Our Annual Report 2015

The **co-operative**
Here for you for life

Contents

Strategic report

Governance report

Financial accounts

Strategic report

Championing a better way of doing business for you and your communities

About us

We can trace our origins back to 1844 when the Rochdale Pioneers formed the first successful co-operative society which was set up to meet the needs of its members. We have remained true to our roots. Today we're still a member-owned organisation which does business in a different way.

From those humble beginnings of just one small shop in Rochdale, the co-operative philosophy has spread far and wide, so much so that today one billion people worldwide are members of co-operatives.

We have become one of the world's largest consumer co-operatives, with interests across food, funerals, insurance, electrical and legal services. Our clear Purpose – championing a better way of doing business for you and your communities – sets us apart. We're owned by the people who use our businesses and as members they have a direct say in how we do business and how their business is governed.

We are a people business...

Over **18 million food** transactions per week on average

70,000 colleagues work with **us**

1,000 apprentices started with **us** (in the last three years)

3.6 million members use their membership cards with **us**

We're on the doorstep and in your community

- There's a Co-op store in every postal area with over 2,800 food stores and almost 1,000 funeral homes across the UK.
- We insure over 1.4 million policyholders and respond to over 100,000 legal services enquiries each year.

We do the right thing for our members and their communities

- In our shops:
  - More of our meat, proportionally, comes from British farmers than any other large food retailer.
  - All our eggs are free range.
  - We pioneered Fairtrade and are the world's largest convenience store seller of Fairtrade products. When customers buy Co-op Fairtrade they directly support producer communities - from building schools in Argentina to clinics in South Africa.
  - Through buying Co-op Fairbourne Springs water, our customers help to improve access to fresh clean water across Africa.
  - We're moving fast to reduce the sugar content of our products, and at least 30% of our promotions relate to healthier items, including three fruit and veg lines on promotion every day.
  - We've invested heavily in reducing the prices of our fresh meat and produce.
- Our Funeralcare business introduced affordable funerals for those in tight financial circumstances.
- Our Electricals business offers extended warranties at cost to its customers, avoiding the large mark-ups charged by competitors.
- In our Insurance business, we help young, safe drivers to obtain affordable insurance through the use of telematics. When customers found their homes flooded last year, we didn't increase their home insurance premiums when they came to renew their policies.
- Through the carrier bag levy, we've raised funds for 570 good causes in local communities, chosen by our members.

2015: one year into our Rebuild…

A solid overall financial performance...

Group Revenue
£9.3bn
FLAT

Underlying Profit before Tax
£81m ↑ **£8m**

Net Debt
£692m
At year end
↓ **£51m**

We made progress across our businesses...

The **co-operative** food

3.8%
Increase in convenience like-for-like sales

97
New Food stores opened

The **co-operative** funeralcare

5.5%
Rise in the number of funerals arranged

25
New Funeral homes opened

The **co-operative** insurance

10.1%
Rise in the number of policies in force

While investing in the foundations for our future...

£125m invested in Food price and products

8.5%
Pay increase for 40,000 of our frontline Food store colleagues by October 2016

Implemented our **governance reforms**, and held our first AGM under **One Member One Vote**

Report from Group Chair – Allan Leighton

Preparing to relaunch the Co-op

I've had a busy, fulfilling and exciting first year as Chair of the Co-op.

When I arrived we'd just passed the vital reforms our members knew were needed to bring us back to being a great Co-op. One year on and our focus has switched decisively from the past to the future as we moved from the Rescue to Rebuild phase of our strategy and prepare ourselves for Renewal.

We've been investing in that future in every part of our business, and our members and customers are already seeing the difference, as this report will show.

But there's a great deal more to come. Our ambition goes far beyond restoring our commercial success. Our place in society is only justified if we can demonstrate, beyond doubt, that there's a Co-op difference – or, as we say, a better way of doing business for you and your communities.

Strengthening the Co-op

In Food, Funeralcare, General Insurance, Legal Services and Electrical, we've been pushing ahead with innovations that are improving our products and services and our customer experience. To achieve that we've been recruiting new talent and coupling it with existing expertise at every level of the Co-op.

I'm particularly proud of the new Board we've established and the breadth of experience now guiding our progress. When we passed our constitutional reforms in 2014 we didn't know if the Co-op would be an attractive option for directors of the calibre and character we wanted to attract. They needed to be commercially driven but co-operatively minded. They needed to understand that the Co-op was not just another PLC. We needn't have worried. Our directors joining us in 2015, Stevie Spring and Peter Plumb, clearly understand the importance of our ownership model and aim to strengthen the communities in which we trade. Stevie and Peter have joined Simon Burke and Sir Christopher Kelly as Independent Non-Executive Directors.

The same can be said of our three Member Nominated Directors (MNDs), voted on to the Board directly by our members for the first time. Hazel Blears, Paul Chandler and Ruth Spellman have provided a vital member voice, as well as sound business acumen, ensuring the interests and concerns of our most important stakeholders are never left outside of the Boardroom. The MND role has proved to be very worthwhile, so we look forward to adding a fourth MND to the Board this year, with the approval of our members at the Annual General Meeting (AGM).

Just recently, I am pleased to advise that the Board has appointed Ian Ellis, the Group's Chief Finance Officer, as an Executive Director and Lord Victor Adebowale as an Independent Non-Executive Director. You can learn more about all of our directors on page 38.

Our new Members' Council and Council President are ensuring our Board and our senior management uphold our Co-op values and are held accountable to our members. The Council members are also becoming highly effective champions of the Co-op in their own communities up and down the country.

A highlight of 2015 was our first One Member One Vote AGM, which saw tens of thousands casting their votes, hundreds attending in person and more watching the proceedings live online for the first time. Our new Co-op democracy is up and running and it's off to a good start. We intend for this event to grow with even greater levels of participation as we demonstrate that the Co-op puts its members and their communities first.

Re-thinking Co-op membership

Even though we're only just into the second year of our three-year Rebuild programme, we're already confident enough of our progress to be planning a major relaunch of the Co-op in 2016. I can assure you this will be far more than a marketing makeover and the biggest thing to happen to our Co-op for 25 years.

We'll be announcing an entirely new Co-op membership that will be both innovative and compelling. This will be in addition to the annual member dividend which we hope to bring back once we start our Renewal phase.

We're also building a new network of Co-op Local Forums that will draw on the dedication and volunteer time of Member Pioneers, who'll work closely with our Community Champions to ensure we are fully integrated into the communities we serve.

Underpinning all of this is our intention to simply get back to 'Being Co-op', living our Values and Principles and doing the things that have always mattered most to our members.

So there's a great deal of good work going on at the Co-op. We're investing for the future and at the same time drawing on the values and lessons of our past.

Report from Group Chair – Allan Leighton continued

The Co-op in the UK has survived because we've maintained our social relevance and demonstrated to our members that we can offer both value and values. We're now well set to build on that tradition with renewed passion and determination.

Our colleagues are at the forefront of our work to Rebuild the Co-op and on behalf of the Board I thank them for the great job they are doing as true champions of the Co-op.

Allan Leighton
Group Chair

Report from Group Chief Executive – Richard Pennycook

Stronger performance drives significant investment

Our Rebuild programme is extensive, covering every aspect of our work, and the changes we have put in place to get our house in order have been considerable. I'm pleased to say that our progress has been faster than expected. I put that down not only to the approach we are following but the determination and commitment of colleagues at every level and the affection that our members and customers hold towards the Co-op. All of this means we will be ready to relaunch the Co-op in the second half of this year.

A solid performance

In 2015 all of our businesses performed solidly, with a particularly strong showing in our core Food convenience store estate (a market that remains fiercely competitive) and in our Funerals business where we are the market leader. General Insurance would have performed in line with expectations in the first year turnaround had it not been for the impact of the floods in Northern England at the end of the year.

For the Co-op as a whole, our underlying profit before tax is up from £73m in 2014 to £81m in 2015. This measure strips out one-off gains made in 2014 through the sales of our Pharmacy and Farms businesses – disposals we made to reduce our high levels of debt and to get our balance sheet back to good health. In early 2016 we also renegotiated the terms of our borrowing further to reduce interest rate payments and to allow headroom for the investment we want to make during the Rebuild phase of our recovery.

The increase in profit during 2015 needs to be seen in the context of our overall investment strategy. All of our investment is designed to bring either immediate or long-term benefit to our customers and members, their communities and our own colleagues. This year's profit figure would have been considerably higher if we were not following this planned and budgeted course of action, designed to create a successful, sustainable Co-op.

2015 saw us invest £125m in price and products in the Food business with an emphasis on fresh produce that's putting quality healthy food within everyone's reach. We've also continued the expansion of our convenience Food stores in 2015, adding a further 97 stores to the estate. That expansion will continue throughout 2016 with a further 100 stores, half of these in London and the South East.

Longer-term investment was also committed to General Insurance in 2015 where we announced a ten-year contract with IBM to provide a new integrated insurance IT platform which will transform our insurance offer and the customer experience.

In Legal Services we launched a new website making our offer clearer and easier to navigate. In 2015 Legal Services was firmly back in profit. And at the end of 2015 we demonstrated our confidence in the business with the acquisition of Collective Legal Solutions further to expand our reach into local communities.

Investing in colleagues has been central to our thinking since we began our Rebuild. In Food we raised the pay for the vast majority of our frontline store colleagues by 8.5%, taking us ahead of the initial level set for the Government's new National Living Wage.

Looking ahead, in Funeralcare we're making substantial investment through refurbishing the existing estate and adding over 200 extra branches in the next three years, bringing the network to over 1,100. A further £9m will go into replacing our fleet of funeral vehicles. We also want to address increasing concerns around the affordability of funerals for the less well off in our communities. In 2016 we've substantially improved our offering, including the choice of a Simple Funeral for under £2,000, which maintains our reputation for quality and customer care.

Maintaining responsible levels of debt has been an important part of our financial strategy. During 2015 our net debt reduced by £51m to £692m. Just two years ago, our net debt stood at £1.4bn. Reducing our debt has not been at the expense of investment, however. Our businesses generated £283m of cash, allowing us to invest to strengthen our business and grow the strongest parts of our Co-op. In 2015 we spent £320m on capital investment, principally on opening 97 new Food stores and refitting a further 264. We also opened 25 new funeral homes. Funding the investment in our Food business was helped by selling 91 Food stores that no longer fit with our focus on convenience food shopping, which helped to raise £175m.

We know we're lagging behind in how we operate online and through social media. The challenge stretches from how we present our products and services to the way we talk to our customers, and – essential for a Co-op – how we maintain an ongoing dialogue and build a deeper relationship with our millions of members.

Report from Group Chief Executive – Richard Pennycook continued

To address this, we're recruiting much needed skills and experience from the digital world. Our aim is to catch up fast and then leap ahead of our rivals. The appointment of Mike Bracken as Chief Digital Officer brings us a leader with an international reputation in this area.

In 2015 I was also pleased to welcome Ian Ellis as our new Chief Finance Officer. I can also announce that Pippa Wicks, our Interim Chief Operating Officer who has helped steer us through our Rescue and the first part of our Rebuild, is joining us in this role on a permanent basis.

Tackling loneliness

Towards the end of 2015 we signalled a return to our heritage of campaigning on the issues that matter most to our members. Following extensive consultation and a national vote, our members and colleagues chose to focus our efforts on tackling loneliness among all ages and in all communities across the UK. We have formed a partnership with the British Red Cross. Together we have begun a detailed assessment of what's needed to address the isolation and distress faced by tens of thousands of people. We aim to raise £3.5m and involve our businesses, our colleagues and our members in addressing the issue. As we announce our 2015 results, I'm delighted to say we have just passed the £1m milestone.

When we relaunch the Co-op later in the year you'll see the fruits of much of our labour during 2015 and the first half of 2016. As Allan has said in his introduction, this will be a great deal more than a quick facelift or a brief advertising campaign. We plan fundamentally to reset our relationship with our members for the long term. Our commitment is to prove beyond question that the Co-op does things well and does things differently because it puts its members first.

Richard Pennycook
Group Chief Executive

Report from President of the Members' Council – Nick Crofts

> Giving a voice to our millions of members

I am extremely proud to be the President of the Members' Council. I love our Co-op, and serving as our Society's President during a time of such change is an extraordinary honour. Being part of the team working to restore our Co-op to its rightful place in the heart of our communities is tremendously exciting.

The Members' Council was 'born' in May. The Transitional Council, which operated from November 2014 until May 2015, developed much of our ongoing operational architecture and ways of working. I would like to pay tribute to the outgoing members of the Transitional Council and also to Lesley Reznicek who served as its Interim President until July and to Lesley's three Vice Presidents, Tricia Davies, Jenny de Villiers and Robin Stewart. I also want to thank the former Board members and Regional Chairs who gave so much of their time, energy and experience during the transitional phase to get us to such a good place in such a short space of time.

Stronger relationships with the Board and Executive

The Council's priority since May 2015 has been to make sure that we are fulfilling our constitutional responsibilities and are able to represent the interests of our millions of members. To achieve this we've focused on building relationships with the newly-established Group Board and Executive. These strong relationships are the bedrock on which everything else the Council hopes to achieve will be built.

The Council has set up regular formal meetings with the Board and the Executive to ensure member interests remain at the heart of the Co-op's decision making. Allan Leighton, the Co-op Board Chair, has attended meetings of both Council and Senate. Richard Pennycook, Chief Executive Officer, attends very regularly.

At each Council meeting, we hold a Directors' Forum, when Council members are able to put questions to our Board directors. I am always struck by the quality of the questions – probing, strategic, and reflective of a deep knowledge of and passion for our Co-op.

An important development in 2015 was the agreement to add an additional Member Nominated Director to our Group Board, increasing the number to four. This was accomplished after last year's contentious AGM. The Council played a key role in this and it is a sign of the developing maturity of the relationships that a positive agreement was reached.

We have also explored ways in which Council can work with the businesses, seeking to blend the co-operative knowledge and commitment of Council members with the commercial expertise of our Executive to help shape our Co-op's approach.

This is typified by the establishment of the new Co-op Way Policy Committee. The committee, composed of Executives and Council members, will review our Society's policies to ensure that our co-operative difference is deeply embedded in everything we do.

Joint piloting of the Co-op Local Forums, as part of the work to re-think Co-op membership and ground it in the communities we serve has been a useful example of this approach.

Holding the Co-op to account

2015 also saw the start of a major piece of work for the Council – Meaningful Holding to Account. Working with Co-operatives UK, we have commissioned research into the UK and global best practice of holding to account frameworks, to assist the Council in drawing up its own framework. Holding the Group Board to account for the way in which our Society is governed is a key responsibility of the Members' Council and one which we will embed further in future years.

Over the coming three years, the Council will continue to develop the Meaningful Holding to Account Framework. Within this, there are four emerging priority areas – member value, how it is created, developed and sustained; being a leader ethically and sustainably; the member voice and member experience; and leadership within the national and global co-operative movement.

These four thematic priorities are linked by one golden thread – that everything our Society does demonstrates our co-operative difference.

Of course, the Members' Council itself needs to be held to account for the work that we do on behalf of our millions of members. To that end we held a series of Your Co-op meetings throughout the UK in spring 2016. Communication between Council and our members – in both directions – is a huge priority. I certainly recognise that there is very much more work to do on that front.

A particular highlight for me personally during 2015 was announcing our Charity Partnership with the British Red Cross. Tens of thousands of our members and colleagues voted, showing that democracy is alive and well at the heart of our Co-op. We're working with the British Red Cross to tackle loneliness and social isolation. Campaigning on social issues that matter to our members has always been an element that makes our Co-op unique. I'm tremendously proud of that work.

Report from President of the Members' Council – Nick Crofts continued

Finally, I would like to thank all members of the Council and Senate for their enormous commitment, passion, skills and enthusiasm. We work as a team to deliver on the priorities of our millions of members. Vice Presidents Dan Crowe and Marc Bicknell in particular have played a massive part in the leadership of the Council, and I am grateful for their support and wisdom.

Our Rebuild could be the great revival story of our times. This is certainly an exciting time for our Co-op.

Nick Crofts

Nick Crofts
President of the Members' Council

Our strategy and business model

Making membership meaningful again

The Co-op has its origins in Rochdale, Lancashire. When the Rochdale Pioneers Society was famously established in 1844, it was based on the notion of ethical trading and belief that its profits should be shared among members according to their purchases. Membership was meaningful then, and we want to make sure it is again today.

Getting this right lies at the heart of rebuilding the Co-op. In 2015, we've spent time looking at different co-operatives across the world, putting in place the foundations for launching a refreshed offer for members. While we're going back to our roots, we're also planning to use the digital tools available today to make new benefits easily accessible.

Making membership meaningful is our duty as a co-operative. But it will also differentiate us as a business, giving us a sustainable competitive advantage. More will be revealed as we progress with our Rebuild in 2016.

Foundations for the future

The Co-op is on a three-stage journey to recovery, with Rescue, Rebuild and Renew phases. Having rescued the organisation in 2014, we moved into the three-year phase of rebuilding the Co-op's foundations at the end of 2014. We plan to do this by the end of 2017, when we'll be ready to move on and renew the organisation.

In 2015, we fixed some of the basics and made big savings to help fund investments for the future and to keep our debt down. Importantly, we established the new Board and Members' Council to steer our strategy. New senior management were appointed, with the skills to deliver the Co-op's recovery. We also found lots of ways to cut costs and re-prioritise our spending, releasing money to invest in our Rebuild.

At the core of our plan to Rebuild is our Purpose: 'Championing a better way of doing business for you and your communities.' And we've planned how to invest in revitalising each of our businesses, improving our offer to customers and members.

Rebuilding our businesses

Food

We aim to make our Food business the UK's number one convenience retailer through our strategy called True North. Most of our stores are already convenience stores but we'll continue to sell some of our non-core stores to concentrate on stores that fit a convenience model, where our customers increasingly want to shop.

We're investing in refitting our stores to make them more appealing to shoppers. At the same time, we're improving our range of own-brand foods and tailoring them to local needs. In 2015, our Yorkshire stores championed local foods such as sausages, beer and bread. The availability of our ranges is being enhanced. And prices and quality are being improved to deliver even better value.

At a time of flat sales in UK food retailing, and falling prices, people spent more in our stores. Our actions position our Food stores for further growth.

Our business model

The Co-op has five businesses that offer goods and services in a way that reflects our Purpose. Each of them will have Co-op membership at its heart. Our businesses are:

- ✓ **Food**
- ✓ **Funeralcare**
- ✓ **General Insurance**
- ✓ **Legal Services**
- ✓ **Electrical**

We also hold investments in the Co-operative Bank (20%) and a travel joint venture with Thomas Cook (30%). Finally, we have a 50:50 joint venture with Hermes Real Estate for development of the NOMA estate, regenerating part of Manchester's city centre.

Funeralcare

Our Funeralcare business is already the market leader. This is not enough and our aim is to lead the market, being cherished by clients, members and colleagues as the leading funeral care provider, and at the heart of every community we serve.

We plan to grow Funeralcare, improving our market share and extending our geographical coverage. We have ambitious plans to open over 200 new funeral homes over the next few years to better serve our clients and members. Our funeral business will find new ways to be at the centre of every community, genuinely engaging with and championing the needs of those we serve. We're also looking to improve the benefits and services we offer, while making sure that funerals are fairly priced.

General Insurance

We aim to become our members' choice for insurance services and to champion a better kind of insurance for them and our customers. We'll build on the competitive advantage provided by our presence in communities, insight into our members and our trusted brand.

Our General Insurance business is being completely transformed. In 2015, we appointed IBM to build and run an integrated insurance IT platform. From 2017, this will give us a market-leading digital platform, allowing us to improve the products and services we offer, and to adapt them to our members' changing needs.

The new platform will help us to reduce costs and engage our members, so supporting our future growth.

Our strategy and business model continued

Legal Services

In 2015, our Legal Services business was stabilised and returned to profit. In order to improve our service to members, we're investing in becoming more efficient, so that we can process cases faster. We reviewed how to improve the growth potential of the Wills & Probate unit and moved quickly in this area through the acquisition of Collective Legal Solutions to expand our reach into local communities. We will also make sure that Personal Injury works closely with the General Insurance business, providing fair outcomes for our members through the claims process.

Providing our members with easy and straighforward access to legal services remains central to our strategy and in 2016 we plan to review how Legal Services can better serve them into the future.

Electrical

Our Electrical business differentiates itself by being the UK's fairest electrical retailer, with outstanding customer service and championing honest pricing for warranties.

We are investing in improving our website, making it more engaging for shoppers, we plan to offer online credit and we will be launching click and collect.

The future

As we rebuild the Co-op, making membership meaningful will be at the core of everything we do – making us different and strengthening our brand.

We'll become a lean and efficient organisation, with high-performing teams of people and systems. Each of our businesses will make a strong return on the money invested in them, as will the entire Co-op, giving us the financial strength to serve members well.

In 2015, we made great progress but there's a lot still to do. 2016 will see many of our Rebuild plans come to life – it will be an important year in the history of the Co-op, part of rebuilding our great organisation for the next 150 years.

2015 at a glance - our key performance indicators

- ✓ **A good year of progress, led by Food and Funeralcare**
- ✓ **Ongoing focus on rebuilding our businesses and investing in our people**
- ✓ **Return to our campaigning heritage with launch of a partnership with British Red Cross to tackle loneliness**

Group Revenue

£9.3bn

2014: £9.4bn

See page 15

FLAT

Capital Spend

£320m

2014: £294m

See page 16

£26m ↑

Colleagues

69,980

At year end

2014: 69,241

739 ↑

Campaigning

Over

80,000

members and colleagues helped to decide our national campaign on loneliness

Underlying Profit before Tax

£81m

2014: £73m

See page 15

£8m ↑

Group Estate

2,802

Food stores

2014: 2,796

See page 17

6 ↑

986

Funeral homes

2014: 961

See page 18

25 ↑

Net Debt

£692m

At year end

2014: £743m

See page 16

£51m ↓

Colleague Engagement

73%

Overall engagement score

2014: 67%

See page 25

6% ↑

Members

Over

90,000

of our members voted in our inaugural AGM under One Member One Vote

Finance Review

Key facts at a glance

- ✓ £9.3bn sales, slightly lower than 2014
- ✓ Underlying profit before tax of £81m, up £8m (11%) on last year
- ✓ Net debt down £51m to £692m

The results for 2015, the first full year of our three-year Rebuild programme, reflect a year of good progress. Underlying profits were slightly above expectations despite the impact of the devastating floods that hit our General Insurance customers and members so hard. Strong performances in Food and Funerals delivered profit growth, offset by planned investment in the business and our growth strategy that contributed to an increase in costs of supporting functions.

Despite the capital and revenue investment, both in our estate and our infrastructure, we reduced our net debt by £51m to £692m. Our financial position was further strengthened after the year end with the negotiation of a new five-year revolving credit facility on improved terms, which reduces interest costs and provides greater flexibility for Rebuild.

Sales

Headline sales of £9.3bn were slightly (0.9%) lower than 2014 but the reduction reflected disposals in 2014 of our Farms and Sunwin Services businesses, together with the impact of lower fuel prices within our Food estate. Food store sales were up 0.8% overall despite disposals of non-core stores. On a like-for-like basis, Food performed strongly, with like-for-like sales growth of 1.6%, 3.2 percentage points above the market (as measured by IGD), which fell by 1.6% overall. Our convenience stores delivered like-for-like growth of 3.8%, 1.3 percentage points ahead of the convenience market.

We arranged over 97,000 funerals in 2015, 5.5% more than in 2014, and overall sales in our Funerals business were up 9.9% on the prior year at £399m.

Sales fell by 7.5% in General Insurance to £343m, a planned reduction in net earned premiums arising from a managed exit from less profitable business sectors. However, gross written premiums rose by 16% with increased new business in Motor in the final quarter, supported by increased member participation and improved retention rates within the direct customer business. Retention in Home business fell slightly as a result of increasing market competition.

Profits

Reported profit before tax was £23m compared to £124m last year. Although there are a number of items unrelated to our core trading performance that impact profits in both years, the most significant was the £121m profit on the sale of our Farms business in 2014. Excluding this, profit before tax was £20m up on last year. Underlying profit before tax which excludes disposals and other one-off or non-trading items, was £81m, an increase of £8m, or 11%, on last year. We include details of how our underlying profit before tax relates to reported profit before tax below the income statement on page 75.

While the underlying profit before tax increase was the result of interest savings, trading profits reflected strong underlying trading performance, particularly considering the challenges posed by a hugely competitive and deflationary food trading environment and the impact of the storms that hit our insurance business.

Food profits of £250m were up £8m on 2014, largely driven by strong like-for-like sales growth and cost efficiencies that offset the impact of food price deflation and the costs of our investment in lower prices and colleague pay. Funerals, boosted by strong volumes, saw profits rise by 18.2% to £78m. Our General Insurance business was performing in line with expectations and above last year until the impact of the December storms, which we estimate cost us £13m after reinsurance recoveries and reinstatement. This led to a loss of £13m, £12m higher than the loss in 2014. In 2014 we put plans in place to restructure our Legal Services business and, as a result of these actions, we turned a loss of £5m in 2014 into a £0.7m profit in 2015.

We signposted that 2015 was the first year of investment in our Rebuild plan and this was particularly true in our support functions where we're investing in a range of strategic initiatives including Co-op membership, our brand, and in building efficient, web-enabled colleague processes and structures in Human Resources. This investment contributed to a £31m increase in costs from supporting functions, which offset underlying savings in core ongoing activity. Further increases are planned in 2016 with over £70m of costs to be invested in our Rebuild programmes. This reduces to around £40m in 2017. As a result of this we expect our operating profit to fall next year.

We're also investing significantly in transforming our General Insurance business with spend of £47m in the year to support the new operating platform. This forms the majority of the £62m of one-off items in the year. Disposal losses of £14m mainly related to closures of non-core Food stores and non-trading properties.

Finance Review continued

Financing and cash flow

Underlying interest fell by £30m to £83m, a fall of over 25%, reflecting the reduction in debt in late autumn 2014 following the disposal of the Pharmacy and Farms businesses.

Net debt reduced by £51m during the year to £692m, despite gross capital spend of £320m, principally on store refits and new stores. Trading cash flows generated £283m and disposals of non-core food stores and some investment properties raised a further £175m.

Our funding position is strong. The majority of our debt relates to bonds not maturing until July 2020 and July 2026. At the year end date, our shortest maturity was the £411m revolving credit facility, used for working capital requirements, which was due to expire in July 2017. This was successfully refinanced in February 2016 with a new five-year £355m facility maturing in February 2021.

Our General Insurance business, as a regulated entity, is funded separately to the Trading Group. In May 2015, £70m of sub-ordinated debt with a ten-year term was raised to support the Transformation Programme, while ensuring targeted capital buffer requirements were met. Regulatory capital requirements were met at all times during 2015 and the business has been monitoring capital against forthcoming Solvency II measures to ensure a smooth transition. The strategic plan for 2016-2018 projects that regulatory capital buffer targets will be met throughout the planning period.

Tax

Although we made a profit before tax of £23m in 2015, we will not be paying corporation tax in respect of the year because we have brought forward capital allowances and tax losses in excess of the taxable profit. These allowances and losses are explained in more detail in notes 7 and 16. In 2015 we paid £208m (2014: £188m) to the Government in respect of VAT, Business Rates, Stamp Duty Land Tax and National Insurance.

In the latter half of 2015, we were awarded the Fair Tax Mark. The Fair Tax Mark is a natural fit for the way the Co-op approaches its tax affairs and we believe it provides further evidence of how we seek to put our values, principles and Purpose into action. We have added further disclosures into our tax notes (notes 7 and 16 to the accounts) to increase transparency of our tax affairs and our tax policy can be found here: www.co-operative.coop/corporate/investors/tax policy.

Pensions

In autumn 2015, after consultation with colleague and unions, we closed our defined benefit pension scheme, Pace Complete, to the build-up of future benefits and moved to a defined contribution scheme for all colleagues for future service. This was an important step in making our pension offer fairer to all our colleagues but also affordable for the long term. Further details are given in the Co-op People section on page 24.

Our accounts show a net surplus of £1,151m across all our schemes. The Pace Complete scheme has an accounting surplus of £1,266m with most of the other schemes in a small deficit position and so partially offsetting this. However, on a statutory funding basis, which values pension liabilities on a more prudent basis than the accounting basis, we expect that the forthcoming triennial valuation will show Pace Complete to be in deficit. It's the statutory funding basis that informs the future cash funding obligations of the Group along with the Group's other requirements for cash. It should also be noted that within our balance sheet we still include the pension assets and liabilities of the Co-operative Bank ('the Bank') and will continue to do so until agreement has been reached on how to separate this out.

Investments in joint ventures

We have several joint venture arrangements with other parties, most notably a 20% stake in the Co-operative Bank and a 30% stake in a travel joint venture with Thomas Cook. The income statement includes a loss of £11m (2014: £3m loss) in respect of joint ventures, although there are a number of larger elements within the net amount as explained below.

At the year end, we have written down the value of our investment in the Bank by £39m from £224m to £185m. The reduction in the investment value reflects the market conditions that have impacted the banking sector, pushing down share prices, in particular, the longer than expected low interest rate environment and increased payment protection insurance (PPI) provisions. Our value is based on public information contained within the Bank's accounts and investor presentations. The Bank recorded a loss of £611m in the year.

Our investment in the travel joint venture is held at £38m at year end. In September 2016 the joint venture reaches its fifth anniversary, at which point any amounts still outstanding under the £37m minimum dividend guarantee become payable. Having only received £5m dividend to date, we have recognised a receivable of £32m reflecting the remaining amount payable under this guarantee. The agreement also gives us the option from September 2016 to sell our 30% stake for a minimum of £50m.

Outlook

2015 represented an important start to the Rebuild phase but as we reshape the Co-op for the future, there are still lots of things to put right. Our financial position and trading performance have strengthened but as we progress we need to continue to build the platforms for the future, reshaping what we do and how we serve our members. As indicated last year, we made no dividend payments to members in 2015 and we have been clear that this will continue while we are in the Rebuild phase. Further guidance will be provided as we progress and move towards our Renewal phase.

Business Review

Food

Revenue
£7.0bn FLAT

Underlying operating profit
£250m ↑ 3.3%

Colleagues
62,459 ↑ 1.9%

Number of stores
2,802 ↑ 6

Key facts at a glance

- ✓ £125m invested in lowering prices
- ✓ 97 new stores opened
- ✓ 91 non-core stores closed
- ✓ 264 stores refitted
- ✓ Over 800 community pioneers, up 65% on last year
- ✓ 1.6% like-for-like sales growth (3.8% in convenience)

Co-op stores have always existed to serve the needs of local communities, and in 2015 we made great progress in going back to our roots and back to the basics. We cut prices by over 15% on fruit and veg and saw volumes grow by almost 20%. We opened more convenience stores and worked hard to improve our range, making it more locally relevant. In return, customers and members have rewarded us with transactions up by 14 million (1.5%) on last year.

With over 2,800 shops – stretching from the Isles of Scilly to the Shetlands – we want to become the UK's number one convenience retailer, making a difference in every community. Through our strategy called True North, we're aiming simply to sell good food, provide an easy shopping experience and top this off with friendly colleagues.

We're adapting our stores to customers' changing shopping habits. Most people want to buy little and often these days. In 2015, we opened 97 new stores and closed 91 other sites. The Co-op now has just over 2,100 convenience stores and will continue to open more while closing some of our larger stores.

To make the Co-op shopping experience easier, we refitted 264 stores. In refitted stores, customers have a clear view into the front of the store, showcasing our produce offer, there's more space for tills and self-service, and the flow of the store is more intuitive and in line with their shopping trip.

To make sure people can buy what they want, we're tailoring our ranges to local communities and backing British products. In Yorkshire, we started to sell more local produce, such as beer, sausages and bread (see Our story on page 18), aiming to do the same across other parts of the UK in 2016. And always mindful of health, we cut the amount of sugar in products such as juices and cereals by nearly 250 million teaspoons.

