requirements of section 37 of the Pensions Act 1995, there would be no further balance sheet effect.

There is also a risk that changes in the assumptions for life expectancy, interest rates or in price inflation could result in a deficit in the scheme. Other assumptions used to value the defined benefit obligation are also uncertain, although their effect is less material.

Other guarantees

The Group is the Principal and a Statutory Employer of the Somerfield Scheme. A Group subsidiary, Somerfield Stores Ltd, is also a Statutory Employer to the scheme. The Group provides a guarantee in respect of Somerfield Stores Ltd employer debt that may become payable to the Somerfield Scheme upon insolvency or winding up of the scheme.

Notes to the Financial Statements continued

16. Pensions continued

The Group has granted an additional guarantee in respect of participating employers' liabilities in relation to the Somerfield Scheme up to 105% funding on the section 179 Pensions Act 2004 valuation basis. This enables the calculation of the risk-based element of the Pension Protection Fund levy to be based on the Group's insolvency rating.

Winding up

Although currently there are no plans to do so, the Trustee could choose to wind up the scheme following termination by the Group. In this case, unless otherwise transferred to an approved pension arrangement or paid as a lump sum to the member, the benefits would be secured with insurance policies and annuity contracts. The cost of securing benefits with an insurance company would be significantly more than the defined benefit obligation calculated in accordance with IAS19 (2011).

Liabilities may also arise for the Group as an employer participating in a pension scheme in certain circumstances set out in legislation, for example on ceasing to participate in the pension scheme or becoming insolvent. The liability would be the value of the deficit at the time, calculated by reference to the cost of buying out the scheme's liabilities in the insurance market.

Britannia Pension Scheme

Nature of Scheme

The Britannia Scheme is a multi-employer, hybrid scheme, consisting of DB and DC sections. The scheme closed on 6 October 2012 with active members at the date of closure being invited to join Pace for future pension accrual.

The DB section pays pensions based on service to 6 October 2012 and final pay for employees who commenced employment prior to 1 September 2001, when it closed to new members.

Members of the DC section that were active at the date of closure were given the option to transfer their funds to a Pace DC section. The Trustee agreed to wind-up the DC section from February 2013, with any remaining members given the option of transferring their funds to an alternative approved pension arrangement, or securing benefits with an insurance contract.

The weighted average duration of the defined benefit obligation is 23 years.

Multi-employer provisions

Following the merger of Britannia Building Society and the Bank in 2009, a Co-operative Financial Services subsidiary undertaking of the Group, Co-operative Financial Services Management Services Limited ('CFSMS') became the Sponsor, and a Statutory Employer, of the Britannia Scheme. Three other participating employers of the Britannia Scheme are Bank wholly owned subsidiary entities. The Bank itself is not a participating employer in the scheme, but provides a guarantee to the Britannia Trustee in relation to funding the pension obligations.

As Bank subsidiary entities are also participating employers of the Britannia scheme, the scheme is recognised as a multi-employer pension scheme in accordance with IAS19 (2011). As a multi-employer pension scheme, CFSMS is exposed to the risk of funding the pension obligations associated with the current and former employees of other participating employers.

In previous years, the scheme assets and liabilities were recognised on the CFSMS balance sheet, and included in the Group's financial statements. As the Group does not have a right to a refund of surplus in respect of the Britannia Scheme, the net pension asset was restricted to zero in the 2013 financial statements.

However, the majority of CFSMS employee members of the scheme, providing services to the Bank, have transferred their employment to the Bank during 2014. As a result, the share of the scheme obligations attributable to CFSMS can no longer be reliably and consistently measured. Therefore, in accordance with IAS19 (2011), the Group will now account for the scheme as though it were a defined contribution scheme. As a result, the pension scheme does not appear on the balance sheet in the Group's 2014 financial statements, but pension contributions are included as an expense in the income statement.

Funding objective

The funding objective is for the Britannia Scheme to target 100% funding on a basis that should ensure that benefits can be paid as they fall due in accordance with the Statutory Funding Objective. Funding costs are recharged to the Bank where applicable.

Notes to the Financial Statements continued

16. **Pensions** continued

Funding the liabilities

The Scheme Actuary completed a full actuarial valuation of the Scheme as at 5 April 2011, in accordance with the scheme specific funding requirements of the Pensions Act 2004. The results of the valuation showed that the Britannia Scheme had a shortfall of £3.7m. CFSMS paid a lump sum of £3.7m in 2012 to eliminate this shortfall. The next full actuarial valuation is due to be completed by 5 July 2015.

As a Statutory Employer, CFSMS is required to meet the pension obligations in relation to benefits accrued under CFSMS and former participating employers. Following the loss of control of the Bank and subsequent transfer of employees from CFSMS to the Bank, the Group and the Bank have entered discussions with the Trustee of the Britannia Scheme with regard to transferring the status of Sponsor (and Statutory Employer) to Bank. Therefore CFSMS does not expect to pay any contributions to the Britannia Scheme over the next annual reporting period.

In addition, the Group agreed that, for so long as the Principal Employer of the Britannia Scheme is an entity outside of Bank's control, such employer will not take any action in relation to the scheme without Bank's prior agreement where such action would or might be expected to increase the liabilities of the Bank or contributions payable by Bank in connection with the Britannia Scheme.

Governance

Britannia Pension Trustees Limited is the corporate body that acts as 'Trustee' of the Britannia Scheme. The Chair of the Trustee Board is appointed by and from the Trustee Directors and the Board comprises an Independent Trustee, nominees of Bank and/or Group and elected scheme members. The Trustee, in consultation with the Britannia Scheme's sponsoring employers, is responsible for the risk management arrangements for the Britannia Scheme, agreeing suitable contribution rates, investment strategy and for taking professional advice as appropriate.

Investment strategy

Some risk arises from the Britannia Scheme because the value of the asset portfolio and returns from it may be less than expected. There is also a risk that a change in scheme assets values does not match corresponding changes in pension liabilities.

The Trustee's overall objective is to invest the scheme's assets in the best interest of the members and beneficiaries. To achieve this overall objective the Trustee has agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Britannia Scheme is exposed.

Other risks

Actions taken by the Pensions Regulator, changes to European legislation, or changes in the financial strength of CFSMS or the Bank could result in increased funding requirements. This could materially affect the Group's cash flow.

There is also a risk that changes in the assumptions for life expectancy, interest rates or in price inflation could result in a deficit in the scheme. Other assumptions used to value the liabilities are also uncertain, although their effect is less material.

Other guarantees

Bank has granted an additional guarantee to the Britannia Trustee in respect of participating employers' liabilities in the Britannia Scheme up to 105% funding on the section 179 Pensions Act 2004 valuation basis. This enables the calculation of the risk-based element of the Pension Protection Fund levy to be based on Bank's insolvency rating.

Winding up

Although currently there are no plans to do so the Trustee could choose to wind up the Britannia Scheme. In this case, unless otherwise transferred to an approved pension arrangement or paid as a lump sum to the member, the benefits would be secured with insurance policies and annuity contracts. The cost of securing benefits with an insurance company would be significantly more than the defined benefit obligation calculated in accordance with IAS19 (2011).

Liabilities may also arise for CFSMS as an employer participating in a pension scheme in certain circumstances set out in legislation, for example on ceasing to participate in the pension scheme or becoming insolvent. The liability would be the value of the employer's share of the deficit at the time, calculated by reference to the cost of buying out the scheme's liabilities in the insurance market. The Britannia Scheme is not sectionalised and in the event that other participating employers became insolvent and the full statutory debt was not recovered on insolvency, CSFMS would become liable for the remaining liabilities.

Notes to the Financial Statements continued

16. Pensions continued

Critical accounting estimates and judgements

The weighted average actuarial valuations of the schemes have been updated to 3 January 2015 in accordance with IAS 19.

The principal assumptions used to determine the liabilities of the Group's pension schemes were:

	2014	2013
Discount rate	**3.70%**	4.45%
Inflation rate	**3.30%**	3.60%
Future pension increases where capped at 5.0% pa – Retail Price Index	**3.30%**	3.60%
Future pension increases where capped at 5.0% pa – Consumer Price Index	**2.30%**	2.60%
Future pension increases where capped at 2.5% pa – Retail Price Index	**2.50%**	2.50%
Future pension increases where capped at 2.5% pa – Consumer Price Index	**2.30%**	2.50%
Mortality – base table	**100% (108% for females) of S1NA YoB tables with CMI 2009**	100% (108% for females) of S1NA YoB tables with CMI 2009
Mortality – future improvements	**1.50% p.a.**	1.25% p.a.

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the largest schemes are as follows:

	Member currently aged 65 (current life expectancy)		**Member currently aged 45 (life expectancy at age 65)**	
3 January 2015	**Male**	**Female**	**Male**	**Female**
Pace Scheme	**22.8**	**24.9**	**25.0**	**27.2**
United Norwest Fund	**22.6**	**24.7**	**24.9**	**27.0**
Britannia Scheme	**22.9**	**25.1**	**25.2**	**27.5**
Somerfield Scheme	**22.6**	**24.9**	**24.3**	**26.6**

	Member currently aged 65 (current life expectancy)		Member currently aged 45 (life expectancy at age 65)	
4 January 2014	Male	Female	Male	Female
Pace Scheme	22.4	24.1	24.3	26.0
United Norwest Fund	22.1	24.2	23.9	26.1
Britannia Scheme	22.5	24.7	24.3	26.6
Somerfield Scheme	22.6	24.9	23.8	26.2

Critical accounting estimates and judgements – Sensitivity of defined benefit obligations

The measurement of the Group's defined benefit liability is particularly sensitive to changes in certain key assumptions, which are described below. The methods used to carry out the sensitivity analysis presented below for the material assumptions are the same as those the Group has used previously. The calculations alter the relevant assumption by the amount specified, whilst assuming that all other variables remained the same. This approach is not necessarily realistic, since some assumptions are related: for example, if the scenario is to show the effect if inflation is higher than expected, it might be reasonable to expect that nominal yields on corporate bonds will increase also. However, it enables the reader to isolate one effect from another.

Notes to the Financial Statements continued

16. Pensions continued

Discount rate	This has been selected following actuarial advice received by Group in respect of all defined benefit schemes operated by Group, taking into account the duration of the liabilities. The overall rate is the weighted average of the specific discount rates adopted for individual schemes. An increase or decrease in the discount rate of 0.1% would result in a £194m decrease or a £194m increase (2013: £183m), respectively, in the present value of the defined benefit obligation.
Inflation	Inflation is a significant assumption as it is used to determine salary-related benefits and pension increases before and after retirement. The assumption adopted is consistent with the discount rate adopted. An increase or decrease in the inflation rate of 0.1% would result in a £177m increase or a £177m decrease (2013: £163m), respectively, in the present value of the defined benefit obligation.
Mortality rates	The mortality assumptions adopted are based on those recommended by the actuaries that advise the scheme management and reflect the most recent information as appropriate. The largest scheme is the Pace scheme and the assumptions used indicate that the future life expectancy of a male (female) pensioner reaching age 65 in 2014 would be 22 (24) years and the future life expectancy from age 65 for a male (female) non-pensioner member currently aged 40 of 24 (26) years. An increase in the assumed long term rate of improvement in mortality by 0.25% would increase liabilities by £159m (2013: £154m).

The fair value of the plan assets at the period end were as follows:

	2014 £m	2013 £m
Cash and cash equivalents	**404**	403
Equity instruments	**2,023**	2,728
Debt instruments	**6,712**	4,728
Real estate	**368**	441
Derivatives	**166**	(440)
Investment funds	**1,248**	1,805
	10,921	9,665

The fair value of plan assets split between those which have a quoted market price in an active market and those which are unquoted is as follows:

	2014			2013		
	Quoted £m	**Unquoted £m**	**Total £m**	Quoted £m	Unquoted £m	Total £m
Cash and cash equivalents	**416**	**(12)**	**404**	395	8	403
Equity instruments	**2,023**	**-**	**2,023**	2,725	3	2,728
Debt instruments	**6,396**	**316**	**6,712**	4,001	727	4,728
Real estate	**48**	**320**	**368**	42	399	441
Derivatives	**-**	**166**	**166**	-	(440)	(440)
Investment funds	**284**	**964**	**1,248**	710	1,095	1,805
	9,167	**1,754**	**10,921**	7,873	1,792	9,665

The amounts recognised in the balance sheet are as follows:

	2014 £m	2013 £m
Present value of funded obligations	**(9,920)**	(9,447)
Present value of unfunded liabilities	**(12)**	(18)
Element of Pace attributable to non-Group entities	**(226)**	(145)
Asset limitation (IFRIC14)	**226**	118
Fair value of plan assets	**10,921**	9,665
Net retirement benefit asset	**989**	173

Notes to the Financial Statements continued

16. Pensions continued

The amounts recognised in the income statement are as follows:

	2014 £m	2013 £m
Current service cost	**(60)**	(81)
Interest expense on DBO	**(293)**	(397)
Interest income on plan assets	**300**	411
Interest on impact of asset ceiling	**5**	(1)
Administrative expenses and taxes	**(6)**	(8)
	(54)	(76)

Net pension finance income of £12m (2013: £13m) in the Income Statement excludes £nil net pension finance income (2013: £1m net income) from the Britannia scheme. This is because it was part of Financial Services in 2013 and therefore shown within operating profit, consistent with other lines of interest income in Financial Services companies.

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

	2014 £m	2013 £m
Opening defined benefit obligation	**6,615**	8,791
De-recognised obligation for Britannia Pension Scheme and EFRBS liabilities from the Pace scheme (unfunded)	**(609)**	-
Current service cost	**60**	81
Interest expense on DBO	**293**	397
Participant contributions	**19**	30
Past service costs	**(11)**	-
Remeasurements:		
a. Effect of changes in demographic assumptions	**150**	1
b. Effect of changes in financial assumptions	**707**	399
c. Effect of experience adjustments	**(100)**	68
Benefit payments from plan	**(236)**	(302)
Change in share of Pace attributable to Group from 60% to 80%	**1,439**	-
40% of Pace attributable to non Group entities	**-**	(2,850)
Closing defined benefit obligation attributable to Group	**8,327**	6,615
IFRIC 14 adjustment	**1,605**	2,850
Closing defined benefit obligation	**9,932**	9,465

Notes to the Financial Statements continued

16. Pensions continued

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

	2014 £m	2013 £m
Opening fair value of plan assets	6,670	8,998
De-recognised assets of Britannia Pension Scheme	(631)	-
Interest income	300	411
Return on plan assets (excluding interest income)	1,336	386
Administrative expenses paid from plan assets	(6)	(8)
Employer contributions	101	135
Contributions arising from settlements*	33	15
Participant contributions	19	30
Benefit payments from plan	(236)	(302)
Change in share of Pace attributable to Group from 60% to 80%	1,504	-
40% of Pace attributable to non Group entities	-	(2,995)
Closing fair value of plan assets attributable to Group	9,090	6,670
IFRIC 14 adjustment	1,831	2,995
Closing fair value of plan assets	10,921	9,665

*Within the year, a special, one-off contribution of £33m was paid to the Pace scheme. This was made as part of the agreement to sell the Pharmacy business to Bestway. As part of the agreement, Bestway contributed £33m with the Group reimbursing Bestway an amount of £3m, creating a profit of £30m within discontinued operations. In the prior year, a contribution of £15m was made by the Group's former Life fund as part of the agreement to sell the Life and Savings business to Royal London. This also created a profit of £15m within discontinued operations in the prior year.

Changes in the effect of the asset ceiling are as follows:

	2014			2013		
	Asset £m	DBO £m	Asset ceiling £m	Asset £m	DBO £m	Asset ceiling £m
Britannia Pension Scheme						
As at the start of the period	631	(604)	(27)	603	(587)	(16)
De-recognised Britannia Pension Scheme	(631)	604	27	-	-	-
Service cost	-	-	-	-	-	-
Interest income/(expense)	-	-	-	27	(26)	(1)
Administrative expenses paid from plan assets	-	-	-	(1)	-	1
Employer contributions	-	-	-	-	-	-
Benefits paid	-	-	-	(16)	16	-
Actuarial gains/(losses)	-	-	-	18	(7)	(11)
At end of the period	-	-		631	(604)	(27)
Pace						
At the start of the period	(2,995)	2,850	(145)	-	-	-
Interest income/(expense)	99	(94)	5	-	-	-
Re-measurement of asset ceiling effect	1,065	(1,151)	(86)	-	-	-
40% of Pace attributable to non Group entities	-	-	-	(2,995)	2,850	(145)
At end of the period	(1,831)	1,605	(226)	(2,995)	2,850	(145)

As Pace is now a multi-employer scheme (from 20 December 2013), 20% (2013: 40%) of the assets and liabilities have been notionally, for accounting purposes, allocated to the Co-operative Bank and then reversed as the Bank has no right to a refund of the surplus per IFRIC 14.

Notes to the Financial Statements continued

16. Pensions continued

Accounting policies

The Group operates various defined contribution and defined benefit pension schemes for its employees as stated above. A defined contribution scheme is a pension plan under which the Group pays contributions into a separate entity and has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement. In respect of the defined benefit pension scheme, the pension scheme surplus or deficit recognised in the balance sheet represents the difference between the fair value of the plan assets and the present value of the defined benefit obligation at the balance sheet date. The calculation of the defined benefit obligations is performed annually by qualified actuaries (and half annually for Pace) using the projected unit credit method. Plan assets are recorded at fair value. When the calculation results in a potential asset for the Group, the recognised asset is restricted to the present value of the economic benefits in the form of any future refunds from the plan or reductions in future contributions to the plan. Obligations for contributions to defined contribution plans are expensed as the related service is provided. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

Remeasurements of the surplus/liability of each scheme (which comprise actuarial gains and losses, asset returns excluding interest income and asset ceiling movement excluding interest) are included within other comprehensive income. Net interest expense and other items of expense relating to the defined benefit plans are recognised in profit or loss. Current service cost and administrative costs of the plans are recognised in operating profit. Net interest expense is determined by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then net defined asset/liability taking into account changes in contributions or benefits payments in the asset/liability within the period.