The availability and quality of our range got better. Instead of just making sure that the full range was available in the morning, we did so throughout the day. And the Grocer presented us with five gold and eight silver awards for our products, while the Retail Industry Awards named us 'Chilled Retailer of the Year' for the second year in a row and 'Fresh Flower Retailer of the Year'. To reduce waste, we joined forces with the charity FareShare to turn surplus fresh food into nutritious meals for people in need. We redistributed 306 tonnes of food and have a target to increase this to 500 tonnes in 2016.

Finally, great customer service became a priority. Telling our colleagues that 'service rocks', we worked to be friendly, cut queues and enhance complaint handling. We also increased frontline shop workers' wages. They want to improve service and many suggested new ways to do so.

All of the measures described here, which are part of True North, are successfully reconnecting us with members and new customers. Data shows that people are spending more at the Co-op. Across our stores, sales grew by 1.6% on a like-for-like basis. This was a great achievement in a year when we saw food prices industry-wide fall by 1.2%, the first year of falling prices in a generation. Across UK food retailers generally, food sales fell by 1.6%.

Convenience stores did better than the market as a whole, but even here the Co-op outperformed. Like-for-like sales in our convenience stores rose 3.8% against 2.5% for the rest of the market.

As people spent more in our stores, so our profits rose 3.3% to £250m (2014: £242m), in spite of the money invested in new stores and cutting prices. Our profitability is growing, unlike our main competitors which saw profits fall. Falling petrol prices masked the effect of our better food performance on sales, which were in line with last year at £7.0bn (2014: £7.0bn). As our business becomes financially stronger, we'll continue to reinvest the profits in improving our customers' shopping experience.

We're committed to leading the way on food ethics in the convenience sector. Understanding what matters most to customers guides our actions. We support British farmers and growers by making British produce available in our stores. We help our customers to make healthier choices. We champion Fairtrade, and make sure that the many workers in our extended supply chain are treated fairly. We also minimise avoidable food waste within our operations and we're working to ensure that as much of our food packaging as possible can be recycled.

Business Review continued

At our 2015 Annual General Meeting, our members called on us to reconfirm our commitment to leading the way on Fairtrade. We responded positively, and one of the highlights this year included the launch of an innovative website and social media campaign, www.growingstories.coop, where our customers and members can talk to our producers. Our Fairtrade sales were up 5.0% in 2015, in contrast to an overall decline of 5.9% in the UK Fairtrade market. Further details of our commitment to Fairtrade can be found on page 31.

Our Food business is on the up. 2015 was the year when our drive to reconnect with customers started to show results. Over the next two years we'll build on our momentum. As profitability increases, we'll plough the proceeds back into communities, improving our convenience offer and serving our members. And we'll help communities more directly, notably through the work of our community pioneers who engage in community outreach at a local level.

Our story

Championing Yorkshire

Eggs, bread, sausages and beer are among 130 foods from local suppliers that we started to stock in our Yorkshire stores in 2015. Working with 50 of the county's local manufacturers and micro producers, we're testing this initiative in Yorkshire ahead of introducing it across the UK.

This initiative is a direct response to customer feedback. Products made in the vicinity of our stores are prized by customers who want to support locally produced regional food, which often helps to define a specific area such as Yorkshire.

Sam Moss, Director of Leeds Brewery, said: "Leeds Brewery is proud to be a Yorkshire producer and we are delighted to be teaming up with our local Co-op stores to get our beer on shelves across the region. Yorkshire is renowned for producing some of the best food and drink products in the country and we are thrilled to be part of this new local sourcing initiative."

Funeralcare

Revenue **£399m** 9.9% ↑	**Underlying operating profit** **£78m** 18.2% ↑
Funeral homes **986** 25 ↑	**Colleagues** **4,292** 4.3% ↑

Key facts at a glance

- ✓ 99% of customers satisfied or very satisfied (98.8% last year)
- ✓ 25 new funeral homes opened
- ✓ Over 97,000 funerals conducted, up 5.5% on last year
- ✓ Nearly 35,000 funeral plans sold, up 25.6% on last year

Already the UK's largest funeral director, we grew our market-leading position, arranging over 97,000 funerals across the country and opening 25 new funeral homes. Every year we open new funeral homes to serve an increasing number of communities, providing access to our high quality services. In 2015, we opened funeral homes as far apart as Billericay, Bournemouth and Rochdale.

We continued to significantly invest in our services, spending £6m on our funeral homes and crematoria, and £9m on our vehicles. This allows us to continue to provide first-rate standards of care to the bereaved at a reasonable price.

Investment in our colleagues is also critical, as it is through them that we deliver our high-quality care. We continue to be the only UK funeral director to offer an apprenticeship in Funeral Operations and Services, and in 2015 we welcomed our 1,000th apprentice to the business. Since its launch, the scheme has attracted thousands of applicants across a wide range of ages.

More people chose a Co-op funeral in 2015. While we held our market share, a high death rate led to us arranging 5.5% more funerals overall. Sales increased 9.9% to £399m (2014: £363m). Due to the economies of scale in our business, profit increased 18.2% to £78m (2014: £66m). This rise in profits strengthens Funeralcare, allowing us to invest significantly to serve more clients, members and communities across the UK and grow our business.

Business Review continued

Sales of our pre-paid funeral plan also grew by more than 25%, with nearly 35,000 plan sales in total and the stock of funeral plans and funeral benefit option plans now totalling over 480,000. The Co-op remains one of the only funeral plan providers to cover all costs of a funeral, with most other providers' plans only covering a contribution towards third-party costs.

Our customers continued to be very pleased. Our promise is to arrange a loved one's funeral with care, respect, clarity and reassurance 24 hours a day, 7 days a week. Almost all customers (99%) said they were 'satisfied' or 'very satisfied', maintaining 2014's high rating. One of the main reasons for our high levels of client satisfaction is the personal care we provide. Every funeral we arrange is unique and tailored to each individual that comes into our care.

Following the relaunch of our website at the end of 2013, traffic on the site increased by 50% in 2015 compared with 2014. The site offers advice, online memorials and the ability to organise a pre-paid funeral plan online. Some 60% more funeral plans were arranged in 2015 compared to 2014.

Our story

Support for bereaved children

To help bereaved primary school children come to terms with the loss of a loved one, we produced four animated films looking at the issues young people face when a parent or grandparent dies.

Teaming up with the Child Bereavement, Trauma and Emotional Wellbeing Service, we're offering these free films to schools, medical professionals, community groups and bereaved families. The four films include: 'Our Year Since Dad Died' and 'Our Year Since Gran Died'.

This follows the success of our Amy and Tom books, which similarly help bereaved children. More than 25,000 were given away across the country.

Bereavement affects many children. In the UK, a parent of a dependent child dies every 22 minutes, leaving 41,000 children without a parent each year.

Like the rest of the Co-op, we exist to serve our members and their communities. As well as delivering high-quality funeral services, we're also deeply involved in the communities we serve. In 2015, this ranged from producing DVDs helping children coping with bereavement (see Our story) to sponsoring local bowls clubs and events, to seminars for student nurses, to memorial Christmas trees helping people remember lost loved ones at a difficult time of year. We're also committed to sustainable sourcing of timber for coffins. In 2015, 95.6% of the coffins manufactured by Co-operative Funeralcare (FSC® C008811) were made from FSC® (Forest Stewardship Council®) certified wood from certified forests and other controlled sources.

2016 will be an important year for Funeralcare. We plan to step up our investment in expanding into new communities and improving our existing funeral homes and services. We want to accelerate our progress towards making high-quality, affordable funerals available nationwide. Most importantly we want to better support many more of our members through the traumatic experience of bereavement and to simply be there when it matters.

General Insurance

Revenue **£343m** ↓ 7.5%	**Underlying operating loss** **£13m** ↓ £12m
Policies in force **1.42m** ↑ 10.1%	**Colleagues** **1,274** ↑ 8.5%

Key facts at a glance

- ✓ 1.42 million policies in force (1.29 million last year)
- ✓ Over £1m of Co-operative Food vouchers issued as part of Great Grocery Giveaway
- ✓ 174 flood victims temporarily re-homed

2015 marked the beginning of our journey to champion a better kind of insurance for our members and their communities. Through the launch of the Transforming General Insurance programme, with investment in a new IT platform, we took the first steps towards providing better pricing and tailored services for our members.

Business Review continued

Our response to the floods in the North of England during December, and especially over Christmas, showed how committed our colleagues are to their communities (see Our story). We were one of the few insurers to open on Boxing Day, and senior management personally visited the flooded towns and villages, reassuring people that their claims would be dealt with promptly. The impact of the floods, which we estimate will cost us £13m, was one of the main reasons for Insurance reporting a loss of £13m in 2015 (2014: £1m).

The year's biggest step towards rebuilding our Insurance business was the appointment of IBM to build and run an integrated insurance IT platform. From 2017, this will give us a market-leading digital platform, allowing us to improve the products and services we offer, and to adapt them to our members' changing needs. The IBM platform will transform our business, making it sustainable in the coming years, not only increasing our competitiveness but also reducing operating costs. However, the cost of this investment for the future is substantial, with £47m spent in 2015, and treated as a one-off cost so not impacting on the underlying loss.

Intelligent use of members' data allows us to understand them better and to reduce insurance premiums accordingly, in line with our aim to deliver a better kind of insurance. By starting to deploy this predictive analysis in 2015, we were able to cut premiums for members.

The Great Grocery Giveaway was one of our most successful marketing campaigns in recent years. In 2015, over £1m of Co-operative food vouchers were sent to customers to use in their local stores.

Pricing in the motor and home insurance markets has been extremely competitive for several years, but towards the end of 2015 market conditions eased. Although motor premiums have increased, we have been able to offer our members great value insurance. While the cost of investing in our new platform will stretch into 2017, after that we expect a return to profitability, giving us the financial strength to continue giving our members an even better deal.

In line with our co-operative values and desire to make our products stand out, we continued to apply ethical screening to the investment portfolios backing our insurance policies. We avoided investing in bonds issued by companies that didn't meet our standards in areas such as human rights, the environment, trade and animal welfare.

In 2016, our members and other customers will see some big changes. Both our Home and Motor new business will move to the new IBM platform and our new website will launch, bringing with it a far more engaging and interactive service. Building on the success of 2015, this will allow more members to receive lower premiums thanks to our improved ability to be more specific and personal in our member pricing.

Our story

Helping Christmas flood victims

After storms Desmond, Eva and Frank swept through the North of England in December 2015, a large number of colleagues volunteered to work over the Christmas break to help the hundreds of policyholders whose homes were damaged by flooding.

They dealt with new claims and contacted customers within 250 metres of areas at risk of flooding to see if they needed help. Our loss adjusters also drafted in extra support and severely affected customers received £50 of Co-operative Food vouchers to help them through Christmas.

174 customers who were unable to stay in their homes were re-housed in temporary accommodation as quickly as possible. Affected customers were not required to follow the standard claims processes. They were immediately authorised to carry out any emergency repairs to their homes, safe in the knowledge we would reimburse the full costs to them.

Jonathan Guy, Head of Claims, said: "When I was out visiting our customers, it was clear that they all had differing priorities, so getting to understand what was important to them and then tailoring the claim appropriately to make sure their needs were taken into account was really crucial."

We don't expect individuals to be priced out of insurance as a result of the floods and we will not apply an increase to policy excesses for flood cover.

Business Review continued

Legal Services

Revenue **£18m** ▼ 14.3%	**Underlying operating profit** **£0.7m** ▲ £6m
Customer satisfaction **88%** FLAT	**Colleagues** **355*** ▲ 5.0%

*Colleague numbers exclude Collective Legal Solutions independent associates who are not permanent members of staff

Key facts at a glance

- ✓ Return to profit despite significant investment in digital technology
- ✓ 88% customer satisfaction rating
- ✓ Acquisition of Collective Legal Solutions

Buying a house, writing a will, dealing with the financial affairs of a deceased family member or going through a divorce are all part of life. We help our members and customers to deal with these events as quickly, helpfully and transparently as possible. Simply put, we aim to give people an outstanding service (see Our story) and in 2015 we took important steps towards improving our ability to do so.

We appointed new experienced heads of probate, family law and personal injury to strengthen the Legal Services management team, and help us to develop our services and improve member loyalty. When added to investments being made in digital technology, they'll help us to meet the needs and interests of our members across the UK.

Our customers gave us a satisfaction rating of 88% for 2015. This ranks us highly among legal services firms. But we know we can do better. So we're investing in technology platforms, workflows and training, sharpening our focus on dealing with legal issues quickly and effectively.

Legal Services returned to profit, following 2014's reduction in costs. Our investments in digital technology limited the profit to £0.7m but this was an improvement on 2014's £5m loss. Revenue declined to £18m (2014: £21m) as personal injury volumes continued to normalise and as we shaped and refined the business back to core service propositions.

Strengthening our Wills, Trust and Estate planning services, we bought Collective Legal Solutions in December 2015. With over 100 associates and support colleagues, this business provides face-to-face services to customers in inheritance-related legal matters throughout England and Wales. We intend to enhance our estate planning services further in 2016 by offering digital products. The addition of digital will allow clients access through their channel of choice.

We launched our new website during the year, allowing us to use digital technology to improve our services. Enhancements will be made during 2016 to allow customers to engage more easily with us.

We continue to work closely with our Co-op business partners to look after members and customers at critical times in their lives, such as when they have an accident or are managing a bereavement. It is at these key moments of truth that our businesses can work together to better serve our members.

As we moved into 2016, our family legal aid contracts came to an end and we decided not to renew these contracts as we had a limited range and reach of services, and developing services required significant investment. The Government's Autumn Statement 2015 announced two proposals that, if implemented, will significantly change the personal injury market. It's too early to assess the full impact at this stage; the consultation process will clarify the changes which are likely to take effect in 2017.

Our story

From sound advice to warm friendship

Helping people at critical times in their lives means we often receive notes thanking us for our services. But in 2015, one email sent by the Plymouth Herald's classical music writer who'd recently lost his father stood out.

Mr B said: "Having enjoyed excellent service from the Co-operative Funeral Service, both when my mother passed away, and now my father, it seemed a natural, and essentially seamless transition to hand on the legal business to essentially the same firm, or rather, a different company but still under the Co-operative umbrella, and all the traditional values this still stands for.

"I realise that the appointment of a particular case-handler is arbitrary, but I want to say that in pairing me with Amy Arnold, I don't think you could have done any better. She handled everything with total professionalism, yet amazing warmth and friendship, and ensured that the all-important lines of communications between us were never compromised during the eight months it took to finalise."

Supporting people in this way is what we're in business for.

Business Review continued

Our Legal Services business is successfully rebuilding itself. 2015 was the year when our business returned to profitability, giving us the financial strength to continue improving our service to members and their communities. In 2016, we'll work to give people a better deal when they seek legal advice in the UK. We aim to make legal services more affordable, helpful and efficient.

Electrical

Revenue **£79m**	↓ 6.0%	**Underlying operating loss** **£1.0m**	↓ £1.8m
Customer satisfaction rating **98%**	FLAT	**Home deliveries** **642,000**	↑ 5.0%

Key facts at a glance

- ✓ 98% 'excellent' customer satisfaction rating
- ✓ 642,000 home deliveries, up 5% on last year
- ✓ 16% increase in website conversion rates
- ✓ 89% rise in Black Friday sales
- ✓ 24% rise in Christmas sales

Co-operative Electrical prides itself on being the UK's fairest electrical retailer, committed to offering the best products together with excellent customer service, and championing honest pricing for warranties (see Our story). Our customers recognise this as our 98% Feefo (an online ratings and reviews provider) customer satisfaction rating for 2015 shows.

While internet sales remained strong, buying group volumes were lower than in 2014 due to other co-operative societies exiting their department stores. Profitability was also challenged due to aggressive market conditions, leading to a loss of £1m (2014: profit of £0.8m). However, there were strong sales in the key Black Friday and Christmas seasons. Our customers spent 89% and 24% respectively more on our goods at these times compared with 2014.

Our outstanding customer service defines us. When it comes to delivery, Co-op is the only electrical retailer to offer a 60-minute delivery slot free of charge.

2016 will be the year when we do even more for our customers. We are investing in improving our website, making it more engaging for shoppers, we plan to offer online credit and we will be launching click and collect, giving more reasons for our members and customers to shop at Co-operative Electrical.

Our story

Championing cost price warranties

Believing that the electrical goods warranty market treats customers unfairly, we've championed selling warranties at cost price. In 2015, our first full year of making cost price warranties available, three times more people chose to buy them than in 2014.

Co-op is the only electrical retailer not to make a profit on selling extended warranties. What's more, our warranty policy is market-leading, covering a wide set of possible claims. No other retailer in the UK gives this peace of mind.

"We've clearly staked out our position as the consumer's champion," says James Holland, Managing Director, Co-operative Electrical. "The extended warranty sector doesn't have a good reputation. What we are doing is making it fair."

Support functions

Key facts at a glance

- ✓ Over 200 ways to save money identified within procurement
- ✓ New Chief Digital Officer

Transforming how we operate

The Co-op's plans for recovery require a thorough reorganisation of how we do business. For our planned revival to be successful, we must reform our support functions – from human resources, to procurement and digital services.

Managing people

People come first, and the way we manage them is changing. We've appointed highly capable managers to all the key leadership positions, started to remove inconsistencies in how people are paid and made clear that the Co-op's Purpose as a members' organisation is at the heart of what we do.

Business Review continued

Our people are learning to love the Co-op again – they're rediscovering their emotional attachment.

We're changing the Co-op's culture by encouraging people to perform as well as they can, and rewarding them if they do. To achieve this, we've introduced a rigorous performance review process. We've also rolled out a new grading structure, aligning roles and incentives across our businesses.

Becoming lean

Across the Co-op, we've made great progress cutting costs and re-prioritising where we spend. This releases money for investment in our Rebuild. We've saved money in lots of different ways, such as challenging business rates payments on our properties, forward buying of electricity and reshaping insurance premiums.

Within procurement, more than 200 ways were found to save money. To give a few examples, £974,000 was saved by rebidding waste contracts and increasing the income for our recyclate, around £390,000 from reviewing mobile phone contracts and around £275,000 from reducing layers in the facilities management supply chain.

Adapting to digital

Just as the internet is at its best when it joins people together, so it has great potential for serving the Co-op and our members. In 2015, we laid the foundations for wiring world-class digital capabilities into the core of our businesses. We appointed a Chief Digital Officer who sits on our nine-member Group Executive, hired a number of other specialists and planned how digital will improve our communication with members.

Nostalgia FM was an example of how digital services can make our products fun and interesting. General Insurance designed this tool for drivers to enter the date of their driving test and receive a music playlist from that month.

In 2016 and beyond, we will launch a series of digital services and businesses. This will enable us to better service our existing members, while building affinity and awareness of the Co-op to a new generation and it will strengthen our link with communities. In the years ahead, we may even explore entirely new Co-op digital businesses.

Co-op People

Key facts at a glance

- ✓ Almost 70,000 colleagues
- ✓ 8.5% pay rise for frontline Food store colleagues during the year
- ✓ Increased our leadership capability with around 40% of the top 100 roles being new to the Co-op in the last two years
- ✓ Over 85% of colleagues are also members of the Co-op

The Co-op's people make us successful. They serve our members, and are driving our recovery. That's why they're at the heart of our Rebuild. They're acquiring the skills needed to engineer our recovery, and are more motivated than ever.

Over the years, our approaches to working practices, pay, benefits and performance had become inconsistent across our different businesses. Inefficiencies had crept into people management. Then motivation fell during the Co-op's crisis in 2013 and 2014. As a result, many of our colleagues weren't so engaged in the Co-op as in the past.

In 2015, we've begun to turn the corner, although there's still a lot to do. We've attracted highly capable managers to all the key leadership positions, started to remove inefficiencies and made clear that we're returning the Co-op to its roots as an organisation that serves members and their communities. Our people are learning to love the Co-op again – they're rediscovering their belief in our Purpose.

Having great leaders

As we set about rebuilding the Co-op, how can we create the leadership we need? We realised that we didn't have enough of the high-quality managers we needed to recover. As a result, we have established a new group of 100 senior managers over the past two and a half years in the key roles that are steering the Rebuild, with around 40% being new to the Co-op. This group are known as our Enterprise Leaders.

These Enterprise Leaders are setting our business strategy and changing our culture, with the goal of bringing our Purpose to life, engineering our financial recovery and delivering better benefits for members. On a day-to-day basis, they're there to nurture colleagues' talents and to help and empower them to do great things for our members.

We want to change the Co-op's performance by encouraging people to do as well as they can, and rewarding them if they achieve this. We have, therefore, introduced a rigorous performance management process that makes it clear what we expect of our people and regularly review the progress they're making.

We also recognise we need to find and build our leaders of the future. In 2015, we celebrated our 1,000th apprentice joining the Co-op; we've ambitious plans to grow this in the future. We'll be investing more in developing the leaders we already have, and it starts with giving them the skills to excite, motivate and coach our colleagues to great performance.

Rewarding people fairly

Attracting, retaining and motivating the best people means offering fair reward. In 2015, we've made it clear that pay and other types of reward will be awarded consistently, fairly and transparently. In future, greater rewards will be given for enthusiastic and efficient customer service, and high performance. We want to encourage a culture of supporting our members and customers within their communities. Our view is that colleague reward should be through not only pay but also the benefits we provide, alongside opportunities to progress and to make a real difference to the communities we serve.

Like many large organisations, we've reviewed our pension schemes to make them affordable and ensure they continue to meet more of our colleagues' needs. In 2015, we moved all colleagues to our defined contribution pension scheme that pays a certain sum into a colleague's pension fund every month. We have raised the contribution levels available to colleagues and also the matching contributions from the Co-op. We continue to work hard to make all colleagues aware of this benefit, especially those in entry-level roles and front-line colleagues. This replaced the defined benefit scheme, Pace Complete, that paid a guaranteed level of income to retirees and which has now closed to future accrual.

The Co-op has historically been supportive of the principle of a statutory floor for basic pay, and campaigned for the introduction of the National Minimum Wage. As a major step, we are proud that in 2015 we agreed a pay deal that meant 40,000 colleagues who work in frontline roles within Co-op Food stores received a rise of 8.5% in their hourly rate. Since our decision to introduce this new rate, the Chancellor announced the creation of the National Living Wage in the July 2015 Budget Statement. Our 8.5% increase for Food store colleagues took us ahead of the Chancellor's initial Living Wage level and we're committed to ensuring that colleague reward is fair and broadly in line with market practice, while recognising that levels will need to remain affordable.

Co-op People continued

Further support for colleagues has also come in the form of our Rental Deposit Scheme, launched in 2015, which provides an interest-free loan to help pay for a tenancy deposit when moving into a privately rented home. Approximately 100 Co-op colleagues have already taken up this benefit.

Engaging colleagues

2015 was our thirteenth year of Talkback, our annual colleague engagement survey. The positive news is that engagement with the Co-op is recovering and more colleagues are having their say by completing Talkback (85% in 2015 compared with 82% in 2014). In the depths of our crisis, the impact of negative news headlines contributed to a decline in our scores, and undermined colleague pride in the Co-op and its values. But as our colleagues see the business beginning to recover, they're rediscovering their emotional connection to the Co-op.

This year we've seen our colleague engagement score return almost to its pre-crisis levels, increasing by six percentage points since 2014 to 73% (pre-crisis 74%). Overall connection, affiliation with, and enthusiasm about the Co-op has recovered, and advocacy about the Co-op as a place to work is also continuing to increase.

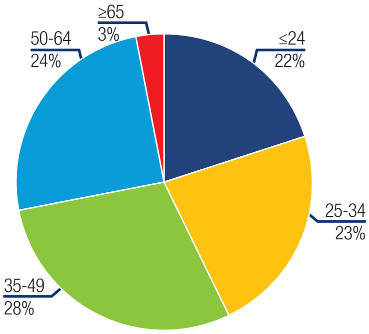
In addition, when compared to our retail external benchmark (including Aldi, Asda, Tesco, Morrisons and more), most comparable aspects of our colleagues' experiences at work are in line with or above the sector average. However, we remain behind the retail average on some 'outcomes' of colleague engagement, such as advocacy of the value of our products and services.

In 2016, we'll do more work to refresh the emotional connection between colleagues and the Co-op. We want to empower colleagues to bring the Co-op difference to life every day, and enable leaders and managers to create the conditions for this to happen. We are investing in the development of 5,000 leaders through a programme which will equip them to inspire, support and release the potential of every colleague in a way that is true to 'Being Co-op'.

Diversity

Our diverse mix of customers and members must be reflected in the make-up of our colleagues. A diverse workforce leads to higher engagement, better understanding of the communities we serve, higher levels of innovation and ultimately a better performing Co-op.

Proportion of colleagues in each age band



As a result, we promote diversity and inclusion among our colleagues, and provide them with the support they need to be successful at the Co-op. Our approach to diversity ensures we remain focused on fair and equal treatment at work. This means we take our responsibilities seriously around age, disability, marriage and civil partnership, pregnancy and parental leave, race, religion and belief, gender, gender reassignment and sexual orientation.

The Stonewall Workplace Equality Index ranked us 72 in its 2015 index of Britain's top 100 employers actively encouraging 'gay-friendly' places to work. Our lesbian, gay, bisexual and transgender (LGBT) colleague network, Respect, has around 700 members and 9,700 Twitter followers. Respect raises awareness of LGBT issues and supports the professional development of its members. In 2015, Co-op supported four Pride events – in Manchester, Brighton, Bristol and Glasgow.

In terms of gender, we've signed the Government's 'Think Act Report' initiative, which encourages businesses to make genders equal at work in areas such as recruitment and retention. Our colleague network, Aspire, is led by and for female colleagues, although anyone can join. Aspire now has 500 members, with a good Twitter following. It provides career advice, mentoring, networking opportunities, personal development and opportunities to hear more about the career experiences of our senior managers.

Our two established networks, Respect and Aspire, have supported many of our colleagues, benefiting both the business and our communities. In 2016, we aim to re-establish the REACH network which will focus on race and cultural awareness. We're also continuing our three-year project, which we started in 2013, to identify how we can better support our older colleagues, which includes encouraging their continued employment if that is what they choose. Also, since 2006 we have not enforced a retirement age.

Proportion of female, ethnic minority and disabled colleagues and managers

	Group	**Managers**
Female	56%	42%
Ethnic minority [1]	1.87%	2.57%
Disabled [2]	0.81%	0.74%

[1] Based on colleagues identifying themselves as belonging to an ethnic group
[2] Based on colleagues identifying themselves as having a disability

Sustainability Review

Key facts at a glance

- Over 80,000 members and colleagues helped to decide our latest national campaign on loneliness
- Almost 9,000 colleagues took part in community activities in work time, up from 7,700 last year
- £5.8m of support for UK communities, down from £8.3m last year
- £1.8m of support for the co-operative movement, in line with last year
- World's largest retailer of Fairtrade wine
- 43% reduction in direct greenhouse gases since 2006
- Food waste redistributed helped to provide 730,000 meals for those in need

As we progress through the Rebuild phase of our recovery, we're re-focusing our efforts on doing things 'the Co-op Way' and are planning to achieve much more over the coming years. We're addressing ethical and sustainability matters across four key impact areas: our membership and communities; our operations; our products and services; and our people.

We're exploring and developing new ways of engaging with our members and communities. We're reinvigorating our long-established drive to campaign for a better society. And we're continuing to develop our ecological and social responsibility policies and practices, in line with our Sustainable Development Policy.

In line with our ethical values and members' expectations, we seek to report on our sustainability progress, or otherwise, in an open and honest way. As part of our external sustainability assurance (page 197), verified data is identified by the symbol ◊. More detail on our sustainability performance is provided online[1].

Our membership and communities

Member engagement and member voice

We're working to make sure that members have an even stronger voice across the business – from product development through to shaping our community engagement and campaigning (see Our story).

Democratic member representation with the Group is achieved through election of members to the Members' Council (see page 71) and Member Nominated Directors on the Group Board (see page 42). Furthermore, our Co-operative Young Members' Board, an advisory panel of 15 members aged 16–25, encourages young members to be actively involved in our business.

Our story

Tackling loneliness and social isolation

Our new national campaign was announced in July 2015, following extensive member and customer engagement.

Over 30,000 members and colleagues shared ideas to identify potential themes that were important to tackle and that resonated with our Purpose.

In 2015, almost 80,000 of our members and colleagues voted on the issue, on which we would work with a charity partner to fundraise and campaign – our largest ever engagement around a charity vote. They chose to tackle loneliness and social isolation, working with the British Red Cross.

We've set ourselves a target to raise at least £3.5m by January 2017. By March 2016, we'd already raised £1m. During 2016, we'll engage colleagues, members and customers in our fundraising efforts and volunteering, and establish links with the British Red Cross locally. What's more, we'll start to tackle loneliness in communities across the UK, through our campaign.

Campaigning for a better society

As a national business with a presence in thousands of communities throughout the UK, we're well placed to influence change on issues that matter to our members at both a local and national level.

Campaigning in this way helps to define and differentiate us, and we're probably one of very few businesses that articulates such a commitment within its Purpose.

Our new national campaign to tackle loneliness and isolation has a close fit with what many of our colleagues do, over and above their everyday jobs (see Our story on page 27).

---

[1] www.co-operative.coop/sustainabilityperformance The pages will be updated with 2015 data and commentary in July 2016.

Sustainability Review continued

Our campaigning

Since our formation in **1844** we've **campaigned** for a better society

Today the general public recognise us as the **No.1** UK business on campaigning

80,000

Colleagues and members voted to decide on our Charity Partnership with **British Red Cross** to respond to the hidden epidemic of loneliness in our communities

Loneliness affects **1in7** of our members and customers

and **35%** know someone who is **lonely**

Part of our response is to fundraise **£3.5m** to tackle loneliness with the British Red Cross

So that together we can help reconnect **tens of thousands** of people with their communities

Community activities and volunteering

Against the backdrop of the challenges of Rebuild, we have continued to invest in our communities, not least through the increased engagement of our colleagues.

We have long recognised that while financial support is required for certain community activities, more often it can be the engagement of our colleagues and members 'on the ground', in partnership with other community enterprises (be it the British Red Cross or other local organisations) that can add real value and be the catalyst for change.

Our story

Helping a bereaved client

Campaigning to tackle loneliness and isolation is so right for us to champion. It reflects what many of our colleagues do day-in day-out by voluntarily going over and above their everyday jobs.

At a time of bereavement, many of us can experience loneliness for the first time and have no one to turn to. When Sue Stanton, one of our Funeral Directors, made contact with a client in relation to the collection of her husband's ashes, she found that the client had become isolated. She had no relatives or friends and could no longer venture outdoors. This had made her deeply distressed about finally laying her late husband's ashes to rest.

On learning that her husband had a love for the sea and that this was where she had hoped his final resting place would be, Sue, along with colleague Kyle King, arranged special access for her to scatter her husband's ashes at the end of the North Pier in Blackpool. They then took her for coffee and a chocolate éclair before taking her home with a bunch of flowers.

But it didn't end there. Our colleagues stay in touch and have helped her to reconnect with the community, by including her in community activities they arrange. Their client has said that they provided her with real friendship and conversation, that she will never forget their kindness, and can now rest knowing her husband has reached his final destination.

Sustainability Review continued

During 2015, 8,989◊ colleagues (2014: 7,746) from across our businesses took part in community activities during work time, equating to a donation of time worth £1.0m◊ (2014: £0.9m).

This includes formal volunteering through our volunteer programme, delivered in partnership with The Co-operative Foundation; colleagues setting up and running community projects; and locally-organised activity throughout our businesses, including our Community Pioneers, Community Pilots and community outreach from our Funeralcare business.

Our Funeralcare business is closely engaged in the communities in which it operates. Initiatives include 'Be Safe Be Seen', which provides reflective badges for school children, along with road safety advice; and the production and distribution of DVDs and books to help children cope with bereavement, more details of which can be found on page 19.

Carrier bags and community funding

We're putting the proceeds of the carrier bag levy[2] directly back into the communities where the funds are raised. What's more, we've committed to add all profits from our reusable bag range to the proceeds of the carrier bag levy, enhancing the benefits for communities.

The levy has been in place in Scotland since October 2014 and has resulted in 80% fewer bags being given away. We were able to raise a pot of over £750,000[3] for community projects in Scotland within the first 12 months. Members and colleagues voted for 570 local good causes to receive awards of £595,000 and for three national partners to receive £172,000. Funds will be dispersed in 2016 and details provided in our 2016 Review.

In Wales, the levy has been in place since 2011, and our proceeds have been supporting Welsh Wildlife Heroes in partnership with Wildlife Trusts Wales.

Community Pilots

Our ambition is to create the UK's leading local community model to support and enable the initiatives which matter most to our members in their local area.

We've been running over 50 Community Pilots. Launched in the second half of 2015, these pilots are evaluating how our members and colleagues can best deliver our Purpose in their local area. We have also expanded our in-store Community Pioneers programme to over 800 stores (2014: 500).

Community Pioneers engage and support their local communities – for example, organising fundraising events and providing meeting places for community groups. The findings from these pilots will help us improve our approach to community engagement in the future, and will be reported on in our next review.

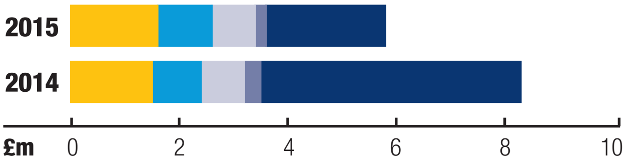
The Co-operative Foundation

The Co-operative Foundation is our corporate foundation. We appoint trustees who make independent decisions, in line with the Foundation's own charitable objectives. The Foundation works in partnership with us to provide opportunities for Co-op colleagues to volunteer with community projects.

The Foundation's Truth About Youth programme concluded in 2015. This major initiative aimed to challenge and change negative perceptions of young people. Through a five-year investment, more than 100,000 young people led or participated in projects showcasing their positive contributions to society. The Foundation is now developing a new strategy that will build on the legacy of this work.

UK community investment

The Co-op's activities in 2015 led to a total investment of £5.8m in UK communities:



	2015◊	2014
🟨 Cash	**£1.6m**	£1.5m
🟦 Colleague time	**£1.0m**	£0.9m
⬜ Gifts in kind	**£0.8m**	£0.8m[r]
🟪 Management costs	**£0.2m**	£0.3m
⬛ Leverage *	**£2.2m**	£4.8m
Total	**£5.8m[4]**	£8.3m[r]

* Leverage includes donations by colleagues, customers, members and suppliers.

International communities

As well as supporting UK communities, we provided £1.1m◊ of support for communities overseas (2014: £1.2m). This included £745,000◊ (2014: £650,000) raised through sales of our own-brand bottled water[5], Fairbourne Springs which has helped improve access to clean water for over 1.5m people since 2007.

---

[2] Further detail on the carrier bag levy can be found here: www.co-operativefood.co.uk/carrier-bags

[3] The £750,000 raised through the Scottish carrier bag levy is not included within our overall community investment figure (£5.8m), as it was not distributed during 2015. It will be included within our 2016 figures.

[4] As a co-operative we have, for many years, funded community investment from our profits. No dividend payments were made during 2014 and 2015, and, as a result, our community investment was lower than in prior years. The amount of cash and colleague time that we invested in UK communities increased slightly in 2015 compared to 2014 (see graph). However, our overall community investment was lower than 2014, due to a lower level of leverage through the Co-operative Foundation as it develops its new strategy.

[5] Also sold in independent co-operative societies.

Sustainability Review continued

Support for the co-operative movement

In line with the sixth Co-operative Principle of ‘co-operation between co-operatives’, we collaborate with and provide support for the wider co-operative movement. We aim to deliver this support primarily through representative bodies of the co-operative movement. In 2015, we paid £1.8m◊ to these bodies (2014: £1.8m). The largest portion was for Co-operatives UK, the national trade body that campaigns to promote, develop and unite co-operative enterprises; along with The International Co-operative Alliance, The Co-operative Party, Co-operative College and Co-operative News.

In 2015, we agreed with Co-operatives UK that it would take over the funding of some smaller co-operative organisations, which we had previously supported directly. We'll provide additional funding to Co-operatives UK in 2016, for this purpose. We also supported Co-operatives Fortnight 2015, working collaboratively to promote the co-operative movement.

Support for Co-operative academies

We sponsor seven academy schools in Manchester, Leeds and Stoke-on-Trent through the Co-operative Academies Trust. An eighth academy, in Manchester, is due to join the Trust in 2016. Through the academies, we offer support to students and staff, including access to resources, high-quality governors, work experience, placements, training and leadership development. The improvements achieved by all academies in recent years have continued with all but one now inspected 'good' by Ofsted. In addition, the Co-operative Academies Trust has been identified as making a very strong difference for the most disadvantaged pupils[6].

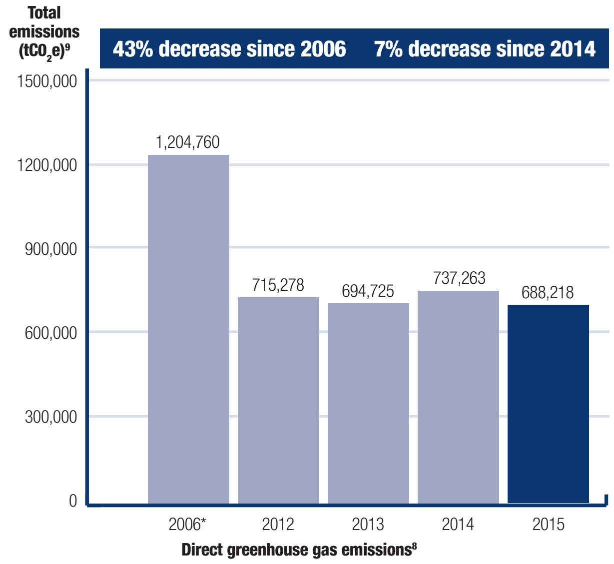
Our operations: environment

Climate change

We recognised the need to act on climate change long before most businesses, and for over a decade we've reported our climate impacts annually. Our ambition continues to be 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 energy consumption, increasing efficiency, and generating and using renewable energy.

Since 2006, our total direct GHG emissions have reduced by 43%◊ as detailed in the table below, with strong emissions reductions in energy (45%◊), refrigerant leakages (44%◊) and transport (36%◊). Overall, total direct GHG emissions decreased by 7%◊ in 2015, in part due to a decrease in the GHG intensity[7] of electricity supply.

Direct greenhouse gas emissions



*Baseline year

In 2015, energy consumption reduced by 5%◊, due primarily to behaviour change initiatives and a targeted Food store improvement programme. GHG emissions by source are detailed in the table below.

Direct greenhouse gas emissions by source

	Total emissions (tCO_2e)◊	
Source of emissions	**2015**	2014
Fuel combustion	**33,868**	35,170
Electricity consumption[10]	**357,520**	403,386
Refrigerant leakages[11]	**166,630**	167,136
Transport[12]	**130,200**	131,571
Total	**688,218**	737,263
Carbon intensity (tCO_2e/£m gross income)	**68.16**	72.18

---

[6] Chain Effects Report (2015), The Sutton Trust.

[7] GHG emissions per unit of electricity are calculated by Defra and updated annually. Due to changes in the UK energy mix Defra decreased this metric from 0.49426 $kgCO_2e$/kWh for electricity purchased in 2014 to 0.46219 $kgCO_2e$/kWh for electricity purchased in 2015.

[8] We measure our direct GHG emissions in tonnes of carbon dioxide equivalent (tCO_2e), using the latest UK government guidance. 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.

[9] 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.

[10] If electricity from renewable sources is accounted as zero carbon, then emissions from electricity would be 3,575 tCO_2e.

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

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

Sustainability Review continued

Waste

Our waste management follows the well-established waste hierarchy of reduce, reuse and recycle. 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're maximising environmental benefits. We're also working to increase the proportion of our packaging made from material that can be widely recycled.

Food waste has negative environmental and social impacts. While only a relatively small proportion of overall food waste in the UK comes directly from food retailers, we have a responsibility to reduce our impacts.

We redistribute surplus fresh food from our operations to people and communities suffering from food poverty, via the charity FareShare. We increased our efforts during 2015, distributing 306 tonnes (2014: 82 tonnes) of food from depots and we aim to increase this to 500 tonnes in 2016. We also carried out a trial in Leeds to explore redistribution of food waste from small stores.

Food redistributed in 2015 helped to provide **730,000** meals for **those in need**

Up from **196,000** meals in 2014

We aim to increase this to **1 million** meals in 2016

Our operations: ethical sourcing

In 2015, our approach to ethical sourcing has been guided by our Sound Sourcing Code of Conduct, Sustainable Procurement and Supplier Policy, and our Human Rights and Trade Policy.

We source own-brand products for sale in our Food stores from 1,700 sites around the world that employ half a million workers, an indication of the scale of our potential supply chain impacts.

Further detail on our British and responsible sourcing can be found on page 31.

Labour standards

Our Sound Sourcing Code of Conduct identifies the labour standards we expect suppliers of own-brand products to meet and we are a member of the Ethical Trading Initiative.

Leading from within our Food business, our approach combines:

- a robust monitoring programme to help ensure fair treatment of workers
- working in partnership and building capacity with suppliers to achieve continuous improvement; and
- training our colleagues to improve awareness and understanding of our own impacts on workers and communities.

Approved third-party auditors have carried out 512 site audits (2014: 460) to monitor compliance with our sound sourcing criteria in the past two years, which includes 100% of high-risk tier-one[13] suppliers. Seventeen supplier events were also carried out, reaching suppliers from 530 sites.

Human rights and trade

We believe that trade can bring positive change for human rights, but also recognise that in exceptional circumstances the benefits of trade can be undermined. Own-brand food suppliers are reviewed against our Human Rights and Trade Policy, which identifies the rare conditions under which we may suspend trade with a nation state or designated region.

Modern slavery

In 2014, we reported on our support for the introduction of new legislation to tackle modern slavery. The Modern Slavery Act 2015 requires all companies over a certain size that carry out business in the UK to produce a 'slavery and human trafficking statement' for each financial year. We welcome the new provisions – having lobbied for greater transparency and disclosure on modern slavery – and recognise the importance of the issue and the need for transparency. We'll be publishing our first statement in line with requirements.

---

[13] 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

Our operations: tax

We were awarded the Fair Tax Mark in November 2015. The Fair Tax Mark demonstrates that our business is open and transparent about its tax affairs and sets a new standard for businesses for responsible tax practice and reporting. We applied for the recognition following a recommendation from our Members' Council, another demonstration of the added value to be derived from member engagement.

Our products and services

We have both a responsibility and an opportunity to have a significant and positive impact through the products we sell and services we provide. From sustainably-sourced coffins in our Funeralcare business to ethically-screened insurance investments, details are provided both below and in relevant Business Review sections of this report (pages 17 to 23).

Fairtrade

We were the first major retailer to champion Fairtrade, pioneering the sale of fairly traded goods before the FAIRTRADE Mark was introduced. We continue to respond to our members' support for Fairtrade. In 2015 we were recognised as the world's largest retailer of Fairtrade wines, and we're the largest convenience seller of Fairtrade products in the world.

Going forward, we're aligning our strategic priorities with the Fairtrade Foundation to maximise producer impact, and exploring how we can extend our already strong commitments across major categories including cocoa and flowers. In line with this, from 2016 all bags of sugar sold in our shops (own-brand and branded) will be Fairtrade; and for Easter 2016, all our own-brand Easter Eggs will be Fairtrade[14].

Further information on our commitment to Fairtrade is included on page 18.

Diet and health

We aim to help customers make healthy and informed choices. During 2015, we continued to target salt, saturated fat and sugar reductions in key products whilst maintaining the taste and value our customers want and expect.

In September 2015, we removed all the added sugar from our entire range of own-brand chilled juice drinks – the first retailer to do so. We ensure a minimum of 30% of our food and drinks promotions are for healthier offerings.

We are committed to providing customers with open and honest food labelling. Over 40% of own-brand products that carry front-of-pack nutritional labelling do not carry any red traffic lights. We will continue to improve the nutrient profile of our own-brand food and seek ways to make the healthiest choice the easiest choice for our customers.

British farming

Within our Food supply chain, we know that food provenance matters to our customers. In line with this, we aim to lead UK convenience retailers in supporting British farmers and growers. Through our farming groups, we have developed long-term relationships with carefully selected meat and dairy suppliers, and extended this work in 2015 to develop relationships with produce suppliers.

Responsible sourcing

We know that animal welfare is important to customers and members and are committed to providing products that have been produced to good animal welfare standards.

We are also one of the UK's leading retailers for forest and marine stewardship, and are committed to sustainable sourcing of wood for coffin manufacture in our Funeralcare business (page 19).

Ethical screening of insurance investments

Our General Insurance business screens investments against its Ethical Policy, which includes issues of human rights, the environment, international development and animal welfare. Any potentially problematic investments are referred to our Ethical Policy Unit for assessment and final recommendation. Thirty-seven fixed-income investment opportunities were screened in 2015 and six investment opportunities were declined.

Sustainability management and reporting

A Co-op Way Policy Committee is being established to oversee our ethical policies across the Co-op. The Committee will be responsible for the prioritisation, review and development of policies relating to co-operative values, principles and ethics and for reporting on their implementation into the businesses. The Committee will be made up of Group Executives alongside members elected from the Members' Council, and will be responsible for obtaining Board and Council approval for final recommended policies.

Our process of prioritising sustainability issues takes on board member and other stakeholder views, issues raised through the Group's risk management framework, our co-operative approach, and a consideration of external standards, norms and emerging issues.

At a business level, development and oversight of policies relating to ethics and Co-operative Values and Principles includes the Food Policy Group, which oversees progress on issues relating to food ethics and the Employee Relations & Policy Forum.

Delivery of these policies is both by a central function, which provides a Co-op-wide perspective, and by functions embedded within the business. These business-based functions include teams within Food, Consumer Services, Strategy, Human Resources, Finance, Procurement, Estates and Membership.

---

[14] Own-brand Easter eggs refers to boxed individual eggs.

Sustainability Review continued

Reporting and assurance

The process of accounting, assurance and reporting on our material social, ethical and environmental issues is important to drive performance and it provides crucial information to our stakeholders.

This review presents an overview of sustainability performance and progress. Further detail, including progress against our targets, is available via our online performance pages: www.co-operative.coop/sustainabilityperformance[15].

Our sustainability reporting is reviewed by nominated members of our Members' Council, in line with responsibilities set out in our Rulebook. We have engaged DNV GL to carry out assurance of our reported sustainability performance.

Sustainability assurance

The content reported within this Sustainability Review section, along with sustainability related aspects of the Business Review and Co-op People sections of this report, have been subject to independent, external sustainability assurance. Our additional online sustainability reporting will also be subject to the same assurance process.

A summary assurance statement can be found on page 197, and the full assurance statement with DNV GL's scope of work, findings and conclusions can be found online here: www.co-operative.coop/sustainabilityperformance.

---

[15] The pages will be updated with 2015 data and commentary in July 2016.

Principal risks and uncertainties

Background

Following the difficulties faced by the Co-op, which were widely publicised, 2015 has seen the first year of the Rebuild phase. The appointment of a new Director of Internal Audit and the creation and appointment of a new Chief Risk Officer in early 2015 has strengthened risk management oversight within the Co-op. Under the Chief Risk Officer the rebuild of risk management has commenced with the establishment of a new Co-op-wide Risk Management Framework, the implementation of an improvement plan and an increased understanding and management of the key risks faced by the organisation.

Process and approach to risk

2016 will see further enhancements to deliver improved rigour and embedded risk management disciplines under the stewardship of a refreshed Executive Risk Committee, accountable for ensuring that the key risks for the organisation are managed in line with the appetite set by the Board.

The Board and the Risk and Audit Committee have reviewed and agreed the persistent risks facing the Co-op, against which the key risks are being managed. Executive members have been assigned ownership of these key risks to ensure that the appropriate policies, minimum standards and processes are in place to provide oversight for each risk, to include responsibility for implementing a robust and effective action plan to reduce or mitigate the risk. Assurance on these key risks is provided to the Board which has responsibility for ensuring the Group operates within its associated levels of risk on a regular basis.

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 has been addressed with an extensive training and awareness programme that commenced in 2015 and continues into 2016. 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.

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 colleague welfare.

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

Persistent Risk Area	Description	What are we doing to manage and/or reduce the risk?
Strategic and Business	Ensuring effective implementation of our strategic plan to secure a sustainable future	Implementation of our strategy to rebuild the Group is progressing as planned. There is governance in place across most of the Rebuild programmes and work is underway to address the remaining inconsistencies. Disciplined, comprehensive programme and portfolio management to govern anticipated benefits is being put in place by the Group Transformation team, along with Group-wide communication.
	Delivering on the financial objectives of Food's True North strategy in the face of continuing volatility in the UK grocery market	Focus on convenience and own-brand development delivering market-beating sales growth and growing customer numbers and transactions. All key change and business development activities being managed through a structured and disciplined Transformation Office. Market movements monitored closely and plan execution adapted as necessary.
	Delivering the Bank Separation Programme within agreed time, cost and quality criteria with no impact to our customers	A robust Separation Programme capability is embedded and operating within a defined delivery and governance framework that interlocks with executive management, key stakeholders and the three lines of defence model. An experienced (IT) delivery partner is engaged on a fixed cost basis. The agreed separation delivery plans allow flexibility for the separation of the General Insurance and Bank infrastructure in line with their required timescales. This will reduce the delivery dependencies and ensure the Group programme is delivered within agreed time and cost. In addition, independent assurance has been undertaken by the Group's Outsourced Internal Audit Delivery Partner with no material findings.

Principal risks and uncertainties continued

Persistent Risk Area	Description	What are we doing to manage and/or reduce the risk?
Strategic and Business (cont)	Strengthening the General Insurance (GI) business model	Achieve acceptable profits and return on equity, by ensuring insurance risks are carefully selected in accordance with risk appetite, risk strategy and priced to reflect the underlying risk. Three year GI Transformation programme addressing legacy operating model.
	Stabilising and strengthening governance model	Significant governance reform delivered and being embedded with establishment and implementation of a new Board (composed of a majority of independent directors), a Council and Senate. Relationship between the Board and Council continues to evolve; Board directors participate in Council meetings. Defined roles and responsibilities, inductions and training for new personnel and Board.
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. Favourable media coverage over the course of 2015 as the Rebuild programme achieves momentum. New Committee being established, including members of the Council to ensure strategies and policies support the Group's Purpose and Values. Proactive engagement on local issues within local communities, which align with the Group's Purpose and needs of our members.
	Maintaining food standards and securing ethical sourcing through our supply chain in support of a better way of doing business	Robust technical quality assurance policies, auditing and monitoring to ensure ongoing compliance with standards, both ethical and technical. Clear sourcing policies, comprehensively reviewed and communicated. Fair, transparent relationships developed through supply chain. 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.
Financial and Treasury	Meeting our banking covenants	Robust action taken to return Group to a sustainable position, including major disposals to significantly reduce debt. Continual engagement with banks and bondholders on business performance and development. Refinancing of five-year £355m syndicated bank Revolving Credit Facility completed in February 2016, under which financial covenants provide comfortable headroom to progress with the Group's Rebuild plans.
	Pension scheme funding	Pension Strategy Committee established to manage the Group's pension risk exposure. New pensions offer agreed and implemented which will reduce future liabilities. Pace Complete, the defined benefit scheme, has been closed to future accrual. Trustees are required to perform triennial valuations and target full funding on an ongoing basis.
Regulatory 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 semi-annual self-assessment exercises, and compliance with standard Group accounting policies. Independent testing by internal and external auditors. Confidential whistle blowing hotline in operation.

Principal risks and uncertainties continued

Persistent Risk Area	Description	What are we doing to manage and/or reduce the risk?
Regulatory Compliance (cont)	Health & Safety or Environmental breach resulting in loss of life, litigation, financial penalties or reputation damage	Clearly defined policies in place specifying requirements for effective management of the risks and to drive compliance. Group-wide project to review all relevant processes and procedures delivered with introduction of 'Safe & Secure' programme to meet set standards of compliance. Health & Safety forums being set up across the organisation. Environmental reviews undertaken, including surveys. Full and continuous engagement with relevant authorities. Compulsory e-learning training across the organisation. Employment of suitably qualified and experienced compliance and risk officers.
	Data Protection or PCI breach	Data protection principles and PCI DSS requirements covered in appropriate policies. Employment of suitably qualified and experienced compliance and risk officers. Group-wide project to review all policies and procedures continuing. Full and continuous engagement with relevant authorities. PCI compliance programme being delivered in conjunction with the Barclaycard Risk Reduction programme. Compulsory e-learning training across the organisation.
	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.
Operational Risk	Loss of capability due to major incident e.g. fire, flood, terrorism, war, political or civil unrest	Group Business Continuity Management Policy reviewed. Incident management strategies are tested on a regular basis. Programme in place to enhance the resilience of critical IT infrastructure.
	Strengthening arrangements to maintain the business in the event of an incident or major disruption	New Work Area Recovery Arrangements secured for 2016. Reporting to Executive Committee in relation to Business Continuity and Incident Management. Disaster Recovery testing completed against priority services.
	Providing a stable, resilient IT platform from which the Group's strategic objectives can be met	IT Resilience programme in place delivering improvement initiatives across critical systems following detailed review of IT resilience risk position.
	Protecting the IT environment from external threats, cyber risk and electronic data loss	Information Security Improvement Programme driving improvements to security controls across the Group. Approved governance structure implemented, security policies reviewed and being updated. Regular penetration testing conducted.
	Recruit, develop and maintain appropriate talent across the Co-op	Group-wide Talent Management process continues to facilitate design of robust development plans focusing on senior management. Objective, externally benchmarked capability assessments for recruitment to senior management roles.

Governance report

Executive Biographies

Richard Pennycook

Chief Executive

Appointed as Chief Executive of the Group in 2014, after having joined as Chief Financial Officer in 2013. Previous main Board roles at Morrisons, RAC and JD Wetherspoon. Also Chairman of The Hut Group Limited and Institute for Turnaround, and Chairman-elect of Howdens Joinery Ltd.

Richard was appointed as an Executive Director of the Group on 13 January 2015.

Pippa Wicks

Chief Operating Officer

Working with the Group since 2014 from the business consultants AlixPartners where she co-founded the firm's European operations. Prior to joining AlixPartners, she was CEO of FT Knowledge, a division of Pearson plc, 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.

Mike Bracken

Chief Digital Officer

Joined the Co-op as Chief Digital Officer in October 2015. His focus will be on creating a Co-op fit for the digital age, based on an open, agile culture and excellent digital services. Since 2011, Mike was at the Cabinet Office as Executive Director of Digital and more recently was also appointed as the Government's first Chief Data Officer.

Ian Ellis

Chief Finance Officer

Joined as Chief Finance Officer for the Group in 2015. Previously CFO for Wilkos for nearly eight years and prior to that held a number of senior finance positions at Morrisons and Northern Foods Plc.

Ian was appointed as an Executive Director of the Group on 6 April 2016.

Sam Walker

Chief HR Officer

Joined the Group in 2013 from Britvic Soft Drinks. Has over 27 years' experience in HR across a number of sectors including media, FMCG, pharmaceuticals and utilities. She has also worked within marketing, sales and operations.

Alistair Asher

Group General Counsel

Joined the Group in 2013 from Allen & Overy LLP where he was a senior partner and Global Head of the Financial Institutions Group. Alistair had a 34 year career with Allen & Overy, 26 of them as a partner and represented several major building societies, banks and companies in a wide range of commercial and corporate finance transactions.

Rod Bulmer

Chief Executive, Consumer Services

Joined the Group Executive in 2014 after seven years with 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.

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 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.

Helen Grantham

Group Secretary

Joined as Group Secretary in January 2016. Qualified as a solicitor in 1989 and for the last 20 years has practised as both a General Counsel and Company Secretary for listed companies working at Board level, most recently for Dixons Carphone PLC.

Board Biographies

Allan Leighton

Appointed as Independent Chair on 19 February 2015.

Committee Membership

Nominations (Chair)

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 Ltd, Entertainment One Ltd, Wagamama and Canal & River Trust. Allan is also Deputy Chairman of Pandora AS.

Sir Christopher Kelly

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

Committee Membership

Remuneration, Nominations

Skills and Experience

Sir Christopher chaired the Group's independent review which considered the events leading up to the re-capitalisation plan for The Co-operative Bank plc in 2013. Prior to this Sir Christopher was a senior public servant for many years. Sir Christopher 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. Sir Christopher has also been a senior official in HM Treasury and was Permanent Secretary of the Department of Health.

Ruth Spellman

Appointed as a Member Nominated Director on 16 May 2015.

Committee Membership

Remuneration, Nominations

Skills and Experience

In 2012, Ruth was appointed as Chief Executive of the Workers' Educational Association (WEA) - an organisation with the same roots as the Co-op. She is the first female to hold this position. Ruth was awarded an OBE in 2007 for services to workplace learning.

Ruth's non-executive roles include being a Director of the Centre for Talent and Innovation and a Council Member of the Open University. Ruth is also Chair of the Staff Strategy Committee and Trustee of Adviza, a careers advisory company. In her career, Ruth has been a CEO of three membership organisations. Ruth was formerly Chief Executive of the Chartered Management Institute (CMI), and has previously been CEO of the Institution of Mechanical Engineers and Investors in People (IIP) UK. Ruth worked as a senior consultant in HR in the private sector and was HR Director of the NSPCC.

Paul Chandler

Appointed as a Member Nominated Director on 16 May 2015.

Committee Membership

Risk & Audit

Skills and Experience

Paul was Chief Executive of Traidcraft from 2001 to 2013, and President of the European Fair Trade Association from 2005 to 2012. Drawing on his fair trade experience and early career at Barclays Bank, Paul is now focusing on promoting responsible practices in business and financial services. Paul is also Chair of the William Leech Foundation and Durham Cathedral Council, a Director of Shared Interest, a Fellow of St Chad's College in Durham University and a Trustee of the County Durham Community Foundation.

Board Biographies continued

Hazel Blears

Appointed as a Member Nominated Director on 16 May 2015.

Committee Membership

Risk & Audit, Nominations

Skills and Experience

Hazel was a Labour Member of Parliament from 1997 to 2015, representing Salford and Eccles. Hazel has held a number of senior positions in government including Public Health Minister, Police and Counter Terrorism Minister and Communities Secretary. Hazel also served on the National Intelligence and Security Committee. Hazel's other roles include being a Member of the Advisory Board of Aspire (a health and social care co-op), Chair of the Social Investment Business and Chair of the Institute for Dementia at Salford University.

Simon Burke

Appointed as an Independent Non-Executive Director on 14 November 2014.

Committee Membership

Risk & Audit (Chair), Nominations

Skills and Experience

Simon was previously an Independent Non-Executive Director of the Group's subsidiary, Co-operative Food Holdings Ltd. Simon was appointed Chair of the Group Risk & Audit Committee on 25 June 2015.

Simon is a Chartered Accountant and is currently a Non-Executive Director for the BBC, and Chair of The Light Cinemas (Holdings) Limited and Blue Diamond Limited. Simon was previously Chair of both BathStore and Hobbycraft, and CEO for Virgin Retail, Virgin Cinemas and Virgin Entertainment Group.

Peter Plumb

Appointed as an Independent Non-Executive Director 25 June 2015.

Skills and Experience

Peter has been the CEO of Moneysupermarket.com, the leading price comparison service in the UK, since 2009. Peter studied civil engineering at Birmingham University and gained an MBA from IMD in Switzerland. Peter was UK Managing Director of dunnhumby, the engine room of Tesco's Clubcard, and has also held senior leadership roles in top consumer businesses including Disney, Dyson and PepsiCo.

Stevie Spring

Appointed as an Independent Non-Executive Director on 25 June 2015.

Committee Membership

Remuneration (Chair)

Skills and Experience

Stevie is a respected Board Director with broad Executive and Non-Executive experience across the private, public and not for profit sectors. After a successful career in brand marketing and consumer advertising, she became CEO of Clear Channel, the world's largest radio, out of home and live entertainment company; then of Future PLC, an international media company, where she led its digital transformation.

Stevie's portfolio currently includes Chairing ITG; Kino-mo (both technology companies specialising in retail) and BBC Children in Need. Stevie serves on the Boards of Kent University and the ALCS and was named in The Sunday Times/Debretts 2016 list of Britain's 500 most influential people.

Lord Victor Adebowale CBE

Appointed as an Independent Non-Executive Director 6 April 2016.

Skills and Experience

Victor is Chief Executive of the social care enterprise, Turning Point. He's been involved in a number of taskforce groups who advise the Government on mental health, learning disabilities and the role of the voluntary sector.

He's Co-Chair of the Black and Minority Ethnic Mental Health National Steering Group and a member of the Advisory Council on the Misuse of Drugs. He's also a member of the National Employment Panel, the New Economics Foundation Board and the Institute for Fiscal Studies Council. On top of all that, Victor is on the policy advisory board of the Social Market Foundation, and on the board of the National School of Government.

Richard Pennycook (the Group Chief Executive) and **Ian Ellis** (the Group Chief Finance Officer) also serve on the Board as Executive Directors. Their biographies can be found on page 37.

Governance Review

Dear Member

2015 saw the final elements of our modernised and reformed governance regime being introduced at the Annual General Meeting (AGM). We are pleased to say the new arrangements are bedding in well, with your new Group Board and Members' Council working together on some key initiatives.

A crucial part of the changes was the creation of a new Group Board, which would have the skills and experience to lead the Group through the next crucial journey of Rebuild. During the year we welcomed three Member Nominated Directors (MNDs), Hazel Blears, Paul Chandler and Ruth Spellman, all of whom were successfully elected from our base of 2.7 million eligible members. In June, we also welcomed the appointment of two Independent Non-Executive Directors (INEDs), Stevie Spring and Peter Plumb, further strengthening the Group Board. All have made a great contribution already to the progress we are making. We have also recently appointed Lord Victor Adebowale as an additional INED and Ian Ellis, the Group's Chief Finance Officer, as an Executive Director.

Equally important was the establishment of the structure and ways of working for our Members' Council and the implementation of new processes to support One Member One Vote. May 2015 saw the historic occasion of our first AGM under the new governance rules and for the first time, our members had a direct say in the future of the Group. Over 90,000 members voted on motions put forward to the meeting and, of those, more than 500 voted in person at the AGM itself.

We are now well into the three-year Rebuild programme and the primary focus for the Board over the coming year is to ensure the execution and delivery of our commercial and member strategy. Our Governance priorities for 2016 are to further strengthen the Group Board by the appointment of a fourth MND, to encourage more members to have their say by voting on motions and to make the 2016 AGM even more engaging for members than last year's.

I look forward to seeing you there!

Allan Leighton
Group Chair

Governance Review continued

Compliance with the UK Corporate Governance Code

The Co-operative Group is a consumer co-operative which is jointly owned by over 5 million members. It is registered under the Co-operative and Community Benefit Societies Act 2014 and has listed debt instruments with the UKLA. It is not mandatory for the Group to comply or report on its compliance with all the provisions of 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 in line with the 'comply or explain' approach.

The Group also adheres to the spirit of the Corporate Governance Code for Consumer Co-operatives and reports compliance with this directly to the publisher of this Code, Co-operatives UK.

The route to reform

Background

This section provides an update on the Governance Reform Project which commenced in 2014 to deliver radical reform of our governance arrangements and structures.