Notes to the Financial Statements continued

17. Deferred taxation

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 20% (2013: 20%).

	2014 £m	2013 £m
Deferred tax asset	263	257
Deferred tax liability	(344)	(189)
Net deferred tax (liability)/assets	(81)	68
Comprised of:		
Other temporary differences	28	26
Temporary differences arising on derivatives and interest	1	1
Retirement benefit obligations	(198)	(35)
Capital allowances on fixed assets	187	157
Unrealised gains on investments, investment properties and rolled-over gains	(137)	(132)
Claims equalisation reserve	(6)	(6)
Tax losses	44	57
	(81)	68

Other temporary differences arise on other accounts provisions including funeral bond, holiday pay and onerous lease provisions of £28m (2013: £26m).

	2014 £m	2013 £m
At beginning of period	68	(20)
Income statement charge		
– Group	(17)	(42)
Disposals	13	93
Charged to other comprehensive income:		
– Retirement benefit obligations	(145)	20
– Other	-	17
At end of period	(81)	68

Accounting policies

Deferred tax is provided for, with no discounting, using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profits, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available for utilisation. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Notes to the Financial Statements continued

18. Inventories and biological assets

	2014 £m	2013 £m
Inventories	**434**	520
Biological assets	**-**	6
	434	526

Inventories are comprised of the following:

	2014 £m	2013 £m
Raw materials, consumables and work in progress	**8**	9
Finished goods and goods for resale	**426**	511
	434	520

There are no biological assets in the current period following the sale of the Farms business during 2014.

The period end inventory provision is £12m (2013: £16m) and relates largely to the Food business in the current period and the Food and Pharmacy businesses in the prior period. A net charge of £1m (2013: credit of £4m) has been made to the income statement largely relating to the Food business. £5m of the provision was disposed of as part of the sale of the Pharmacy business to Bestway. In the prior period the credit was a result of improved leakage performance in the Food business. Inventory held at fair value less cost to sell is not material in either period. There was no inventory pledged as security for liabilities in the current or prior period.

Accounting policies

Inventories are stated at the lower of cost, including attributable overheads and net realisable value.

Biological assets in the prior year were stated at fair value less estimated point of sale costs, with any resultant gain or loss recognised in the income statement. Point of sale costs include all costs that would be necessary to sell the assets, excluding costs necessary to get the assets to market.

19. Trade and other receivables

	2014 £m	2013 £m
Non-current	**24**	38
Current	**566**	1,069
	590	1,107

	2014 £m	2013 £m
Trade receivables	**242**	281
Prepayments and accrued income	**84**	398
Amounts receivable from disposal of businesses	**13**	168
Other receivables	**99**	134
Receivables arising from insurance	**152**	126
	590	1,107

Trade receivables are stated net of an impairment provision of £9m (2013: £9m). £3m (2013: £3m) has been charged to the income statement during the period offset by a credit of £3m (2013: credit of £2m).

On 31 December 2014, the Group received the final payment of £168m due from Royal London for the sale of the Group's former Life and Savings business.

In the prior period the Group changed its accounting estimate in respect of future cancellations of Funeral Benefit Options ('FBOs'). As a result, a higher proportion of costs associated with gaining and administering FBOs are expensed at the point of sale. The impact on the results for 2013 was: a £1m decrease in underlying operating profit representing a further charge in relation to plans sold during 2013; and a £12m charge in relation to plans sold in prior years. The prior year element of the charge was reported within one-off items (see note 1).

Notes to the Financial Statements continued

19. Trade and other receivables continued

Within trade receivables is £130m (2013: £79m) of supplier income that is due to Food from suppliers. As at 8 April 2015, £129m (2013: £79m) of the current year balance had been invoiced and settled.

Trade receivables include amounts totalling £29m (2013: £46m), which are overdue but not considered to be impaired, age analysed as follows:

	2014 £m	2013 £m
Amounts overdue:		
Less than 3 months	**17**	34
3 to 6 months	**5**	5
More than 6 months	**7**	7
	29	46

Amounts overdue but not impaired typically comprise high volume/low value balances for which the individual trading businesses do not seek collateral but continue to work with counterparties to secure settlement. No other receivables are overdue.

Accounting policies

Loans and receivables are initially recognised at fair value, being cost inclusive of attributable transaction costs; and are subsequently carried at amortised cost using the effective interest method.

Bad and doubtful debts

The amount charged against operating profit comprises collective provisions against identifiable losses. Both provisions are based on a year end appraisal of debtors, loans and advances on the basis of objective evidence that a loss has been incurred. Receivables, loans and advances are shown in the balance sheet after deducting these provisions. Debts are written off when there is no realistic prospect of further recovery of the amounts owing.

Impairment

The carrying amounts of the Group's receivables are reviewed at each balance sheet date and whenever there is any indication of impairment. If any such indication exists, the assets' recoverable amount is estimated. Any adjustment to the level of impairment provision is recognised within the income statement in operating profit.

20. Assets and liabilities held for sale

Assets held for sale at 3 January 2015 relate to a number of foodstores. The assets held for sale in the prior period relate to the planned sale of buildings, including the CIS Tower and surrounding land and buildings of the Group's NOMA estate to a joint venture. This sale completed in the first half of 2014. An impairment charge of £7m (2013: £nil) has occurred on these foodstores following reclassification to assets held for sale.

	2014 £m	2013 £m	**2014 £m**	2013 £m
	Assets held for sale		**Liabilities held for sale**	
Total	**85**	59	**-**	-

Assets classified as held for sale

	2014 £m	2013 £m
Property, plant and equipment	**85**	59
	85	59

Notes to the Financial Statements continued

20. Assets and liabilities held for sale continued

Accounting policies

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Group's accounting policies. Thereafter, generally the assets (or disposal group) are measured at the lower of their carrying amount and fair value less cost to sell. Any impairment loss on a disposal group is first allocated to goodwill, and then to remaining assets and liabilities on a pro rata basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property and biological assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

21. Investments

	2014 £m	2013 £m
Current	**260**	301
Non Current	**661**	670
Total investments	**921**	971

The investments as held by CISGIL are analysed as follows:

	2014 £m	2013 £m
Fair value through profit or loss:		
Deposits with credit institutions	**156**	208
Available for sale:		
Listed debt securities	**765**	763
	921	971

Accounting policies

CISGIL classifies its financial assets (excluding derivatives) as either:

- available for sale; or
- financial assets at fair value through income or expense; or
- loans and receivables.

i) Recognition of financial assets and financial liabilities

Financial assets are recognised by CISGIL on the trade date which is the date it commits to purchase the instruments. Loans are recognised when the funds are advanced.

All other financial instruments are recognised on the date that they are originated.

ii) Derecognition of financial assets and financial liabilities

Financial assets are derecognised when they are qualifying transfers and:

- the rights to receive cash flows from the assets have ceased; or
- CISGIL has transferred substantially all the risks and rewards of ownership of the assets.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires. When an existing liability is replaced by the same counterparty on substantially different terms or the terms of an existing liability are substantially modified, the original liability is derecognised and a new liability is recognised, with any difference in carrying amounts recognised in the income statement.

iii) Financial assets designated as available for sale

CISGIL classifies the holdings in debt securities as available for sale. Initial measurement is at fair value, being purchase price upon the date on which CISGIL commits to purchase plus directly attributable transaction costs.

Notes to the Financial Statements continued

21. Investments continued

Subsequent valuation is at fair value with movements recognised in other comprehensive income as they arise. Where there is evidence of impairment, the extent of any impairment loss is recognised in the income statement (for further information refer to vii).

On disposal, gains or losses previously recognised in other comprehensive income are transferred to the income statement.

iv) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and CISGIL does not intend to sell immediately or in the near term. For CISGIL this includes insurance premium debt receivables but excludes salvage and subrogation. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently these are measured at amortised cost. The amortised cost is the initial amount at recognition less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, less impairment provisions for incurred losses.

v) Financial investments at fair value through income or expense

Investments, other than those in debt securities, are designated as financial assets at fair value through income or expense, where they are managed and their performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy, and information is provided internally to key management personnel on that basis. Initial measurement is at fair value, being purchase price upon the date on which CISGIL commits to purchase. Directly attributable transaction costs are expensed immediately on recognition.

Subsequent valuation is at fair value with changes in fair value being recognised in gains less losses within the income statement in the period in which they arise. Where there is no active market or the investments are unlisted, the fair values are based on commonly used valuation techniques.

vi) Financial liabilities

Financial liabilities are contractual obligations to deliver cash or other financial assets. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs. Financial liabilities, other than derivatives, are subsequently measured at amortised cost.

Financial liabilities primarily represent borrowed funds. Borrowings are recognised initially at fair value, which equates to issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

vii) Impairment of financial assets

Assessment

At the balance sheet date, CISGIL assesses its financial assets not carried at fair value through income or expense for objective evidence that an impairment loss has occurred.

Objective evidence that financial assets are impaired can include default by a borrower or issuer, indications that a borrower or issuer will enter bankruptcy or the disappearance of an active market for that financial asset because of financial difficulties.

Measurement

Any impairment loss on assets classified as available for sale, and those carried at amortised cost, are recognised immediately through the income statement.

The amount of the loss is the difference between:

- the asset's carrying amount (calculated on an amortised cost basis); and
- the present value of estimated future cash flows (discounted at the asset's original or variable effective interest rate for amortised cost assets or at the current market rate for available for sale assets).

Impairment of financial assets classified as available for sale

Impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to the income statement.

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement. However any further recovery in fair value of an impaired available for sale equity security is recognised directly in equity.

Notes to the Financial Statements continued

21. **Investments** continued

Impairment of financial assets carried at amortised cost

The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of an asset is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point when it is deemed that following a subsequent event the risk of loss has reduced to the extent that a provision is no longer required.

viii) Gains less losses arising from financial assets

Gains less losses arising from financial assets represents unrealised fair value movements of assets held at fair value through income or expense as well as realised gains/losses on available for sale assets.

Sale and repurchase agreements

CISGIL participates in reverse sale and repurchase transactions whereby CISGIL buys gilts but is contractually obliged to sell them at a fixed price on a fixed future date. Cash pledged under reverse repo arrangements are classified as deposits with credit institiutions within financial investments at fair value through the income or expense on the balance sheet as a result of CISGIL's documented risk management policy.

Notes to the Financial Statements continued

22. Insurance contracts liabilities and reinsurance assets

a) Analysis of insurance contract liabilities

Note liabilities are denoted positive in the below analysis

	2014 £m	2013 £m
Non-current		
Reinsurance Assets	**(67)**	(53)
Insurance Liabilities	**334**	396
Total non-current	**267**	343
Current		
Reinsurance Assets	**(5)**	(4)
Insurance Liabilities	**404**	470
Total current	**399**	466
Net total	**666**	809

	2014 £m	2013 £m
Gross general insurance contracts:		
– Claims reported	**407**	495
– Claims incurred but not reported	**135**	145
– Claims settlement expenses	**13**	17
– Unearned premiums	**172**	207
– Provision for unexpired risks	**11**	2
Total gross insurance liabilities	**738**	866
Recoverable from reinsurers		
– Claims reported	**(39)**	(23)
– Claims incurred but not reported	**(33)**	(32)
– Unearned premiums	**-**	(2)
Total reinsurers' share of insurance liabilities	**(72)**	(57)
Net general insurance contracts:		
– Claims reported	**368**	472
– Claims incurred but not reported	**102**	113
– Claims settlement expenses	**13**	17
– Unearned premiums	**172**	205
– Provision for unexpired risks	**11**	2
Total net insurance liabilities	**666**	809

Reinsurance is used to limit risk to the balance sheet for the various classes of general insurance direct business. Proportional and non-proportional types of reinsurance cover have been purchased in accordance with assumptions made regarding the possible levels of losses and required returns on equity.

Notes to the Financial Statements continued

22. Insurance contracts liabilities and reinsurance assets continued

Indemnification agreement

On 15 January 2006, CISGIL assumed responsibility for the benefits and burdens arising from the run off of general insurance liabilities of the Co-operative Insurance Society Limited (CISL) under the terms of an indemnification agreement. Insurance contract liabilities at the end of 2013 included £63.5m of gross liabilities from the policies underwritten by CISL. These policies were formally novated by the Part VII transfer to CISGIL on 31 March 2014. Consequently, the analysis in note 22 v) shows claims development of all general insurance liabilities.

b) General insurance contracts – assumptions, changes in assumptions and sensitivity

i) Basis of assessing liabilities

CISGIL has access to historical data and trends relating to the general insurance business of CISL for which it has now assumed responsibility.

CISGIL uses a combination of recognised actuarial and statistical techniques to assess the ultimate cost of claims. These include:

- projecting historic claims payment and recoveries data;
- projecting numbers of claims;
- adjusting case estimates for future inflation and on to a provisioning basis;
- deriving average costs per claim to apply to claim numbers; and
- projecting historic claims paid and incurred data (payment plus estimates) – statistical actuarial techniques including chain ladder, Bornhuetter-Ferguson and Cape Cod.

Detailed claims data, including individual case estimates, is used to derive patterns in average claims costs and timings between occurrence and estimate/payment of claims. The most common method used is the chain ladder method. This technique involves the analysis of historical claims development trends and the selection of estimated development factors based on this historical pattern. The selected development factors are then applied to cumulative claims data for each accident year which is not yet fully developed to produce an estimated ultimate claims cost for each accident year. A degree of judgment is required in selecting the most appropriate development factors.

The chain ladder method can be quite volatile for relatively undeveloped origin periods so a Bornhuetter-Ferguson/Cape Cod method is often used in such cases. This method uses some prior expectation of the ultimate claims, and stabilises the projected ultimate by weighting between the prior expected ultimate and the projected based on the assumed development factors. The Cape Cod method differs from the Bornhuetter-Ferguson method in that it uses a trending of ratios (such as the average cost) to arrive at a prior expected ultimate for use in the projections.

The work is undertaken and supervised by suitably qualified personnel. Claims provisions are separately computed for each claim type such as bodily injury, accidental damage, storm, flood and subsidence. All provisions are calculated with explicit allowance for reinsurance and subrogation recoveries. Provisions are not discounted for investment return other than any required additional provision for unexpired risks, periodic payment settlements and provisions relating to asbestos exposure within the electric industry ('EIROS' claims).

Discounted reserves in respect of periodic payment settlements are £21m (2013: £24m) and EIROS discounted reserve amounts to £4m (2013: £3m). Further details around expected settlement patterns for claims arising on these reserves are disclosed within the insurance risk section in note 31.

The EIROS reserve was based on a report produced for the industry at the end of 2013, by Towers Watson an actuarial consultancy. This gave Towers Watson's estimate of both the undiscounted and discounted incurred but not reported (IBNR) reserves as at the end of June 2013. This was the most recent report available when CISGIL calculated our year end 2014 reserves.

In respect of business yet to be earned, the adequacy of the premium to cover future claims costs and expenses was assessed to determine the requirement for an Unexpired Risk Provision (URP) by comparing the discounted premium and outgoings. As at the end of 2014 CISGIL held an URP of £11m (2013: £2m).

As outlined within the risk management section, there is significant uncertainty in the assessment of liabilities, and provisions are set to be adequate to cover the anticipated eventual cost. Sensitivity analysis is performed to assist the selection of key parameters and, hence, the provisions adopted. Provisions are subject to detailed review regarding the appropriateness of key assumptions and the quantum of the provisions established.

The overall objective of CISGIL's reserving policy is to produce reliable and accurate reserves. Assumptions underlying the reserving calculations are agreed by the Quarterly Reserving Committee (QRC). Methodologies are peer reviewed throughout the calculation process. Provisions are approved and signed off by the QRC, and any margin above the actuarial best estimate reserve is set by the Chief Financial Officer.

Notes to the Financial Statements continued

22. Insurance contracts liabilities and reinsurance assets continued

Periodic reports are produced by the actuarial team and presented to the Periodic Reserving Committee in order to advise management of the performance of the business. More detailed reports are produced on a quarterly basis providing information on the performance of the business against plan. These reports are presented to the QRC and form the basis of reporting the performance to the Board.

ii) Key assumptions

Principal assumptions underlying the claims provisions include:

- allowance for future inflation rates being different to those implied in the claims data; and
- for bodily injury claims, allowance has been made for:
  - i) use of the appropriate Ogden Tables;
  - ii) awards for general damages in accordance with the 12th edition of the JSB guidelines;
  - iii) a proportion of large claims being settled by periodic payments; and
  - iv) improvements in the case estimation techniques resulting in earlier recognition of the size of the claims.

The gross insurance provision for claims and loss adjustment expenses arising in respect of prior years of £393m (2013: £427m) includes a movement of £11m (2013: £47m) arising from a release/(increase) of reserves, as follows:

	2014 £m	2013 £m
Fire and Accident (increase)/release of reserves	**(4)**	7
Motor release of reserves	**19**	43
(Increase) in claims handling reserves	**(4)**	(3)
Movement in gross insurance liabilities	**11**	47

iii) Sensitivity analysis

There is greater uncertainty over motor claims provisions than other provisions as they often involve claims for bodily injury and associated legal costs which typically have a longer period to settlement. Motor provisions represent the most significant proportion of the total general insurance outstanding claims liabilities (gross of salvage and subrogation). Sensitivity information is given for motor claims provisions together with limited information for all other classes. The following table indicates the effect on gross claims provisions (gross of reinsurance and salvage and subrogation) of changes in key assumptions. The impact of the increased uncertainty on the income statement risk is mitigated through holding management margin on the best estimate reserves that is proportional to the level of uncertainty.