At a Special General Meeting in August 2014, members voted in favour of a new Rulebook which defined the new governance structure. From October 2014, the Group Board and its Committees operated under a transitional phase, working to put in place the four principles of reform which were designed to modernise and reform our governance arrangements. The transitional phase continued during the first half of 2015, until the adoption of the new Rulebook by members at the AGM on 16 May 2015.

To support the implementation of the governance reforms, one key focus for the Transitional Group Board was to ensure its governance arrangements were fit for purpose. As such the Transitional Group Board adopted a Board Composition Charter ('the Charter'). The Charter, which was approved by the Transitional Council, set out plans for the Transitional Group Board to meet the principle of creating a new Group Board which would be individually and collectively qualified to lead an organisation of the Group's size and complexity.

Composition of the Transitional Board

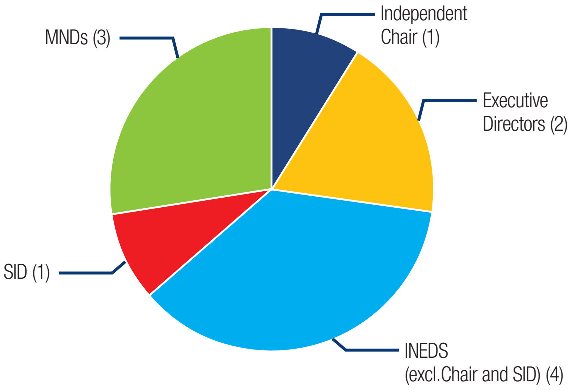
The following directors served on the Transitional Group Board until the conclusion of the AGM on 16 May 2015:

- Ursula Lidbetter (Group Chair and Chair of the Transitional Search Committee)
- Simon Burke (INED)
- Marc Bicknell
- Duncan Bowdler
- Eric Calderwood (Chair of the Transitional Remuneration Committee)
- Martyn Cheatle (Chair of the Transitional Risk and Audit Committee)
- Michael Harriott
- Sir Christopher Kelly (Senior Independent Non-Executive Director (SID))
- Frank Nelson

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

Creation of a new Group Board

The Governance Reforms led to the creation of a Board of directors which would be, individually and collectively, qualified to lead an organisation of the size and complexity of the Group. Accordingly the make-up of the Board is now as follows:



Recognising the contribution made by its members, the Group Board and Members' Council have initiated the change processes to create a fourth MND seat.

Governance Review continued

Independence

During the Transitional period, the Group did not comply with the Code provision B.1.2 in relation to the Board always having a majority of INEDs. This was due to the Rules of the Group reflecting its co-operative status and the method of directors' elections. The Transitional Board did, however, support the Code principle that the Board should have the appropriate balance of skills, experience and knowledge and these requirements were appropriately reflected in the Transitional Board composition.

Following the creation of the new Group Board, the Group did comply with this provision. The current Rules require that the Group Board shall always have a majority of INEDs (as defined in the Rules), and, to maintain an effective balance, at least two Member Nominated Directors and one Executive Director. A proposal is being put to members at the forthcoming AGM to change our Rules on Board balance which will mean that (a) at least half of the Board shall be INEDs and (b) at least half of the Board, excluding the Group Chair, shall comprise INEDs and MNDs who are determined by the Board to be independent having regard to the UK Corporate Governance Code.

Independent Chair

The Chair of the Group is Allan Leighton. Allan took up office on 19 February 2015 and, in accordance with Code provision B.1.1, he was determined to be independent on appointment. More details on the role of the Group Chair can be found on page 44.

Senior Independent Director (SID)

Sir Christopher Kelly served as Senior Independent Director of the Group until the conclusion of the Transitional period and, following his successful election by members at the AGM, continued in this office. More details on the role of the SID can be found on page 44.

Independent Non-Executive Directors (INEDs)

In addition to the Group Chair and the SID there are four INEDs. These are Simon Burke, Peter Plumb, Stevie Spring and Lord Victor Adebowale, all of whom are subject to election by members at the AGM on 21 May 2016.

The appointment of INEDs is subject to the recommendation of the Nominations Committee, whose report is found on page 66 of this report. It is the role of the Council Scrutiny Committee to verify the screening process for the Group Chair and the INEDs and to oversee the screening process for the MNDs. The report of the Scrutiny Committee can be found on page 73.

Executive Directors

The Group Chief Executive, Richard Pennycook, currently holds the position of Executive Director on the Group Board. Richard was appointed on 13 January 2015 and was successfully elected by members at the AGM on 16 May 2015. In addition, the Group Board has recently appointed Ian Ellis, the Group's Chief Finance Officer, as an Executive Director.

Member Nominated Directors (MNDs)

The MNDs ensure that our members have a voice at the heart of the boardroom. As Group Board directors, they have the same responsibilities as other Board directors, including the duty to act in the best interests of the Co-operative Group and its members. The three MNDs elected in 2015 by our members are Hazel Blears, Paul Chandler and Ruth Spellman.

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 are required to meet the Membership and Eligibility criteria contained within the Rules, key to which is a strong commitment to Co-operative Values and Principles.

What is the Group Board's responsibility?

The Group Board understands its responsibility to members for the long-term success of the Group, operating within the framework of Co-operative Values and Principles. We monitor performance against the strategy using key financial and non-financial indicators including identified risks. Throughout the year both the Transitional Group Board and the new Group Board sought to adhere to the International Co-operative Alliance Values and Principles, by actively engaging and listening to its members, colleagues and customers, and other stakeholders.

What decisions can the Board take?

The Group Board does not have a formal schedule of matters reserved specifically for its decision, which is required under Code Provision A.1.1; however, the Group's Rule 43.3 reserves the following matters to the Group Board which cannot be delegated to management:

- 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.
- 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 colleagues; 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 to one or more directors, Board Committees, officers or colleagues, or to 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 comprehensively reviewed by the Risk and Audit Committee during the year and approved by the Group Board in September 2015.

Governance Review continued

Board meetings throughout the period

The Transitional Group Board met six times up to the end of the Transitional period on 16 May 2015. Of these meetings, one was called specifically to consider the appointment of the new Independent Group Chair.

The new Group Board met five times from its inception on 16 May 2015.

The table below sets out the frequency and attendance of directors at meetings of the new Group Board from the end of the Transitional period to the end of the reporting period:

Director	Date of Appointment	Number of Group Board Meetings Attended
Independent Non-Executive Directors		
Allan Leighton (Group Chair)	19 February 2015	5(5)
Simon Burke	-	5(5)
Sir Christopher Kelly (SID)	-	5(5)
Peter Plumb	25 June 2015	3(5)*
Stevie Spring	25 June 2015	5(5)
Executive Directors		
Richard Pennycook	13 January 2015	5(5)
Member Nominated Directors		
Hazel Blears	16 May 2015	5(5)
Paul Chandler	16 May 2015	5(5)
Ruth Spellman	16 May 2015	5(5)

The number in brackets indicates the number of meetings the director was eligible to attend. Ian Ellis and Lord Victor Adebowale are not included in this table, having been appointed during 2016.

* Unable to attend due to prior commitments before appointment

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 their iPad. Those unable to attend are invited to submit their views to the Chair in advance of the meeting.

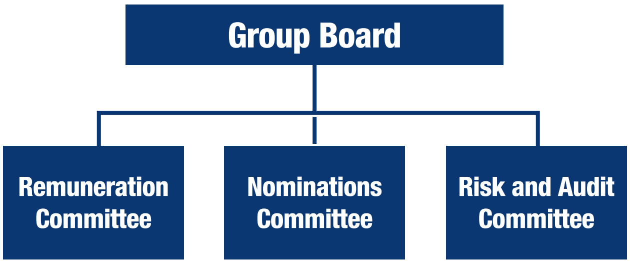
Private sessions of the Board are scheduled and take place at each Board meeting. All directors have open access to the Chair and may request a private meeting.

The biographies of those current directors serving on the Board are set out on pages 38 and 39.

Copies of the letters of appointment for all directors are available to members to view on request to the Group Secretary.

Board Committees

The Group Board governs through its Board Committees:



Each of these Committees has a role in ensuring the effectiveness of the Group. The responsibilities of these Committees are set out in each Committee's report and the respective terms of reference for the Board Committees can be found on the Group's website at www.co-operative.coop/corporate/investors/governance.

Under the Rules, the Group Board also has the power to delegate authority to ad hoc committees which may be required to consider specific matters from time to time.

The Group Board ensures that its Committees have sufficient resources to undertake their duties. All Group directors have access to all Committee minutes and papers and a report is provided by the relevant Committee Chair at each Group Board meeting as appropriate.

The Risk and Audit Committee report can be found on page 47, the Remuneration Committee report can be found on page 53 and the Nominations Committee report can be found on page 66.

In addition to the main Board Committees, the Group operates Committees in conjunction with the Council such as the Member Nominated Director Joint Selection and Approvals Committee, the Stakeholder Working Group and the Co-op Way Policy Committee.

Governance through our subsidiaries

Throughout the period, the Group exercised its oversight role of the General Insurance business through a separately registered society, CIS General Insurance Limited. This entity is regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) and has its own distinct Board and committees.

Governance Review continued

The roles of the Group Chair and the Group Chief Executive

The Group Chair

Ursula Lidbetter chaired the Transitional Board until the appointment of Allan Leighton on 19 February 2015. Ursula 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.

Code provision A.2.1 states that the roles of chairman and chief executive should not be exercised by the same individual, and a division of responsibilities between these roles should be clearly established and agreed upon by the board. In addition, Code provision A.3.1 states that the chairman should on appointment meet the independence criteria of the Code.

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

This principle is now, however, applied through the Group's Rules and the Board Composition Charter which provide that the Group Chair shall be independent on appointment and shall be regarded as an Independent Non-Executive Director.

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 Group 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; however, the Board Composition Charter envisages that the Chair is expected to become fully engaged in the activities of the Group and consequently is not expected to maintain their independence for the duration of their term.

The Group Chief Executive

The Group's Rules did not previously allow Executives to sit on the Group Board; however, following changes to the Group's governance arrangements, the Group Chief Executive, 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 Group 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 (SID)

The primary role of the SID is to provide a sounding board for the Group 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 the Group Chair's performance and any other issue which cannot conveniently be raised with the Group 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 is also responsible for conducting the annual appraisal of the performance of the Group Chair.

The Group Secretary

Under the Group's Rules, the appointment and removal of the Group Secretary is a matter for the Group Board. The Group Secretary reports to the Group Chair and is a member of the Executive by virtue of their office. All directors have access to the advice and services of the Group Secretary.

The Rules reserve certain powers and discretions to the Group Secretary. In particular, the Group Secretary is responsible for advising the Group Chair and the Group Board on all governance matters, ensuring that Board procedures are followed and that there is a good flow of information, facilitating induction programmes for new directors and developing directors' training and continuing professional development.

Following the implementation of the Governance Reform Project, Claire Davies stepped down from the role of Group Secretary on the conclusion of the AGM on 16 May 2015. Harry Baines was appointed as Interim Group Secretary following the AGM and held this role until 1 July 2015 when Debbie Adams took up the position. Debbie Adams subsequently left the Group on 31 December 2015 and consequently the Group Board appointed an Interim Group Secretary, Helen Grantham.

Governance Review continued

Term of office

INEDs and Executive Directors are appointed for a two-year term and are subject to election by members at the first AGM following their appointment. They are then subject to re-election by members at each second AGM.

With the exception of the 2015 elections, all MND seats are also for a period of two years. Each MND seat is subject to re-election by members every two years.

With the exception of Executive Directors, the maximum term of office any director may serve is six years.

2015 elections

At the AGM on 16 May 2015, the following directors were successfully elected by members:

- Richard Pennycook – Executive Director
- Allan Leighton – Independent Non-Executive Director
- Sir Christopher Kelly – Independent Non-Executive Director

A key part of the new Governance arrangements for the Group was the inclusion of three Member Nominated Directors on the Group Board. During the first half of 2015, three candidates were put forward for these inaugural roles for election by our 2.7 million eligible members. The term of office of these three seats were two years for two of the seats and one year for one seat. Consequently, the following directors were elected:

- Paul Chandler – two-year term
- Ruth Spellman – two-year term
- Hazel Blears – one-year term

Elections in 2016

The Nominations Committee is responsible for leading the appointment and nomination process for Group Board directors. There were no directors due for re-appointment during the period, however, the following directors will be put to members for election at the 2016 AGM:

- Simon Burke (INED)
- Peter Plumb (INED)
- Stevie Spring (INED)
- Lord Victor Adebowale (INED)
- Ian Ellis (Executive Director)

In addition, Richard Pennycook will be put forward for re-election by members. Richard was elected by members at the AGM in 2015 and, although not required by Rule, Richard has committed to put himself forward for election at each AGM.

Election of the MNDs

Following feedback from our members on the 2015 MND selection process, the Group Board agreed plans with the Council for a new process for selecting future MND candidates. In recognising the importance and success of the MNDs on the Group Board, the creation of a fourth MND position was also agreed.

During the second half of the year, therefore, the Group Board and Council established a joint task group, which was Council-led and included representatives from the Group Board, Council and Independent Co-operative Societies. The role of this joint task group was to review the MND election process and make recommendations. The key elements of the new process were:

- a clearer and simpler application and sifting process to encourage more participation in elections;
- a structured assessment event run jointly by the Board and Council, with advice from a professional search firm;
- a joint Board and Council agreement on final selection of candidates to go forward on the ballot paper; and
- the creation of an Academy that will develop members in the skills and understanding needed to become a Board director, in order to build a talent pool of future candidates.

A new joint Board and Council Committee was created in 2015 (the MND Joint Selection and Approvals Committee) to lead on future MND election processes.

Nominations for the fourth MND seat and the retiring seat closed at the end of December 2015 resulting in a number of strong and suitably qualified candidates. There were also a number of applicants who were suitable to join our Academy. Election papers will be issued to eligible members in mid-April 2016, with the result of the MND elections being announced at the AGM on 21 May 2016.

Engagement and relations with our members

The Code requires that boards should ‘have a dialogue with shareholders based on the mutual understanding of objectives’.

The Governance Reforms led to the establishment of our Members’ Council, which is a body comprising 100 elected members, to represent members and to act as guardian of the Co-operative’s Purpose, Values and Principles, together with the Society’s Constitution, with the power to hold the Group Board to account.

The Group Board is committed to regular dialogue with the Members’ Council. Questions raised by the Council are responded to by Group management and where appropriate the Group Board. There is also a regular flow of information at all levels of the business to the Council and the Council’s committees.

Governance Review continued

Members of the Group Board attend Council meetings to listen and respond to questions from Council members. In addition, the Group Board established a Stakeholder Working Group (SWG). The SWG comprises four representatives from the Group Board and four from the Council. Its purpose is to provide a forum for co-ordination and discussion between the Group Board and the Council on topical subjects of interest to members.

In terms of engagement with the wider membership, whilst this is the main role of the Council, the Group Board considers that the move to One Member One Vote reaffirms the importance of direct member participation in the affairs of the Group.

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. Motions can be put to a Group General Meeting by the Board, the Council, four qualified Independent Society Members (ISMs) or by 100 eligible members.

The Group's federal relationship with the ISMs is now undertaken through a new federal structure, Federal Retail and Trading Services Limited (FRTS). FRTS was incorporated in 2014 and is 75% owned by the Group. The remaining 25% is split between the seven largest ISMs. It is chaired by an Independent Chair – John Coombs.

Conflicts of interest

The Group Board has in place a Board Conflicts Toolkit. This Toolkit provides a practical framework to manage situations which may involve a director having a conflict of interest.

There are specific provisions in the Group's Rules about how conflicts should be dealt with and how interests should be declared.

Consistent with their legal obligations, Group directors have 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 Group Board has considered the current external appointments of all directors which could give rise to a situational conflict and has authorised potential conflicts where appropriate.

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

Directors' and Officers' liability insurance

Throughout the year, the Group has purchased and maintained Directors' and Officers' liability insurance cover in respect of legal action against its directors and officers in relation to Group business.

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

Board effectiveness

Under the Group's Rules the Nominations Committee is responsible for conducting an annual formal and rigorous evaluation of the Board's performance. Details on how this was conducted are in the Nominations Committee report on page 66.

Independent professional advice and Board support

All directors have unrestricted access to the Group Secretary, Group Secretariat and Executives within 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.

Annual General Meeting

The AGM is held and conducted in accordance with the Co-operative Community and Benefit Societies Act and the Group's Rules. Participation in and attendance at the AGM is open to eligible members of the Group.

Due to the federal nature of the Group, the number of votes for each ISM is calculated based on the amount of trade each ISM conducts with the Group. To facilitate this, therefore, votes cast at the AGM are usually cast on a weighted voting poll.

Report of the Risk and Audit Committee

Introduction from the Committee Chair

It will come as no surprise that 2015 was an active year for the Risk and Audit Committee. The extent of change taking place in the Co-op creates significant challenges in maintaining a strong control environment, monitoring risk, and achieving good levels of compliance. In addition, in common with other parts of the organisation, we had to address an inheritance which needed updating, refocusing and in some cases wholesale change. So in carrying out our work this year we have been particularly mindful of the IT infrastructure, the state of the compliance culture in the organisation, and the simple breadth and scale of the change programmes underway. All of these will remain a strong focus for us.

Key milestones for us this year have been:

- Appointment of new heads of Internal Audit and of Risk for the Group.
- Complete overhaul of the Internal Audit team, creating an organisation capable of executing a comprehensive and thorough programme of audit and improvement of the control environment.
- New risk mapping, dashboards, and other monitoring tools.
- Start of a very substantial programme to overhaul our IT and data security systems across the Group, aimed at achieving fit-for-purpose systems, strong IT controls, resilient architecture, and strong security over our data; all of which is being closely monitored and reviewed by the Committee.
- A successful, competitive tender for the external audit, resulting in a recommendation to members to appoint Ernst & Young LLP as the new auditors with effect from 2016.
- A plan to refresh our auditing of sustainability standards across the Group.
- Renewed focus on health and safety in our operations, based on comprehensive risk assessments and reviews of compliance across the Group, which we are reviewing routinely at the Committee.

Our sense is that a good start has been made in addressing the wide range of work to be done in bringing our standards up to where we want them to be. We will be busy over the coming years in seeing this programme through. Our work in this respect forms part of the Rebuild plans for the Co-op, which cover everything from business performance, to investment in new infrastructure and corporate governance.

The following pages of this report describe the Committee's 2015 activities in more detail.

I have been greatly supported this year by the energy and thoroughness of my colleagues on the Committee, Member Nominated Directors Hazel Blears and Paul Chandler. Our Committee came into being at the end of the Transitional arrangements, when its previous members, Marc Bicknell, Duncan Bowdler and Chair Martyn Cheatle all stepped down. I would like to thank them for their work on your behalf, and in particular for steering the Committee through the exceptionally difficult financial years 2013 and 2014.

Simon Burke
Chair of the Risk and Audit Committee

Report of the Risk and Audit Committee continued

Membership and attendance

Watching over the integrity of financial reporting and effectiveness of risk management is essential in any large organisation. In order to perform this role, the Risk and Audit Committee was established on 16 May 2015, replacing the Transitional Risk and Audit Committee. Until the conclusion of the Group's Annual General Meeting (AGM) on 16 May 2015, the following directors served on the Transitional Risk and Audit Committee - Martyn Cheatle (Chair), Marc Bicknell, Simon Burke and Duncan Bowdler. The table below lists the members and attendance at the Risk and Audit Committee.

Committee Member	Date of Appointment	Number of Meetings Attended
Simon Burke (INED, RAC Chair*)	16 May 2015	2 (2)
Hazel Blears (MND)	16 May 2015	2 (2)
Paul Chandler (MND)	16 May 2015	2 (2)

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

* Interim Chair of the Risk and Audit Committee, confirmed in post in June 2015

INED - Independent Non-Executive Director

MND - Member Nominated Director

As recommended by the UK Code on Corporate Governance ('the Code'), the Committee had at least three independent directors serving as members. The Board considers that Simon Burke's relevant and recent financial experience qualifies him for his position as Chair of the Committee. Additionally, two MNDs – Hazel Blears and Paul Chandler – were appointed. With members' interests in mind, they bring objectivity and independent scrutiny to bear when reviewing the Group's business systems, operations and financial probity.

Each Committee meeting is attended by the Chief Finance Officer (CFO), Director of Group Internal Audit, Chief Risk Officer, Corporate Finance Director and the external auditors. Other key colleagues may attend by invitation. The external auditors attended all Committee meetings in the year. Additionally, the Committee met the internal and external auditors privately, giving them the opportunity for discussion without management being present.

What the Committee does

Working on behalf of the Board of directors, the Committee is responsible for reviewing and making recommendations in the following areas:

- the integrity of the Group's annual report and accounts and other formal announcements relating to its financial performance;
- the annual report's fairness, balance and clarity;
- the effectiveness of the Group's system of risk management and internal control, including an annual review of the effectiveness of processes and whistleblowing;
- the independence and appointment of the external auditor, including approval of its fees and a review of its effectiveness;
- the effectiveness of the Internal Audit function;
- the Group's compliance with the Grocery Supply Code of Practice (GSCOP); and
- an annual review of the management of the Group's pension schemes.

How the Committee operates is described in more detail in its terms of reference. They are available at:

www.co-operative.coop/corporate/investors/governance/risk-and-audit-committee/

In 2015, the Committee's main activities were to:

- consider the appropriateness of the published financial information, including the annual and interim reports and the significant judgements and assumptions made;
- monitor progress with the Risk Improvement Plan implemented in response to the Independent Governance Review undertaken by Lord Myners (May 2014) and the Independent Report into Governance and Risk undertaken by Grant Thornton (June 2014);
- review the effectiveness of the risk and control systems, including the Internal Audit department's work, its plans and reports;
- review the Risk Dashboard and discuss with management its handling of specific risk topics;
- approve changes to the Delegation of Authority List;
- review the Grocery Supply Code of Practice Annual Compliance Statement;
- conduct a full external audit re-tendering process and recommend the appointment of Ernst & Young LLP (described in more detail on page 50);
- check the annual review of the Group's pension schemes;
- monitor reports on whistleblowing; and
- oversee the adherence to Health & Safety policies and standards.

Regular reports were received from KPMG and its representatives were consulted during each meeting.

Report of the Risk and Audit Committee continued

Significant issues relating to the financial statements

When reviewing the 2015 financial statements, the Committee considered the following key areas of judgement. In all cases, it discussed them with management and the external auditor:

Area of focus	What was done
Going concern The Group's ability to remain within its facilities and banking covenants continues to be monitored. The key risks identified are the Group's trading performance, in particular the growth targets for 2016 and following years in Food and Funerals; the timing of cash flows from property and store disposal; forecast capital expenditure; and the success of central cost saving initiatives. CIS General Insurance Limited (CISGIL), the Group's insurance business, is separately funded and has to comply with a number of regulatory capital requirements.	The Committee noted the key considerations so that it could judge whether to prepare the Group's accounts on a 'going concern' basis. These included an analysis of banking covenants and headroom between projected cash flows for the Trading Group and the banking facilities available to the Group, as well as the appropriateness of 'going concern' status for CISGIL and CBG/CFSMS and a restructuring of Co-operative Banking Group.
Accounting for The Co-operative Bank ('the Bank') The Group's investment in the Bank was initially recorded at fair value. As a result, the Group's share of the Bank's profit for each period, and its investment carrying value, requires consideration of the Group's 20.2% share of the Bank's reported result; the annual unwind (amortisation) of the fair value adjustments made on initial recognition of the investment; and an impairment charge (if required). This ensures that the period end carrying value does not exceed the investment's market value.	Over the year, the Committee considered reports which illustrated the sensitivity of assumptions around the accounting judgements made by management on the impairment charge which reduced the Group's investment in the Bank. In addition they considered the approach taken to the Bank's share of the Pace scheme.
Impairment – carrying value of goodwill, property, plant and equipment The Group's balance sheet includes significant goodwill and property, plant and equipment balances, principally in relation to its Food store estate. 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.	The Committee reviewed the results of management's annual impairment review, and discussed the key judgements and assumptions underpinning the calculations. The discount rate had been benchmarked against the market and analysed externally.
Provisions including onerous lease (see note 24 in the financial statements) The Group makes provisions where liabilities are likely to 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 regarding material provisions were reviewed by the Committee. It checked these judgements with external experts, which supported them. The provisions were assessed for consistency of approach compared with previous years, and against the Group's accounting policies.
Pensions (see note 15 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, including market benchmarking, was also reviewed. This gave 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.	The Committee received a detailed paper about the policy and application of the recognition of supplier income. Work undertaken by Internal Audit on the treatment of supplier income gave the Committee further assurance.
Inventory Judgement is involved in assessing the amount of inventory held, including estimates of the level of stock leakage and wastage arising. Judgement is also applied to value 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.

Report of the Risk and Audit Committee continued

Area of focus	What was done
Insurance 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. These described the key judgements and conclusions surrounding the appropriateness and consistency of estimates which had been applied to CISGIL reserving. The relative levels of prudence compared with previous years were also considered.

Review of the Committee's effectiveness

As the Risk and Audit Committee has only recently been established, it has not yet performed a review of its effectiveness. It plans to conduct a review in the next six months, as it is required to each year. When selecting its new members, however, the Committee took into account the requirements of the Code. This ensures that the right mix of skills, experience and knowledge are in place to provide the depth of independent challenge required. In addition, both newly appointed MNDs undertook a full induction programme.

External audit activities

The Code states that audit committees should have primary responsibility for recommending the appointment, re-appointment and removal of the external auditor, and for assessing the effectiveness of the external audit process.

KPMG LLP are the Group's auditors. They also provide the Committee with relevant reports, reviews, information and advice throughout the year. All of these activities are set out in their engagement letter.

Independence, objectivity and fees

The external auditor must be judged to be independent for the audit to be objective. The Group, therefore, has an External Auditor Independence Policy, which is designed to maintain the independence and objectivity of the external auditor. In addition, the Group has a policy regarding the appointment of former KPMG employees, and the approach to be taken when using the external auditors for non-audit work.

The Committee must pre-approve services above certain cost thresholds, which it sets. In addition, external auditors cannot perform the following tasks:

- 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.

The policy was last reviewed by the Committee in 2013. It has been reported upon, in respect of non-audit fees, at each of the Risk and Audit Committee meetings during the year. The Committee is satisfied that the non-audit services provided did not prejudice the external auditor's independence.

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

Effectiveness and appointment of auditors

To fulfil its responsibilities in respect of the independence and effectiveness of the external auditor, the Committee reviewed KPMG's:

- terms, areas of responsibility, duties and scope of work as set out in the engagement letter;
- audit strategy for the Group;
- detailed findings, including a discussion of any major issues that arose during the audit;
- performance, through an internal survey of effectiveness; and
- letter confirming its independence and objectivity.

External audit tender

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. The Risk and Audit Committee conducted a tender process for a new external auditor during the year. The process was initiated in November 2015 and concluded in January 2016.

The Risk and Audit Committee has recommended to the Board that Ernst & Young LLP (EY) be appointed as the Group's external auditor. The Board accepted this recommendation and EY will be put forward for election by members at the 2016 AGM. The Risk and Audit Committee would like to thank KPMG for their contribution to the Group over the years.

The Chair of the Risk and Audit Committee created and led the audit tender team. It comprised the Group CFO, the Director of Group Internal Audit and the Group Accounting Director. Five firms were invited to tender, one of which was a 'mid-tier' audit firm.

Report of the Risk and Audit Committee continued

In order to arrive at the recommendation, two of the audit firms met with the following Co-op representatives:

- the Chair of the Risk and Audit Committee;
- members of the Executive including the CFO;
- senior finance and IT executives from across the Group; and
- the Director of Group Internal Audit and the Chief Risk Officer.

The feedback from the meetings, as well as the Request For Proposal responses, were reviewed in detail by the audit tender team and summarised for the Committee.

The short-listed firms then presented their proposed audit approach to all members of the Risk and Audit Committee and the audit tender team, followed by a 'question and answer' session. Following each meeting, the Group's representatives discussed the presentation. It reviewed content, the view presented, answers to questions and the strengths and weaknesses of each team. At the end of the meetings, the audit tender team had an extensive debate about the shortlisted firms.

Internal audit

During 2015, the new Director of Group Internal Audit developed and delivered a transformation plan for Internal Audit (IA). An outcome of this is that IA has been re-purposed, reorganised and its status within the Group reset.

IA is an independent appraisal function that derives its authority from the Group Board through the Committee. Its primary role is to provide professional, objective assurance while providing insightful improvements to governance, risk and control.

The Committee reviewed and approved the scope of the IA work programme. At each meeting, the Committee receives a report from the Group Director of IA on:

- the work of IA and progress against plan;
- management responses to the issues identified in the audit reports issued; and
- the timeliness of management's remediation activities.

During the year, the Committee reviewed IA reports covering key processes, systems and controls and IT projects and programmes. The reports have covered different areas in the Group.

Internal control

The Group Board has overall responsibility for the system of internal controls. The internal control framework used by the Group is based on the globally recognised COSO model, which has five key control component areas. These are: Control Environment; Risk Assessment; Control Activities; Information and Communication; and Monitoring Activities.

The Committee, on behalf of the Group Board, is responsible for reviewing the effectiveness of the system of internal controls. The system of control is designed to manage rather than eliminate the risk of failure to achieve business objectives. It can only provide reasonable and not absolute assurance against misstatement or loss.

Each Group Executive member was asked to review the effectiveness of internal control for his/her area of responsibility, and to self-certify the results of the review under three headings:

- Description of the key elements of internal control operated.
- Notes of the key improvement initiatives being undertaken.
- Representation that the Executive member and his/her management team has reviewed the systems of risk and internal control for the half year and the full year ended 2 January 2016.

IA's validation of, and the Committee's review of the Executive's self-assessments, form a key part of the annual review of effectiveness of the systems of risk and control.

The internal control framework contains, but is not limited to, 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, supported by a performance management system that drives the achievement of business objectives.
- Co-ordinated activity across the whole Group through executive management meetings, independent committees to subsidiary boards, transformation steering groups and other relevant forums.
- Defined policies for capital and revenue expenditure. Larger capital and revenue expenditure requires Group Board authorisation.
- A Code of Business Conduct covering relations with customers, members, colleagues, suppliers, community and competitors. This code provides procedures to allow any colleague to report, in confidence, suspected serious malpractice. An anti-fraud policy, with guidance, further supports this code.

Risk assessment

Assessing and managing risk is fundamental to safeguarding our members' interests, protecting our reputation, complying with regulatory standards and achieving our business objectives.

The Group Board and executive management are responsible for identifying and evaluating the Co-op's principal business risks. They must implement and maintain systems for managing those risks in an efficient and effective manner.

To enable this, business areas and change programmes maintain risk registers that identify the likelihood and impact of risks within their areas, and the actions being taken to manage them. Risk assessments are updated and reported to Group Risk. Details of the Group's key risks can be found on pages 33 to 35.

Report of the Risk and Audit Committee continued

Control activities

The Group's control procedures are designed to ensure that risks are appropriately managed. This includes risks around the completeness and accuracy of accounting for financial transactions, as well as for limiting the potential exposure to loss of assets or fraud. Procedures and reference information are maintained regarding the Group's Rules, accounting policies and procedures, insurance, colleagues 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. Colleagues 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 Group adopts the 'three lines of defence' approach to assuring its activities. The operation of the system of internal control is the responsibility of line management. Various functions, including Group Risk, monitor and check compliance. IA provides independent assurance.

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

Whistleblowing procedure

In line with best practice and to ensure that the Group operates within the highest ethical standards and its Values and Principles, a whistleblowing procedure, known as 'Speak Up', has been in operation during the year. The policy, managed by an external independent provider, allows colleagues to raise concerns about business practices confidentially should they not wish to talk to someone within the Co-op. 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 whistleblowing 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 website.