Assumption

	2014			2013	
	Changes in parameter	**Effect on gross provision £m**	**% Effect**	Effect on gross provision £m	% Effect
Motor					
Average cost of claims for last three years – bodily injury and legal	**10%**	**47**	**11.4%**	65	12.3%
Mean term to settlement – bodily injury and legal	**+1/2 year**	**8**	**2.0%**	10	1.9%
Rate of future inflation – bodily injury and legal	**1%**	**13**	**3.1%**	18	3.5%
Ogden discount rate – bodily injury	**-1/4%**	**4**	**0.9%**	2	0.4%
Other classes					
Mean term to settlement (liability)	**+1/2 year**	**1**	**2.1%**	-	2.1%
Mean term to settlement (non-liability)	**+ 1/2 year**	**1**	**1.5%**	1	1.4%
Rate of future inflation (liability)	**1%**	**2**	**6.4%**	1	4.9%
Rate of future inflation (non-liability)	**1%**	**1**	**1.2%**	1	1.3%

Notes to the Financial Statements continued

22. Insurance contracts liabilities and reinsurance assets continued

c) Changes in General Insurance liabilities and reinsurance assets

i) Change in insurance contract liabilities (net of salvage and subrogation)

	2014				2013			
	Gross £m	**Unexpired risk provision £m**	**Salvage & subrogation £m**	**Net £m**	Gross £m	Unexpired risk provision £m	Salvage & subrogation £m	Net £m
At the beginning of the year	657	2	(24)	635	756	-	(61)	695
Movement in the year	(102)	9	3	(90)	(99)	2	37	(60)
At the end of the year	555	11	(21)	545	657	2	(24)	635

Salvage and subrogation is included within assets as part of insurance receivables.

ii) Claims and loss adjustment expenses

	2014			2013		
	Gross £m	**Reinsurance £m**	**Net £m**	Gross £m	Reinsurance £m	Net £m
Claims reported	**495**	**(23)**	**472**	558	(16)	542
Claims incurred but not reported	**145**	**(32)**	**113**	180	(26)	154
Claims settlement expenses	**17**	**-**	**17**	18	-	18
At the beginning of the year	**657**	**(55)**	**602**	756	(42)	714
Claims paid during the year	**(390)**	**8**	**(382)**	(436)	7	(429)
Increase/(decrease) in liabilities:						
– arising from current year claims	**299**	**(9)**	**290**	384	(18)	367
– arising from prior year claims	**(11)**	**(16)**	**(27)**	(47)	(2)	(49)
Total movement	**(102)**	**(17)**	**(119)**	(99)	(13)	(112)
Claims reported	**407**	**(40)**	**367**	495	(23)	472
Claims incurred but not reported	**135**	**(32)**	**103**	145	(32)	113
Claims settlement expenses	**13**	**-**	**13**	17	-	17
At the end of the year	**555**	**(72)**	**483**	657	(55)	602

iii) Provisions for unearned premiums

	2014			2013		
	Gross £m	**Reinsurance £m**	**Net £m**	Gross £m	Reinsurance £m	Net £m
At the beginning of the year	**207**	**(2)**	**205**	273	(3)	270
Increase in the year	**365**	**(25)**	**340**	443	(32)	411
Release in the year	**(400)**	**27**	**(373)**	(509)	33	(476)
Movement in the year	**(35)**	**2**	**(33)**	(66)	1	(65)
At the end of the year	**172**	**-**	**172**	207	(2)	205

Notes to the Financial Statements continued

22. Insurance contracts liabilities and reinsurance assets continued

iv) Unexpired risk provision

	2014			2013		
	Gross £m	**Reinsurance £m**	**Net £m**	Gross £m	Reinsurance £m	Net £m
At the beginning of the financial year	**2**	**-**	**2**	-	-	-
Increase in the financial year	**11**	**-**	**11**	2	-	2
Release in the financial year	**(2)**	**-**	**(2)**	-	-	-
Movement in the financial year	**9**	**-**	**9**	2	-	2
At end of the financial year	**11**	**-**	**11**	2	-	2

Additional provision is made for unexpired risks where the claims and expense, likely to arise after the end of the financial year, in respect of contracts concluded before that date, are expected to exceed the unearned premiums at the end of the financial year. The provision related to the motor class of business.

v) Analysis of claims development

	Accident year											
	2004 £m	**2005 £m**	**2006 £m**	**2007 £m**	**2008 £m**	**2009 £m**	**2010 £m**	**2011 £m**	**2012 £m**	**2013 £m**	**2014 £m**	**Total £m**
Gross of reinsurance												
At end of the accident year	**551**	**480**	**419**	**385**	**347**	**326**	**411**	**497**	**502**	**368**	**285**	**4,571**
– One year later	**527**	**468**	**412**	**388**	**320**	**333**	**455**	**530**	**473**	**347**	**-**	**4,253**
– Two years later	**495**	**440**	**403**	**378**	**310**	**341**	**480**	**527**	**473**	**-**	**-**	**3,847**
– Three years later	**467**	**414**	**394**	**364**	**300**	**329**	**466**	**518**	**-**	**-**	**-**	**3,252**
– Four years later	**450**	**423**	**387**	**367**	**297**	**320**	**456**	**-**	**-**	**-**	**-**	**2,700**
– Five years later	**454**	**419**	**388**	**366**	**294**	**320**	**-**	**-**	**-**	**-**	**-**	**2,241**
– Six years later	**453**	**422**	**382**	**362**	**294**	**-**	**-**	**-**	**-**	**-**	**-**	**1,913**
– Seven years later	**453**	**430**	**385**	**361**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1,629**
– Eight years later	**452**	**429**	**384**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1,265**
– Nine years later	**453**	**427**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**880**
– Ten years later	**454**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**454**
Estimate for cumulative claims	**454**	**427**	**384**	**361**	**294**	**320**	**456**	**518**	**473**	**347**	**285**	**4,319**
Cumulative payments to date	**(449)**	**(404)**	**(371)**	**(349)**	**(291)**	**(306)**	**(433)**	**(472)**	**(381)**	**(247)**	**(129)**	**(3,832)**
Gross outstanding claims liabilities before discounting	**5**	**23**	**13**	**12**	**3**	**14**	**23**	**46**	**92**	**100**	**156**	**487**
Provision for prior years before discounting												**57**
Discounting												**(2)**
Gross outstanding claims liabilities												**542**

	£m
Gross claims reported	**407**
Gross claims incurred but not reported	**135**
Gross outstanding claims liabilities	**542**

Gross ultimates have increased as the indemnification agreement came into force after the application of CIS Reinsurance contracts. Following the Part VII transfer, CISGIL have now taken on the Gross Liabilities that were previously reinsured under CIS Reinsurance contracts.

Notes to the Financial Statements continued

22. Insurance contracts liabilities and reinsurance assets continued

v) Analysis of claims development continued

	Accident year											
	2004 £m	**2005 £m**	**2006 £m**	**2007 £m**	**2008 £m**	**2009 £m**	**2010 £m**	**2011 £m**	**2012 £m**	**2013 £m**	**2014 £m**	**Total £m**
Net of reinsurance												
At end of the accident year	547	478	417	373	335	313	398	481	490	351	276	4,459
– One year later	525	466	409	378	306	321	434	515	456	330	-	4,140
– Two years later	493	437	401	370	296	325	459	517	459	-	-	3,757
– Three years later	465	411	393	358	292	318	445	509	-	-	-	3,191
– Four years later	448	420	386	359	290	310	439	-	-	-	-	2,652
– Five years later	452	414	385	359	287	307	-	-	-	-	-	2,204
– Six years later	451	415	380	355	288	-	-	-	-	-	-	1,889
– Seven years later	451	421	380	354	-	-	-	-	-	-	-	1,606
– Eight years later	450	421	380	-	-	-	-	-	-	-	-	1,251
– Nine years later	451	419	-	-	-	-	-	-	-	-	-	870
– Ten years later	452	-	-	-	-	-	-	-	-	-	-	452
Estimate for cumulative claims	452	419	380	354	288	307	439	509	459	330	276	4,213
Cumulative payments to date	(447)	(403)	(370)	(342)	(285)	(301)	(425)	(466)	(376)	(242)	(125)	(3,782)
Net outstanding claims liabilities before discounting	5	16	10	12	3	6	14	43	83	88	151	431
Provision for prior years before discounting												41
Discounting												(2)
Net outstanding claims liabilities												**470**

	£m
Net claims reported	368
Net claims incurred but not reported	102
Net outstanding claims liabilities	**470**

It is to be expected that releases will normally be made to prior years claims as current reserves are set such that no adverse deterioration is expected. However, from time to time the random occurrence of significant large individual claims or events being worse than expected can give rise to a required strengthening, in addition to normal claims development being adverse. The 2014 result includes movement on prior year reserves of £27m (2013: £49m).

Insurance Accounting policies

Contracts under which CISGIL accepts significant insurance risk from another party (the policyholder), by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary are classified as insurance contracts. A contract that qualifies as insurance remains an insurance contract until all the risks and obligations are extinguished or expire. All contracts of general insurance business written by CISGIL are classified as insurance contracts. General insurance business is accounted for on an annual basis.

i) Unearned premium provision

For general insurance business, the proportion of written premiums relating to periods of risk beyond the year end is carried forward to future accounting periods. The relevant proportion is calculated using the daily pro rata basis. Outward reinsurance premiums are treated as earned in accordance with the profile of the reinsured contracts.

ii) Claims incurred

Insurance claims incurred comprises claims paid during the year, together with related handling costs and the change in the gross liability for claims in the period net of related recoveries including salvage and subrogation.

Notes to the Financial Statements continued

22. Insurance contracts liabilities and reinsurance assets continued

iii) Claims outstanding

Claims outstanding comprises provisions representing the estimated ultimate cost of settling:

- estimates on claims reported by the balance sheet date ('claims reported'); and
- expected additional cost in excess of claims reported for all claims occurring by the balance sheet date ('claims incurred but not reported').

Aggregate claims provisions include attributable claims handling expenses and are set at a level such that no adverse run off deviations are envisaged. Adverse run off deviations, which are material in the context of the business as a whole, would be separately disclosed in the notes to the financial statements including the claims development tables.

Anticipated reinsurance recoveries and estimates of salvage and subrogation recoveries are disclosed separately within assets under the headings of 'reinsurance assets' and 'insurance receivables and other assets' respectively.

In accordance with accounting regulations, discounting of outstanding claims is permitted in certain circumstances. For statutory accounts the outstanding reserves are discounted in respect of periodical payments and a portion of liability type claims from the electric industry ('EIROS') for which separate assets are held of appropriate term and nature.

iv) Unexpired risk provision

Additional provision is made for unexpired risks where the claims and expenses, likely to arise after the end of the financial year in respect of contracts concluded before that date, are expected to exceed the unearned premiums less deferred acquisition costs carried forward for those contracts. Provision for unexpired risks is calculated for each category of business. Where categories of business are managed together a combined calculation is performed. Surpluses and deficits within each category are offset within the calculation. The provision is determined after taking account of future investment return arising on investments supporting the unearned premium provision and unexpired risk provision. Such provisions ensure that the carrying amount of unearned premiums provision less related deferred acquisition costs is sufficient to cover the current estimated future cash flows, including claims handling expenses and therefore meets the minimum requirements of the liability adequacy test as set out in IFRS 4 (Insurance Contracts).

v) Acquisition costs

Costs directly associated with the acquisition of new business, including commission, are capitalised and amortised in accordance with the rate at which the gross written premiums associated with the underlying contract are earned. See note 11.

vi) Reinsurance

Contracts with reinsurers that give rise to a significant transfer of insurance risk are accounted for as reinsurance contracts. Amounts recoverable under such contracts are recognised in the same period as the related claim. Premiums, claims and receivables are presented on a gross basis in the income statement and balance sheet.

Amounts recoverable under reinsurance contracts are assessed for impairment at each balance sheet date. If objective evidence of impairment exists, reinsurance assets are reduced to the level at which they are considered to be recoverable and an impairment loss is recognised in the income statement.

23. Share capital

	Nominal and paid-up value Members' share capital	
	2014 £m	2013 £m
Corporate shares of £5 each	**9**	9
Individual shares of £1 and 10p each	**61**	61
	70	70

IFRIC 2 determines the features that allow shares to be classified as equity capital.

Members' share capital

Members' share capital comprises corporate and individual shares. The rights attached to shares are set out in the Society's rules. Shares held by corporate members (corporate shares) are not withdrawable and are transferable only between corporate members with the consent of the Society's Board. Shares held by individual members (individual shares) are withdrawable on such period of notice as the Society's Board may from time to time specify.

Notes to the Financial Statements continued

23. Share capital continued

As the Board has an unconditional right to refuse redemption of both classes of shares, both corporate and individual shares are treated as equity shares.

Both classes of share maintain a fixed nominal value with corporate shares attracting a limited rate of interest. Per the transitional rules, voting for corporate members is in proportion to trade with the Society with corporate members totalling 21.9% of the vote at the Annual General Meeting. Each individual member has one vote with individual members totalling 78.1% of the vote at the Annual General Meeting.

Distribution of reserves in the event of a winding-up

The Society's rules state that any surplus in the event of a winding-up shall be transferred to one or more societies registered under the Co-operative and Communities Benefit Act 2014. Such societies must be in membership of Co-operativesUK Limited and have the same or similar rule provisions as regards to surplus distribution on a dissolution or winding-up as the Society. If not so transferred, the surplus shall be paid or transferred to Co-operativesUK Limited to be used and applied in accordance with co-operative principles.

24. Interest-bearing loans and borrowings

This note provides information about the contractual terms of the Trading Group's interest-bearing loans and borrowings. For more information about the Group's exposure to interest rate and foreign currency risk, and a breakdown of IFRS 13 level hierarchies in relation to these borrowings, see note 31.

	2014 £m	2013 £m
Non-current liabilities:		
5 5⁄8% Eurobond Notes due 2020*	**470**	-
6 1⁄4% Eurobond Notes due 2026*	**369**	-
7 5⁄8% First Mortgage Debenture Stock 2018*	**21**	-
11% final repayment subordinated notes due 2025	**109**	-
Instalment repayment notes (final payment 2025)	**18**	-
Corporate investor shares	**2**	-
Non-current portion of finance lease liabilities	**4**	6
	993	6

	2014 £m	2013 £m
Current liabilities:		
Unsecured bank loans	**50**	500
5 5⁄8% Eurobond Notes due 2020*	**-**	467
6 1⁄4% Eurobond Notes due 2026*	**-**	362
7 5⁄8% First Mortgage Debenture Stock 2018*	**-**	50
11% final repayment subordinated notes due 2025	**-**	109
Instalment repayment notes (final payment 2025)	**1**	20
Corporate investor shares	**11**	26
Current portion of finance lease liabilities	**5**	3
Other unsecured loans	**2**	7
	69	1,544

* These drawn down loan commitments are designated as financial liabilities at fair value through the income statement. All of the other liabilities, except the finance lease liability, are classified as loans and receivables in accordance with IAS 39.

Notes to the Financial Statements continued

24. Interest-bearing loans and borrowings continued

As detailed in the 2013 annual report, at 4 January 2014, principally as a result of the recognition of an impairment charge of £226m in respect of Somerfield goodwill, a covenant issue arose which was addressed following the year end by the agreement of an amendment to the net asset covenant calculation by the Group's Banking syndicate. This ensured that the Trading Group was able to satisfy this covenant within the terms of the Group's unsecured bank loan facilities (total facilities of £900m of which £454m was drawn down at the 2013 year end). In addition, following the reduction in the Group's investment in the Co-operative Bank plc on 20 December 2013, an amendment was obtained following the year end from the 2018 Debenture stock holders to ensure that the Total Consolidated Borrowings to Tangible Consolidated Net Worth covenant within the terms of the Group's 7 5/8% First Mortgage Debenture stock 2018 was satisfied.

In accordance with relevant accounting standards, because the covenant amendments were received post year end, the Group was deemed not to have an unconditional right to defer payment of its borrowings for more than 12 months at 4 January 2014. As a consequence, the previous year end balance sheet was presented on the basis that all debt that could technically have become repayable, whether by default, cross default or cross acceleration, was classified within current liabilities, even though the covenant issue had subsequently been resolved. This presentation did not reflect the amended terms of the debt as at the date of signing the accounts. In the 2013 annual report the Group also presented an adjusted balance sheet to reflect the amended terms of the borrowings as agreed post balance sheet date but prior to signing the accounts.

Corporate investor shares

Corporate investor shares may be issued to existing corporate members who hold fully paid corporate shares and are registered under the Co-operative and Communities Benefit Act 2014. The rate of interest payable is determined by the London Interbank Offered Rate (LIBOR).

Terms and repayment schedule

The 7.625% First Mortgage Debenture Stock 2018, which is secured over freehold and leasehold properties, with an original value of £50m, was subsequently reduced to £21m as a result of a partial redemption exercise in April 2014. The residual carrying amount of £21m is to be paid to holders upon maturity.

The 5.625% Eurobond Issue 2020 has an original value of £450m (carrying amount of £470m) and the 6.25% Eurobond Issue 2026 has an original value of £350m (carrying amount of £369m). These bonds have each been paying an additional 1.25% coupon since 8 July 2013 following the downgrade of the Group's credit rating to sub investment grade. Both these Bonds are to be paid to holders upon maturity.

In December 2013 the Group issued two subordinated debt instruments; £109m 11% final repayments notes due 2025 and £20m instalment repayment notes, final payment 2025. As at 3 January 2015 the amounts outstanding are final repayments notes of £109m and the instalment repayment notes of £19m.

The unsecured bank loans consist of a £450m Revolving Credit Facility which is undrawn as at 3 January 2015. The Group also holds a £50m bilateral facility which was fully drawn as at 3 January 2015. These facilities terminate on 26 July 2017 and 25 March 2015 respectively.

The Group also holds £16m (GBP equivalent) of uncommitted facilities, renewed annually.

Reconciliation of movement in net debt

Net debt is a measure that shows the Trading Group's net indebtedness to banks and other external financial institutions and comprises the total of cash and short term deposits less deposits held in trustee-administered bank accounts and current and non-current interest-bearing loans and borrowings.

Notes to the Financial Statements continued

24. **Interest-bearing loans and borrowings** continued

For period ended 3 January 2015

	Start of period £m	Non cash movements £m	Cash flow £m	Movement in corporate investor shares £m	Transfer from current to non-current £m	End of period £m
Cash and cash equivalents	**200**	**-**	**107**	**-**	**-**	**307**
Less:						
– Deposits held in trustee-administered bank accounts	**(50)**	**-**	**(3)**	**-**	**-**	**(53)**
– Interest-bearing loans and borrowings – non-current	**(6)**	**(9)**	**484**	**(2)**	**(1,460)**	**(993)**
– Interest-bearing loans and borrowings – current	**(1,544)**	**-**	**-**	**15**	**1,460**	**(69)**
Net debt	**(1,400)**	**(9)**	**588**	**13**	**-**	**(808)**

For period ended 4 January 2014

	Start of period £m	Non cash movements £m	Cash flow £m	Movement in corporate investor shares £m	Transfer from non-current to current £m	End of period £m
Cash and cash equivalents	180	-	20	-	-	200
Less:						
– Deposits held in trustee-administered bank accounts	(52)	-	2	-	-	(50)
– Interest-bearing loans and borrowings – non-current	(1,501)	37	-	1	1,457	(6)
– Interest-bearing loans and borrowings – current	(313)	(17)	224	19	(1,457)	(1,544)
Net debt	(1,686)	20	246	20	-	(1,400)

Finance lease liabilities

Finance leases have the following maturities in the Trading Group:

	2014 £m	2013 £m
Less than one year	**5**	3
Greater than one year but less than five years	**4**	6
Greater than five years	**-**	-
	9	9

Under the terms of the lease agreements, no contingent rents are payable. The difference between the total future minimum lease payments and their present value is immaterial.

Accounting policies

The Trading Group measures its financial liabilities (excluding derivatives) in two main ways. Quoted debt is designated at fair value through profit or loss when the Group enters into transactions designated to offset the impact of fair value movements (the Group has used interest rate swaps designed to offset certain extended debt instruments). Other material financial liabilities (such as the debt raised from the LME) are measured at amortised cost.

Financial assets and liabilities at fair value through profit or loss are:

- acquired or incurred principally for the purpose of selling or repurchasing in the near term;
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking; or
- upon initial recognition designated at fair value through profit or loss to eliminate or significantly reduce a measurement of recognition inconsistency.

Notes to the Financial Statements continued

24. Interest-bearing loans and borrowings continued

Debt that is at fair value through profit or loss is measured at fair value with movements in the carrying value brought into the income statement as they arise. This group of financial liabilities is also managed, and its performance is evaluated on a fair value basis, in accordance with the risk management strategy.

Financial liabilities not fair valued through profit or loss are measured at amortised cost using the effective interest method.

No assets are classified as held to maturity.

25. Trade and other payables

	2014 £m	2013 (restated) £m
Current	**1,381**	1,889
Non-current	**841**	894
	2,222	2,783

	2014 £m	2013 £m
Trade payables	**697**	849
Value added tax, PAYE and social security	**34**	18
Accruals and deferred income	**256**	419
Member payments payable	**25**	25
Funeral bonds	**676**	619
Deferred consideration	**-**	300
Other payables	**533**	551
Other reinsurance liabilities	**1**	2
	2,222	2,783

Further details on the maturity profile of trade and other payables of the Trading Group can be found in note 31.

Other payables include a payable to the Bank of £181m (2013: £187m). This was included within tax payable in the prior year, but this balance has been reclassified as it is an amount payable to the Bank in respect of historic group relief.

Deferred consideration in the prior period related to the additional contribution that the Group was required to inject into the Bank as part of the LME. This was paid in full during 2014.

Accounting policies

Prepaid funeral plans (plans)

Prepaid funeral plans are accounted for in accordance with IAS 18. A small proportion of revenue is recognised on the sale of each plan, equivalent to the upfront marketing and administration costs incurred in the initial sale. The proportion of the plan value that is recognised varies depending on the sales channel, reflecting different underlying costs of the different channels. The remaining revenue is recognised when the funeral is delivered.

At the point of sale both the initial plan investment and the liability for the funeral delivery are recorded at the plan value less the revenue recognised on sale. On future measurement, the plan investment is recorded at fair value as it is designated as available for sale. A liability adequacy test is performed by a qualified Actuary every three years on the funeral plan liability to ensure it at least reflects the anticipated cost of delivering the funeral in the future. In between actuarial valuations, the underlying assumptions of investment growth and cost inflation are reviewed by management to ensure the plan liability continues to at least reflect the anticipated cost of delivering the funeral in the future.

Funeral benefit options (FBOs)

FBOs are attached to Guaranteed Over 50's life insurance plans (GOFs) sold by the Group's 3rd party insurance partners. An FBO is the assignment of the sum assured proceeds of a GOF policy to Funeralcare for the purposes of undertaking their funeral. In exchange the GOF customer is awarded a discount on the price of the funeral.

Notes to the Financial Statements continued

25. Trade and other payables continued

No revenue is recognised by the Group at the point of assignment and instead an element of the costs that have been incurred in obtaining the FBO are deferred onto the Balance Sheet. These are then expensed at the point of redemption when the revenue is recognised.
Any plans that are cancelled are written off at the point at which Funeralcare are made aware of the cancellation. A separate provision is also made to cover the expected cancellations of FBOs. No investment or liability is recognised for FBOs as the option does not guarantee a funeral and the liability for which remains with the insurance partner. Any difference between the funeral price and the sum assured at the point of redemption is the liability of the deceased estate or whoever takes responsibility for arranging the funeral.

26. Provisions

	2014 £m	2013 £m
Non-current	**375**	311
Current	**146**	189
	521	500

	Uninsured claims £m	**Onerous leases £m**	**Restructuring & integration £m**	**Litigation £m**	**Regulatory/ other £m**	**2014 Total £m**	2013 Total £m
At beginning of the period	**92**	**232**	**82**	**14**	**80**	**500**	601
Credit to income statement	**(2)**	**(11)**	**(1)**	**(5)**	**(17)**	**(36)**	(21)
Charge to income statement	**34**	**81**	**77**	**2**	**16**	**210**	766
Provisions utilised on disposal	**-**	**-**	**-**	**-**	**(3)**	**(3)**	(5)
Discounting	**-**	**11**	**-**	**-**	**-**	**11**	10
Payments	**(33)**	**(35)**	**(47)**	**(1)**	**(47)**	**(163)**	(275)
Reclassification	**-**	**-**	**-**	**-**	**2**	**2**	-
Disposals arising from loss of control of subsidiary	**-**	**-**	**-**	**-**	**-**	**-**	(576)
At end of the period	**91**	**278**	**111**	**10**	**31**	**521**	500

Critical accounting estimates and judgements

Uninsured claims

This provision relates to potential liabilities arising from past events which are not covered by insurance. The provision includes an assessment, based on historical experience, of claims incurred but not reported at the period end. The claims are expected to be settled substantially over the next three years. Discounting does not materially impact the level of the provision.

Onerous leases

This provision primarily relates to properties that are no longer used for trading. The provision is recorded net of estimated rental income from sub-letting the properties. The provision is calculated on a property by property basis by reference to the headlease term and includes property holding costs such as business rates. Rental streams are assumed to terminate at the next most likely break point. The leases expire at dates ranging over many years and payments under lease commitments, net of amounts receivable under sub-lettings, will be approximately £150m (2013: £76m) payable over the next five years. All costs have been discounted at a rate of 6.9% (2013: 3.5%). In previous years a rate of 8% had been used in relation to costs relating to the former Somerfield head office where the provision was fair valued at this rate on acquisition in 2009.
A £15m impairment provision was fully utilised and transferred to the net book value of land and buildings during the year.

Notes to the Financial Statements continued

26. Provisions continued

The Group has changed its estimation methodology on onerous leases this year. The discount rate used this year end was 6.9% based on the Group's cost of finance, compared to a rate of 3.5% in 2013 that was based on a risk free rate. In previous years the onerous lease cashflows were discounted using a risk-free (20 year gilt) rate because the underlying cashflows were only partially risk adjusted. However, volatility in gilt rates in recent years led to volatility in the calculation of the discounted provision. In 2014 a new approach has been adopted to reduce this volatility.

Restructuring and integration

£49m (2013: £39m) was provided in 2014 in respect of the cost of separating Group IT and other change management systems from the Bank. Other provisions relate to the rationalisation of the corporate head office and divisional central support functions. Costs for these provisions are expected to be incurred over the next three years.

Litigation

The provision represents management's prudent estimate of costs arising from potential litigation. The majority of these costs are expected to be incurred within the next one to three years.

Regulatory/other

The significant movements in the year relate to the contractual requirement for the Group to build a separate clone system for the Life and Savings business following its sale to Royal London.

Accounting policies

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Notes to the Financial Statements continued

27. Reconciliation of operating profit/(loss) to net cash inflow from operating activities

	2014 £m	2013 £m
Operating profit/(loss)	**227**	(181)
Profits/(losses) on discontinued operations	**109**	(1,862)
Depreciation and amortisation charges (excluding DACs)	**279**	349
Non-current asset impairments	**22**	413
Profit on disposal of businesses and non-current assets	**(311)**	(25)
Change in value of investment properties	**(16)**	18
Effect of exchange rate movements	**-**	(1)
Effect of non-cash pension costs	**-**	(7)
Decrease in inventories and biological assets	**26**	2
Decrease/(increase) in receivables	**106**	(88)
(Decrease)/increase in payables and provisions*	**(476)**	331
Interest payable on subordinated liabilities	**-**	96
Impairment losses on loans and advances	**-**	518
Impairment losses on investments	**-**	(19)
Interest amortisation	**-**	(4)
Amortisation on investments	**-**	153
Fair value amortisation	**-**	216
Unwind of fair value adjustments on transfer of engagements	**-**	46
Preference dividend	**-**	38
Tax received	**-**	14
Net cash flow used in Trading activities	**(34)**	7
Decrease in deposits by banks	**-**	(855)
Increase in customer accounts	**-**	(4,088)
Increase in debt securities in issue	**-**	(613)
Increase in loans and advances to banks	**-**	67
Increase in loans and advances to customers	**-**	2,907
Net movement of other assets and other liabilities	**-**	(1)
Investment property movement	**-**	(30)
Fair value through profit and loss movement	**51**	288
Derivative financial instruments movement	**-**	38
Assets available for sale movement	**37**	(28)
Movement in deferred acquisition costs	**15**	(5)
Reinsurance assets	**(15)**	89
Loan receivables at amortised cost	**3**	-
Insurance and other receivables	**50**	(149)
Insurance and participation contract provisions	**(128)**	(163)
Unallocated divisible surplus	**-**	(75)
Investment contracts	**-**	62
Amounts owed to credit institutions	**-**	(25)
Other provisions	**-**	70
Insurance and other payables	**8**	(4)
Other reinsurance liabilities	**-**	(2)
Net asset value attributable to unit holders	**-**	14
Asset and liability movements in Financial Services	**21**	(2,503)
Net cash flow used in operating activities	**(13)**	(2,496)

*The decrease in payables and provisions includes £313m capital contribution to Co-operative Bank Plc.

The cash flows above and in the cash flow statement include discontinued operations and Reclaim Fund cash flows.

Notes to the Financial Statements continued

27. Reconciliation of operating profit/(loss) to net cash inflow from operating activities continued

Accounting policies

Cash and cash equivalents comprise cash balances, call deposits and balances with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

28. Commitments and contingent liabilities

a) Capital expenditure committed by the Group at the year end was £5m (2013: £8m). This all related to property, plant and equipment.

b) Commitments under operating leases:

The Group's operating leases include stores, warehouses and vehicles. These have varying terms, restrictions and renewal rights.
At 3 January 2015, the future minimum lease payments under non-cancellable operating leases were:

	2014		2013	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Within one year	**176**	**10**	185	14
In two to five years	**631**	**9**	655	17
In over five years	**1,540**	**-**	2,018	-
	2,347	**19**	2,858	31

The total of future minimum sublease payments expected to be received under non-cancellable subleases less than 50 years is £206m (2013: £254m).

29. Related party transactions and balances

The nature of the relationship of related parties and the extent of material transactions and balances with them are set out below or are disclosed elsewhere within the financial statements.

	Relationship	**2014 £m**	2013 £m
Sales to associated undertakings and joint ventures on normal trading terms	(i)	**0.6**	2.9
Subscription to Co-operatives UK Limited	(ii)	**0.7**	1.0

i) Details of the Society's associates and joint ventures are set out in note 13.

ii) The Society is a member of Co-operatives UK Limited.

The Society's corporate members include consumer co-operative societies which, in aggregate, own the majority of the corporate shares with rights attaching as described in note 23. The sales to corporate members, on normal trading terms, were £1,479m (2013: £1,462m) and the amount due from corporate members in respect of such sales was £83m at 3 January 2015 (4 January 2014: £76m). A distribution of £nil (2013: £10m) was paid to corporate members based on their trade with the Group.

Transactions with directors and key management personnel

Disclosure of key management compensation is set out in the Remuneration Report. A number of trading transactions are entered into with key management in the normal course of business and are at arms length. Key management are considered to be members of the management executive and directors of the Co-operative Group. Other than the compensation set out in the Remuneration Report, there were no transactions greater than £1,000 with the Group's entities (2013: £1,000).

Notes to the Financial Statements continued

29. **Related party transactions and balances** continued

The Group also enters into transactions with key management personnel within General Insurance. Details of the transactions carried out during the period and balances are as follows:

	2014 £m	2013 £m
At beginning of period	**-**	0.2
Net movement	**-**	(0.2)
At end of period	**-**	-

Transactions with associates and joint ventures

The following balances are outstanding with the Bank for the period ends in which it has been an associate:

	2014 £m	2013 £m
Loans	**(51)**	(110)
Intercompany assets	**126**	157
Bank balance	**247**	92
Intercompany liabilities	**(163)**	(430)

The Group owns 20.2% of the Co-operative Bank Plc's ordinary shares and has the right to representation on the board of the Bank. As such the Bank is an associate of, and related party to, the Group and there are material transactions between the two entities. As part of the Recapitalisation Plan and the Bank ceasing to be a wholly owned subsidiary of the Co-operative Group, the Bank and the Group entered into the following agreements
and arrangements.

Relationship agreement

In anticipation of the completion of the LME and the Bank ceasing to be a wholly owned subsidiary of the Group, the Group and the Co-operative Banking Group entered into an agreement with the Bank on 4 November 2013 (the Relationship Agreement) to regulate the basis of their on-going relationship.

Principles

The Co-existence Principles govern the use of trademarks containing 'Co-operative' or 'Co-op' and other associated trademarks owned by both parties.

2014 Commitment Agreement

On 4 November 2013, the Co-operative Banking Group entered into the 2014 commitment agreement with the Bank (the 2014 Commitment Agreement), conditional on the successful implementation of the LME, to subscribe for new ordinary shares satisfied by an irrevocable undertaking to pay £333m (the Undertaking to Pay to the Bank). These commitments were satisfied with the final tranche paid by the Group in December 2014.

Intra-group Loan

On 4 November 2013, the Group, the Co-operative Banking Group and the Bank entered into an intra-group loan facility (the Intra-group Loan) whereby the Group made available to the Co-operative Banking Group during 2014 a term loan facility of up to £313m to be utilised by way of advances. The maturity date of the loan facility is 27 July 2019. The purpose of the Intra-group Loan was to support the Co-operative Banking Group's undertaking to pay the Bank the agreed 2014 capital commitment as a result of the LME, which was paid in full by December 2014.

Pensions Undertaking

On 4 November 2013, the Group and the Bank entered into an undertaking whereby the Group agreed with the Bank not to require the Bank to cease to participate in Pace in connection with the LME. The parties also agreed at the request of one of the parties to enter into good faith discussions to reach agreement on the separation of Pace and agree the Bank's proportion of employer contributions in Pace (and if not agreed, the matter will be referred to an independent third party).

Notes to the Financial Statements continued

29. Related party transactions and balances continued

IT separation costs agreement

On 22 January 2015 the Bank entered into an IT separation costs agreement with CFS Management Services Limited (CFSMS), Co-operative Group Limited (CGL) and Co-operative Banking Group Limited (CBGL). This agreement was required by the Bank as a prerequisite for the Bank to enter into an outsourcing agreement with IBM for enterprise computing services (which was entered into on 23 January 2015). Under the IT separation costs agreement, both CGL and CFSMS undertake to support activities for the separation of the Bank's IT infrastructure from the wider Co-operative Group's IT infrastructure, to enable the smooth transition to IBM. Further, CGL and CFSMS undertake that any notice to terminate the existing IT services agreement (in the case of CGL) and the CFSMS-Bank Framework Agreement (in the case of CFSMS) would not take effect prior to 31 December 2017 to give the Bank sufficient time to separate the Bank's IT infrastructure. The IT separation costs agreement also allocated the contributions to be made towards the Co-operative Group's own costs of keeping the wider Co-operative Group's existing IT infrastructure stable and operable during and following the Bank's separation of its IT infrastructure; to this end CBGL (as the parent of CFSMS) undertook to contribute a maximum of £95m towards such Co-operative Group costs, with the Bank to make a contribution of up to £25m, based on a formula in the event that the total cost of this Co-operative Group project fall between £76m and £120m.

Deed of surrender and release – Bank ATMs in Group Food stores

On 1 January 2008 the Bank was granted a licence by the Group to install and operate ATMs at a number of Co-operative Food stores in the UK. On 14 April 2014 the Group served notice on the Bank to terminate this licence with effect from 1 January 2016. As part of a new arrangement between the Group and another third party, on 20 November 2014, the Group and the Bank entered into a deed for the Bank to surrender immediately any rights of occupation it may have in relation to these premises. In consideration for this early surrender, the Group paid the Bank £8.2m.