The Committee considers the whistleblowing 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 2015 on behalf of the Remuneration Committee. This is my first report since becoming Chair of the Committee in June 2015.

The Committee has been conducting a thorough review of future executive reward in the light of feedback from members about the way in which their money is spent and the move from Rescue to Rebuild.

Increase in pay for colleagues in our stores

An important change for the Co-op in 2016 will be a further increase in hourly pay rates for our colleagues in the frontline of our business, serving customers in our stores. As the result of a two-year pay deal last October, I am pleased to say that the majority of our colleagues are already paid above the new National Living Wage coming into effect in April 2016. All colleagues who are not yet paid at this rate will have their pay increased to it in April. The standard rate for new starters in our food stores will also be increased by 1.8% then.

Structure of this report

This report is in two parts:

- Part I is the Executive Remuneration Policy which the Committee is developing for executive pay.
- Part II is the Annual Report on Remuneration, which describes how the existing policy was applied in 2015 and how the Committee is applying it in 2016.

Members will be asked to vote twice at the Annual General Meeting (AGM). In the first vote you will be asked to accept the report on remuneration. In the second you will be asked to approve the policy. Both votes are advisory. While technically not binding, in the event of a vote against the remuneration policy, the Board has committed to consult with a sub-committee of the Council about amendments to the policy, with a view to bringing an amended version forward for another vote at the 2017 AGM. In the meantime, the existing policy will remain in force until it is amended.

The Committee would welcome your support in the votes on the Executive Remuneration Policy and the Annual Report on Remuneration at the AGM.

I recommend the Report and Policy to you.

Stevie Spring
Chair of the Remuneration Committee

Remuneration Report continued

I Executive remuneration policy

In 2013-14 when the Co-op was facing a period of crisis, the Transitional Remuneration Committee put in place remuneration arrangements to ensure that we had the appropriate team to help the Co-op deal with some profound financial and operational challenges.

The objective of the current review is to ensure that we have a policy fit for the Rebuild phase of our recovery, and beyond, which better reflects our Values and Principles as a co-operative.

Some changes have already been made. Much work remains to be done.

Reward philosophy

The Co-op is committed to a reward strategy which:

- is fair;
- allows us to compete for skills and talent and to encourage and reward high performing colleagues; and
- reflects our Purpose and Values as a co-operative in spending members' money.

This is supported by our reward principles:

- A median pay position against relevant, competitive benchmarks for fully competent performance;
- Incentive plans which clearly reward both performance against stretching targets and commitment to the Co-op Values and Principles;
- A benefit package which will be aligned to the Co-op Values and Principles.

Changes in the policy already agreed and implemented: (i) executive pensions

The most significant change in the policy agreed in 2015 was that senior executives' pension arrangements have been aligned with those of other colleagues.

Following a consultation with colleagues, the Board decided in 2015 that the defined benefit pension scheme should be closed – not an easy decision, but one which was justified for the long-term sustainability of the Co-op in the interests of members and colleagues. From 29 October 2015, all colleagues have had the opportunity to build up a defined contribution pension, with employer contributions of up to 10% of base salary. The previous maximum employer contribution had been 8%.

To keep it in line with all other colleagues, the executive pension benefit allowance of 16% of base salary has been reduced to 10%.

Changes in the policy already agreed and implemented: (ii) new performance metrics and targets for incentive plans

A new, more focused and more uniform approach to performance assessment was introduced for the 2015 Annual Incentive Plan (AIP). Executives and other colleagues who participate in the plan are each assessed on both business performance and personal performance. Business performance targets are generally based on budgeted profit for the year.

For the 2015-17 Long Term Incentive Plan (LTIP), the most significant measure (weighted 40% of the potential incentive) is the net debt:EBITDA ratio, the aim being to reduce the debt burden to the Co-op as much as possible but not at the expense of profit. Additional measures are colleague engagement (25%), membership spend (25%) and brand health (10%). We will continue to monitor the LTIP for the most senior leaders in the organisation to ensure that it is both market competitive and consistent with the other elements of our reward philosophy.

Changes in the policy for future implementation: (i) rebalancing of executive salaries

During the Rescue period, executive packages became heavily weighted towards fixed, guaranteed pay. All new Executive packages will be based on a lower proportion of fixed to variable pay, and remaining Group Executive packages will be rebalanced in this way at the end of the Rebuild phase. In the meantime, no base salary increases were awarded to the Group Executive in 2015. No increases are planned in 2016.

Changes in the policy for future implementation: (ii) reduction in Group Executive's notice period

All future appointees to the Group Executive will have a six month notice period. The existing members of the Group Executive have been asked to reduce their current 12 month notice period to six months with effect from 1 July 2016. This change is being finalised.

Changes in the policy for future implementation: (iii) reduction in Chief Executive's pay and notice period

At his request, and with the full support of the Board, the Chief Executive has agreed a very large reduction in his own remuneration package. The key changes are:

- Base salary to reduce from £1,250,000 to £750,000 with effect from 1 July 2016.
- Maximum Annual Incentive Plan award to be set at 40% of base salary, compared to 100% currently, with effect from the 2017 AIP.
- Maximum Long Term Incentive Plan payment of 50% of base salary, compared to 100% currently. This will take effect from the LTIP cycle starting in 2017.

Combined with the reduction in pension contribution, the effect of these changes will be to reduce the Chief Executive's maximum total remuneration by more than 60%. Richard Pennycook has also agreed to reduce his notice period from the Society to six months, from the current 12 months.

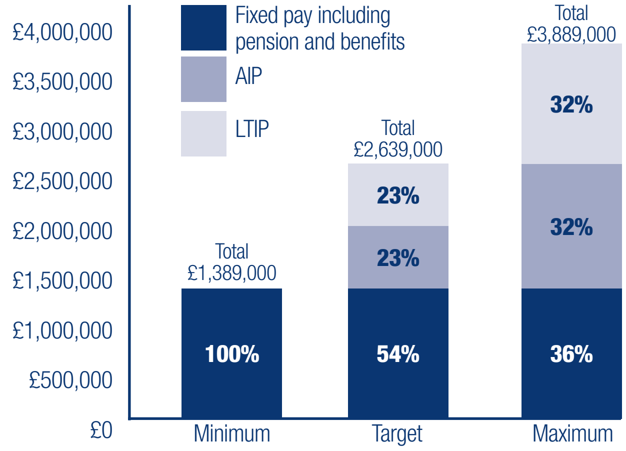
The first chart on the following page shows the potential remuneration package for the Chief Executive in 2016 under the current policy. The Chief Executive was the only executive appointed to the Board in 2015. Ian Ellis, the Group's Chief Finance Officer, has been appointed to the Board during 2016.

Remuneration Report continued

The charts show the following performance scenarios:

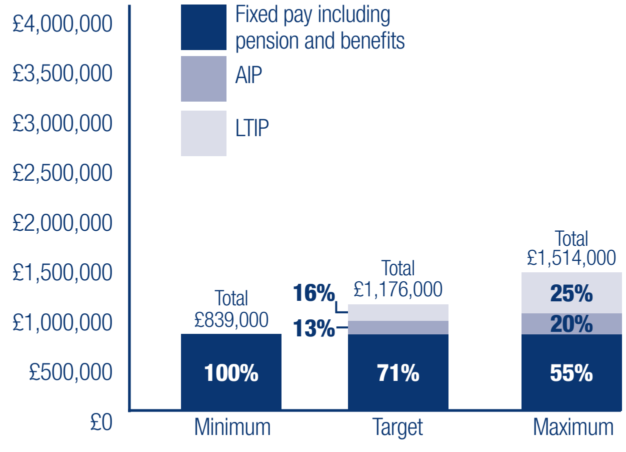
- 'Minimum' is the remuneration due if none of the performance based elements payout.
- 'Target' shows the total package where the AIP and LTIP awards both pay at the target level, being the amount payable for target performance. The target AIP payment is 50% of salary and the target LTIP opportunity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

Potential Remuneration of Chief Executive under present policy



The second chart is based on the revised reward package that will begin to take effect from July 2016. The target AIP payment is 20% of salary and the target LTIP opportunity is 25% of salary. The chart does not show the effect of any interim arrangements between reward packages.

Potential Remuneration of Chief Executive under new arrangements



Policy for the recruitment of new members of the Group Executive

The remuneration package for any new executive will be set using the same policies that apply to current executives, benchmarked externally according to role. This means that the Committee would seek to set the total package at the middle of the individual's relevant market for fully competent performance.

The following additional items of remuneration may 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. When applicable, this is provided under a relocation policy that 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 incentive type awards.** Under exceptional circumstances and at its absolute discretion, the Committee will consider compensating a new executive for variable remuneration awards lost from a previous employer. 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 and will be subject to performance criteria.

Entitlements of executives on leaving the Co-op

In the event of termination, the Committee will review and approve all payments due to an executive with the aim of minimising the costs to the Co-op. Payments will be based on contractual and statutory obligations, including legal fees. Where negotiated, a contribution towards career support may be made.

The notice period in newly recruited executives' service contracts will not exceed six months. Current executive contracts can be terminated by a maximum of one year's notice. Where it is deemed commercially beneficial for an individual to remain under a contract of employment with the Co-op but not to work their notice, they are placed on garden leave and only contractual payments are made. Where an individual is not required to work their notice and receives a payment in lieu, the Co-op is only obliged to pay base salary. The payment in lieu would 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. 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.

Remuneration Report continued

Comparison of remuneration policies for the Group Executive and wider colleagues

For base salary, benefits and pension, the same principles are applied to all colleagues. The stated policy is that total remuneration for fully competent performance should be at the middle of an appropriately defined basket of external comparators, which will necessarily vary by role. That policy will apply to all colleagues.

The Annual Incentive Plan currently allows executives to earn a higher proportion of salary as bonus than other colleagues in the plan. The Co-op is working towards all colleagues being eligible to participate in an incentive scheme.

Those at senior management grades able to influence long-term performance are the only colleagues who are eligible for Long Term Incentive Plan awards. The level of opportunity varies by grade, with those in the Group Executive able to earn the highest amounts.

Claw back provisions apply to both the AIP and LTIP plans. These enable the Committee to recoup part or all of a payment under these arrangements if the Co-op's results were materially misstated, should have been assessed materially differently, or where an individual ceases to be employed by the Co-op as a result of misconduct. Malus provisions allow, under specific circumstances, that the Committee can decide that an award which has not yet vested should lapse.

Fees for non-executive directors

Fees for non-executive Board directors are determined by the Non-Executive Fees Committee of Council. Fees are described in the section: Annual Report on Remuneration on page 62.

Summary of Executive Reward Policy

The current Executive Reward Policy is summarised below.

	Element	Link to strategy	Summary and operation	Maximum opportunity
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 executive 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 colleague population, which will influence the awards to the executive, unless there are exceptional circumstances.
	Benefits	To offer a benefits proposition to attract and retain talented leaders.	The benefits provided to the Group Executive will be in line with normal market practice and could include a car or car allowance, fuel in certain cases, time-limited relocation assistance, healthcare cover and life cover. The Group Executive are also able to take advantage of benefits offered to all colleagues, for example childcare vouchers and discounts on certain products and services.	These benefits are provided in accordance with regularly updated policies that are consistent with market practice. Overall they will represent a small proportion of the total compensation.
	Pension	To provide the same level of pension benefits to all colleagues across the Co-op.	The following options are available: – Defined Contribution employer pension contributions of up to 10% of salary (16% prior to 29 October 2015). – Cash alternative of up to 10% of salary (16% prior to 29 October 2015). – Prior to 29 October 2015, Defined Benefit pension accrual was available if two years' service had been completed.	The maximum Society contribution is 10% of salary. Payable into the scheme or as a cash alternative.

Remuneration Report continued

	Element	Link to strategy	Summary and operation	Maximum opportunity
Variable elements	Annual Incentive Plan (AIP)	To motivate and incentivise achievement of performance measures.	The Group Executive will be eligible for a payment under an AIP agreed by the Committee. The performance measures and targets for each 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 claw back provisions.	For 2016, the AIP opportunity for the Group Executive is unchanged at 50% of salary at target performance (maximum pay-out will be 100% of salary at stretch performance). Note 1 Note 3
	Long Term Incentive Plan (LTIP)	To incentivise senior management towards the achievement of mid-term specific performance targets and results, and promote the behaviours considered by the Committee to be key to the long-term success of the Co-op.	The Group Executive will be eligible to participate in an LTIP agreed by the Committee. Key terms of the 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 Co-op 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 Co-op and can reduce any payments under the award as it determines appropriate. – Payments made under the LTIP are subject to claw back and malus provisions.	For 2016, the LTIP opportunity for the Group Executive is unchanged at 50% of salary at target performance (maximum pay-out will be 100% of salary at stretch performance). Note 2 Note 3

Notes to the table:

Note 1: The Remuneration Committee is reviewing the current balance of fixed to variable remuneration. The policy of total remuneration being at the middle of the appropriate comparator market for fully competent performance will continue. Members will be updated on progress in the next Annual Report.

Note 2: The performance measures for the 2016-18 LTIP are not finalised but will be aligned with financial performance and the Co-op's Values and Principles, including colleague engagement, customer perception and membership.

Note 3: AIP and LTIP opportunity for the Chief Executive will in future be aligned to those of a Grade B colleague (those holding strategic management roles), namely maximum 40% opportunity in AIP and maximum 50% opportunity in LTIP.

Remuneration Report continued

II 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 2015 financial year. Pippa Wicks was a member of the Group Executive during 2015 on an interim basis and is therefore not included in Table 1a. Pippa Wicks has been engaged by the Co-op through AlixPartners and the total fees paid in respect of her services during 2015 were £1.25m excluding VAT.

Table 1a – 2015 remuneration for Executives in post at 2 January 2016

	Date of appointment to the Executive (Note 1)	Date of stepping down from Executive (Note 1)	**Basic salary**	**Taxable benefits (Note 2)**	**2015 AIP (Note 3)**	**2013-2015 LTIP (Note 4)**	**Pension benefits (Note 5)**	**Other (Note 6)**	**Total**	Basic salary	Taxable benefits	2014 Performance related payment	2012-2014 LTIP	Pension benefits	Other (Note 6)	Total
			2015 £'000	**2015 £'000**	**2015 £'000**	**2015 £'000**	**2015 £'000**	**2015 £'000**	**2015 £'000**	2014 £'000	2014 £'000	2014 £'000	2014 £'000	2014 £'000	2014 £'000	2014 £'000
Richard Pennycook	1 Jul 2013		**1,250**	**25**	**1,125**	**638**	**181**	**377**	**3,596**	1,164	26	900	–	160	265	2,515
Alistair Asher	1 Jul 2013		**550**	**17**	**358**	**404**	**80**	**–**	**1,409**	534	17	550	–	85	–	1,186
Mike Bracken	30 Sep 2015		**85**	**3**	**–**	**–**	**9**	**11**	**108**	–	–	–	–	–	–	–
Rod Bulmer	9 Jun 2014		**650**	**17**	**488**	**–**	**108**	**–**	**1,263**	363	10	650	–	51	–	1,074
Ian Ellis	4 Sep 2015		**213**	**4**	**140**	**–**	**26**	**14**	**397**	–	–	–	–	–	–	–
Steve Murrells	16 Jul 2012		**750**	**38**	**675**	**553**	**109**	**78**	**2,203**	729	33	750	–	117	138	1,767
Sam Walker	17 Mar 2014		**425**	**17**	**85**	**91**	**89**	**–**	**707**	335	14	425	–	54	–	828

Table 1b – 2015 remuneration for Executives who left the Executive during the 2015 financial year

	Date of appointment to the Executive (Note 1)	Date of stepping down from Executive	**Basic salary**	**Taxable benefits (Note 2)**	**2015 AIP (Note 3)**	**2013-2015 LTIP (Note 4)**	**Pension benefits (Note 5)**	**Other (Note 6)**	**Total**	Basic Salary	Taxable benefits	2014 Performance related payment	2012-2014 LTIP	Pension benefits	Other (Note 6)	Total
			2015 £'000	**2015 £'000**	**2015 £'000**	**2015 £'000**	**2015 £'000**	**2015 £'000**	**2015 £'000**	2014 £'000	2014 £'000	2014 £'000	2014 £'000	2014 £'000	2014 £'000	2014 £'000
Claire Davies	12 May 2014	16 May 2015	**102**	**6**	**66**	**–**	**16**	**–**	**190**	167	10	265	–	26	–	468
Nick Folland	11 May 2013	16 May 2015	**212**	**7**	**138**	**291**	**32**	**124**	**804**	524	17	550	–	84	132	1,307
Debbie Adams	1 Jul 2015	31 Dec 2015	**91**	**7**	**–**	**–**	**13**	**22**	**133**	–	–	–	–	–	–	–
Paula Kerrigan	17 Mar 2014	15 Jun 2015	**186**	**8**	**100**	**74**	**29**	**–**	**397**	315	14	400	–	51	–	780

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 Co-op.
2. **Taxable benefits** include car, fuel, car cash allowance and healthcare (where applicable).
3. **AIP payments** relate to payments under the Annual Incentive Plan.
4. **2013-2015 LTIP payments** relate to cash payments made under the 2013-15 Long Term Incentive Plan.
5. **Pension** includes benefits accrued in the year from participation in pension schemes (using new disclosure calculation rules and factor of 20 for the build-up of Defined Benefit pension) and/or cash allowances in lieu of retirement benefit.
6. **Other payments in 2015, which were agreed at the date of appointment**, include:
   - A payment of £335,000 to Richard Pennycook as compensation for incentive scheme awards that he forfeited on taking a new executive position.
   - A payment of £124,000 to Nick Folland as compensation for incentive scheme awards that he forfeited on resignation from his previous employer.
   - Payments totalling £78,000 to Steve Murrells, comprising £50,000 as compensation for incentive scheme awards that he forfeited on resignation from his previous employer and £28,000 as part of continuing obligations under the relocation arrangements agreed on his recruitment and which ended during 2015.
   - Payments were agreed under the relocation policy to assist the following executives to stay close to their workplace during the working week. During 2015, Richard Pennycook received £42,000, Ian Ellis received £14,000, Debbie Adams received £22,000 and Mike Bracken received £10,000. Relocation payments are generally limited to a period of two years.
   - Debbie Adams received salary, pension contributions, car allowance and relocation allowance while employed as Group Secretary until her termination due to resignation on 31 December 2015.

Remuneration Report continued

Will the Group Executive receive a salary increase in 2016?

As part of the annual salary review for the Executives, the Committee has agreed that the Group Executive salaries would not be increased in 2016.

What directorships, other than those linked to the Co-op, do the Group Executive hold?

Richard Pennycook holds the following directorships.

Position	Remuneration in 2015 (£)
Chair, The Hut Group Limited	20,000
Chair, The Institute for Turnaround	–
Chair-Elect, Howdens Joinery Limited	52,000
Senior Independent Director, Persimmon plc	65,000

What LTIP scheme interests do the Executives hold?

Awards are made annually under the Long Term Incentive Plan (LTIP), 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 2 January 2016. Table 2b shows the maximum potential award under each plan held by former Executives who left or stepped down from the Executive during the 2015 financial year.

Lapsed awards include the portion of the award that did not vest due to not fully meeting the performance conditions.

Table 2a – LTIP awards held by Executives in post at 2 January 2016

Name of Executive	Award	Notes	Maximum award opportunity at start of the year £	Maximum 2015-2017 award opportunity granted £	Awards vested in year £	Awards lapsed in year £	Maximum award opportunity at the year end £
Richard Pennycook	2015-2017	1	–	1,250,000	–	–	1,250,000
	2014-2016	2	900,000	–	–	–	900,000
	2013-2015	3	750,000	–	637,500	112,500	–
Alistair Asher	2015-2017	1	–	550,000	–	–	550,000
	2014-2016	2	550,000	–	–	–	550,000
	2013-2015	3	475,000	–	403,750	71,250	–
Mike Bracken	2015-2017	1	–	263,000	–	–	263,000
Rod Bulmer	2015-2017	1	–	650,000	–	–	650,000
	2014-2016	2	650,000	–	–	–	650,000
Ian Ellis	2015-2017	1	–	544,000	–	–	544,000
Steve Murrells	2015-2017	1	–	750,000	–	–	750,000
	2014-2016	2	750,000	–	–	–	750,000
	2013-2015	3	650,000	–	552,500	97,500	–
Sam Walker	2015-2017	1	–	425,000	–	–	425,000
	2014-2016	2	425,000	–	–	–	425,000
	2013-2015	3,4	107,500	–	91,375	16,125	–

Notes to Table 2a

1. The 2015-2017 LTIP awards are subject to performance conditions which are deemed key to the success of the Rebuild phase. The measures are:
    - Net debt to EBITDA ratio (40% weighting. If the Threshold for this financial measure is not achieved, no part of the LTIP pays out.)
    - Membership spend as a percentage of total sales value (25% weighting)
    - Co-op colleague engagement (25% weighting)
    - Brand health (10% weighting)
2. 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 cash flow measure and a reputation measure. These measures are equally weighted.
3. The 2013-2015 LTIP performance period has ended. The performance conditions, which were equally weighted and deemed to be critical Rescue objectives, were:
    - 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 Rescue phase.

    The Committee was satisfied that the Rescue conditions were achieved and the Co-op was ready to enter the Rebuild phase.
4. The 2013-2015 LTIP award held by Sam Walker was granted before she was appointed to the Group Executive. The award was at the level commensurate with her grade and as a member of the key retention category of participants.
5. LTIP grants were not made to Debbie Adams.

Remuneration Report continued

Table 2b – LTIP awards for Executives who left the Group during 2015

Name of Executive	Award	Notes	Maximum award opportunity at start of the year £	Maximum 2015-2017 award opportunity granted £	Awards vested in year £	Awards lapsed in year £	Maximum award opportunity at the year end £
Claire Davies	2014-2016	1,2	265,000	–	–	147,222	117,778
Nick Folland	2014-2016	1,2	550,000	–	–	290,278	259,722
	2013-2015	1,2	425,000	–	291,007	133,993	–
Paula Kerrigan	2014-2016	1,2	400,000	–	–	211,111	188,889
	2013-2015	1,2,3	107,500	–	73,608	33,892	–

Notes to Table 2b

1. The 2013-2015 LTIP performance period has ended and the outcome of the performance conditions are set out in the notes to Table 2a above.
2. The Group Executive members in the table retained part of their LTIP awards under the terms of their settlement agreements.
3. The 2013-2015 LTIP award held by Paula Kerrigan was granted before she was appointed to the Group Executive, at a level commensurate with her grade and as a member of the key retention category of participants.

What pension benefits are the Executives entitled to?

The table below shows the pension entitlements for the Group Executive. The figures shown below reflect the period that the individuals were appointed to the Group Executive.

Comparative figures for 2014 are shown in brackets.

Table 3a – pension entitlements for Executives in post at 2 January 2016

	Date of appointment to the Executive	Years of Group Service	Total Defined Benefit Pension accrued at 2 Janaury 2016 (Note 1) £'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 2 £'000	Employer Contributions to Defined Contribution Pension £'000	Payment in lieu of pension benefit £'000	Total Pensions Benefits £'000	Defined Benefit Pension Normal Retirement Date (Age)
Richard Pennycook	1 Jul 2013	2	–	–	–	–	–	181 (160)	181 (160)	–
Alistair Asher	1 Jul 2013	2	–	–	–	–	–	80 (85)	80 (85)	–
Mike Bracken	30 Sep 2015	–	–	–	–	–	–	9	9	–
Rod Bulmer	9 Jun 2014	1	34	2,361	1,978	31 (6)	4 (–)	73 (45)	108 (51)	65
Ian Ellis	4 Sep 2015	–	–	–	–	–	–	26	26	–
Steve Murrells	16 Jul 2012	3	–	–	–	–	–	109 (117)	109 (117)	–
Sam Walker	17 Mar 2014	2	4	3,814	3,814	58 (–)	11 (–)	20 (54)	89 (54)	65

Remuneration Report continued

Table 3b – Pension entitlements for Executives who left or stepped down from the Executive during the 2015 financial year

	Date of appointment to the Executive	Date of stepping down from Executive	Years of Group Service	Total Defined Benefit Pension accrued at 2 Janaury 2016 (Note 1) £'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 2 £'000	Employer Contributions to Defined Contribution Pension £'000	Payment in lieu of pension benefit £'000	Total Pensions Benefits £'000	Defined Benefit Pension Normal Retirement Date (Age)
Claire Davies	12 May 2014	16 May 2015	1	–	–	–	–	8 (13)	8 (13)	16 (26)	–
Debbie Adams	1 Jul 2015	31 Dec 2015	–	–	–	–	–	13	–	13	–
Nick Folland	11 May 2013	16 May 2015	2	–	–	–	–	4 (9)	28 (75)	32 (84)	–
Paula Kerrigan	17 Mar 2014	15 Jun 2015	1	–	–	–	–	29 (51)	–	29 (51)	–

Notes to Tables 3a and 3b

1. Total Defined Benefit pension is that which would be paid annually on retirement at normal retirement age based on service to 2 January 2016 and includes any transferred-in benefits as appropriate. There is no additional pension benefit payable in the event of an Executive's early retirement.
2. All 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.

What arrangements have been agreed for former Executives?

Details of the settlement agreements for Executives who have left the Co-op during 2015 are shown below.

Claire Davies	Claire Davies's role was made redundant on 16 May 2015 as a result of the role relocating. Her earnings whilst she was an active member of the Executive up to 16 May 2015 are shown in Table 1b. The terms of her settlement agreement included £66,000 being her contractual entitlement to salary for the balance of her notice period. An amount of £140,000 was negotiated to resolve any claims arising from her employment, and £12,000 was paid towards outplacement support. Claire Davies retains the part of the 2014-2016 LTIP that relates to the period of time she was in employment and this remains subject to the original performance measures and the original performance periods. Details of this award, including the portion that lapsed on termination of employment, are set out in Table 2b. She also retains eligibility to participate in the 2015 AIP on the same terms as other executives, but with any payment made on a pro rata basis to reflect her period of employment within the 2015 performance year.
Nick Folland	Nick Folland's role was made redundant on 16 May 2015. His earnings whilst he was an active member of the Executive up to 16 May 2015 are shown in Table 1b. The terms of his settlement agreement included an amount of £413,000 being his contractual entitlement to salary for the nine months balance of his notice period, £20,000 towards career advice, and ongoing participation in the healthcare benefit to 31 December 2015. Nick Folland retains the parts of the 2013-2015 LTIP and 2014-2016 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. Details of these awards, including the portion that lapsed on termination of employment and those that have vested, are set out in Table 2b. He also retains eligibility to participate in the 2015 AIP on the same terms as other executives, but with any payment made on a pro rata basis to reflect his period of employment within the 2015 performance year and additionally subject to completion of certain objectives and handover requirements.

Remuneration Report continued

Paula Kerrigan	Paula Kerrigan's employment terminated on 15 June 2015. Her earnings whilst she was an active member of the Executive up to 15 June 2015 are shown in Table 1b. Under the terms of Paula Kerrigan's settlement agreement, for the remainder of the notice period after termination of employment on 15 June 2015, the Society was only obliged to pay Paula Kerrigan the difference between her base salary and contractual benefits from the Society and the earnings from her new employer. If she had remained on garden leave for her entire notice period she would have been paid a total of £300,000 (comprising base salary, benefits and pension for the period), but instead this overall cost was reduced to £176,000 which will be paid in instalments until 18 February 2016. This mitigated the cost to the Society by £124,000. The terms of her settlement agreement also included an amount of £20,000 towards career advice. Paula Kerrigan retains the parts of the 2013-2015 LTIP and 2014-2016 LTIP that relate to the period of time she was in employment and these remain subject to the original performance measures and the original performance periods. Details of these awards, including the portion that lapsed on termination of employment and those that have vested, are set out in Table 2b. She also retains eligibility to participate in the 2015 AIP on the same terms as other executives, but with any payment made on a pro rata basis to reflect her period of employment within the 2015 performance year. This good leaver eligibility for 2015 AIP was additionally subject to completion of certain objectives and handover requirements.
Debbie Adams	Debbie Adams's employment terminated on 31 December 2015. Her earnings whilst she was an active member of the Executive are shown in Table 1b. The terms of the settlement agreement did not provide for termination payments other than contractual pay and benefits earned up until her termination date.

Under the terms of their settlement agreements the following former executives who left the Co-op during 2013 and 2014 retained the parts of their 2013-2015 LTIP that related to the period of time they were in employment, other than Rebecca Skitt who exceptionally retained one third of her 2013-15 LTIP as part of her negotiated settlement. These remained subject to the original performance measures and the original performance periods. The following payments were made on the vesting of these awards following the end of the 2013-2015 performance period:

	Date Employment Terminated	2013-2015 LTIP awards vested in year
Gill Barr	4 July 2014	£133,450
Mark Craig	1 April 2014	£66,583
Moira Lees	20 December 2013	£90,903
Rebecca Skitt	1 September 2014	£184,167
Niall Booker	5 September 2015 (1/3rd of full LTIP paid by Co-op)	£340,000

Non-executive directors' remuneration

On 16 May 2015 the Group Board was appointed, made up of Independent Non-Executive Directors, including the Group Chair, and Member Nominated Directors, together with the Group Chief Executive. At this point the Transitional Board ceased.

This section of the report includes details of the payments made to the non-executive directors (NEDs) in office prior to 16 May 2015 and those in place following this date.

1. What are the fees for the NEDs post 16 May 2015?

NED Role	Fees
Group Chair	• The basic fee for the Group Chair role is £250,000 per annum. No additional fees are paid.

Independent Non-Executive Directors (INEDs)	• The basic fee for an INED is £60,000 per annum.
	• The following additional fees 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.

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 chairs of a committee. There is no additional fee for being a member of any committee.

The Group Chair has access to a pool car and driver for Co-op business if required. No other benefits will be provided for the Group Chair or any other NED member of the Group Board.

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

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

No additional fees will be paid to an Executive who sits on the Group Board or on any of the operating division boards.

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

Remuneration Report continued

2) What were the fees for the Elected Directors pre 16 May 2015?

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 a fee of £11,574 per annum (the Chairs of these Boards received a total of £23,148 per annum which included their membership fee). • Additional fees for membership of and for chairing other committees varied depending on the duties/committee and ranged 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 was Simon Burke who was previously a member of the Co-operative Food Board. His fee arrangements from his role on the Food Board continued during the Transitional Period. This fee was £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 Co-op'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.

How long are directors appointed to the Board for?

Appointments to the Board are for the following periods:

- The Group Chair and INEDs have been appointed for an initial two-year term subject to election and re-election in accordance with the Rules.
- All directors (other than MNDs) 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. While not obliged to do so under the Rules, the Chief Executive has stated he will seek re-election at each 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 will ordinarily serve terms of two years and may serve a maximum of three terms of two years each, subject to the Member Nominated Director Election Regulations. One MND elected in 2015, Hazel Blears, was elected for a one year term to ensure not all MNDs had the same term. If re-elected she may serve for a further three terms of two years.

Remuneration Report continued

What did the NEDs earn during the year?

The fees shown are rounded to the nearest £1,000. The information is provided in two tables covering the period prior to, and post, the 2015 AGM.