CFSMS transactions

CFSMS is a subsidiary of the Co-operative Banking Group and continues to undertake the provision of supplies and services on behalf of the Bank. Further details of the CFSMS–Bank Framework agreement are disclosed below.

CFSMS-Bank Framework

On 16 February 2006, CFSMS and the Bank entered into the CFSMS-Bank Services Agreement pursuant to which CFSMS provides assets such as office equipment, materials and office space, and other facilities and services, and consultants who act as secondees to the Bank. The Bank provides CFSMS with an indemnity for all liabilities, losses, damages, costs and expenses of any nature as a result of CFSMS entering into and performing the agreement in respect of the assets, services and personnel provided to the Bank. CFSMS and the Bank commenced unwinding this arrangement during 2014 with the transfer of the employment of most staff to the Bank (see 'Transfer of Staff from CFSMS to Bank' below) and the transfer of assets to the Bank (see 'Tangible and Intangible Assets' below).

Transfer of staff from CFSMS to Bank

As explained in relation to the CFSMS-Bank Framework above, from 16 February 2006 CFSMS provided consultants acting as secondees to the Bank. The employment of substantially all Bank dedicated staff provided under that arrangement was transferred to the Bank under the Transfer of Undertakings (Protection of Employment) Regulations, on 23 January 2014.

IT Security

The Bank's specialist IT security team will continue to provide an IT security service in relation to the IT infrastructure which the Bank and Co-operative Insurance Services General Insurance (CISGIL) share until that infrastructure is separated. This service comprises a small number of people. The Bank has historically provided ad hoc IT security services to the Co-operative Group. Whilst no services are currently being provided, the Bank and the Co-operative Group entered in to an agreement to provide a framework for future services on 28 November 2014.

Tangible and intangible assets

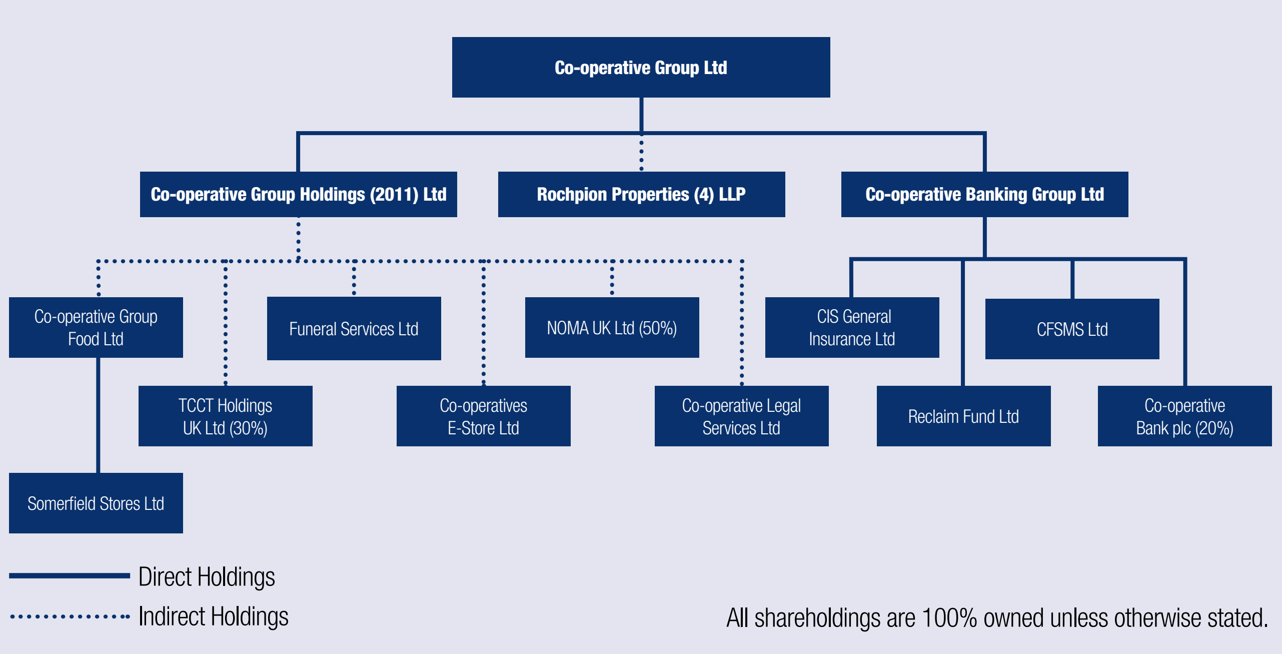
A number of assets were originally purchased by CFSMS using funds advanced by the Bank and then provided to the Bank by CFSMS under the 2006 CFSMS–Bank services agreement referred to above. As part of the separation activity, in November 2014 the Bank purchased the legal title of all Bank specific assets held by CFSMS (shared assets remained with CFSMS) through an SPV called CBG Asset Management Limited.

The Group has transacted with the Travel associate for corporate travel management services in both periods. In addition, the Travel associate has bought energy services off the Group in both periods. These transactions were all at arms length.

Notes to the Financial Statements continued

30. Principal subsidiary undertakings

The composition of the Group and its principal subsidiaries, joint arrangements and associates on 3 January 2015 is as follows:



More information on the principal subsidiary undertakings of the Society are below. They are all registered in England and Wales and their principal place of business is the United Kingdom.

	Society holding %	Nature of business
Financial Services:		
Co-operative Banking Group Ltd	100	Holding society
CIS General Insurance Ltd	100	General insurance
CFS Management Services Ltd	100	Service company
Reclaim Fund Ltd	100	Reclaim Fund
Trading:		
Co-operative Group Holdings (2011) Ltd	100	Property management
Co-operative Group Food Ltd	100	Food retailing
Somerfield Stores Ltd	100	Food retailing
Co-operatve Foodstores Ltd	100	Food retailing
Co-operatives E-Store Ltd	100	Electricals online
Funeral Services Ltd	100	Funeral directors
Co-operative Legal Services Ltd	100	Legal services
Rochpion Properties (4) LLP	100	Holds property

All of the above have been fully consolidated into the Group's accounts. There are no non-controlling interests in any of these entities. For further information on the Group's principal associated undertakings, refer to note 13.

Notes to the Financial Statements continued

30. Principal subsidiary undertakings continued

Notes

i) All of the principal subsidiaries are audited by KPMG LLP.

ii) All of the Group's Financial Services subsidiaries have a year end of 31 December as they report on a monthly cycle rather than a periodic Saturday close cycle for the trading companies. Transactions between the 31 December 2014 and 3 January 2015 are not significant to the Group.

iii) All transactions between entities are in the usual course of business and are at arms length.

iv) The Group completed the sale of Co-operative Healthcare Holdings Ltd (Pharmacy) to Bestway Group on 6 October 2014 which included disposing of the following principal subsidiaries: Co-operative Group Healthcare Ltd, National Co-operative Chemists, the Co-operative Pharmacy National Distribution Centre Ltd and Donald Wardles and Son Ltd.

v) Farmcare Ltd was sold to the Wellcome Trust on 2 August 2014.

vi) Sunwin Services Group (2010) Ltd was sold to Cardtronics Inc. on 3 November 2014.

vii) Millgate Insurance Brokers Ltd ceased trading on 11 April 2014.

Significant restrictions

CIS General Insurance Ltd (CISGIL) is a regulated business and as such CISGIL may only recommend the payment of a dividend to Co-operative Banking Group Limited if it has sufficient capital to do so having regard to CISGIL's regulatory requirements and the CISGIL board's risk appetite.

31. Financial risk management

Financial risk management – Trading Group

The principal financial risks facing the Trading Group are set out below. Overall group risks and the strategy used by the Group to mitigate these risks are discussed in the Principal Risks and Uncertainties section on pages 47 to 50.

Introduction

The Trading Group meets its working capital needs through a number of facilities totalling £1,449m. During 2014, the Group repaid in full a £450m Bank Syndicate Term, satisfied in full its remaining £313m Capital Contribution obligations as part of the agreement to support the Co-operative Bank and partially redeemed a £50m Debenture which now stands at £21m. These payments were predominantly funded through proceeds arising from business disposals. The Group's Syndicated Bank Facilities have therefore been amended to £450m, comprising a Revolving Credit Facility. Following the maturity of a £50m bilateral facility in March 2015, the remaining facilities of £1,399m are predominantly due for repayment between 2017 and 2026, demonstrating the establishment of core medium and long term funding for the Trading Group.

Credit risk

Credit risk arises from the possibility of customers and counterparties failing to meet their obligations to the Trading Group. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed for all customers requiring credit over a certain amount. The Trading Group does not require collateral in respect of financial assets. The majority of businesses in the Trading Group have cash-based rather than credit-based sales hence customer credit risk is relatively small.

Investments are allowed only in liquid securities and only with counterparties that have a credit rating equal to or better than the Trading Group. Transactions involving derivative financial instruments are with counterparties with whom the Trading Group has a signed netting agreement as well as sound credit ratings. Given the policy on credit ratings, management has no current reason to expect that any counterparty will fail to meet its obligations.

Notes to the Financial Statements continued

31. Financial risk management continued

At the balance sheet date there were no significant concentrations of credit risk. Further information regarding the age profile of trade receivables is shown in note 19. The carrying value of all balances that attract a credit risk, which represents the maximum exposure, is set out below:

	Carrying amount 2014 £m	Carrying amount 2013 £m
Trade and other receivables (excluding prepayments and accrued income)	**338**	371
Interest rate swaps	**67**	29
Cash deposits	**307**	200

Interest rate risk

Hedging

Interest rate risk arises from movements in interest rates that impact on the fair value of the assets and liabilities and related finance flows. The Trading Group adopts a policy of ensuring that between 50-90% of its exposure to changes in interest rates on borrowings is on a fixed-rate basis. The fixed proportion as at 3 January 2015 was 78% (at 4 January 2014: 78%). Interest rate swaps, denominated exclusively in sterling, have been entered into to achieve an appropriate mix of fixed and floating rate exposure within the Trading Group's policy. The swaps mature over the next twelve years following the maturity of the related loans (see the following table) and have fixed swap rates ranging from 3.27% to 5.46% (at 4 January 2014: 3.27% to 5.68%). At 3 January 2015, the Trading Group had interest rate swaps with a notional contract amount of £895m (at 4 January 2014: £1,201m).

The Trading Group does not designate interest rate swaps or forward foreign exchange contracts as hedging instruments. Derivative financial instruments that are not hedging instruments are classified as held for trading by default and thus fall into the category of financial assets at fair value through the income statement. Derivatives are subsequently stated at fair value, with any gains and losses being recognised in the income statement.

The net fair value of swaps at 3 January 2015 was a net asset of £19m (2013: net liability £38m) comprising assets of £67m (2013: £29m) and liabilities of £48m (2013: £67m). These amounts are recognised as fair value derivatives.

Notes to the Financial Statements continued

31. **Financial risk management** continued

Effective interest rates and repricing analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice:

				2014			
	Effective interest rate	**Total £m**	**6 months or less £m**	**6-12 months £m**	**1-2 years £m**	**2-5 years £m**	**More than 5 years £m**
Cash and cash equivalents	**0.563%**	**-**	**-**	**-**	**-**	**-**	**-**
Secured debt:							
First mortgage debenture 2018	**8.875%**	**(21)**	**-**	**-**	**-**	**(21)**	**-**
Unsecured bond issues:							
– 5 5/8%* Fixed-rate sterling eurobond	**6.875%**	**(450)**	**-**	**-**	**-**	**-**	**(450)**
– 5 5/8% Effect of interest rate swaps	**-2.212%**	**-**	**(375)**	**-**	**-**	**-**	**375**
– 6 1/4%* Fixed-rate sterling eurobond	**7.500%**	**(350)**	**-**	**-**	**-**	**-**	**(350)**
– 6 1/4% Effect of interest rate swaps	**-1.328%**	**-**	**(150)**	**-**	**-**	**-**	**150**
Unsecured subordinated notes:							
– 11% Final Repayment Subordinated Notes	**11.000%**	**(109)**	**-**	**-**	**-**	**-**	**(109)**
– Instalment Repayment Subordinated Notes	**11.000%**	**(19)**	**-**	**-**	**-**	**-**	**(19)**
Other unsecured loans	**2.406%**	**(52)**	**(52)**	**-**	**-**	**-**	**-**
Effect of interest rate swaps	**4.189%**	**-**	**370**	**-**	**-**	**(145)**	**(225)**
Corporate investor shares	**1.567%**	**(13)**	**(10)**	**(1)**	**(2)**	**-**	**-**
Finance lease liabilities		**(9)**	**(2)**	**(2)**	**(2)**	**(3)**	**-**
		(1,023)	**(219)**	**(3)**	**(4)**	**(169)**	**(628)**

				2013			
	Effective interest rate	Total £m	6 months or less £m	6-12 months £m	1-2 years £m	2-5 years £m	More than 5 years £m
Cash and cash equivalents	0.563%	200	200	-	-	-	-
Secured debt:							
– First mortgage debenture 2018	7.625%	(50)	-	-	-	(50)	-
Unsecured bond issues:							
– 5 5/8% Fixed-rate sterling eurobond	6.875%	(450)	-	-	-	-	(450)
– 5 5/8% Effect of interest rate swaps	-2.312%	-	(375)	-	-	-	375
– 6 1/4% Fixed-rate sterling eurobond	7.500%	(350)	-	-	-	-	(350)
– 6 1/4% Effect of interest rate swaps	-1.379%	-	(150)	-	-	-	150
Unsecured subordinated notes:							
– 11% Final Repayment Subordinated Notes	11.000%	(109)	-	-	-	-	(109)
– Instalment Repayment Subordinated Notes	11.000%	(20)	-	(1)	(1)	(4)	(14)
Other unsecured loans	4.737%	(507)	(53)	(4)	(50)	(400)	-
Effect of interest rate swaps	4.034%	-	676	-	-	(451)	(225)
Corporate investor shares	2.137%	(26)	(20)	(6)	-	-	-
Finance lease liabilities		(9)	(2)	(1)	(4)	(2)	-
		(1,321)	276	(12)	(55)	(907)	(623)

* With effect from 8 July 2013 an additional 1.25% coupon is currently being paid on these bonds (see note 24).

Notes to the Financial Statements continued

31. **Financial risk management** continued

Foreign currency risk

The Trading Group is exposed to foreign currency risk on purchases that are denominated in a currency other than sterling. The currencies giving rise to this risk are Euro and New Zealand (NZ) Dollars.

The Trading Group hedges at least 90% of all trade payables denominated in a foreign currency. At any point in time the Trading Group also hedges 90% of its estimated foreign currency exposure in respect of orders placed and not invoiced over the following four months.
The Trading Group uses forward exchange contracts to hedge its foreign currency risk. The forward exchange contracts have maturities of less than six months after the balance sheet date. Where necessary, the forward exchange contracts are rolled over at maturity.

In respect of other monetary assets and liabilities held in currencies other than sterling, the Trading Group ensures that the net exposure is kept to an acceptable level, by buying or selling foreign currencies at spot rates where necessary to address short term imbalances.

At 3 January 2015, the Trading Group had forward currency transactions in Euro and NZ Dollars with a notional contract amount of £7m (2013: £8m).

Liquidity risk

This is the risk that the Group will not have sufficient facilities to fund its future borrowing requirements and will require funding at short notice to meet its obligations as they fall due. The Group's funding maturity profile is managed to ensure appropriate flexibility through a mix of short, medium and long term funding together with diversified sources of finance, at a reasonable cost, to meet the Group's needs.

As at 3 January 2015, the Trading Group had available borrowing facilities totalling £1,465m (2013: £1,944m), which comprised uncommitted facilities of £16m (2013: £15m) and committed facilities of £1,449m (2013: £1,929m). These are detailed below:

Bank facilities as at 3 January 2015

	2014		2013	
	Expiry	**£m**	Expiry	£m
Uncommitted facilities	**August 2015**	**16**	August 2014	15
Syndicate Term Loan		**-**	July 2017	450
Syndicate Revolving Credit Facility	**July 2017**	**450**	July 2017	450
Bilateral Facility	**March 2015**	**50**	March 2015	50
		516		965
Debenture	**December 2018**	**21**	December 2018	50
Eurobond issue – 2020	**July 2020**	**450**	July 2020	450
Final repayment notes – 2025	**December 2025**	**109**	December 2025	109
Instalment repayment notes – 2025	**December 2025**	**19**	December 2025	20
Eurobond issue – 2026	**July 2026**	**350**	July 2026	350
		1,465		1,944

Notes to the Financial Statements continued

31. Financial risk management continued

The following are the maturities of financial liabilities as at 3 January 2015:

	Carrying amount £m	Contractual cash flows £m	6 months or less £m	6-12 months £m	1-2 years £m	2-5 years £m	More than 5 years £m
Non-derivative financial liabilities							
Secured bank loans	**(21)**	**(21)**	**-**	**-**	**-**	**(21)**	**-**
Unsecured bank facility	**(50)**	**(50)**	**(50)**	**-**	**-**	**-**	**-**
Sterling Eurobond 2020	**(470)**	**(450)**	**-**	**-**	**-**	**-**	**(450)**
Sterling Eurobond 2026	**(369)**	**(350)**	**-**	**-**	**-**	**-**	**(350)**
Final repayment subordinated notes – 2025	**(109)**	**(109)**	**-**	**-**	**-**	**-**	**(109)**
Instalment repayment subordinated notes – 2025	**(19)**	**(19)**	**-**	**(1)**	**(1)**	**(4)**	**(13)**
Finance lease liabilities	**(9)**	**(9)**	**(2)**	**(2)**	**(2)**	**(3)**	**-**
Trade and other payables	**(2,067)**	**(2,067)**	**(1,462)**	**(187)**	**(132)**	**(149)**	**(137)**
Derivative financial liabilities							
Interest rate swaps used for hedging	**(48)**	**(48)**	**2**	**-**	**-**	**(23)**	**(27)**

The following are the maturities of financial liabilities as at 4 January 2014:

	Carrying amount £m	Contractual cash flows £m	6 months or less £m	6-12 months £m	1-2 years £m	2-5 years £m	More than 5 years £m
Non-derivative financial liabilities							
Secured bank loans	(50)	(50)	(50)	-	-	-	-
Unsecured bank facility	(507)	(507)	(507)	-	-	-	-
Sterling Eurobond 2020	(467)	(450)	(450)	-	-	-	-
Sterling Eurobond 2026	(362)	(350)	(350)	-	-	-	-
Final repayment subordinated notes – 2025	(109)	(109)	(109)	-	-	-	-
Instalment repayment subordinated notes – 2025	(20)	(20)	(20)	-	-	-	-
Finance lease liabilities	(9)	(9)	(2)	(1)	(4)	(2)	-
Trade and other payables	(2,189)	(2,189)	(1,359)	(25)	(658)	(69)	(78)
Derivative financial liabilities							
Interest rate swaps used for hedging	(67)	(67)	-	-	-	(51)	(16)

The amounts above only include the maturities of the principal of the financial liabilities. Due to the terms of some of the Group's debt instruments, the contractual cash flows from interest payments are variable dependent on the Group meeting certain financial credit standing/performance criteria.