Table 4 – Non-executive members of the Group Board post-2015 AGM

	Notes	Group Board £'000	Group Audit & Risk Committee Chair £'000	Group Remuneration Committee Chair £'000	Senior Independent Director £'000	2015 Total £'000	2014 Total £'000
Allan Leighton (Chair)	1	**Note 1**	**–**	**–**	**–**	**Note 1**	–
Hazel Blears		**38**	**–**	**–**	**–**	**38**	–
Simon Burke	2,3	**38**	**8**	**–**	**–**	**46**	Note 3
Paul Chandler		**38**	**–**	**–**	**–**	**38**	–
Sir Christopher Kelly	2,3	**38**	**–**	**–**	**10**	**48**	Note 3
Peter Plumb		**31**	**–**	**–**	**–**	**31**	–
Ruth Spellman		**38**	**–**	**–**	**–**	**38**	–
Stevie Spring	2	**31**	**–**	**8**	**–**	**39**	–

Notes

1. Allan Leighton has waived his fee of £250,000 per annum. Instead this is paid direct by the Co-op to the Co-operative Community Investment Foundation.
2. The Group Risk & Audit Committee Chair, the Remuneration Committee Chair and the Senior Independent Director each receive an additional fee of £15,000 per annum.
3. Fees for Simon Burke and Sir Christopher Kelly appear in both Table 4 and Table 5a, which precludes a comparison in the tables against their total 2015 fee. Simon Burke's total 2015 fee was £66,000 (2014: £52,000) and Sir Christopher Kelly's total 2015 fee was £75,000 (2014: £10,000).
4. No additional fee is paid to the Chair of the Nominations Committee.

Table 5a – Non-executive members of the Group Board pre-2015 AGM

	Notes	Group Board £'000	Group Audit & Risk £'000	Group Remuneration & Appointments Committee £'000	Co-operative Food Holdings Limited Board £'000	Co-operative Specialist Business Limited Board £'000	Co-operative Banking Limited £'000	Regional Board & Area Committee Fees £'000	Pension Fund Trustee £'000	2015 Total £'000	2014 Total £'000
Ursula Lidbetter (Former Chair)	1,5	**44**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**44**	120
Allan Leighton (Chair)	2	**Note 2**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**Note 2**	–
Marc Bicknell	7	**4**	**1**	**1**	**8**	**–**	**–**	**3**	**–**	**17**	43
Duncan Bowdler		**4**	**1**	**–**	**–**	**–**	**6**	**3**	**–**	**14**	39
Simon Burke		**20**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**20**	See Table 4
Eric Calderwood	3,6	**4**	**–**	**2**	**4**	**–**	**–**	**3**	**2**	**15**	43
Martyn Cheatle	4	**4**	**2**	**–**	**4**	**–**	**–**	**–**	**–**	**10**	30
Michael Harriott	8	**4**	**–**	**1**	**–**	**8**	**–**	**3**	**–**	**16**	38
Sir Christopher Kelly	5	**27**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**27**	See Table 4
Frank Nelson		**4**	**–**	**1**	**4**	**–**	**–**	**3**	**–**	**12**	24

Notes:

1. Ursula Lidbetter stepped down as Chair on 19 February 2015.
2. Allan Leighton was appointed Group Chair on 19 February 2015. He has waived his fee which is instead paid direct by the Co-op to the Co-operative Community Investment Foundation.
3. Eric Calderwood was Chair of Group Remuneration Committee.
4. Martyn Cheatle was Chair of Group Risk & Audit Committee.
5. Sir Christopher Kelly and Ursula Lidbetter were members of Group Remuneration and Appointments Committee but not paid any additional fees.
6. Eric Calderwood continued to receive fees for Chair of tcg Pensions Trustees (Scotland) - Lothian & Borders to December 2015.
7. Marc Bicknell was Chair of Co-operative Food Holdings.
8. Michael Harriott was Chair of Co-operative Specialist Businesses Limited Board.
9. All Board members of the Co-op Board attended Transitional Search Committee Meetings but did not receive any additional fees for this Committee.

Remuneration Report continued

Table 5b – Former group Board members receiving payments to AGM on 16 May 2015

	Notes	Group Board £'000	Group Audit & Risk £'000	Group Remuneration & Appointments Committee £'000	Co-operative Food Holdings Limited Board £'000	Co-operative Specialist Business Limited Board £'000	Group Values & Principles Board £'000	Regional Board & Area Committee Fees £'000	Co-operatives UK & Co-operative Press Board £'000	2015 Total £'000	2014 Total £'000
Jenny Barnes		4	–	–	4	–	–	3	1	12	33
Herbert Daybell	1	4	–	–	4	–	1	3	–	12	37
Andrew Donkin	3	4	–	–	–	4	–	3	–	11	22
Jenny de Villiers		4	–	1	–	4	–	3	1	13	33
Robert Harber		4	–	–	4	–	–	3	–	11	21
Ray Henderson	2	4	–	–	4	–	–	3	–	11	34
David Morrow	4	4	–	–	–	4	–	3	–	11	22
David Pownall	5	4	–	–	–	4	–	3	1	12	37
David Smith		4	–	–	–	4	–	3	–	11	21

Notes

1. Herbert Daybell – Chair of Group Values & Principles Board.
2. Ray Henderson stepped down from Co-operatives UK Board 3 February 2015.
3. Andrew Donkin's fees for Regional Board & Area Committee varies because he also received a fee for serving as a Regional Values & Principles Committee Member.
4. David Morrow's Regional Board & Area Committee Fees vary because he sits on the Northern Ireland Council Members' Committee.
5. David Pownall received fees for both Co-operatives UK Board and Press Board.

No additional benefits or payments were made to these former Board members.

For certain former Board members it was agreed that it was fair and reasonable that they continue to receive their director's fee until the AGM in May 2016, as originally envisaged prior to the establishment of the Transitional Board. The former directors who will continue to receive such fees, together with the additional fees received during 2015 following the AGM are Michael Harriott (£23,504) and Jenny de Villiers (£17,057). The following directors also received fees in respect of certain post-AGM duties: Jenny Barnes (£898 in respect of the Co-op Press Board) and Eric Calderwood (£3,673 as Pension Fund Trustee Chair).

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

Role of the Committee

The Committee is responsible for determining and overseeing the Executive Remuneration Policy for the Co-op to ensure a consistent approach across the Co-op and its subsidiaries.

Terms of reference

The terms of reference of the Committee are available on the Co-op website.

Members of the Committee

The Co-op Remuneration Committee was appointed with effect from 25 June 2015 and superseded the previous Transitional Remuneration Committee that had been appointed on 30 September 2014. The members of the Committee and attendance during the 2015 year were as follows:

Committee member	Date of appointment	Number of meetings attended
Stevie Spring (Chair)	25 June 2015	4 (4)
Sir Christopher Kelly	25 June 2015	4 (4)
Ruth Spellman	25 June 2015	4 (4)

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

The Chief Executive, the Group Secretary and the Chief HR Officer are also invited to attend the meetings of the Committee, but are not customarily 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 Co-op. The Co-op Board believes that all members of the Committee are independent for the purpose of reviewing remuneration matters.

Independent advice

In carrying out its responsibilities, the Committee has access to independent advice as required. During 2015, the Committee retained New Bridge Street (an Aon Hewitt company) as its independent remuneration adviser. The fees paid to New Bridge Street during this period totalled £80,743 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 £4,845 excluding VAT.

Report of the Nominations Committee

Chair's Introduction

I was privileged to join our Group as Chair in February 2015 and I am writing my first Nominations Committee Report to you, having been appointed as Chair of the Committee when it came into being in May 2015.

This has been a busy year of change following the introduction of the new governance framework in 2015. The Board has been transformed with the appointment of five Independent Non-Executive Directors (INEDs) and the election of three Member Nominated Directors (MNDs).

We have built an excellent team with a broad mix of skills and experience to support and challenge the Executive. I am pleased to report that all directors have made a valuable contribution to the Group Board since their appointment and I am looking forward to working with them in the future.

We have a strong commitment to diversity and 27% of our Board are female.

Allan Leighton
Chair of the Nominations Committee

Background

As part of the Transitional arrangements, the Group operated a Transitional Search Committee. This Committee had a limited remit which was to oversee and co-ordinate the appointment of Independent Non-Executive Directors to the new Group Board.

Following the 2015 Annual General Meeting, and the creation of the new Group Board, the Transitional Search Committee was replaced by the newly created Nominations Committee.

To make this report easier to read, it covers the activities of both the Transitional Search Committee and the Nominations Committee, referred to throughout as 'the Committee'.

Role of the Committee

The Committee is responsible for:

- leading the selection process for Independent Non-Executive Directors (INEDs), Executive Directors and other specified non-Board appointments;
- reviewing and approving the qualification, commercial experience and co-operative values requirements of INEDs and Executive Directors, confirming that they satisfy such requirements throughout their term of office and before they are appointed, elected or re-elected;
- reviewing the effectiveness of the Group Board by ensuring that the Group Board composition provides an appropriate balance of skills, experience, diversity and gender balance to provide effective leadership and oversight;
- evaluating the performance of directors both individually and collectively;
- ensuring that appropriate succession plans are in place for key roles; and
- submitting proposals to the Non-Executive Directors' Fees Committee in respect of the remuneration of the Group Chair, INEDs and MNDs.

In addition to the above, the Nominations Committee currently has the following responsibilities in relation to the Member Nominated Directors (MNDs):

- reviewing and approving the qualification, commercial experience and co-operative values requirements of MND candidates; and
- monitoring whether the MNDs satisfy the Membership criteria and Eligibility criteria throughout their terms of office.

In fulfilling its obligations regarding MNDs, the Committee has, during 2016, received the support of the Member Nominated Director Joint Selection and Approvals Committee, a joint Council and Board Committee.

Report of the Nominations Committee continued

Terms of reference

The Nominations Committee was newly created as part of the Group's Governance Reforms and its Terms of Reference were approved by the Group Board in June 2015.

Membership and attendance

The table below shows the membership and attendance at meetings of the Nominations Committee following the AGM in 2015:

Committee Member	Number of meetings attended
Allan Leighton (Chair)	2 (2)
Simon Burke (INED)	2 (2)
Sir Christopher Kelly (SID)	2 (2)
Hazel Blears (MND)	2 (2)
Ruth Spellman (MND)	2 (2)
Nick Crofts (Council President)	1 (1)

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

The Committee is chaired by the Group Chair and the Group Chief Executive is invited to attend by the Chair.

Committee focus

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

- February 2015 - Allan Leighton appointed Independent Group Chair.
- June 2015 – Stevie Spring and Peter Plumb appointed as Independent Non-Executive Directors.
- June 2015 – Simon Burke confirmed as Risk and Audit Committee Chair following interim appointment in this role.
- Approval of the shortlist of candidates put forward in the 2015 Member Nominated Director election.

In addition, the Committee has undertaken the following activities:

- Prepared reports for the Council Scrutiny Committee, to enable this committee to scrutinise the INED appointment process.
- Agreed the approach to the annual Board evaluation process.

In its search for the new Group Chair and INEDs, the Committee was supported by professional search firm, Odgers Berndtson. The Committee also engaged the services of Peter Jackson, an independent adviser with substantial Board experience, to assist in the interview/selection process of the Chair. The 2015 MND selection process was supported by independent search firm, Warren Partners.

Review of directors' qualification and commercial experience

The Committee is required to review and approve the qualifying and commercial experience requirements for INEDs, MNDs and Executive Directors and to confirm whether these have been satisfied throughout their term of office and before they are appointed.

Having undertaken this review, the Committee can confirm that the INEDs, MNDs and the Executive Directors have all met the requirements.

Board evaluation

The Group Board takes its performance seriously and as such it is enshrined in the Group's Rules that the Committee shall conduct an annual formal and rigorous evaluation of the Board's performance.

As the new Group Board was only formed following the end of the Transitional period on 16 May 2015, the Committee commenced an internal evaluation of the Group Board during 2016.

Our Senior Independent Director, Sir Christopher Kelly, led this process which involves directors being asked to rate their satisfaction with key areas such as the timeliness and usefulness of information provided to directors, the culture and communication within the Boardroom and with key Committees, together with any training and development needs. The evaluation has been facilitated through a tailored questionnaire accessed via the Diligent Board pad application.

The results of the Board Evaluation are due to be considered by the Committee later in the year and will be used by the Committee to form a report and make recommendations to the Group Board. The results will also directly inform the Committee's nomination and appointment strategy for the Board together with the programme of Board and director development.

Induction and training

Consistent with Co-operative Values and Principles, the Group is committed to ongoing learning and development for all its directors. As such, before accepting a position as a director, an individual must agree to undertake training during their first year of office and otherwise as deemed appropriate by the Group Secretary. This training includes, in particular, information on the roles and responsibilities of being a director of a co-operative society.

All directors undergo a comprehensive and timely induction on appointment to the Group 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 contribution.

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;

Report of the Nominations Committee continued

- legal duties and responsibilities including statutory duties of a director, Board policies and procedures, Board Code of Conduct, governance structures, relationship with the Members' Council and Co-operative Values and Principles; and
- bespoke induction tailored to each individual director's needs.

The Group Secretary is responsible for evaluating the adequacy of directors' training and that it meets the requirements contemplated by the Group Rules.

Succession planning

The Board Composition Charter sets out the following principles in relation to the experience and skills of directors. These principles also apply to succession planning:

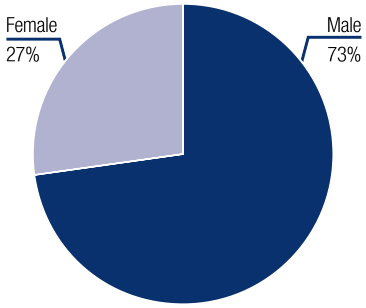
- The collective experience and skills of the directors is broad enough to enable the Board to provide effective oversight of the Group and its various businesses as a whole.
- It reflects a diverse range of backgrounds, views and perspectives.
- It provides an effective voice for members.
- It allows 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.

Diversity on the Group Board

The Board Composition Charter states 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'.

Whilst the new Group Board has not to date set its aspirations in terms of gender diversity, the current balance on the Board meets the target set by the Davies Review in 2011, which was to have at least 25% female representation by 2015.

Group Board Gender Diversity



Focus for 2016

We have already made some important additions to the Board, with the appointment of Stevie Spring and Peter Plumb in 2015 and the more recent appointments of Ian Ellis and Lord Victor Adebowale. Much remains to be done during the year to ensure that the responsibilities of the Committee are reviewed and implemented. Key activities will include:

- the search and selection of a permanent Group Secretary;
- conducting an evaluation of the performance of the Group Chair;
- implementing and delivering a comprehensive directors' training programme;
- ensuring the Group has an effective Diversity and Inclusion policy; and
- ensuring we maintain a Board composition which is of the right calibre, size and balance to continue leading the Group through its Rebuild stage.

Directors' Report

Results and distributions

The profit before taxation was £23m (2014: £124m). The directors do not recommend a final dividend. The Group Board determined not to pay an interim dividend in 2015.

Going concern

The financial statements are prepared on a going concern basis as the directors have a reasonable expectation that 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, the Co-operative Banking Group and 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 general accounting policies section of the financial statements (page 84).

Longer term viability

The directors have assessed the longer term viability of the Group, taking into account the Group's current position and the potential material impact of the principal risks as set out on pages 33 to 35.

The directors have determined that a three-year period to 31 December 2018 is an appropriate period over which to provide its viability statement as this is the period reviewed by the Group board in the strategic planning process. The directors believe that this presents the Board with a reasonable degree of confidence over this longer term outlook.

Following their review, the directors have therefore concluded that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to 31 December 2018.

Post balance sheet events

There have been no material post balance sheet events.

Corporate governance report

The corporate governance report is contained on pages 40 to 46. 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 Co-op People section on pages 24 and 25.

Corporate responsibility and the environment

The Sustainability Review can be found on pages 26 to 32. 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. 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 currently 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.

The Group made donations totalling £625,600 (2014: £625,600) to the Co-operative Party, representing the Group's financial subscription to the Party for 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.

A motion will be put to the members at the 2016 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.

Directors' Report 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 rolling programme of internal audits to test compliance, a comprehensive training programme for all colleagues involved in dealings with our suppliers, an online supplier portal with a dedicated support team, and the provision of regular reports 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, all of which have been thoroughly investigated and resolved. Engagement with the Groceries Code Adjudicator has been ongoing since her appointment in 2013 and quarterly meetings are 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 Group 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 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 Group'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

Upon the recommendation of the Group Risk and Audit Committee, Ernst & Young LLP have expressed their willingness to be appointed and succeed KPMG LLP as auditors of the Group. A resolution to appoint Ernst & Young LLP as auditors and to authorise the directors to determine their remuneration will be proposed at the forthcoming Annual General Meeting.

By Order of the Board

Helen Grantham
Group Secretary
6 April 2016

Council's Annual Statement

Introduction

Since its first report in 2014, there has been a great deal of activity within the Council and its Committees. Council met seven times in 2015 and on each occasion conducted challenging questioning to hold the Board to account. This is in accordance with one of its key roles to ensure that decisions and strategy of the Board were carried out in accordance with the Co-op's Purpose, the Values and Principles and our Rules.

The Council, following the elections in May 2015, is now up to full strength of 100 Council members. Our Council members together form a voice for the 12 regional constituencies and continue to provide a forum in which members' interests are represented. Council is made up of 76 individual members, including 16 colleagues, from the 12 constituencies, with 15 Council members representing our Independent Society Members and 9 seats allocated to special members (youth, Isle of Man, Co-operative Young Members' Board and Council-appointed members to assure diversity).

President and Vice-Presidents

After elections of Council held in July, Nick Crofts was elected as President for a two year term. Marc Bicknell was appointed as Vice President (Business Strategy, Performance & Development) for a period of one year, and Dan Crowe was appointed as Vice President (Co-operative Performance, Democratic Processes & Member Voice) for a period of two years in order to allow for a yearly rotation of Vice Presidents.

Senate, Committees and 'Task and Finish' Groups

In July, Council also appointed 12 Senate members in addition to the President and Vice Presidents, of whom three are representatives of Independent Society Members. The Senate together provide a more regular point of contact between the Council and the Board.

The Senate has worked with the Board and also the Executive in the preparation of a Council three-year strategic plan, where the priorities of the Council are set out. The committees are the engine room of the Council activity, carrying out 'deep dives' into specific issues. There are three standing committees of Council: Ethics and Social Responsibility; Business Performance; and Governance. Within their respective terms of reference, these committees have established Task and Finish Groups with specific topics to review as regards Board decisions or strategy.

Areas of report from these groups include: diversity, remuneration of colleagues, business review, financial accounts and sustainability. Findings are reported to the Board for their consideration. These groups form a very important element of the Council's role in holding the Board to account. Council members also contribute to the Food Policy Working Group, Local Sourcing Group and the Community Pilots Joint Working Group.

Upholding the Values and Principles

Council members are mindful of ensuring that their work is making a co-operative difference for our members as whole. Council members both collectively and individually are involved in many different aspects of the Co-op locally with members, regionally in supporting initiatives with community engagement managers and nationally by attendance at Council meetings. Members are able to contact the Council for information and Council is developing a more extensive communications policy. These are somewhat early days in the new governance structures and communication channels will improve over time.

Activities and achievements of Council in 2015

The Council achieved full strength with 100 Council members only in May 2015 but has been extremely quick to move forward with the work needed to hold the Board to account. The priority has been to ensure impact with the Board on the key issues which affect the Co-op as a whole and which Council knows are important to members, but doing so in a way which is collaborative and co-operative.

There are strategic issues on which the Board consults with the Council and the relationship is developing in a way which will allow for the Members' Council to influence policy in line with our Values and Principles. It has been an objective of the Council to become more involved in ethical and sustainability policies and it is very pleased to report that Council members will be involved in a new 'Co-op Way' working group whose purpose it is to review policies ranging from anti-slavery to ethical supply chains; child labour to equality and diversity. This will help to embed co-operative thinking within strategic decisions at all levels.

Council meetings also provide the time for working groups to discuss and develop responses to the Board on Council's assessments of decisions. This work is developed more deeply though the Council's committees and 'deep-dive' groups which consider in detail matters such as remuneration policies, key performance indicators and sustainability reporting. Feedback from these groups is given to the Board, which in turn influences forward planning.

Over the last year Council has taken the members' motions passed at the 2015 Annual General Meeting and been a champion of those resolutions and intentions. The members' motions were on the subjects of political expenditure which supports the objectives of the co-operative movement; a re-affirmation of the Co-op's commitment to the brand and working with other co-operative societies to maximise its future success; and a resolution to re-confirm the Co-op's commitment to Fairtrade ensuring we remain the UK's leading supermarket supporter of Fairtrade. This was the voice of members and has been integral to the work of Council to date.

Council's Annual Statement continued

Our President, Nick Crofts, was invited to address the International Co-operative Alliance Global Conference and General Assembly in November. Our Co-op is part of an international movement and it was fitting that Nick was invited to speak on the subject of the reforms to our governance. Learning from exemplary co-operatives around the world is hugely important.

The Council itself has been a vibrant place over the last year. It was very pleasing to have heavily contested elections to the Council in 2015 with lots of votes cast by our members. Diversity among Council members and candidates remains an issue on which there is more to do.

The central point of reference for the Members' Council is the purpose of every co-operative society – to serve our members by carrying out business as a co-operative for the benefit of our members, in accordance with the International Co-operative Alliance Values and Principles.

In response to long-term requests from our members, the Council took a championing role in the local sourcing initiative for Food stores in the Yorkshire area. The aim of stocking more local produce has proved successful and is being rolled out to other parts of the UK.

In recognition that transparency regarding tax remains one of the top ethical issues for consumers, Council members championed participation in the Fair Tax Mark and encouraged our Finance team to obtain accreditation for our Co-op, which was secured in the latter half of 2015.

All the activities and impacts mentioned above will be developed in 2016 to reflect Council members' conscientious and serious approach in representing members' views and to carry out its fundamental governance role.

Report of the Scrutiny Committee

This is the first report from the Scrutiny Committee which was established under the Rules to oversee the adequacy of background checks and due diligence on directors and prospective directors and also to scrutinise the objectivity, transparency and fairness of the process for the:

- selection/appointment of Independent Non-Executive Directors (INEDs); and
- approval of Council-nominated Member Nominated Director (MND) candidates.

Over the Group's 2015 financial year, the following individuals were appointed as INEDs: Allan Leighton (Chair), Simon Burke, Stevie Spring and Peter Plumb. The Scrutiny Committee has been supplied with due diligence information and background check information in respect of these appointments. The Scrutiny Committee has also questioned a member of the Transitional Search/Nominations Committee involved in the appointments. Having reviewed the candidate information and supporting evidence linked to the membership and eligibility criteria set out in the Membership Regulations and the Board Composition Charter, the Committee is able to report in its opinion:

- that the background checks and due diligence carried out on Allan Leighton*, Simon Burke, Stevie Spring and Peter Plumb were adequate; and
- that the decisions made by the Transitional Search Committee and Nominations Committee as regards these appointments were fair, transparent and objective.

* The Committee's scrutiny of Allan Leighton's appointment took place prior to ratification of his appointment by members at the 2015 Annual General Meeting (AGM).

In reporting to members on MND candidates selection and approval process conducted in 2015, the Scrutiny Committee comments that in the short timescale allocated for the agreement of the 2015 ballots, the process did not deliver the outcome anticipated as regards the number of candidates and contested MND elections. Though six MND candidates were selected by the Council only three were approved by the Board. All three were subsequently elected by members (albeit in uncontested elections) at the 2015 AGM: Hazel Blears, Paul Chandler and Ruth Spellman.

Having reviewed the candidate information and supporting evidence linked to membership and eligibility criteria, as set out in the MND and Member Election Regulations and the Board Composition Charter, the Committee is able to report in its opinion:

- that the background checks and due diligence carried out on Hazel Blears, Paul Chandler and Ruth Spellman were adequate; and
- as insufficient evidence was made available, the Committee was unable to determine whether the Transitional Search Committee's approval of all Council selected MND candidates was a fair, transparent and objective process.

The Scrutiny Committee notes and welcomes the constructive dialogue between Council and Board and the agreement of a more effective and collaborative new MND process for 2016 which will address members' concerns about the transitional process in 2015. This involves the establishment of an MND Joint Selection and Approval Committee which is a joint committee of the Council and Board.

Financial accounts

Consolidated Income Statement

for the period ended 2 January 2016

In plain English - what does this show?

Our consolidated income statement shows all our earned sales for the year minus the expenses. The result is the net profit that we have made.

	Notes	**2015** **£m**	2014 (restated*) £m
Revenue	2	**9,301**	9,388
Operating expenses	3	**(9,232)**	(9,208)
Other income	4	**43**	47
Operating profit	1	**112**	227
Finance income	5	**39**	69
Finance costs	6	**(117)**	(169)
Share of losses of associates and joint ventures	13	**(11)**	(3)
Profit before tax	1	**23**	124
Taxation	7	**(8)**	(17)
Profit after tax but before profit on discontinued operations		**15**	107
Profit on discontinued operations, net of tax	8	**-**	109
Profit for the period (all attributable to equity holders of the parent)		**15**	216

Non-GAAP measure: underlying profit before tax**

In plain English - what does this show?

The table below adjusts the profit figure shown in the consolidated income statement above by stripping out the impact of items that are not generated by our businesses' day-to-day trading. These are typically the profits or losses from selling businesses or properties or other one-off items. This helps readers of our accounts to understand how our businesses are performing.

	Notes	**2015** **£m**	2014 (restated*) £m
Analysed as:			
Profit before tax (as above)		**23**	124
Add back losses/(deduct gains):			
One-off items	1	**62**	74
Property and business disposals	3	**14**	(99)
Change in value of investment properties	12	**(24)**	(16)
Finance income	5	**(39)**	(69)
Non-cash finance costs	6	**34**	30
Accelerated interest due to the early repayment of debt	6	**-**	26
Share of (profit) / losses of associates and joint ventures	13		
- Bank		**39**	10
- Travel		**(27)**	(6)
- Other		**(1)**	(1)
Underlying profit before tax		**81**	73

*See general accounting policies section on page 81 for more details of the restatement.

**For a definition of underlying profit before tax, refer to note 1.

Consolidated Statement of Comprehensive Income

for the period ended 2 January 2016

In plain English - what does this show?

The consolidated statement of comprehensive income includes other income and costs that are not included in the consolidated income statement on the previous page. These are usually revaluations of property, pension schemes and certain financial investments.

	Notes	**2015 £m**	2014 £m
Profit for the period		**15**	216
Other comprehensive income:			
Items that will never be reclassified to the income statement:			
Remeasurement gains on employee pension schemes		**105**	707
IFRIC 14 pension onerous liability remeasurement	15	**(19)**	-
Revaluation of property, plant and equipment	10	**-**	11
Related tax on items	7	**(5)**	(145)
		81	573
Items that are or may be reclassified to the income statement:			
Changes in value of available for sale assets		**(9)**	26
Share of other comprehensive income from associates	13	**-**	14
		(9)	40
Other comprehensive income for the period net of tax		**72**	613
Total comprehensive income for the period (all attributable to equity holders of the parent)		**87**	829

Consolidated Balance Sheet

as at 2 January 2016

In plain English - what does this show?

The analysis below provides a snapshot of the financial position of the Group at the end of 2015. It sums up the Co-op's assets and liabilities.

	Notes	**2015** **£m**	2014 (restated*) £m
Non-current assets			
Property, plant and equipment	10	**1,965**	1,998
Goodwill and intangible assets	11	**948**	925
Investment properties	12	**87**	99
Investments in associates and joint ventures	13	**285**	316
Investments in funeral plans	14	**781**	661
Investments from insurance activities	20	**650**	661
Reinsurance contracts	21	**63**	67
Derivatives	31	**55**	67
Pension assets	15	**1,378**	1,247
Trade and other receivables	18	**23**	24
Deferred tax assets	16	**230**	263
Reclaim Fund assets	35	**73**	73
Total non-current assets		**6,538**	6,401
Current assets			
Inventories and biological assets	17	**445**	434
Trade and other receivables	18	**646**	566
Cash and cash equivalents		**405**	327
Assets held for sale	19	**-**	85
Investments from insurance activities	20	**241**	260
Reinsurance contracts	21	**6**	5
Reclaim Fund assets	35	**488**	407
Total current assets		**2,231**	2,084
Total assets		**8,769**	8,485
Non-current liabilities			
Interest-bearing loans and borrowings	22	**1,071**	993
Trade and other payables	23	**967**	841
Derivatives	31	**37**	48
Provisions	24	**352**	375
Pension liabilities	15	**227**	258
Deferred tax liabilities	16	**340**	344
Insurance contracts	21	**511**	334
Reclaim Fund liabilities	35	**487**	406
Total non-current liabilities		**3,992**	3,599
Current liabilities			
Overdrafts		**4**	8
Interest-bearing loans and borrowings	22	**22**	69
Income tax payable		**13**	13
Trade and other payables	23	**1,462**	1,381
Provisions	24	**87**	146
Insurance contracts	21	**235**	404
Total current liabilities		**1,823**	2,021
Total liabilities		**5,815**	5,620
Equity			
Members' share capital	25	**72**	70
Retained earnings		**2,787**	2,691
Other reserves		**95**	104
Total equity		**2,954**	2,865
Total equity and liabilities		**8,769**	8,485

*See general accounting policies section on page 81 for more details of the restatement.

Board's certification

The financial statements on pages 75 to 190 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 **Richard Pennycook** Chief Executive **Helen Grantham** Group Secretary 6 April 2016

Consolidated Statement of Changes in Equity

for the period ended 2 January 2016

In plain English - what does this show?

The analysis shows how our net assets have changed during the year.

	Notes	Members' share capital £m	Retained earnings £m	Other reserves £m	Total equity £m
Balance at 3 January 2015		**70**	**2,691**	**104**	**2,865**
Profit for the period		**-**	**15**	**-**	**15**
Other comprehensive income:					
Remeasurement gains on employee pension schemes		**-**	**105**	**-**	**105**
Pace pension surplus attributable to non Group entities	27	**-**	**(255)**	**-**	**(255)**
Adjustment to pension surplus under IFRIC 14	27	**-**	**255**	**-**	**255**
IFRIC 14 pension onerous liability remeasurement	15	**-**	**(19)**	**-**	**(19)**
Gains less losses on available for sale assets		**-**	**-**	**(6)**	**(6)**
Available for sale cumulative gains transferred to the income statement		**-**	**-**	**(3)**	**(3)**
Share of other comprehensive income from associates	13	**-**	**-**	**-**	**-**
Tax on items taken directly to other comprehensive income	7	**-**	**(5)**	**-**	**(5)**
Total other comprehensive income/(expense)		**-**	**81**	**(9)**	**72**
Contributions by and distributions to members:					
Shares issued less shares withdrawn		**2**	**-**	**-**	**2**
Contributions by and distributions to members:		**2**	**-**	**-**	**2**
Balance at 2 January 2016		**72**	**2,787**	**95**	**2,954**

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 (2014: £74m). Further details of the balance sheet items can be found in note 35.

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 end of the period is £11m (2014: £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 other comprehensive income as they arise. The period end balance is a £10m credit (2014: £19m credit). There has been a £6m loss (2014: £29m gain) following the revaluation of available for sale assets during the period. £3m of gains (2014: £3m of gains) were transferred to the income statement during the period. A tax credit of £nil (2014: £nil credit) has also affected this reserve.

Consolidated Statement of Changes in Equity continued

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:							
Remeasurement gains on employee pension schemes		-	707	-	707	-	707
Pace pension surplus attributable to non Group entities	27	-	(226)	-	(226)	-	(226)
Adjustment to pension surplus under IFRIC 14	27	-	226	-	226	-	226
Revaluation of property, plant and equipment	10	-	-	11	11	-	11
Gains less losses on available for sale assets		-	-	29	29	-	29
Available for sale cumulative gains transferred to the income statement		-	-	(3)	(3)	-	(3)
Revaluation reserve recycled to retained earnings		-	95	(95)	-	-	-
Share of other comprehensive income from associates	13	-	14	-	14	-	14
Tax on items taken directly to other comprehensive income	7	-	(145)	-	(145)	-	(145)
Total other comprehensive income / (expense)		-	671	(58)	613	-	613
Contributions by and distributions to members:							
Dividend - non-controlling interests		-	-	-	-	(1)	(1)
Contributions by and distributions to members:		-	-	-	-	(1)	(1)
Balance at 3 January 2015		70	2,691	104	2,865	-	2,865

Consolidated Statement of Cash Flows

for the period ended 2 January 2016

In plain English - what does this show?

This table analyses the cash coming in and out of the Group during the year. It splits the cash by type of activity - showing how much our businesses have generated and how or where we have spent that cash.

	Notes	**2015 £m**	2014 (restated*) £m
Net cash from / (used in) operating activities	9	**283**	(89)
Cash flows from investing activities			
Acquisition of property, plant and equipment		**(297)**	(279)
Proceeds from sale of property, plant and equipment		**161**	341
Purchase of intangible assets		**(15)**	(15)
Acquisition of businesses		**(5)**	-
Acquisition of investments in joint ventures and associates		**(3)**	-
Proceeds from sale of investments		**-**	4
Disposal of businesses, net of cash disposed		**14**	796
Dividends received from investments	13	**6**	5
Net cash (used in) / from investing activities		**(139)**	852
Cash flows from financing activities			
Interest paid on borrowings		**(80)**	(150)
Issue / (repayment) of corporate investor shares		**4**	(13)
Repayment of borrowings, net of derivatives	22	**(50)**	(484)
Issue of borrowings, net of derivatives	22	**68**	-
Dividends paid to non-controlling interests		**-**	(1)
Finance leases repaid		**(4)**	(1)
Net cash used in financing activities		**(62)**	(649)
Net increase in cash and cash equivalents		**82**	114
Cash and cash equivalents at beginning of period		**319**	205
Cash and cash equivalents at end of period		**401**	319
Analysis of cash and cash equivalents			
Overdrafts		**(4)**	(8)
Cash and cash equivalents per balance sheet		**405**	327
		401	319

*See general accounting policies section on page 81 for further details of the restatement.

Included in the above are cash flows from discontinued operations. An analysis of these can be found in note 8.

General Accounting Policies

In plain English - what does this note show?

This section outlines the general accounting policies of the Group 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's 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 52 week period ended 2 January 2016. As permitted by statute, a separate set of financial statements for the Society are not included.

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.

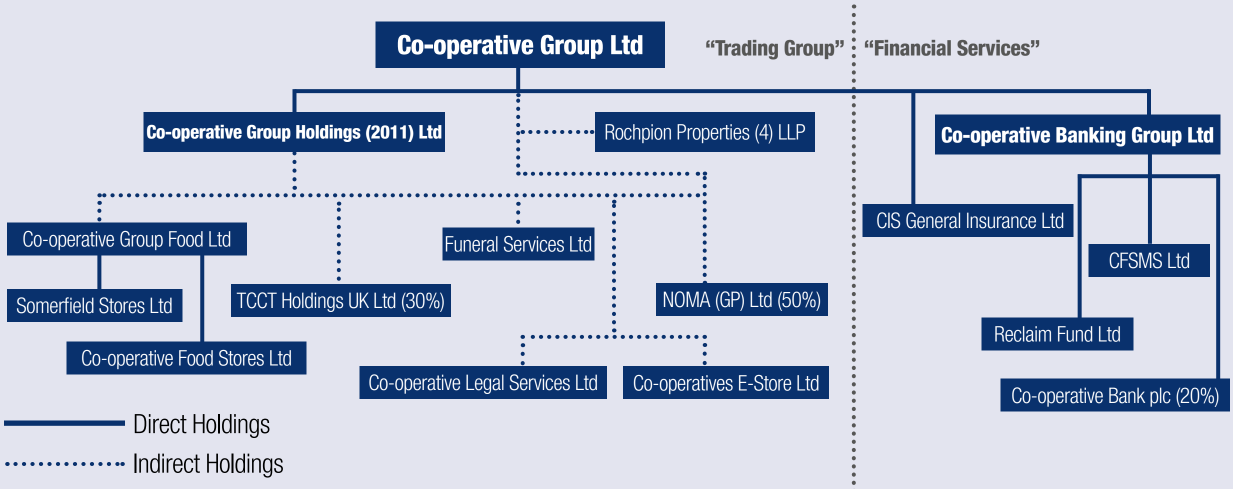
The accounting policies set out in the notes have been applied consistently to all periods presented in these financial statements, except where stated otherwise.

Basis of consolidation

The financial statements consolidate Co-operative Group Limited ("the Society"), which is the ultimate parent society ('parent'), and its subsidiary undertakings. 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.

The diagram below shows the composition of the Group and its principal subsidiaries, joint arrangements and associates. Further details can be found in note 34. A full list of subsidiaries that make up the Group for the purposes of these financial statements can be found at:

http://www.co-operative.coop/corporate/aboutus/oursubsidiaries/



All shareholdings are 100% owned unless otherwise stated.

General Accounting Policies continued

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.

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.

Definition of Trading Group and Financial Services

Throughout the financial statements reference is made to the Financial Services activities of the Group to distinguish it from other Trading Group activity. The Financial Services entities comprise CIS General Insurance Limited (CISGIL) and other smaller entities (mainly holding, ancillary companies and the Reclaim Fund Limited) and the Group's remaining 20.2% investment in the Co-operative Bank Plc. This distinction is made as the Trading Group, CISGIL and the rest of Financial Services are separately funded.

Accounting dates

The financial statements are prepared for the 52 weeks ended 2 January 2016. Comparative information is presented for the 52 weeks ended 3 January 2015. Since the financial periods are virtually co-terminus with the calendar years, the current period figures are headed 2015 and the comparative figures are headed 2014.

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. For the period ending 2 January 2016, 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 (Generally Accepted Accounting Principles) measures

One off costs include costs relating to activities such as large restructuring programmes 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 tax, has been presented. This is shown at the bottom of the income statement and is reconciled back to the statutory measure of profit before tax. In calculating this non-GAAP measure, property and business disposals (including individual store impairments), the change in value of investment properties, one off costs, profit / losses from associates / joint ventures and non-underlying interest are added back.

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.

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)
- Non-current asset impairment (Notes 10 & 11)
- Accounting for the Group's investment in The Co-operative Bank Plc (Notes 13 & 26)
- Pensions (Notes 15 & 27)
- Inventories (Note 17)
- Provisions (Note 24)
- General Insurance claims and reserves (Notes 21 & 28)

General Accounting Policies continued

The Group has applied all endorsed IFRSs that are effective on a European basis for the Group's financial statements for the period ended 2 January 2016 and the comparative period.

Restatements

Revenue of £45m has been deducted from sales in Food and netted in cost of sales in the prior year. This relates to income received from suppliers for the Group hauling their products to the Group's depots and as such is more appropriately recorded as an adjustment to the cost of inventory. There is no impact on net assets.

The restatement of the comparative period cashflow, balance sheet and net debt figures reflects adjustments to exclude £53m cash deposits held in trustee-administered bank accounts (which can only be utilised to meet liabilities in respect of funeral plans) from cash and to include them instead within investments in funeral plans. As this restatement is not material from a balance sheet perspective, a third balance sheet as required under IAS 1 has not been included.

Payments to pension schemes of £48m relating to deficit payments made by the Group are now included within operating cashflows when they were previously shown in financing to better reflect their nature as an employee related expense.

Cash held in the Reclaim Fund of £488m (2014: £407m) is no longer shown in the cashflow statement as the cash is not available for use by the Group. Reclaim Fund cashflows have also been excluded from the reconciliation of operating profit to net cash flow used in operating activities (note 9).

The restatement of the comparative period operating segments note, the operating expenses note and non-GAAP measure of underlying profit before member payments reflects the following:

- the result from the Group's Estates business has been reported in the segmental analysis within Food (previously reported within in costs of supporting functions) to align with, and following a change in, the information that is reported to the Chief Operating Decision Maker (CODM) which is the Group Board;
- impairment charges on loss making food stores or funeral branches are now shown in profit or loss on property and business disposals (previously these were included within underlying segment operating profit). This reduces volatility in the underlying profit measure and therefore assesses the businesses on their true underlying performance;
- CISGIL transformation costs of £6m previously reported in underlying profit are now included within one off costs;
- certain central costs previously reported within costs from supporting functions are now reported within the Food result to align with, and following a change in, the operational responsibility in this area and consequently the information that is reported to the CODM.

The impact of the restatements noted above are summarised in the table below:

£'m	2014 reported	Estates	Impairment	CISGIL	Central Costs	2014 restated
Underlying segment operating profit:						
Food	251	(15)	8	-	(2)	242
Funerals	66	-	-	-	-	66
CISGIL	(7)	-	-	6	-	(1)
Other businesses	8	-	-	-	-	8
Costs from support functions	(146)	15	-	-	2	(129)
Total	**172**	**-**	**8**	**6**	**-**	**186**
One-off items	(68)	-	-	(6)	-	(74)
Property and business disposals	107	-	(8)	-	-	99
Change in value of Investment properties	16	-	-	-	-	16
Operating profit	**227**	**-**	**-**	**-**	**-**	**227**

General Accounting Policies continued

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.

- IFRS 14 Regulatory Deferral Accounts;*
- Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11);
- Clarification of Acceptable Methods of Depreciation and Amortisation and Amendments bringing bearer plants into the scope of IAS 16 (Amendments to IAS 16 and IAS 38);
- Equity Method in Separate Financial Statements (Amendments to IAS 27);
- Annual Improvements to IFRSs 2010 -2012 Cycle – various standards;
- Annual Improvements to IFRSs 2012 -2014 Cycle – various standards;
- Disclosure Initiative (Amendments to IAS 1);
- Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12*);
- Disclosure Initiative (Amendments to IAS 7*).

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 2018. 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. Furthermore, the introduction of the new standard may affect revenue recognition on funeral plans and Management are currently assessing the potential impact of the new standard on the financial statements.

- IFRS 16 Leases*

  IFRS 16 fundamentally changes the accounting for leases by lessees. It eliminates the current IAS 17 dual accounting model, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases and, instead, introduces a single, on-balance sheet accounting model that is similar to current finance lease accounting. It will be effective for annual periods beginning on or after 1 January 2019. As the Group has material operating lease obligations the introduction of the new standard will have a material impact upon both assets and liabilities on the balance sheet and the rental charge recorded in the income statement. Management are assessing the impact of this standard on its financial statements. More information on the Group's operating leases commitments, which are currently off balance sheet, can be found in note 32.

  *Not yet endorsed by the European Union.

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 17 to 23). The Directors have also assessed the financial risks facing the Group, its liquidity position and available borrowing facilities. These are principally described in Note 22 to the accounts. In addition, Notes 22 and 30 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.

General Accounting Policies continued

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 30, 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 April 2017 (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 and other less material financial services subsidiaries. Following a change in the Group's company structure, CISGIL is no longer directly owned by CBG thus reducing the regulatory risk associated with CBG. CBG is self-funding. Profitability and cash flow forecasts for CBG, prepared for the period to April 2017 (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.

CISGIL

CISGIL has significant deposits with credit institutions of £199.1m, considerably in excess of the Board's target minimum liquidity requirement of £21m.

CISGIL is required to comply with a number of regulatory capital requirements. At 31 December 2015, CISGIL's total regulatory capital was £258.6m which is in excess of all externally imposed regulatory capital requirements. In May 2015, CISGIL successfully raised £70m of sub-ordinated debt with a ten year term which will support the ongoing Transformation Programme whilst ensuring future capital targets are met.

In assessing capital resilience for the period under review, CISGIL has considered a number of stress and reverse stress tests on capital in the context of maintaining future capital levels 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 £66.1m, which includes claims expenditure as a result of the December 2015 severe weather events and expenditure related to the Transformation Programme. Losses are forecast to continue in 2016 and 2017, driven by the ongoing Transformation Programme.

From 1 January 2016, CISGIL will operate under the new Solvency II regulatory framework. Under this regime the regulatory capital requirement includes an Add on which is in respect of additional operational risks associated with the ongoing Transformation Programme. Including the Add on, current forecasts show that CISGIL's available capital will remain significantly above all Solvency II capital requirements for the foreseeable future.

The key risk to CISGIL throughout the Transformation Programme is execution risk. Poor governance or failure to deliver the new platform could result in the need for an alternative strategy to be deployed with cost, time and business sustainability impacted. CISGIL has sought to mitigate this risk through the development of a robust governance structure around the programme, to provide oversight and direction to the plan with an established escalation process for decision making and risk assessment.

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.

Notes to the Financial Statements

Section A - where does our profit come from?

1. Operating segments

In plain English - what does this note show?

This note shows how our different businesses have performed. This is how we report and monitor our performance internally. These are the numbers that our Board reviews during the year.

	2015				
	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	**6,958**	**250**	**260**	**273**	**(213)**
Funeralcare	**399**	**78**	**78**	**16**	**(20)**
General Insurance	**343**	**(13)**	**(60)**	**55**	**(47)**
Other businesses	**97**	**9**	**9**	**-**	**(1)**
Federal[g]	**1,504**	**-**	**-**	**-**	**-**
Costs from supporting functions	**-**	**(160)**	**(175)**	**22**	**(29)**
Total	**9,301**	**164**	**112**	**366**	**(310)**

	2014 (restated - see d below)				
	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	7,041	242	331	238	(210)
Funeralcare	363	66	66	19	(21)
General Insurance	371	(1)	(7)	48	(63)
Other businesses	134	8	20	4	(4)
Federal[g]	1,479	-	-	-	-
Costs from supporting functions	-	(129)	(183)	19	(31)
Total	9,388	186	227	328	(329)

a) Underlying segment operating profit is a non-GAAP measure of segment operating profit before the impact of property and business disposals (including individual store impairment), change in value of investment properties, profits / losses from associates / joint ventures 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 periodic results reported into the CODM (see general accounting policies for definition) and whether the respective division's results meet the IFRS 8 minimum reporting thresholds. The 'Other Businesses' category includes activities which are not reportable per IFRS 8. The significant constituent parts of 'Other businesses' are the Group's Legal Services, Electricals and, prior to its disposal in the previous year, the Sunwin Services Group, and their results have been combined as allowed by IFRS 8. The Farms business is included within Food in the comparative figures. Other Financial Services entities (mainly holding, ancillary companies and the Reclaim Fund Limited) are included within costs from supporting functions.

d) The operating segments for 2014 have been restated such that the results of the Estates division are now included within Food (previously within Costs from supporting functions). Impairment charges against Food stores that were previously included within underlying segment operating profit are now shown within property and business disposals and certain central costs previously shown within costs from supporting functions are now shown within the Food result (see general accounting policies section).

Notes to the Financial Statements continued

1. Operating segments continued

e) Additions to non-current assets are derived on a cash flow basis. Depreciation and amortisation excludes £9m (2014: £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 £47m (2014: £63m) and additions of £55m (2014: £46m) on deferred acquisition costs are included within General Insurance.

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.

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. The Group acts as a wholesaler to the other independent co-operatives and generates sales because of this. 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 analysis are £nil (2014: £20m) of sales by Sunwin Services Group (prior to the sale of this business), £9m (2014: £9m) sales by Co-op Electrical, £2m (2014: £2m) sales by Legal Services and £2m (2014: £2m) of sales by the General Insurance business.

i) A reconciliation between underlying segment operating profit and operating profit is as follows:

	2015					
	Food £m	**Funeralcare £m**	**General Insurance £m**	**Other businesses £m**	**Costs from supporting functions £m**	**Total £m**
Underlying segment operating profit	**250**	**78**	**(13)**	**9**	**(160)**	**164**
One off items:						
– Restructuring costs	**-**	**-**	**(47)**	**-**	**(15)**	**(62)**
One off items	**-**	**-**	**(47)**	**-**	**(15)**	**(62)**
Property and business disposals	**(14)**	**-**	**-**	**-**	**-**	**(14)**
Change in value of investment properties	**24**	**-**	**-**	**-**	**-**	**24**
Operating profit	**260**	**78**	**(60)**	**9**	**(175)**	**112**

Restructuring costs primarily relate to expenditure incurred in relation to the on-going transformation programme and replatforming work being undertaken within our General Insurance business. The costs associated with the implementation of the transformation programme are charged to the income statement as incurred, with recognition of assets where the technical accounting criteria are met. The remaining restructuring costs relate to Rebuild activity within our supporting functions.

	2014 (restated)					
	Food £m	Funeralcare £m	General Insurance £m	Other businesses £m	Costs from supporting functions £m	Total £m
Underlying segment operating profit	242	66	(1)	8	(129)	186
One off items:						
– Restructuring costs	(23)	-	(6)	-	(56)	(85)
– Past service pension credit	-	-	-	-	11	11
One off items	(23)	-	(6)	-	(45)	(74)
Property and business disposals	96	-	-	12	(9)	99
Change in value of investment properties	16	-	-	-	-	16
Operating profit	331	66	(7)	20	(183)	227

Restructuring costs in 2014 mainly related to costs incurred in the restructuring of the Food distribution network, the executive restructure and the establishment of the Target Operating Model for the Group's support centres.

During 2014, certain former United Co-operative pension funds changed their rules decreasing retirement benefits for early retirees. This reduced estimated future liabilities by £11m and therefore created a one-off credit to the Consolidated income statement.

Notes to the Financial Statements continued

1. **Operating segments** continued

j) A reconciliation between underlying segment operating profit and profit before tax is provided below:

	Note	**2015** **£m**	2014 £m
Underlying segment operating profit		**164**	186
Underlying interest payable	6	**(83)**	(113)
Underlying profit before tax		**81**	73
One-off items (see above)		**(62)**	(74)
Property and business disposals	3	**(14)**	99
Change in value of investment properties	12	**24**	16
Finance income	5	**39**	69
Non-cash finance costs	6	**(34)**	(30)
Accelerated interest due to the early repayment of debt	6	**-**	(26)
Share of profit of associates and joint ventures	13	**(11)**	(3)
Profit before tax		**23**	124

2. Revenue

In plain English - what does this note show?

This note analyses our gross sales and net revenue across the Co-op's different businesses.

	2015 **£m**	2014 (restated*) £m
Sale of goods	**7,037**	7,125
Provision of services	**417**	413
Federal sales	**1,504**	1,479
Gross earned premiums	**374**	398
Premiums ceded to reinsurers	**(31)**	(27)
Net revenue (as shown in the Consolidated income statement)	**9,301**	9,388
Value Added Tax	**765**	789
Gross sales	**10,066**	10,177

*See general accounting policies section on page 81 for more details of the restatement.

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 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 in the previous year, Sunwin Services Group. Revenue is recognised when the service is rendered and the revenue can be reliably measured. See note 23 for further details of the accounting policies relating to prepaid funeral plans and funeral benefit options (FBO's).

Gross earned premiums

Gross written premiums comprise premiums receivable on CISGIL contracts which incepted during the financial year, 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.

Gross written premiums:

- 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 year 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 premium (whether paid in advance or by instalments) is earned evenly over the period of the contract (usually twelve months). The treatment of outward reinsurance premiums is similar to gross premiums written.

Notes to the Financial Statements continued

3. Operating expenses

In plain English - what does this note show?

This note shows what costs we have incurred during the year. It splits costs into key categories such as trading activity expenses and employee benefit expenses.

Operating profit is stated after (charging) / crediting the following:

	2015 **£m**	2014 (restated*) £m
Cost of sales		
- Trading activities	**(6,160)**	(6,206)
- Claims incurred, net of claims recovered from reinsurers	**(244)**	(249)
- Fee and commission expense	**(9)**	(7)
Employee benefits expense (see below)	**(1,234)**	(1,287)
Distribution costs	**(330)**	(327)
Net (loss) / gain on property and business disposals (restated)	**(14)**	99
Change in value of investment properties	**24**	16
Operating lease rentals	**(153)**	(152)
Impairment of non-current assets	**(27)**	(20)
Depreciation	**(256)**	(257)
Amortisation	**(7)**	(9)
Amortisation on deferred acquisition costs in CISGIL	**(47)**	(62)
Subscriptions and donations	**(5)**	(5)

*See general accounting policies section on page 81 for more details of the restatement.

Impairment of non-current assets, depreciation and amortisation relate to continuing businesses. The prior year figures in notes 10 and 11 also include charges relating to discontinued operations. 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. See accounting policy at the end of this note for further details. The operating lease rental charge excludes any charges relating to onerous leases.

Employee benefits expense

	2015 **£m**	2014 £m
Wages and salaries	**(1,089)**	(1,139)
Social security costs	**(60)**	(64)
Pension costs – defined benefit schemes	**(54)**	(58)
Pension costs – defined contribution schemes	**(31)**	(26)
	(1,234)	(1,287)

The average number of people employed by the Group in the UK was:

	2015	2014 (restated*)
Full-time	**25,460**	28,414
Part-time	**43,618**	46,535
	69,078	74,949

*The prior year figures have been restated to exclude discontinued businesses.

Remuneration of key management

For details regarding remuneration of the Group Board and the Management Executive refer to pages 53 to 65.

Notes to the Financial Statements continued

3. Operating expenses continued

Net gain on property and business disposals

	2015 **£m**	2014 (restated*) £m
Property disposals (restated)	**(14)**	(34)
Disposal of Farmcare	**-**	121
Disposal of Sunwin Services Group	**-**	13
Disposal of Motor Group dealerships	**-**	(1)
	(14)	99

* See general accounting policies section on page 81 for more details of the restatement. The total consideration received for Farmcare and Sunwin Services Group (which were disposed in the prior year) was £281m of which £268m was received in cash and cash equivalents in 2014 and £13m was deferred and was received in cash in 2015. As Pharmacy was a discontinued operation in the prior year, the gain on disposal of Pharmacy, and other disclosures relating to the sale, are included within discontinued operations in note 8.

A summary of the assets and liabilities relating to Farmcare and Sunwin Services Group at the point of disposal (in the prior year) 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

Auditors’ remuneration and expenses	**2015** **£m**	2014 £m
Audit of these financial statements	**0.5**	0.4
Amounts receivable by the Society's auditor in respect of:		
- Audit of financial statements of subsidiaries in respect of the Society	**0.2**	0.3
- Other services pursuant to such legislation	**-**	-
Services relating to:		
- Audit related assurance services	**0.4**	0.2
- Other tax advisory services	**0.5**	-
- All other services	**0.3**	0.3
Total	**1.9**	1.2

In the prior period the above figures included auditors’ remuneration and expenses in respect of discontinued operations. Of the total amounts presented, £1.1m related to continuing operations in 2014. 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 2015 were £0.2m (2014: £0.2m).

Tax services were provided to the Pace pension scheme in the year to the value of £20,000 (2014: £nil).

Notes to the Financial Statements continued

3. Operating expenses continued

Accounting policies

Operating expenses

Operating expenses are analysed by nature, as defined by IAS 1. Payments to equity shareholders in their capacity as customers or employees (rather than as members), or member payments to non-members such as charitable organisations, are treated as charges in the income statement.

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 2015, the supplier income deducted from cost of sales in Food was £635m (2014: £612m), of which £138m (2014: £137m) related to long term agreements, £160m (2014: £160m) related to bonus income and £337m (2014: £316m) related to promotional income. This represented 2.1%, 2.4% and 5.1% respectively (2014: 2.1%, 2.4% and 4.8%) 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.

4. Other income

In plain English - what does this note show?

This analysis shows what the Group has earned during the year from activities that are outside our normal trading activities. Such income includes interest that we earn on assets held by our Insurance business as well as rent from properties that we own.

	2015 £m	2014 £m
Investment income	**15**	21
Realised gains arising from financial instruments	**4**	3
Rental income from non-investment property	**11**	11
Rental income from investment property	**2**	2
Fee and commission income	**11**	10
	43	47

Notes to the Financial Statements continued

4. Other income continued

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.

Investment income also includes net gains and losses on financial assets designated as fair value through income and expense, including interest income.

Realised gains less losses arising from financial instruments

When an available for sale financial asset in CISGIL is sold, or impaired, the accumulated gain or loss accumulated in the available for sale investments reserve is reclassified to profit or loss.

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 CISGIL fee income, recognised as the related service is provided, and brokerage commission, receive through sales of additional aggregator related business, earned over the lifetime of the related policy.

5. Finance income

In plain English - what does this note show?

The note gives further details of the finance income that the Group has recognised in the year. This income arises in two ways: (i) the interest earned on our pension scheme and, if a gain, (ii) the movement in the value of our interest rate swap positions (which are used to manage risks from interest rate movements).

	2015 £m	2014 £m
Net pension finance income	**39**	12
Fair value movement on interest rate swaps (see note 31)	**-**	57
Total finance income	**39**	69

Included in the above are interest and bonuses of £65m earned in the year on funeral plan investments. These have been offset by a £65m increase in the corresponding financial liability. See note 23 for further details of our accounting policy for funeral plans.

Notes to the Financial Statements continued

6. Finance costs

In plain English - what does this note show?

Our main finance cost is the interest that we've incurred during the year on the bank borrowings that help fund the business. Other finance costs include the movement in the fair value of certain elements of that debt from year to year, as well as the non cash charge we incur each year on long term provisions as the payout moves one year closer (the discount unwind).

	2015 £m	2014 £m
Loans repayable within five years	**(73)**	(99)
Loans repayable wholly or in part after five years	**(10)**	(14)
Underlying interest payable	**(83)**	(113)
Accelerated interest due to the early repayment of debt	**-**	(26)
Accelerated fee amortisation due to the early repayment of debt	**(2)**	(4)
Fair value movement on quoted Group debt	**(14)**	(15)
Fair value movement on interest rate swaps (see note 31)	**(1)**	-
Discount unwind of provisions (see note 24)	**(17)**	(11)
Other finance costs	**(34)**	(56)
Total finance costs	**(117)**	(169)

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 £17m (2014: £18m).

7. Taxation

In plain English - what does this note show?

Our tax charge is made up of current and deferred tax - this note explains how those items arise. Current tax is the tax arising on the taxable income for the year, whereas deferred tax relates to future periods. This year we have included additional explanatory footnotes (on the following page) to help better explain the key items. The Group were awarded the Fair Tax Mark in 2015 and the additional disclosures are in-line with best practice guidance.

	Footnote	**2015 £m**	2014 £m
Current tax charge - current year	(i)	**-**	-
Current tax - adjustment to group relief payable owed to Co-operative Bank Plc	(ii)	**17**	-
Net current tax credit		**17**	-
Deferred tax charge - current year	(iii)	**(38)**	(5)
Deferred tax credit - adjustments in respect of prior years	(iv)	**13**	1
Net deferred tax charge		**(25)**	(4)
Total tax charge		**(8)**	(4)
Deduct tax credit on discontinued businesses	(v)	**-**	(13)
Total tax charge on continuing businesses		**(8)**	(17)

Notes to the Financial Statements continued

7. Taxation continued

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 20.25% (2014: 21.5%) as follows:

	Footnote	**2015** **£m**	2014 £m
Profit before tax		**23**	124
Tax charge at 20.25% (2014: 21.5%)		**(5)**	(27)
Deferred tax reconciliation:			
Expenses not deductible for tax (including one off costs)	(vi)	**(5)**	(4)
Depreciation and amortisation on non-qualifying assets	(vii)	**(6)**	(5)
Non-taxable profits arising on share disposals	(viii)	**-**	29
Non-deductible costs of investments	(ix)	**(9)**	(13)
Adjustment in respect of previous periods	(iv)	**13**	1
Losses taxed at lower rate / utilisation of losses		**-**	2
Derecognition of tax losses	(x)	**(3)**	-
Restatement of deferred tax to 18% (2014: 20%)	(xi)	**(10)**	-
Subtotal of deferred tax reconciling items		**(20)**	10
Current tax reconciliation:			
Reduction in historic group relief payable owed to Co-operative Bank plc	(ii)	**17**	-
Tax charge on continuing business		**(8)**	(17)

Tax expense on items taken directly to consolidated statement of comprehensive income

	2015 Tax expense £m	2014 Tax expense £m
Actuarial gains and losses on employee pension scheme	**(5)**	(145)
	(5)	(145)

Of the tax taken directly to the consolidated statement of comprehensive income, £5m charge (2014: £145m charge) relates to deferred taxation charge of £17m arising on actuarial movement for the year, net of a credit of £12m which relates to the restatement of deferred tax rates on the pension scheme surplus. See note 16 on deferred tax.

The Finance Act 2013 reduced the main rate of corporation tax from 21% to 20% from 1 April 2015. The Finance Act 2015 will further reduce the main rate of corporation tax to 19% from 1 April 2017 and to 18% from 1 April 2020. This will reduce the company's future current tax charge accordingly. Each deferred tax balance has been measured individually based on the tax rate at which it is expected to unwind (either 18%, 19% or 20%). This results in a blended deferred tax rate of 18.8% at the balance sheet date.

Tax policy

The Group published its Tax Policy on our website http://www.co-operative.coop/corporate/investors/tax-policy/. The disclosures made in these financial statements comply with the commitments made in that policy.

Footnotes to taxation note 7:

i) The Group is not taxpaying in respect of 2015 (apart from an amount explained below) due to the fact it has a number of brought forward capital allowances and tax losses that are in excess of its taxable profit for the period. These allowances and losses are explained in more detail in Note 16. An amount of current tax of £170k (2014: £335k) is in respect of wholly owned IOM resident subsidiary, Manx Co-operative Society, an entity which made a profit of £2.3m in the period by undertaking convenience retailing in the Isle of Man. All other profits reported in these accounts arise solely from activities undertaken in the UK. This is the Group's only non UK resident entity for tax

Notes to the Financial Statements continued

7. Taxation continued

Footnotes to taxation note 7 continued

purposes. A full copy of the most recent accounts is available here: http://www.co-operative.coop/Corporate/PDFs/Annual-Report/2015/Manx-Co-operative-Society-Limited-2015.pdf . In addition the Group has one company registered in the Cayman Islands, Violet S Propco Limited. This dormant company has always been UK resident for tax purposes as it is managed and controlled entirely within the UK. All tax obligations in respect of this company are therefore reported in the UK.

ii) The Group hold a creditor balance in relation to group relief claimed from the Co-operative Bank Plc in 2012 and 2013. This group relief payable is intrinsically linked to and held at prevailing tax rates. As a result of the reduction in corporation tax rates, the total group relief payable has reduced.

iii) Deferred taxation is an accounting standard concept that reflects how certain income and expenses fall into the charge to tax in differing periods from the accounting period than the period the original income or expense arose. These differences are a result of tax legislation. Note 16 explains how each deferred tax balance has moved in the year. £38m of net deferred tax assets have been utilised in 2015 which has resulted in a taxable profit of £nil for this year. It is expected that deferred tax assets will continue to be utilised against future taxable profits, and it is likely that the tax bill of the Group will remain at £nil until at least 2018 due to the utilisation of these assets. No forecasts are available after this date.

iv) Adjustments to tax charges in earlier years arise because the tax charge in the financial statements is an estimate that is prepared before the detailed tax calculations are required to be submitted to HMRC, which is 12 months after the year end. In addition, HMRC may not agree with a tax return some time after the year end and the liability for a prior period may arise as a result. In 2014 the differences are purely in respect of differences between the estimated position for the year and the position submitted to HMRC. During 2015 the Group has revisited the unwind of certain historic deferred tax balances, primarily arising on revaluation of land and buildings. This review has required a release of deferred tax liabilities which had crystallised in historic periods.

v) The tax credit arising on discontinued activities in 2014 was primarily due to the fact that no tax arose on the accounting profit arising on the sale of the Pharmacy business. This was due to the availability of the Substantial Shareholding Exemption. This is a legislative exemption from capital gains for corporate entities who sell more than 10% of their shares in a trading entity. There are a number of tests to satisfy to obtain this exemption. The Group agreed with HMRC in advance of these disposals that the exemption would apply.

vi) Some expenses incurred by the Group may be entirely appropriate charges for inclusion in its financial statements but are not allowed as a deduction against taxable income when calculating the Group's tax liability. Examples of this include certain repairs, entertaining costs and legal costs.

vii) The accounting treatment of depreciation differs from the tax treatment. For accounting purposes an annual rate of depreciation is applied to capital assets. For taxation purposes the Group is entitled to claim capital allowances, a relief provided by law. Certain assets do not qualify for capital allowances and no relief is available for tax purposes on these assets. This value represents depreciation arising on such assets (primarily land and buildings).

viii) In 2014 the Group disposed of its shareholding in Farmcare Limited and Sunwin Security Services Group (2010) Limited. No tax arose on the accounting profit due to the availability of the Substantial Shareholding Exemption. This is a legislative exemption from capital gains for corporate entities who sell more than 10% of their shares in a trading entity. There are a number of tests to satisfy to obtain this exemption. In addition, the Group agreed with HMRC in advance of these disposals that the exemption would apply. No shareholdings were disposed of during 2015.

ix) These represent the write off of the value of certain shareholdings sold in the year as well as the write off of certain land and buildings disposed of during the year.

x) Part of the deferred tax asset in respect of tax losses has been derecognised in the year, as it is considered that these losses will not be able to be utilised in future periods. As such, at 2 January 2016, there is an unrecognised deferred tax asset of £3m (2014: £nil).

xi) It is a requirement to measure deferred tax balances at the substantively enacted corporation tax rate at which they are expected to unwind. Due to the reduction in corporation tax rates from 20% to 18% deferred tax balances have been reduced, and hence released to the income statement, to reflect this decrease in tax rates.