Sensitivity analysis

Interest rate risk

The valuations of the Group's quoted debt and interest rate swaps have been determined by discounting expected future cash flows associated with these instruments at the market interest rate yields as at the Group's year end. This is then sensitised by overlaying a +1% increase to the interest rate yield curve and a 1% reduction in the interest rate yield curve. At 3 January 2015 if sterling (GBP) market interest rates had been 1% higher/lower with all other variables held constant, the post-tax result for the period would have been GBP £63m (2013: GBP £68m) higher and GBP £70m (2013: GBP £75m) lower respectively, mainly arising from the revaluation of the Society's quoted debt marked to market through the consolidated income statement. Profit is relatively less sensitive to movements in GBP interest rates due to the level of borrowings' fixed-interest cover in place as disclosed under 'hedging'.

Foreign exchange risk

At 3 January 2015 and 4 January 2014, if the Euro, US dollar, Australian dollar and NZ dollar had all strengthened or weakened by 10% against sterling (GBP) with all variables held constant, there would have been no material impact to post-tax profit.

Notes to the Financial Statements continued

31. Financial risk management continued

Guarantees

In the course of conducting its operations, the Trading Group is required to issue bank guarantees and bonds in favour of various counterparties. These facilities are provided by the Trading Group's banking syndicate and as at 3 January 2015 the total amount of guarantees/bonds outstanding is £44m (2013: £45m).

Fair values of the Trading Group

The fair value of those financial assets and liabilities recorded at their fair value in the balance sheet at 3 January 2015 and 4 January 2014 respectively are as follows:

	2014			2013		
	Quoted market prices in active market Level 1 £m	**Valuation techniques using observable inputs Level 2 £m**	**Valuation techniques using unobservable inputs Level 3 £m**	Quoted market prices in active market Level 1 £m	Valuation techniques using observable inputs Level 2 £m	Valuation techniques using unobservable inputs Level 3 £m
Non financial assets held at fair value						
Property, plant and equipment	**-**	**-**	**-**	-	-	49
Investment properties	**-**	**-**	**99**	-	-	98
Biological assets	**-**	**-**	**-**	-	6	-
Financial assets						
Trade and other receivables	**-**	**574**	**-**	-	487	-
Cash and cash equivalents	**-**	**307**	**-**	-	200	-
Derivative financial assets and liabilities						
Interest rate swaps:						
Assets	**-**	**67**	**-**	-	29	-
Liabilities	**-**	**(48)**	**-**	-	(67)	-
Non-derivative financial liabilities						
Secured debt:						
– First mortgage debenture 2018*	**(21)**	**-**	**-**	(50)	-	-
Other secured loans	**-**	**-**	**-**	-	-	-
Unsecured bond issue:						
– Fixed-rate sterling eurobond	**(839)**	**-**	**-**	(829)	-	-
Unsecured subordinated notes:						
– Final Repayment Subordinated Notes	**(109)**	**-**	**-**	(109)	-	-
– Instalment Repayment Subordinated Notes**	**(19)**	**-**	**-**	(20)	-	-
Unsecured bank facilities:						
– Other unsecured loans	**-**	**(52)**	**-**	-	(507)	-
Corporate investor shares	**-**	**(11)**	**-**	-	(26)	-
Finance lease liabilities	**-**	**-**	**(9)**	-	-	(9)
Trade and other payables (excluding accruals, deferred income and funeral bonds)	**-**	**(1,171)**	**-**	-	(1,309)	-

* This debenture is secured against a £100m Trading Group portfolio of land and properties.

** Due to the expected illiquid nature of these notes they are reflected at a par valuation.

Notes to the Financial Statements continued

31. Financial risk management continued

Estimation of fair values

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the table.

Derivatives

Forward exchange contracts, such as the Group's interest rate swaps, are either marked to market using listed market prices or by discounting the contractual forward price and deducting the current spot rate. For interest rate swaps, broker quotes are used. Those quotes are back-tested using pricing models or discounted cash flow techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate for a similar instrument at the balance sheet date. Where other pricing models are used, inputs are based on market-related data at the balance sheet date.

Interest bearing loans and borrowings

These are shown at amortised cost which presently equate to fair value or are determined in whole by using quoted market prices.

Trade and other receivables/payables

For receivables/payables, the notional amount is deemed to reflect the fair value.

Hierarchy of fair values

The fixed rate sterling eurobond and the first mortgage debenture values are determined in whole by using quoted market prices. The interest rate swap values are determined in whole by counterparties who use quoted market prices. The forward exchange contracts are valued using an internal valuation technique. All other assets and liabilities stated in the table above are held at par value.

Interest rates used for determining fair value

The Trading Group uses the government yield curve as of the period end plus an adequate constant credit spread to discount financial instruments.

The interest rates used are as follows:

	2014	2013
Derivatives	**0.63% - 1.91%**	0.63% - 2.55%
Loans and borrowings	**3.88% - 10.16%**	3.88% - 10.56%

Notes to the Financial Statements continued

31. Financial risk management continued

Financial Risk Management – CISGIL

CISGIL issues contracts that transfer insurance risk and is exposed to financial risk through its holdings of financial assets and liabilities. This section summarises these risks and the way CISGIL manages them.

Developments during 2014

CISGIL has a stand-alone risk management framework which was based on the Co-operative Banking Group (CBG) framework but adapted for CISGIL's risks, governance and processes. During 2014, a number of enhancements to the framework have taken place:

- enhanced conduct risk management framework – (RMF);
- added group risk as a principal risk;
- further embedded suite of risk policies and control standards;
- refined risk reporting to the Board and Executive Risk Committee;
- strengthened stand-alone 2nd line risk function; and
- formalised and improved the risk event reporting and risk acceptance process.

The following section summarises the risk management structure that are in place.

Our approach to risk management

CISGIL operates a three lines of defence governance model to ensure appropriate responsibility and accountability is allocated to the identification, measurement, management, monitoring and reporting of risks.

Business management is the first line of defence. It is responsible for implementing and operating processes to identify, measure, manage, monitor and report risks. This includes those risks deriving from the development of new products, processes or other business change. It manages the risks that reside within the business areas on a day-to-day basis and implements effective monitoring and control processes to ensure that the business risk profile is understood and maintained within the Board's defined risk appetite.

The Chief Risk Officer and Risk function are the second line of defence. They own the risk management framework, oversee and challenge its implementation and operation by the first line of defence, and consider current and emerging risks across CISGIL. They also provide review and challenge of the delegated authority framework and oversee appropriate escalation of breaches, mitigating actions and reporting to the Executive Risk Committee and the Board.

The Head of Internal audit leads the third line of defence. They independently challenge the overall management of the framework and provide assurance to the Board Audit Committee and senior management on the adequacy of both the first and second lines. The Chair of the Board Audit Committee oversees the internal audit function and risk-based audit plan. CISGIL has contracts in place with external consultants to provide internal audit capability.

Risk assessment of CISGIL

CISGIL has undertaken a robust assessment of the principal risks facing the company. It has developed its own Risk and Solvency Assessment (ORSA) process, which is an integral part in developing its Strategic Plan. One of the outputs of the ORSA process is the ORSA Report. This report provides a comprehensive picture of the risks that CISGIL is exposed to or could face in the future. These risks are described in detail within the report and summarised below.

The prospects of CISGIL as at 31 December 2014 have primarily been assessed using the latest information (the 2014 year end position) and the 2015 – 2019 Strategic Plan, which was approved by the CISGIL Board in December 2014. Based on this information, CISGIL has adequate capital and liquidity to continue its operation, under old and new regulatory regimes. Indicators which could impact upon its operations have been considered and appropriate management action has been taken where necessary to mitigate issues as identified.

As part of CISGIL's Risk Management Framework, its Executive Team are required to attest that they understand the risks and controls in their area of accountability and support an open risk management culture. In support of the attestation, each Executive and/or Risk Framework Owner is required to undertake a Risk and Control Self-Assessment – which identifies the risks to the achievement of their objectives, the controls against these risks together with an assessment of the effectiveness of the controls (Design and Performance) with appropriate testing of control performance. The Risk and Control Self-Assessments are designed to cover all material controls including financial, operational and compliance controls and also cover the minimum requirements outlined in CISGIL's risk policies and control standards.

Notes to the Financial Statements continued

31. Financial risk management continued

Risk management structure

The Board is responsible for approving the general insurance strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance which includes ensuring that there is an adequate system of risk management in place.

CISGIL has developed and implemented a governance and organisation structure, which supports the Board. The Board has established risk and audit sub-committees, and senior management committees, to:

- oversee the risk management process;
- identify the key risks facing the business; and
- assess the effectiveness of planned management actions.

Specific Board authority has been delegated to the Board sub-committees and the Chief Executive Officer (CEO) who may, in turn, delegate elements of these discretions to appropriate members of the senior management team.

CISGIL has developed a Delegated Authority Framework setting out the accountabilities delegated by the CEO to the Executive Team members which are reflected within the individual job descriptions of the Executive Team members. Those with delegated authority consider these in conjunction with their responsibilities as Approved Persons and their associated functional accountabilities. The practical application of this framework is documented in the Delegated Authorities Operating Manual.

Risk management committees

The CIS General Insurance Board (Board)

The responsibilities of the Board include:

- setting the overall Risk Strategy;
- approving the design and implementation of risk management approaches, including the Risk Management Framework Policy and the Risk Appetite Statements and metrics that underpin them;
- delegating authority for oversight of the risk management framework, systems and high-level limits to the Board Risk Committee;
- delegating authority for cascading the setting and approval of the more granular risk limits and tolerances to the CEO;
- using the output of the semi-annual certification process, to approve the effectiveness of the Risk Management Framework with support from internal audit through their risk-based review programme; and
- reviewing and challenging Board Risk Committee reports on the effectiveness of the risk management framework and systems.

CISGIL Board Risk Committee (BRC)

BRC responsibilities include:

- providing oversight and advice to the Board on current and potential risks and the overall risk framework including risk appetite, risk tolerance and risk management strategies;
- reviewing and challenging the design of the Risk Management Framework, Risk Appetite limits and tolerances and recommending to the Board for approval;
- reviewing and challenging the implementation of the Risk Management Framework through the semi-annual certification process and reviewing the quality and effectiveness of the Risk Management Framework, systems and function;
- reviewing and challenging internal controls and process of risk management including the coverage of the risk taxonomy;
- monitoring the organisation's performance and compliance against high-level risk appetite limits and tolerances;
- in co-operation with the Board Audit Committee, monitoring identified risk control failings and weaknesses and management actions taken to resolve them; and
- reporting on the effectiveness of the Risk Management Framework and systems to the Board.

Notes to the Financial Statements continued

31. Financial risk management continued

CISGIL Board Transformation Committee (BTC) (established 2015)

BTC responsibilities include:

- review and challenge Transformation Portfolio activities to ensure performance is in the best interests of key CISGIL stakeholders and aligned to the CISGIL Strategic Plan;
- oversee the overall strategic investment budget and ensure appropriate prioritisation of funding;
- review and oversee the customer journey and customer outcomes throughout transformation;
- monitor, review and challenge performance and forecasts against overall Portfolio benefits and the Strategic Plan; and
- periodically review and approve the mandate of the Transformation Portfolio, in particular ensuring that it has adequate resources to enable it to perform its function effectively.

CISGIL Board Audit Committee (BAC)

BAC responsibilities include:

- review and oversight of financial statements and annual reports before submission to the Board;
- assisting the Board in carrying out its responsibilities relating to internal control, including control breaches and remediation;
- exercising oversight of identified risk control framework failings and weaknesses as well as management actions taken to resolve them; and
- oversight of internal and external assurance and audit.

CISGIL Executive Committee (ExCo)

The ExCo responsibilities include:

- overseeing the establishment and maintenance of appropriate risk management systems and controls in line with the Board agreed Risk Management Framework;
- supporting the CEO in developing, reviewing and approving detailed risk appetite limits and tolerances as delegated by the Board; and
- ensuring the implementation of the risk strategy set by the Board so as to deliver an effective risk management environment for CISGIL.

CISGIL Transformation Steering Executive Committee (TSEC)

The TSEC responsibilities include:

- overseeing the delivery of the CISGIL Transformation and Business Critical Programmes, reviewing and approving new initiatives;
- recommending approval for changes to timescales, costs, quality, scope, risks and benefits; including material drawdown requests;
- proactively managing risks and issues, highlighting thematic hotspots and initiating mitigating action plans;
- overseeing the overall strategic investment budget;
- overseeing the efficient and effective use of GI resources, by monitoring demand to ensure successful delivery of the Roadmap;
- oversight of the CISGIL Benefits Realisation tracking plans; and
- ensuring design decisions consider the implications on both the New Solution and current CISGIL operating model.

CISGIL Executive Risk Committee (ERC)

The ERC responsibilities include:

- driving the detailed implementation of the CISGIL Risk Management Framework approved by the Board;
- providing a mechanism for ensuring that the CISGIL-wide risk and capital management requirements, developments, and processes are in place;
- supporting the CEO in developing the Risk Strategy, Risk Management Framework, and Risk Appetite Statement and recommending to the Board Risk Committee for review, challenge and recommendation to the Board for approval;
- supporting the CEO in approving Risk Policies, proposing Risk Appetite limits and tolerances to Board Risk Committee for review, challenge and recommendation to the Board for approval;
- reviewing approaches to stress testing, risk management reporting and governance, and referring them to the Board Risk Committee for review, challenge and recommendation for approval by the Board;

Notes to the Financial Statements continued

31. Financial risk management continued

- supporting the CEO in semi-annually reviewing the effectiveness of the Risk Management Framework, systems and function and providing a report to the Board Risk Committee;
- on a periodic basis, assessing the performance of the Risk Management Framework; and
- monitoring the business's risk profile against the agreed limits and tolerances and reporting on these to the Board Risk Committee.

Senior Management Committees

CISGIL has other committees that advise and support the CEO and members of the senior management team in carrying out their responsibilities, and provide detailed oversight and monitoring in the following areas:

- Customer and Operations;
- Conduct Risk Steering;
- Commercial;
- Capital, Liquidity, Investment and Pension;
- Reserving;
- Operational Risk;
- Data Governance; and
- Model Governance.

Principal risks

The following are considered to be the principal risks facing CISGIL:

	Risk Type	Definition
A	Strategic and business risk*	The risk to earnings and capital that may arise as a result of strategic/management decisions or business choices or lack of responsiveness to changes in the business environment
B	Reputation risk*	The risk associated with an issue which could in some way be damaging to the brand of the organisation among all or any stakeholders
C	Conduct risk*	The risk that CISGIL's behaviours, offerings or interactions will result in unfair outcomes for customers
D	Regulatory risk*	The risk of fines, public censure, limitation on business, or restitution costs arising from failing to understand, interpret, implement and comply with UK and EU regulatory requirements
E	Insurance risk	The inherent uncertainties as to the occurrence, amount and timing of insurance liabilities
F	Market risk	The risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market risk drivers e.g. interest rates, market prices of assets and liabilities
G	Operational risk*	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events
H	Credit risk	The risk to earnings and capital arising from a debtor's failure to meet their legal and contractual obligations
I	Pension risk*	The risk to capital and company funds from exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets
J	Group risk*	The risks that arise through being part of the Co-operative Group
K	Liquidity risk	The current and prospective risk to earnings or capital arising from CISGIL's inability to meet its obligations when they come due without incurring unacceptable losses

For each of the principal risks, CISGIL appoints a Risk Framework Owner (RFO) and a risk framework must be defined and documented. The framework includes Board approved risk policies and risk appetite statements with underpinning metrics. The metrics have approved limits within which business operations are to be conducted, along with thresholds to give early warning of emerging issues.

Risks marked with an asterisk (*) above are termed unaudited as they are outside the scope of the external audit.

Notes to the Financial Statements continued

31. **Financial risk management** continued

A. Strategic and business risks (unaudited)

Strategic and business risks to earnings and capital arise as a result of strategic/management decisions or business choices or lack of responsiveness to changes in the business environment. Specific strategic and business risks, and management actions, are regularly reported and reviewed by the ERC and Board. CISGIL's objective in managing these risks is to maintain a sufficient capital buffer in excess of minimum regulatory capital requirements to cover projected risks and maintain market confidence, and obtain a sufficient, stable and sustainable return on equity. The Board have defined detailed metrics and limits underpinning these objectives, which are measured, monitored and reported regularly to the ERC and Board. The Board have approved a strategic transformation programme to ensure the business model can respond to the technology driven changing insurance market.

B. Reputation risk (unaudited)

Reputational risk is defined as the risk associated with an issue which could in some way be damaging to the brand of CISGIL either through its strategic decisions, business performance, an operational failure or external perception. CISGIL's objective is to maintain a strong reputation in line with our values and principles through robust operational standards, continual monitoring of our corporate reputation and brand, commitment to our Social Goals Strategy and proactive PR.

As part of the assessment and control of this risk, our business performance and risk profile across all of our risk types are closely monitored and reviewed. CISGIL proactively monitors and manages media, public and customer opinion and works closely with external rating agencies to ensure fair and balanced representation. This approach helps maintain member, customer and market confidence. This risk is regularly monitored and reported to the Operational Risk Committee, ERC and Board.

During the first half of 2014, media coverage associated with reputational issues faced by the Co-operative Group Limited (the Group) led to brand impairment for CISGIL. Since the Group AGM in May 2014, the media profile has improved. The Co-operative Group has now established its recovery strategy which has resulted in an improved brand position, and levels of risk to the brand through group contagion have continued to reduce.

C. Conduct risk (unaudited)

Conduct risk is the risk that CISGIL's behaviours, offerings or interactions will result in unfair outcomes for customers. Accordingly, conduct risk may arise from any aspect of the way a business is conducted, the sole test being whether the outcome is an unfair one for customers. Conduct risk is a key area of focus across the financial services industry, with increasing scrutiny from the Financial Conduct Authority.

CISGIL's objective is to maintain the highest standards in our conduct and treatment of customers and the quality of our customer experience through the operation of a robust Conduct Risk Strategy and framework and the application of systems and controls in conjunction with ongoing oversight and monitoring from risk functions. These established systems and controls mitigate and prevent emerging conduct risk.

During 2014, improvements were made in the control of Conduct Risk including; implementation of Conduct Risk & MI Reporting, Risks and Issues Register, Roll out of conduct risk training. A new Product Governance Forum was established to oversee and govern the product throughout its lifecycle. The establishment of a monthly executive Conduct Risk Steering Committee in 2014 ensures the timely identification, measurement, management, monitoring and reporting of conduct risks through management structures and to the ERC and Board.

D. Regulatory risk (unaudited)

Regulatory risk is the risk of fines, public censure, limitation on business, or restitution costs arising from failing to understand, interpret, implement and comply with UK and EU regulatory requirements. CISGIL's objective is to maintain a robust process to ensure that all regulatory expectations and requirements are met within agreed or mandated timeframes, by promoting and embedding a compliance culture and developing positive regulatory relationships.

Regulatory risks are reported through management structures and regularly monitored and reported to the ERC and Board.

E. Insurance risk

Insurance risk comprises risks that arise in respect of claims that have already occurred and for which reserves are already held (reserving risk) and of claims that are yet to occur (underwriting risk). Underwriting risk includes risks from attritional claims and from natural or man-made catastrophe events.

The main classes of business written are private motor and home business, written directly or through brokers. In addition CISGIL writes some commercial insurance business, which is fully reinsured, and continues to manage some business that is now in run off, including a commercial account, commercial motor business and pet insurance. Almost all risks under general insurance policies cover a 12 month duration.

Notes to the Financial Statements continued

31. Financial risk management continued

E. Insurance risk continued

Principal risks under motor policies are bodily injury to third parties, accidental damage to property including policyholders' and third parties' vehicles, and theft of or from policyholders' vehicles. The most significant factors affecting the frequency and severity of motor claims are judicial, legislative and inflationary changes and the frequency and severity of large bodily injury claims.

Principal risks under home policies are damage from storm and flood, fire, escape of water, subsidence, theft of or accidental damage to contents and liability risks.

CISGIL's aims to manage insurance risk:

- to achieve acceptable profits and return on equity by ensuring that insurance risks are carefully selected in accordance with risk appetite, underwritten in accordance with risk strategy and priced to reflect the underlying risk;
- to minimise reserve risk volatility through robust reserving and modelling approaches; and
- to mitigate catastrophe risk through the use of appropriate reinsurance arrangements.

Insurance risk is managed through the underwriting strategy, reinsurance arrangements, proactive claims handling and the claims provisioning process. The objective of the underwriting strategy is to ensure that the underwritten risks are diversified in terms of type and amount of risk, industry/demographic profile and geography, and only those risks which conform with underwriting criteria are accepted. Exposure mix and the frequency and average costs of claims are monitored throughout the year and where significant deviations from expectation are identified remedial action is taken.

The overriding objective in claims handling is to ensure all claims are properly scrutinised and paid where they fall within the terms and conditions of the policy. The proper scrutiny of claims is facilitated by the use of various technical aids such as weather validation and fraud databases, and the use of claims specialists. The basis for assessing claims provisions is set out in note 22.

The nature of insurance contracts is that the obligations of the insurer are uncertain as to the timing or quantum of liabilities arising from contracts. CISGIL takes all reasonable steps to ensure that it has information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. CISGIL manage this risk through the Reserving Committee which supports the Finance Director in their responsibility to formally reviews claims reserves on a quarterly basis.

CISGIL uses reinsurance to manage insurance risk, and in particular to mitigate the cost of catastrophe events such as storms and floods and the cost of large claims arising within its motor account. The appropriate level of reinsurance is determined by management, using CISGIL's capital model to inform decision making. In 2014 CISGIL had two main reinsurance programmes in place: catastrophe excess of loss cover and motor excess of loss cover. Other reinsurances include the 100% reinsurance of the commercial insurance business being written by CISGIL as mentioned above.

In March 2014, a Part VII transfer was completed to transfer the general insurance business that had been written by Co-operative Insurance Society Limited (CISL) to CISGIL. CISGIL commenced underwriting business in January 2006. Prior to this the general insurance business was underwritten by CIS, a composite insurer writing both life and general insurance business. An indemnification arrangement was implemented at that time whereby CISGIL assumed financial responsibility for the run off of this business and received a premium, settled by transfer of assets, equivalent to the net technical liabilities of this business included in CIS's financial statements at 2005 year end. CIS was subsequently sold to Royal London Group, as part of the sale of the life and savings business, and became a subsidiary of Royal London. The Part VII transfer transferred the general insurance business within that subsidiary to CISGIL, hence CISGIL now has direct financial responsibility for this run off business, rather than via an indemnification agreement.

Insurance risk sensitivity analysis can be found in note 22.

F. Market risk

Market risk is the risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market risk drivers such as interest rates and market prices of assets and liabilities.

CISGIL invests in high-quality fixed and variable interest bonds issued by corporations ('corporate bonds') and the UK government ('gilts'), and in short-term sterling deposits with financial institutions ('cash'). The value of, or income from, assets held is subject to volatility from changes in both market interest-rates and additional spreads related to the specific credit-worthiness of the issuer ('credit-spreads'). Proceeds from maturing investments are also subject to risk over the future return on reinvestment.

CISGIL is also exposed to market interest-rates through the discounted present value placed upon future claims. All future claims are discounted for economic assessment purposes for economic capital. However, IFRS short term insurance reserves (normally less than five years) are not directly affected by market interest-rates as they are undiscounted.

Notes to the Financial Statements continued

31. **Financial risk management** continued

F. **Market risk** continued

In December 2014, capital quality was improved through the issuance of new equity to its immediate parent, the Co-operative Banking Group Limited. Proceeds of the issuance were used to repay the existing £85m subordinated debt to its immediate parent. This removed the interest rate risk upon £65.0m of this debt, which previously paid interest based on three month LIBOR. There was no interest rate risk on the remaining £20.0m as it paid a fixed interest rate.

CISGIL writes contracts of insurance in the United Kingdom and insurance liabilities and borrowings are denominated in sterling. Funds are invested solely in assets denominated in sterling and consequently there is no direct exposure to currency risk.

While CISGIL is not a participating employer, it has an agreement to pay pension contributions relating to staff employed by CFSMS that are assigned to work for CISGIL. This means that CISGIL is indirectly exposed to market risks (including interest rate, credit spread, equity and property), through the Co-operative Group pension scheme (Pace), to which CISGIL contributes.

In summary, the principal market risks that CISGIL is exposed to are:

- changes in interest-rates, which impact both asset and liability values, and investment income; and
- movements in credit-spreads which impact the market value of corporate bonds.

Objective and strategy

CISGIL's objective is to achieve acceptable returns through the use of highly rated UK government and corporate bonds while minimising exposure to equities and other volatile instruments. To enhance certainty over the investment return generated from these assets, management practice is generally to maintain holdings to maturity.

CISGIL determines its strategic asset allocation through considering the risk/reward trade off and the impact upon capital adequacy and solvency of the overall company, which relies on outputs from CISGIL's capital model. CISGIL's investments are managed by Royal London Investment Management (RLAM) with whom CISGIL have an agreed investment mandate with limits for exposure by credit-rating, maximum terms and maximum exposure to individual counterparties. The Capital, Liquidity, Investment and Pension Committee supports the Finance Director to oversee RLAM, monitor and manage asset exposures against the strategic asset allocation and approved investment limits.

CISGIL manages credit-spread and default risks from corporate bonds through the limits for exposure to credit-ratings and individual counterparties. Other risk mitigation techniques employed to manage exposure to counterparty default include transacting only through a diversified range of authorised counterparties and the requirement for certain transactions (including cash, investment and trading in futures, stock lending and gilt repo transactions) to be collateralised on a daily basis. The Capital, Liquidity, Investment and Pension Committee supports the Finance Director in overseeing the monitoring and management of these risks and exposures against limits.

Interest-rate risk is managed through investing in fixed interest securities with a similar duration profile to the liabilities under the general insurance contracts. CISGIL matches the average duration of assets and liabilities in this portfolio by estimating their mean duration. The mean duration of liabilities is calculated using historical claims data to determine the expected settlement pattern for claims arising from insurance contracts in force at the balance sheet date (both incurred claims and future claims arising from the unexpired risks at the balance sheet date). Index-linked investments and other specific debt securities are used to match periodical payment liabilities and provisions relating to exposure within the electric industry ('EIROS' claims) by amount and duration. In order to do this, an expert opinion on life expectancy is used along with an expectation of long term average earnings.

Mean durations are:

	2014 years	2013 years
Adopted insurance liabilities	**2.84**	3.20
Financial assets	**2.35**	2.53

	Amount £m	**Duration years**
Periodical payments		
Insurance liabilities	**21**	17.9
Financial assets	**49**	16.5
EIROS claims		
Insurance liabilities	**2.0**	10.9
Financial assets	**3.0**	14.1

Notes to the Financial Statements continued

31. Financial risk management continued

Sensitivity analysis

Currently, the most significant aspect of market risk to which CISGIL is exposed is changes in credit-spreads upon corporate bonds. The resulting movements in the market values of corporate bonds directly affect CISGIL's internal economic assessment of solvency, including the ICA. As CISGIL has adopted a policy of recognising most investment assets on an 'available for sale' basis, movements in market values of these assets are recognised in other comprehensive income and so have limited impact upon reported IFRS profits.

An increase of 100 basis points in credit-spreads would reduce the carrying value of CISGIL's assets at the end of the financial year by £23m (2013: £18m). This would reduce the value placed upon these assets in CISGIL's internal economic assessment of solvency, including the ICA, by the same amount. On an IFRS basis it would result in a reduction in other comprehensive income of £18m net of tax (2013: £14m). The impact of a decrease of 100 basis points in credit-spreads would have similar but opposite effects.

The method used for this calculation increases the implied redemption yield by 100 basis points and uses this modified yield to calculate the revised market value of each bond in the portfolio. The calculation assumes that a change in credit-spreads would have an immediate and equal impact at all points on the yield curve and upon all corporate bonds regardless of their credit-rating. The probability of this credit-spread change over one year is assessed as 24% (2013: 24%) using CISGIL capital model.

G. Operational risk (unaudited)

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events and includes; internal and external fraud, loss or theft of confidential customer information, loss of key personnel, system capacity issues or programme failure and external events over which CISGIL has limited controls, such as terrorist attack. CISGIL's objective is to minimise operational risk through the implementation of a robust control environment which minimises the potential for loss as a result of the failure of processes, people, technology and due to external events.

CISGIL has defined the following sub-categories within operational risk, which represent the major areas of operational risk exposure. Each sub-category has its own policy, approved by the ERC and is supported by underlying control standards:

- Financial Reporting Risk
- Model Risk
- Technology Risk
- Physical Assets and Security
- Third Party Supplier Risk
- Change Risk
- Product Approval Risk
- Information Risk
- Financial Crime Risk
- People Risk
- Legal Risk
- Business Continuity Planning (BCP)
- Anti-Money Laundering (AML) and Counter Terrorist Financing (CTF)

Operational risks are identified, managed and mitigated through ongoing risk management practices including risk assessments, formal control procedures and contingency planning. Operational risks and key controls are regularly reviewed by the Operational Risk Committee. Significant operational risks are reported to the ERC and Board.

During 2014, the separation of the Co-operative Bank Limited (the Bank) from the Group presented a number of risks to CISGIL including; continuity of service, technology service provision, data access, governance structures of CFS Management Services Limited/the Banking Group. A programme is underway to separate CISGIL's IT from an infrastructure that is currently shared with the Banking Group and Royal London Group. Business continuity arrangements are in place in order to minimise the risk of disruption in the event of a sudden, unplanned occurrence that could seriously disrupt business operations. This includes developing and exercising crisis and incident management teams to maintain appropriate preparedness in the event of a major operational disruption.

CISGIL has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach.

Notes to the Financial Statements continued

31. Financial risk management continued

H. Credit risk

Credit Risk is the risk to earnings and capital arising from a debtor's failure to meet their legal and contractual obligations. CISGIL does not aim to earn a return from credit risk hence its appetite for credit risk is very low. Potential losses arising from credit risk are minimised by the use of high quality reinsurers and highly rated investments.

CISGIL's principal credit risk exposures are as follows:

- default or delay in payments due upon corporate bonds or cash;
- reinsurance counterparties failing to meet financial obligations or entering into restructuring arrangements that may adversely affect reinsurance recoveries; and
- default or delay of repayment of loans and receivables.

CISGIL manages credit risks associated with cash and corporate bonds as part of market risk. See Market Risk section above for details.

Where reinsurance is used to manage insurance risk, there is a risk that the reinsurer fails to meet its obligations in the event of a claim. CISGIL places limits over exposure to a single reinsurance counterparty, or counterparty group, based upon their credit-worthiness. These limits apply when reinsurance is initially placed, usually annually, and then regularly monitored by the Capital, Liquidity, Investment and Pension Committee. Where concern exists over reinsurer credit quality, watch lists are maintained and actively managed.

Insurance receivable and other assets are primarily premium debtors, with an element of salvage and subrogation recoveries and some accrued interest. At the balance sheet date there were no significant concentrations of credit risk. The table below provides an analysis at the balance sheet date of the credit rating of those assets subject to credit risk. Credit ratings are determined by taking an average of ratings provided by Moody's Investors Service, Standard & Poor's and Fitch.

As at 31 December 2014	AAA £m	AA £m	A £m	BBB and below £m	Not rated £m	Total £m
Financial assets at fair value through income or expense:						
– Deposits with approved credit institutions (fixed rate)	-	156	-	-	-	156
Available for sale assets:						
– Listed debt (fixed rate)	100	246	287	83	-	716
– Listed debt (variable rate)	-	-	37	12	-	49
Reinsurance assets	-	32	37	-	3	72
Insurance receivables and other assets	2	2	5	1	149	159
	102	436	366	96	152	1,152
Assets not subject to credit risk						22
						1,174

Notes to the Financial Statements continued

31. Financial risk management continued

As at 31 December 2013	AAA £m	AA £m	A £m	BBB and below £m	Not rated £m	Total £m
Financial assets at fair value through income or expense:						
– Deposits with approved credit institutions (fixed rate)	-	-	208	-	-	208
Available for sale assets:						
– Listed debt (fixed rate)	73	179	430	38	-	720
– Listed debt (variable rate)	-	-	31	12	-	43
Loans and receivables at amortised cost	-	-	-	-	-	-
Reinsurance assets	-	25	29	-	3	57
Insurance receivables and other assets	1	2	8	-	198	209
	74	206	706	50	201	1,237
Assets not subject to credit risk						35
						1,272

The maximum exposure to credit risk, before making allowance for collateral held, is represented by the carrying value of each financial asset in the table. Collateral, in the form of gilts, of £144m (2013: £179m) is held as part of a reverse repo with a cash balance of £147m as at 31 December 2014 (2013: £180m). Cash collateral pledged sits within deposits with approved credit institutions within financial investments at fair value through income or expense on the balance sheet.

Eurozone risk

CISGIL has no direct exposure to the sovereign debt of European countries. There is currently limited detailed knowledge of indirect exposure to European sovereign debt. Indirect exposure is managed as knowledge of an institution's direct exposure is made public. At this point, if the exposure is considered to be in excess of the risk appetite, action will be taken to reduce the risk through the sale of the relevant holdings. Indirect exposure to European countries is also considered as part of the reinsurance placement. The asset profile of the prospective companies is analysed and those which are over exposed are not included in placement of the programme.

The table below shows exposure to European countries arising from corporate bonds. CISGIL has no exposures to European countries as a result of repo arrangements.

As at 31 December 2014	**Up to 1 year £m**	**1 to 5 years £m**	**5 to 10 years £m**	**Total £m**
France	**-**	**7**	**-**	**7**
Germany	**-**	**30**	**-**	**30**
Netherlands	**9**	**39**	**-**	**48**
Spain	**-**	**22**	**-**	**22**
Sweden	**-**	**70**	**-**	**70**
	9	**168**	**-**	**177**

As at 31 December 2013	Up to 1 year £m	1 to 5 years £m	5 to 10 years £m	Total £m
France	-	7	-	7
Germany	-	43	28	71
Netherlands	-	10	-	10
Spain	-	29	-	29
Sweden	-	30	35	65
	-	119	63	182

Notes to the Financial Statements continued

31. **Financial risk management** continued

I. Pension risk (unaudited)

Pension risk is defined as the risk to capital and company funds from exposure to scheme liabilities and risks inherent in the valuation of scheme liabilities and assets.

While CISGIL is not a participating employer, it has an agreement to pay pension contributions relating to staff employed by CFSMS that are assigned to work for CISGIL. This means that CISGIL is exposed to pension risk through the Co-operative Group pension scheme (Pace), a defined benefit scheme. The Pace trustee, in consultation with the Group, is responsible for the risk management arrangements for Pace, agreeing suitable contribution rates, investment strategy and for taking professional advice as appropriate. The scheme is managed at the Co-operative Group level.

In CISGIL's accounts, the scheme is treated as a defined contribution scheme due to the multi-employer exemption. However, CISGIL is exposed to potential future increases in required contributions and capital is set aside for this. The impact of which is assessed under CISGIL's risk management framework and internal economic assessment of solvency, including the ICA. Costs arise through future accruals contribution, deficit repair contributions, expenses and potential employer debt under Section 75 of the Pensions Act. CISGIL engages with the Group to actively manage the volatility in the pension funding position by continuous monitoring, adjustments to scheme contributions, engagement of external advisors and review of investment and pension strategies.

During 2014, risks in the pension scheme were reduced through improving interest rate matching and reducing exposure to equity values.

J. Group risk (unaudited)

Group risk is defined as the risks that arise through being part of the Co-operative Group. Group risk includes elements of Reputation, Operational and Pension risks as per the sections above. CISGIL currently receives operational resources and certain services from Group through CFSMS. CISGIL is therefore subject to third party supplier risk of managing CFSMS and Group as intergroup suppliers. CISGIL ensures clear identification of Group risks and actively engages with the Group to ensure that Group risks are appropriately managed in a robust control environment.

K. Liquidity risk

Liquidity risk is the current and prospective risk to earnings or capital arising from an inability to meet obligations when they come due without incurring unacceptable losses. CISGIL's objective is to meet all policyholder and other funding obligations as they fall due primarily through the use of cash and highly liquid UK government and corporate bonds.

The Board's risk appetite is that liquid assets should be at least equal to 20% of the ultimate cost of a 1-in-100 year windstorm loss before reinsurance recoveries. The ultimate cost is calculated based upon the catastrophe component of CISGIL's capital model. The latest model assesses the ultimate cost of a 1-in-100 year windstorm as £136m (2013: £147m), giving a minimum requirement for £27m (2013: £29m) of liquid assets against actual liquid assets of £674m (2013: £764m).

Liquid assets are considered to be:

Asset type:		**Value included as liquid assets**
Gilts		**100%**
Cash		**100%**
Corporate bonds:	AAA	**85%**
	AA	**85%**
	A	**50%**
	BBB	**50%**
All other investments		**0%**

The level of cash and other assets held are monitored regularly and managed through the Capital, Liquidity, Investment and Pension Committee, with oversight by the ERC and Board. This includes monthly reporting of liquid assets against risk appetite limits.

Notes to the Financial Statements continued

31. **Financial risk management** continued

The following table indicates the time profile of undiscounted cash flows arising from financial liabilities (based upon contractual maturity), and insurance liabilities (based upon estimated timing of amounts recognised in the balance sheet). Included in the analysis on insurance contract liabilities below is £47m (2013: £40m) of discounted reserves relating to PPO and EIROS. Further details are included in note 22.

As at 31 December 2014	**Carrying value £m**	**Gross nominal outflow £m**	**Up to 1 year £m**	**1 to 2 years £m**	**2 to 3 years £m**	**3 to 4 years £m**	**4 to 5 years £m**	**More than 5 years £m**
Insurance contract liabilities	**738**	**738**	**404**	**115**	**69**	**45**	**29**	**77**
Financial liabilities at amortised cost:								
– Other reinsurance liabilities	**1**	**1**	**1**	**-**	**-**	**-**	**-**	**-**
– Insurance and other payables	**30**	**30**	**30**	**-**	**-**	**-**	**-**	**-**
– Cash and cash equivalents	**8**	**8**	**8**	**-**	**-**	**-**	**-**	**-**
	777	**777**	**443**	**115**	**69**	**45**	**29**	**77**
Other liabilities								**-**
Total recognised liabilities								**777**

As at 31 December 2013	Carrying value £m	Gross nominal outflow £m	Up to 1 year £m	1 to 2 years £m	2 to 3 years £m	3 to 4 years £m	4 to 5 years £m	More than 5 years £m
Insurance contract liabilities	866	866	470	132	66	42	27	129
Financial liabilities at amortised cost:								
– Subordinated debt	85	92	33	3	2	54	-	-
– Insurance and other payables	18	18	18	-	-	-	-	-
– Cash and cash equivalents	9	9	9	-	-	-	-	-
	978	985	530	135	68	96	27	129
Other liabilities								11
Total recognised liabilities								989

CISGIL Fair values of financial assets and liabilities

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the annual report and accounts:

a. Financial investments at fair value through income or expense

The fair value of financial assets designated at fair value through income or expense, being short term (less than one month) fixed rate deposits, approximates to their nominal amount.

b. Available for sale assets

Fair value of listed debt securities is based on clean bid prices at the balance sheet date without any deduction for transaction costs.

Available for sale assets are regularly reviewed for impairment. Objective evidence of impairment can include default by a borrower or issuer, indications that a borrower or issuer will enter bankruptcy or the disappearance of an active market for that financial asset because of financial difficulties.

These reviews give particular consideration to evidence of any significant financial difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

Notes to the Financial Statements continued

31. Financial risk management continued

c. Borrowed funds

Fair value measurement is calculated on a discounted cash flow basis using prevailing market interest rates.

d. Other financial assets

For receivables and payables with a remaining life of less than one year, the nominal amount is deemed to reflect the fair value, where the effect of discounting is immaterial.

The table below shows a comparison of the carrying value and fair values of financial instruments.

Financial Liabilities	**2014 Carrying value £m**	**2014 Fair value £m**	2013 Carrying value £m	2013 Fair value £m
Other borrowed funds	**-**	**-**	85	85

Financial asset and liability classification

The table below analyses financial instruments by measurement basis as detailed by IAS 39 (Financial Instruments: Recognition and Measurement).

2014	Designated at fair value £m	Loans and receivables £m	Available for sale £m	Other amortised cost £m	Total £m
Assets					
Financial assets at fair value through income or expense	**156**	**-**	**-**	**-**	**156**
Available for sale assets	**-**	**-**	**765**	**-**	**765**
Other financial assets	**-**	**137**	**-**	**-**	**137**
Total financial assets	**156**	**137**	**765**	**-**	**1,058**
Non-financial assets					**116**
Total assets					**1,174**
Liabilities					
Overdrafts	**-**	**-**	**-**	**8**	**8**
Other financial liabilities	**-**	**-**	**-**	**30**	**30**
Total financial liabilities	**-**	**-**	**-**	**38**	**38**
Non-financial liabilities					**754**
Total liabilities					**792**
Capital and reserves					**382**
Total liabilities and equity					**1,174**

Notes to the Financial Statements continued

31. Financial risk management continued

2013	Designated at fair value £m	Loans and receivables £m	Available for sale £m	Other amortised cost £m	Total £m
Assets					
Financial assets at fair value through income or expense	208	-	-	-	208
Available for sale assets	-	-	763	-	763
Other financial assets	-	184	-	-	184
Total financial assets	208	184	763	-	1,155
Non-financial assets					117
Total assets					1,272
Liabilities					
Other borrowed funds	-	-	-	85	85
Overdrafts	-	-	-	9	9
Other financial liabilities	-	-	-	18	18
Total financial liabilities	-	-	-	112	112
Non-financial liabilities					877
Total liabilities					989
Capital and reserves					283
Total liabilities and equity					1,272

The following table provides an analysis of financial assets and liabilities that are valued or disclosed at fair value, by the three level fair value hierarchy as defined within IFRS7 (Financial Instruments: Disclosure):

- Level 1 — fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 — fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 — fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Based upon guidance issued by The Committee of European Securities Regulators (CESR), CISGIL classifies debt securities in Level 1 only if it can be demonstrated on an individual security by security basis that these are quoted in an active market, i.e. that the price quotes obtained are representative of actual trades in the market (through obtaining binding quotes or through corroboration to published market prices). Pricing providers cannot guarantee that the prices that they provide are based on actual trades in the market. Therefore all of the corporate bonds are classified as Level 2.

Valuation of financial instruments

2014	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Assets				
Financial assets at fair value through income or expense	**-**	**156**	**-**	**156**
Available for sale assets	**-**	**765**	**-**	**765**
Total financial assets at fair value	**-**	**921**	**-**	**921**

Notes to the Financial Statements continued

31. Financial risk management continued

2013	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Financial assets at fair value through income or expense	-	208	-	208
Available for sale assets	-	763	-	763
Total financial assets at fair value	-	971	-	971
Liabilities				
Other borrowed funds	-	85	-	85
Total financial liabilities	-	85	-	85

The valuation techniques using observable inputs relate to debt securities that would otherwise be fair valued using quoted market prices but where there has been short term temporary market inactivity and borrowed funds with no active market price. In obtaining relevant fair values for financial assets, CISGIL has obtained security specific prices from third party market makers based on what the third parties would have traded these particular securities for at the year end date. Financial liabilities have been valued using observable inputs including discounted cashflows and comparable credit spreads.

The following table allows comparison of debt securities (other than those classified at fair value through income or expense) on the basis of the current carrying amount, fair value and amortised cost (pre impairment).

Investments in debt securities as available for sale financial assets:

	2014 £m	2013 £m
Carrying amount	**765**	763
Fair value	**765**	763
Amortised cost	**748**	773

Notes to the Financial Statements continued

32. Reclaim Fund assets and liabilities

The Group is required to consolidate Reclaim Fund Ltd ('RFL') as it is a 100% owned subsidiary of the Group. However the Fund is a not for profit organisation whose surplus is entirely for the benefit of Big Lottery Fund and the Group derives no financial benefit from RFL nor can it access RFL's reserves. For this reason RFL's balance sheet has not been consolidated on a line-by-line basis but instead is separately disclosed within the Group balance sheet. The analysis of Reclaim Fund's assets and liabilities is set out below:

	2014 £m	2013 £m
Non-current		
Investment securities	**73**	69
Current		
Cash	**407**	382
Reclaim fund assets	**480**	451
Non-current		
Provision for reclaims of dormant account balances	**267**	239
Provision for future distributions to Big Lottery Fund	**139**	138
Reclaim fund liabilities	**406**	377

Accounting policies

The calculation of the provision for future repayments of dormant account balances is inherently complex, with significant amounts of uncertainty. The Directors have applied a cautious level of stress within the calculation of the provision which they believe implicitly accounts for the long term nature of the provision.

The Group also records a provision for future distributions to the Big Lottery Fund. This represents amounts which the RFL intends to pay over to the Big Lottery Fund in future periods of which timing is uncertain. The Dormant Bank and Building Society Accounts Act (2008) dictates that the RFL is obliged to pay over the excess of dormant account monies received, after deduction of running costs to the Big Lottery Fund for ongoing distribution to the benefit of the community. Distributions to the Big Lottery Fund are recognised in the income statement when a constructive or legal obligation exists for payment.

Investment securities

Held to maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. They are initially recognised at fair value plus directly attributable transaction costs and are subsequently carried at amortised cost using the effective interest method.

Notes to the Financial Statements continued

33. Detailed analysis of loss on discontinued operations for Bank and Life and Savings, net of tax

The results of discontinued operations are disclosed in note 9. Further details of income and expenses relating to the Bank and the Life and Savings businesses during the prior period are set out in the following note including details of the key accounting policies, key estimates and judgements applied in arriving at these results. These are disclosed to satisfy certain IFRS Financial Services industry disclosures.
All relevant disclosures for the Pharmacy business are included in note 9 or elsewhere in the report. The results below are stated after Group consolidation adjustments and therefore do not replicate the results disclosed in the statutory accounts of the below.

Income and expenses relating to The Co-operative Bank plc were as follows:

	2014 £m	2013 £m
Revenue	-	1,299
Operating expenses	-	(2,596)
Other income	-	44
Operating loss	-	(1,253)
Share of losses of associates and joint ventures	-	-
Tax	-	(162)
Loss for the period	-	(1,415)

Further details of this income and expenses is as follows:

Revenue

	2014 £m	2013 £m
The Co-operative Bank plc:		
– Interest and similar income	-	1,265
– Fee and commission income	-	35
Net revenue	-	1,300

Accounting policies

Interest and similar income

Interest income is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate and early redemption fees. The EIR basis spreads the interest income and expense over the expected life of each instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider assets' future credit losses except for assets acquired at a deep discount. On applying this approach to the mortgage portfolio, judgements are made in relation to estimating the average life of that portfolio. These judgements are made based on specific factors including product terms and historical repayment data. The estimates are updated in each reporting period to reflect actual performance. A key judgement area is the average life of the mortgage portfolio. A change in the average life by one year would result in an increase of 0.2% in gross interest income.

For assets acquired at a value significantly below the carrying value in the acquiree's financial statements because they have incurred losses, expectations of future losses are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include credit losses.

Fee and commission income

Predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the effective interest calculation. Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

All other fee and commission income, such as a loan closure fee or an arrears fee, that is not included in the effective interest calculation, is recognised on an accruals basis as the service is provided.

Notes to the Financial Statements continued

33. Detailed analysis of loss on discontinued operations for Bank and Life and Savings, net of tax continued

Operating expenses

The operating loss is stated after charging the following:

	2014 £m	2013 £m
Cost of sales		
– Banking activities – Interest expense and similar charges	**-**	(931)
– Banking activities – Fee and commission expense	**-**	(72)
Fair value amortisation	**-**	(216)

Other income

Income from activities outside the normal trading activities of the Bank include:

	2014 £m	2013 £m
Net gains on sale of investment securities – loans and receivables	**-**	43
Rental income from investment property	**-**	1
	-	44

Fair value amortisation

When Britannia Building Society transferred its engagements to the Co-operative Bank Plc in 2009, net assets were restated to fair value on merger. Fair value amortisation includes adjustments to reflect the interest rates charged and received on both assets and liabilities where a different rate may be prevalent in today's market. These adjustments unwind over future periods and in 2014 represent a net charge/credit to the income statement of £nil (2013: charge of £216m).

Notes to the Financial Statements continued

33. Detailed analysis of loss on discontinued operations for Bank and Life and Savings, net of tax continued

Income and expenses relating to the Life & Savings business (including TCAM) were as follows:

	2014 £m	2013 £m
Gross earned premiums	-	173
Less premiums ceded to reinsurers	-	(7)
Net premiums	-	166
Expenses:		
– Claims paid	-	(549)
– Technical charges	-	62
– Change in unallocated divisible surplus	-	75
– Investment expenses and charges	-	(55)
– Fee and commission expenses	-	(19)
– Other operating expenses	-	(157)
Other income:		
– Fee and commission income and income from service activities	-	42
– Investment income	-	340
– Gains less losses arising from financial instruments and other assets	-	133
Results from operating activities	-	38
Income tax including tax attributable to policyholder returns	-	(16)
Minority interest	-	(15)
Taxation	-	(2)
Result for the period, net of income tax	-	5

Further details of this income and expenses were as follows:

	2014 £m	2013 £m
Gross premiums:		
Non-participation contracts	-	15
Participation contracts	-	158
Outward reinsurance premiums:		
Non-participation contracts	-	(7)
Net premiums	-	166
Analysis of gross written premiums:		
Premiums under individual contracts	-	171
Premiums under group contracts	-	2
Gross earned premiums	-	173

	2014 £m	2013 £m
Life Contracts:		
Premiums from life assurance business	-	127
Premiums from pensions business	-	45
Premiums from permanent health business	-	1
	-	173

Notes to the Financial Statements continued

33. Detailed analysis of loss on discontinued operations for Bank and Life and Savings, net of tax continued

Investment income

	2014 £m	2013 £m
Interest income from debt securities at fair value through profit or loss	-	198
Dividend income from equities at fair value through profit or loss	-	80
Rental income from investment properties	-	57
Cash and cash equivalents interest income	-	5
	-	340

Net gains on remeasurement of financial and other assets at fair value through income or expense

	2014 £m	2013 £m
Listed equities	-	677
Unlisted equities	-	88
Listed debt securities	-	(481)
Unlisted debt securities	-	(120)
Derivatives	-	(193)
Investment properties	-	34
Net losses on remeasurement of financial liabilities at fair value through profit or loss	-	120
Other investments	-	8
	-	133

	2014 £m	2013 £m
Gross claims paid		
Long term insurance contracts:		
– death benefits	-	94
– surrender benefits	-	270
– maturity claims	-	181
– annuity and other benefits	-	111
Less recovered from reinsurers		
Long term business:		
– death benefits	-	(5)
– annuity and other benefits	-	(102)
Net claims paid	-	549

Notes to the Financial Statements continued

34. Capital resources

	2014 £m	2013 £m
Share capital	**70**	70
Retained earnings and other reserves	**2,795**	1,966
Total capital resources	**2,865**	2,036

Capital management

The Group defines capital as its share capital and reserves. The Group's policy is to maintain a strong base and to be more prudent than industry 'normal' levels as it is not able to raise equity externally. The Group still recognises the need to maintain a balance between the potential higher returns that might be achieved with greater gearing and the advantages and security afforded by a sound capital position. Due to the very different nature of our Trading Group and Financial Services businesses, the Group manages the capital of these businesses separately.

The Trading Group is not regulated and manages capital to ensure an appropriate balance between investing in the future growth of the Group whilst making member payments to stakeholders. The Group annually assesses the affordability of proposed member payments against actual. During the period, the Group made member payments of £nil (2013: £55m) to its stakeholders and invested in future growth through capital expenditure additions of £294m (2013: £311m). Total member funds increased during the period by £829m (2013: a decrease of £2,454m).

The Financial Services business mainly comprises General Insurance. CIS General Insurance Limited is a regulated entity. Its submissions to the FCA in the period have shown that this entity's individually regulated operations have complied with all externally imposed solvency requirements throughout the period.

Co-operative Group Limited
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