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

8. Profit on discontinued operations, net of tax

In plain English - what does this show?

When a key and separate major line of our business is either disposed of, or is classified as being held for sale, then the profit (or loss) of that business is shown separately in the income statement after profit after tax. This note provides further details of such businesses, including analysis of income and expenses, segmental sales analysis and assets, liabilities and cashflows.

In the prior year, on 6 October 2014, the Group announced the completion of the sale of its Pharmacy business to Bestway Group for consideration of £640m and the result of that business for the period up to disposal, and the profit on disposal, was disclosed within discontinued operations.

During the prior year the Group also disposed of its Farms division 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 were not disclosed as discontinued operations as defined by IFRS 5.

Results of discontinued operations	**2015 £m**	2014 £m
Revenue	**-**	578
Expenses*	**-**	(528)
Results from operating activities	**-**	50
Profit on sale of discontinued operations (see below)	**-**	61
Profit before tax	**-**	111
Tax - relating to operating activities*	**-**	(2)
Tax - relating to the loss on sale of discontinued operations	**-**	-
Profit/(loss) for the period	**-**	109

*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 2014 therefore did 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.

Profit on sale of discontinued operations	**2015 £m**	2014 £m
Cash consideration received for the sale of the Pharmacy business	**-**	640
Pharmacy net assets derecognised	**-**	(490)
Pharmacy disposal and separation costs	**-**	(28)
Profit on sale	**-**	122
Further disposal and separation costs in respect of the Co-operative Bank Plc	**-**	(49)
Further disposal costs in respect of the Life and Savings business and TCAM Limited	**-**	(12)
Profit on sale of discontinued operations	**-**	61

In 2014, following a review of the Group's separation of the Co-operative Bank Plc in December 2013, and in light of better information, the Group reassessed the estimated costs on separation and a further £49m charge was recognised in relation to costs to be incurred on the separation of 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 2 January 2016	**-**	**-**	**-**	**-**	**-**

The amounts in the table above for the 52 weeks ended 3 January 2015 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 at the time) did not include this adjustment.

Notes to the Financial Statements continued

8. Profit 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:

	2015 £m	2014 £m
Cash flows used in discontinued operations:		
Net cash from operating activities	**-**	49
Net cash from investing activities	**-**	(21)
Net cash used in discontinued operations	**-**	28

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

9. Reconciliation of operating profit to net cash flow used in operating activities

In plain English - what does this show?

This note shows how our operating profit figure, as reported in the consolidated income statement, is reconciled to the net cash used in operating activities as shown, as the starting position in the cash flow statement. In the analysis below, non-cash items are added back to or deducted from the operating profit figure. The resulting figure is the cash from operating activities.

	2015 **£m**	2014 (restated*) £m
Operating profit	**112**	227
Profit on discontinued operations	**-**	109
Depreciation and amortisation charges (excluding deferred acquisition costs)	**263**	279
Non-current asset impairments	**27**	22
Profit on disposal of businesses and non-current assets	**(13)**	(311)
Change in value of investment properties	**(24)**	(16)
Retirement benefit obligations	**(38)**	(48)
(Increase) / Decrease in inventories	**(11)**	26
(Increase) / Decrease in receivables	**(130)**	106
Increase / (Decrease) in payables and provisions**	**98**	(504)
Net cash flow from / (used) in operating activities before asset and liability movements in Financial Services	**284**	(110)
Fair value through profit and loss movement	**(43)**	51
Assets available for sale movement	**66**	37
Movement in deferred acquisition costs	**(8)**	15
Reinsurance assets	**3**	(15)
Loan receivables at amortised cost	**(3)**	3
Insurance and other receivables	**(68)**	50
Insurance and participation contract provisions	**15**	(128)
Insurance and other payables	**37**	8
Asset and liability movements in Financial Services	**(1)**	21
Net cash from / (used) in operating activities	**283**	(89)

* See general accounting policies section on page 81 for details of the restatement.

** The decrease in payables and provisions in the prior period includes the payment of the £313m capital contribution to Co-operative Bank Plc

The cash flows above and in the cash flow statement include discontinued operations.

Asset and liability movements from Financial Services activity are shown separately from the rest of the Group to aid a member in understanding the impact of fluctuations and volatility in this area.

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.

Notes to the Financial Statements continued

Section B - what are our major assets?

This section of the accounts (notes 10 - 20) outlines the key assets that the Group holds at the balance sheet date.

10. Property, plant and equipment

In plain English - what does this note show?

Property, plant and equipment is mainly our food stores, funeral branches, distribution centres and our support centre facilities. The assets are held on our balance sheet. They include land and buildings as well as fixtures, fittings, equipment and vehicles. This note details the additions, disposals and transfers of these assets in the year, together with depreciation (a charge to the income statement to represent usage of these assets).

For the period ended 2 January 2016	Property £m	Plant and equipment £m	Total £m
Cost or valuation:			
At 3 January 2015	1,548	2,451	3,999
Additions	13	249	262
Acquisition of subsidiaries	2	-	2
Disposals	(11)	(39)	(50)
Transfer to Investment properties (see note 12)	(2)	-	(2)
Fully written down assets*	(2)	(677)	(679)
At 2 January 2016	1,548	1,984	3,532
Depreciation:			
At 3 January 2015	506	1,495	2,001
Charge for the period	25	231	256
Impairment	21	6	27
Disposals	(1)	(37)	(38)
Fully written down assets*	(2)	(677)	(679)
At 2 January 2016	549	1,018	1,567
Net book value:			
At 2 January 2016	999	966	1,965
At 3 January 2015	1,042	956	1,998
Capital work in progress included above	1	11	12

*In previous years fully depreciated assets have been retained in the Group's fixed asset register and included in the table above. As no further economic benefits are expected to arise either from their use or disposal, these assets have been removed from both cost and accumulated depreciation.

The impairment charge of £27m (2014: £20m) primarily relates to charges against loss making stores in Food of £20m (2014: £13m) 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 2 January 2016 using internal valuations based upon the expected rental yield of the property. A further £7m (2014: £1m) of impairment charges relates to non-trading properties. The prior period figure also included a £6m impairment charge in relation to computer software and hardware assets within CISGIL. The charge reflected 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.

Notes to the Financial Statements continued

10. Property, plant and equipment continued

For the period ended 3 January 2015	Property £m	Plant and equipment £m	Total £m
Cost or valuation:			
At 4 January 2014	1,805	2,489	4,294
Additions	60	257	317
Reclassified as assets held for sale (see note 19)	(110)	(50)	(160)
Disposals	(107)	(80)	(187)
Disposal of subsidiary undertakings	(113)	(143)	(256)
Transfer to intangible assets	-	(22)	(22)
Transfer from Investment properties	2	-	2
Revaluation	11	-	11
At 3 January 2015	1,548	2,451	3,999
Depreciation:			
At 4 January 2014	539	1,444	1,983
Charge for the period	26	233	259
Impairment	9	11	20
Reclassified as assets held for sale (see note 19)	(37)	(38)	(75)
Disposals	(31)	(70)	(101)
Disposals of subsidiary undertakings	(14)	(77)	(91)
Transfer to Intangible assets	-	(8)	(8)
Transfer to Investment properties	(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

The disposal of subsidiary undertakings in the prior year related to the sale of our Pharmacy, Farms and Sunwin Services businesses during the year.

In the prior year assets with a cost of £6m and accumulated depreciation of £1m in relation to a web-site in the Funerals business were transferred to Intangibles. Computer software assets with a cost of £16m and accumulated depreciation of £7m in CFSMS were transferred to Intangibles (see note 11).

The revaluation uplift of £11m in the prior year related 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 were vacant) but were adjacent to land farmed by our Farms business. The historical cost carrying value was £4m and the surplus on revaluation was recognised in the statement of other comprehensive income. The properties were fair valued as at 4 Aug 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).

	2015 £m	2014 £m
Plant and equipment includes assets held under finance leases as follows:		
Cost	**38**	39
Accumulated depreciation	**(26)**	(27)
Net book value	**12**	12

No other assets of the Group are held under a finance lease.

Notes to the Financial Statements continued

10. Property, plant and equipment continued

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' four year plan and discounting the cash flows associated with that asset at a pre tax rate of between 10-12% dependent on the business. Certain central corporate costs and tax are also allocated to the asset on a reasonable basis. Cash flows beyond four 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

All properties are measured at cost less accumulated amortisation and impairment losses.

Plant and equipment

Plant and machinery - 3 to 13 years

Vehicles - 3 to 9 years

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 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.

Notes to the Financial Statements continued

10. Property, plant and equipment continued

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

In plain English - what does this show?

The Group holds four main types of intangible assets on its balance sheet which are: (i) goodwill arising on past acquisitions (ii) computer software in relation to the computer systems that we use (iii) deferred acquisition costs (DACs) representing costs associated with generating new insurance business and (iv) intangible assets still to be constructed. This note details the additions, disposals and transfers of these assets in the year, together with amortisation (a charge to the income statement to represent usage of these assets).

For period ended 2 January 2016

	Goodwill £m	Licences £m	Computer software £m	Assets in course of construction £m	Total £m
Cost:					
At 3 January 2015	**1,262**	**-**	**63**	**2**	**1,327**
Additions	**15**	**-**	**-**	**15**	**30**
Disposals	**(9)**	**-**	**-**	**-**	**(9)**
At 2 January 2016	**1,268**	**-**	**63**	**17**	**1,348**
Accumulated amortisation and impairment:					
At 3 January 2015	**373**	**-**	**49**	**-**	**422**
Charge for the period	**-**	**-**	**7**	**-**	**7**
Disposals	**(1)**	**-**	**-**	**-**	**(1)**
At 2 January 2016	**372**	**-**	**56**	**-**	**428**
Net book value:					
At 2 January 2016	**896**	**-**	**7**	**17**	**920**
Deferred acquisition costs (see overleaf)					**28**
At 2 January 2016					**948**

Deferred aquisition costs

	2015 £m	2014 £m
At the beginning of the financial year	**20**	37
Deferred acquisition costs	**55**	46
Amortisation	**(47)**	(63)
At the end of the financial year	**28**	20

All amounts in the current and prior year are expected to be recovered within one year.

Notes to the Financial Statements continued

11. **Goodwill and intangible assets** continued

For period ended 3 January 2015

	Goodwill £m	Licences £m	Computer software £m	Assets in course of construction £m	Total £m
Cost:					
At 4 January 2014	1,276	504	48	2	1,830
Additions	12	-	2	2	16
Transfers from property, plant and equipment (see 10)	-	-	22	-	22
Disposals	(3)	-	(9)	(2)	(14)
Disposals of subsidiaries	(23)	(504)	-	-	(527)
At 3 January 2015	1,262	-	63	2	1,327
Accumulated amortisation and impairment:					
At 4 January 2014	371	176	39	-	586
Charge for the period	-	4	8	-	12
Impairment	2	-	-	-	2
Transfer from property, plant and equipment (see 10)	-	-	8	-	8
Disposals	-	-	(6)	-	(6)
Disposals of subsidiaries	-	(180)	-	-	(180)
At 3 January 2015	373	-	49	-	422
Net book value:					
At 3 January 2015	889	-	14	2	905
Deferred acquisition costs (as below)					20
At 3 January 2015					925
As at 4 January 2014	905	328	9	2	1,244
Deferred acquisition costs					37
At 3 January 2015					1,281

Additions to assets in the course of construction in the year of £15m (2014: £2m) relate to software expenditure on a number of Rebuild strategy projects that will go live in 2016 and 2017.

In the prior year, 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 prior year charge of £4m represented amortisation in respect of the period prior to the announcement of the sale on 26 February 2014. No further amortisation was charged on these assets after that date in line with IFRS 5. In 2014 assets with a cost of £6m and accumulated depreciation of £1m in our Funerals business were transferred to computer software from property, plant and equipment, as were computer software assets with a cost of £16m and accumulated depreciation of £7m in CFSMS (see note 10).

Notes to the Financial Statements continued

11. **Goodwill and intangible assets** continued

Goodwill

The components of goodwill are as follows:

	2015 £m	2014 £m
Food	**866**	862
Other businesses	**30**	27
	896	889

The components of Food goodwill include £610m (2014: £621m) that is allocated to the group of cash generating units (CGUs) that is Food as a whole; £85m (2014: £86m) allocated to stores acquired with the Alldays group and £171m (2014: £155m) assessed against other specific components of the Food business, none of which is individually significant.

The goodwill within other businesses principally relates to the Funerals business.

Impairment

The components of the impairment charge are as follows:

	2015 £m	2014 £m
Included in operating expenses within continuing operations:		
Goodwill in Food	**-**	2
	-	2

The impairment of goodwill in the prior year related to food stores transferred to assets held for sale.

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 4 year plans approved by the Board. The discount rate is based on the post tax cost of capital of the business of 8.1% (2014: 8.1%). Business-specific growth rates are used to extrapolate cash flows beyond the 4 year plan. The cash flows 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% (2014: 1-3%) based on management's best estimate based on the profile of the stores, and including an allocation of central costs) taken into perpetuity and discounted to present value at a rate of 8.1% (2014: 8.1%). In each of the current and comparative years, sensitivity analysis has been performed on this assumption, testing for a 1% increase in discount rate and a decrease in growth to 1%; within both these sensitivities 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% (2014: 1-3%) per annum (dependent on the size of the acquisition group) taken into perpetuity and discounted to present value also using an 8.1% (2014: 8.1%) discount rate and after allocating Corporate costs.

For funerals, average selling price increases and wage and cost inflation have been applied as per the assumptions in the 4 year plan. Cash flows have been projected based on the 4 year plan and into perpetuity from year 4 and discounted back to present value using a discount rate of 8.0% (2014: 8.2%). Sensitivity analysis has been performed with both the growth rate and discount rate adjusted by +/- 1%, and under these sensitivities significant headroom is maintained.

Notes to the Financial Statements continued

11. **Goodwill and intangible assets** continued

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.

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.

Acquisitions of non-controlling interests on or after 3 January 2010 are accounted for as transactions with owners in their capacity as owners and therefore no goodwill is recognised as a result of such transactions. The adjustments to non-controlling interests are based on a proportionate amount of the net assets of the subsidiary. Previously, goodwill was recognised on the acquisition of non-controlling interests in a subsidiary, which represented the excess of the cost of the additional investment over the carrying amount of the interest in the net assets acquired at the date of the transaction.

Computer software

Computer software is 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. The costs associated with the implementation of the transformation programme are charged to the income statement as incurred, with recognition of assets where the technical accounting criteria are met.

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)
- 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

In plain English - what does this note show?

The Group owns properties that we don't occupy or trade from and which we rent out or hold for capital appreciation. These properties are re-valued at each year end and this note shows how that valuation has changed during the year as well showing additions, disposals and transfers in and out of Investment properties

	2015 **£m**	2014 £m
Valuation at beginning of period	**99**	98
Additions	**3**	2
Disposals	**(26)**	(14)
Transfers (net) from / (to) property, plant and equipment	**2**	(3)
Revaluation gain recognised in income statement	**24**	16
Transfers to investments in joint ventures (see note 13)	**(15)**	-
Valuation at end of period	**87**	99

Investment properties have been valued as at 2 January 2016 (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 1.6% (2014: 2.2%). Although the overall yield has decreased, a number of specific developments such as Twin Rivers (see note 26) has caused a revaluation gain this year.

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.

In the prior year transfers (net) to property, plant and equipment comprised of 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 that subsequently met the requirements for recognition as investment properties). Transfers out included 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.

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

In plain English - what does this note show?

This note gives further details of the Group's interests in The Co-operative Bank Plc and TCCT Holdings UK Limited (Travel) as well as some smaller investments in our Manchester property joint venture, NOMA, and our Windfarm joint ventures. These items are called 'investments in associates' as the Group has a significant influence over their activities but does not have control. It shows how the value of these investments in the balance sheet has changed during the year, as well as what share of their profit or loss has been shown in our consolidated income statement. The full investments in associates and joint ventures note is shown in note 26.

A breakdown of the investments held and income received is disclosed below:

	2015		2014	
	Income/(losses) £m	**Investments £m**	Income/(losses) £m	Investments £m
The Co-operative Bank plc (Bank)	**(39)**	**185**	(10)	224
TCCT Holdings UK Limited (Travel) - share of income / (losses)	**(5)**	**38**	6	48
NOMA	**1**	**34**	1	31
Other investments	**-**	**28**	-	13
	(43)	**285**	(3)	316
Income from dividend guarantee (explained on page 110)	**32**	**-**	-	-
Total	**(11)**	**285**	(3)	316

The movements in investments in associates, joint ventures and other investments are as follows:

	2015 £m	2014 £m
At beginning of period	**316**	285
Additions	**3**	31
Transfers from investment property (see note 12)	**15**	-
Share of losses	**(43)**	(3)
Share of other comprehensive income	**-**	14
Dividends received	**(6)**	(5)
Disposals	**-**	(6)
At end of period	**285**	316

Notes to the Financial Statements continued

13. Investments in associates and joint ventures continued

Travel

The travel associate made a £17m loss in 2015 of which the Group's 30% share was £5m. The Group has also recognised income of £32m in relation to a minimum dividend guarantee under the terms of the joint venture agreement. Under this agreement with Thomas Cook Plc, the Group is guaranteed a minimum of £37m of dividends within the first 5 years (i.e. by September 2016). During 2015, the final year of the agreement, it became clear that the joint venture would not be able to pay any further dividends beyond the £5m already paid. Consequently the remaining £32m of dividend payable to the Group will come from the guarantee and not the underlying profits of the joint venture. A financial asset of £32m has therefore been recognised (see note 18) reflecting the dividend guarantee. As well as the guaranteed dividends described above, the Group has a guaranteed put / call option with Thomas Cook Plc which allows the Group to sell its investment in Travel at the higher of £50m or four times the associate's EBITDA. The Group has not ascribed any value to the guarantee at the 2 January 2016 on the basis that the fair value of the investment and the guarantee are broadly the same.

Bank

The Group has impaired its investment in the Bank to £185m in the light of prevailing market conditions that impacted both the Co-op Bank and the wider banking sector in 2015. The lower for longer interest rate environment and increased Payment Protection Insurance ("PPI") claims provisions were key factors bringing downward pressure on the Bank's valuation. The Group has no access to the bank's plans and the valuation is based only on publicly available information. This has caused the Bank investment to reduce by £39m and this decrease has been reported in loss from associates and joint ventures line in the income statement. For more details, refer to note 26.

14. Investments in funeral plans

In plain English - what does this note show?

Investments backing funeral plan policies make up a significant asset on the Group's balance sheet. These assets are invested in either Individual Whole of Life Policies, Trusts or life assurance products on behalf of our funeral plan customers. This note shows how the balance on these assets has moved during the year from additions (new plans that have been taken out by customers), disposals (reflecting redemption of plans by customers) and the interest or bonus income (reflecting the return on the assets during the year). The liability to deliver future funerals, honouring the policies held, is shown in the balance sheet within Trade and Other Payables (see note 23)

Funeral plan investments:

	2015 £m	2014 (restated*) £m
At start of period	**661**	567
New plan purchases	**115**	87
Plans redeemed or cancelled	**(60)**	(40)
Interest and bonus applied	**65**	47
At end of period	**781**	661

*The figures have been restated to include cash deposits of £47m (2014:£53m) held in trustee-administered bank accounts of the Society which can only be utilised to meet liabilities in respect of funeral plans (previously these were shown within cash and cash equivalents). See supporting note 23 for further details of the Group's accounting policy for funeral plan investments.

Notes to the Financial Statements continued

15. Pensions

In plain English - what does this note show?

The analysis shows the value and net position (being either a surplus or a deficit) for all of the Group's defined benefit (DB) pension schemes. The subsequent tables also outline the present value of the obligations for the Group's DB schemes, as well as the fair value of the plan assets for those schemes. The full pensions note including additional disclosures in relation to the nature of the Group's pension schemes is shown in note 27.

The pension assets and liabilities in the balance sheet comprise:

	Assets 2015 £m	Assets 2014 £m	**Liabilities 2015 £m**	Liabilities 2014 £m	**Net 2015 £m**	Net 2014 £m
Schemes in surplus						
The Co-operative Group Pension Scheme (Pace)	**9,185**	9,154	**(7,919)**	(8,025)	**1,266**	1,129
Somerfield Pension Scheme	**931**	958	**(819)**	(845)	**112**	113
Lothian Borders & Angus Co-operative Society Ltd Employees' Pension Fund*	**-**	69	**-**	(64)	**-**	5
Total schemes in surplus	**10,116**	10,181	**(8,738)**	(8,934)	**1,378**	1,247
Schemes in deficit						
United Norwest Co-operatives Employees' Pension Fund	**493**	492	**(616)**	(641)	**(123)**	(149)
Other former United Co-operative Funds*	**104**	159	**(128)**	(203)	**(24)**	(44)
Plymouth and South West and Brixham Funds*	**86**	89	**(144)**	(151)	**(58)**	(62)
Britannia unfunded obligations	**-**	-	**(3)**	(3)	**(3)**	(3)
Total schemes in deficit	**683**	740	**(891)**	(998)	**(208)**	(258)
Total schemes excluding asset limitation / onerous liability (IFRIC 14)	**10,799**	10,921	**(9,629)**	(9,932)	**1,170**	989
Less asset limitation / onerous liability (IFRIC 14)	**-**	-	**(19)**	-	**(19)**	-
Total schemes	**10,799**	10,921	**(9,648)**	(9,932)	**1,151**	989

*Four schemes merged with Pace during 2015. Further details are provided in note 27

Notes to the Financial Statements continued

15. **Pensions** continued

Changes in the present value of the defined benefit obligation (DBO) are as follows:

	2015 £m	2014 £m
Opening defined benefit obligation	**8,327**	6,615
De-recognised obligation for Britannia Pension Scheme and EFRBS liabilities from the Pace scheme (unfunded)	**-**	(609)
Current service cost	**48**	60
Interest expense on DBO	**302**	293
Participant contributions	**13**	19
Past service costs	**1**	(11)
Remeasurements		
a. Effect of changes in demographic assumptions	**(25)**	150
b. Effect of changes in financial assumptions	**(274)**	707
c. Effect of experience adjustments	**(25)**	(100)
Benefit payments from plan	**(295)**	(236)
Change in share of Pace attributable to Group from 60% to 80%	**-**	1,439
Closing defined benefit obligation attributable to Group	**8,072**	8,327
IFRIC 14 adjustment **	**1,576**	1,605
Closing defined benefit obligation	**9,648**	9,932

**This is the Co-operative Bank Plc's notional share (20% of the Pace scheme) which is added back to the Group's balance sheet (see note 27 for more details). This IFRIC14 adjustment excludes schemes which merged with Pace during 2015.

Changes in the fair value of the plan assets are as follows:

	2015 £m	2014 £m
Opening fair value of plan assets	**9,090**	6,670
De-recognised assets of Britannia Pension Scheme	**-**	(631)
Interest income	**332**	300
Return on plan assets (excluding interest income)	**(227)**	1,336
Administrative expenses paid from plan assets	**(6)**	(6)
Employer contributions	**80**	101
Contributions arising from settlements*	**-**	33
Participant contributions	**13**	19
Benefit payments from plan	**(295)**	(236)
Change in share of Pace attributable to Group from 60% to 80%	**-**	1,504
Closing fair value of plan assets attributable to Group	**8,987**	9,090
IFRIC 14 adjustment **	**1,812**	1,831
Closing fair value of plan assets	**10,799**	10,921

*Within the prior year figures, 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 to Pace with the Group reimbursing Bestway an amount of £3m, creating a profit of £30m within discontinued operations

**This is the Co-operative Bank Plc's notional share (20% of the Pace scheme) which is added back to the Group's balance sheet (see note 27 for more details). This IFRIC14 adjustment excludes schemes which merged with Pace during 2015.

Notes to the Financial Statements continued

16. Deferred taxation

In plain English - what does this note show?

Our tax charge is made up of current and deferred tax as explained in note 7. Current tax is the tax arising on the taxable income for the year whereas deferred tax arises in relation to future periods. We show an asset and a liability in the balance sheet to reflect these deferred items. This note shows how those items are calculated and how they affect the year's consolidated income statement. This year we've included additional explanatory footnotes to help better explain the key items.

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 18.8% (2014: 20%).

		2015 £m	2014 £m
Net deferred tax comprises:			
Deferred tax asset		**230**	263
Deferred tax liability		**(340)**	(344)
Net deferred tax liability		**(110)**	(81)
Comprised of:	Footnote:		
Other temporary differences	(i)	**13**	28
Temporary differences arising on derivatives and interest	(ii)	**-**	1
Retirement benefit obligations	(iii)	**(218)**	(198)
Capital allowances on fixed assets	(iv)	**186**	187
Unrealised gains on investments, investment properties and rolled-over gains	(v)	**(114)**	(137)
Claims equalisation reserve	(vi)	**(5)**	(6)
Tax losses	(vii)	**28**	44
		(110)	(81)

	2015 £m	2014 £m
At beginning of the year	**(81)**	68
Income statement charge/(credit):		
Group	**(24)**	(17)
Disposals	**-**	13
Charged to equity:		
Retirement benefit obligations	**(5)**	(145)
At end of the year	**(110)**	(81)

The Finance Act 2013 reduced the main rate of corporation tax from 21% to 20% from 1 April 2015. The Finance Act 2015 will further reduce the main rate of corporation tax to 19% from 1 April 2017 and to 18% from 1 April 2020. This will reduce the company's future current tax charge accordingly. Each deferred tax balance has been measured individually based on the tax rate at which it is expected to unwind (either 18%, 19% or 20%). This results in a blended deferred tax rate of 18.8% at the balance sheet date.

Notes to the Financial Statements continued

16. **Deferred taxation** continued

Footnotes:

i) Certain expenses that have not yet been incurred are able to be properly recorded in the accounts as a provision. However, such expenses do not receive tax relief until they have been paid for. As such the related tax relief is deferred to a future period. Such provisions represent £12m of this value. The balance of £1m is in respect of a non taxable credit arising on the sale of the Travel business to the Joint Venture established with Thomas Cook in 2010 that was required to be recognised in the accounts over a five year period. This non taxable income was reported to HMRC in full in 2011.

ii) On transition to IFRS the Group was required under accounting standards to recognise a Fair Value expense in its accounts. Due to tax statute this expense was not allowed to be deducted against taxable profits in year one, but instead tax relief for this expense is given over a ten year period. 2015 represents the final period when this tax deduction will be available and as such the asset has reduced to nil.

iii) This amount represents the theoretical amount of tax that would be payable by the Group on the wind up of the Pension Scheme.

iv) A deferred tax asset arises on capital allowances where the tax value of assets is higher than the accounts value of the same fixed assets. The reason the Group has a higher tax value for these fixed assets is due to the fact the Group has not made a full claim to its maximum entitlement to capital allowances for the last three years. However, impairment, disposals and depreciation have continued to be charged against the equivalent accounts value. The Group did not make its full entitlement claim due to the fact there were excess trading losses arising in the Group in recent years (primarily from the Bank in 2012 and 2013).

v) This amount represents the theoretical amount of tax that would be payable by the Group on (a) the sale of all investment properties (b) the sale of properties that have been Fair Valued on mergers and transfers of engagements and (c) the disposal of any property that has had an historic capital gain 'rolled into' its base cost, which is an election available by statute designed to encourage corporates to reinvest disposal proceeds from the disposal of trading properties into new trading properties and ventures.

vi) This value arises from the claims equalisation reserve that is required by statute to be taxed in CIS General Insurance Limited, but no accounts value is required to be recognised for accounting purposes.

vii) The Group incurred trading losses and interest losses that were in excess of taxable profits. These losses can be utilised against future trading profits and capital gains and as such represent a deferred tax asset.

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. Deferred tax assets and liabilities are only offset to the extent the Group is able to realise assets and settle liabilities at the same time.

Notes to the Financial Statements continued

17. Inventories

In plain English - what does this note show?

This note shows the make up and value of the inventory that is held at the year end. This mainly consists of goods for resale held either at Food stores or distribution centres. We also hold amounts of store consumables (such as plastic bags) as well as work in progress relating to funeral caskets. The note also shows the amount charged or credited through the consolidated income statement reflecting the change in the provisions we hold against slow-moving or obsolete stock.

Inventories are comprised of the following:

	2015 **£m**	2014 £m
Raw materials, consumables and work in progress	**5**	8
Finished goods and goods for resale	**440**	426
	445	434

The period end inventory provision is £17m (2014: £12m) and relates largely to the Food business. A net charge of £5m (2014: £1m charge) has been made to the income statement largely relating to 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.

18. Trade and other receivables

In plain English - what does this note show?

This note provides a breakdown of the trade and other receivables balances shown in the balance sheet. It includes: trade receivables, prepayments and accrued income, amounts receivable from disposal of businesses, other receivables and receivables arising from the Group's Insurance business. The balances are shown net of any impairments of debts that we don't consider can be recovered. They are split between current debtor items (which will be settled within one year) and non-current debtor items (which will be settled after more than one year).

	2015 £m	2014 £m
Non-current	**23**	24
Current	**646**	566
	669	590

	2015 £m	2014 £m
Trade receivables	**262**	242
Prepayments and accrued income	**72**	84
Amounts receivable from disposal of businesses	**-**	13
Other receivables	**115**	99
Receivables arising from General Insurance business	**220**	152
	669	590

Trade receivables are stated net of an impairment provision of £10m (2014: £9m). £2m (2014: £3m) has been charged to the income statement during the period offset by a credit of £1m (2014: credit of £3m). Within trade receivables is £128m (2014: £130m) of supplier income that is due to Food from suppliers. As at 6 April 2016, £127m (2014: £129m) of the current year balance had been invoiced and settled.

Included within other receivables is a £32m financial asset in respect of dividends still to be received from the Travel associate. See note 13 for more details. This financial asset carries minimal credit risk and is expected to be received within the year. The impact of any discounting to the financial asset has been assessed as immaterial.

Trade receivables include amounts totalling £27m (2014: £29m) which are overdue but not considered to be impaired, age analysis as follows:

	2015 £m	2014 £m
Amounts overdue:		
Less than 3 months	**17**	17
3 to 6 months	**4**	5
More than 6 months	**6**	7
	27	29

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.

Notes to the Financial Statements continued

18. **Trade and other receivables** continued

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.

19. Assets and liabilities held for sale

In plain English - what does this note show?

The note shows the value of those Food stores that the Group holds for sale at the year end (these are stores we plan to sell soon). When this is the case, our balance sheet shows those assets separately as held for sale.

	2015 £m	2014 £m	**2015 £m**	2014 £m
	Assets held for sale		**Liabilities held for sale**	
Total	**-**	85	**-**	-

Assets classified as held for sale

	2015 £m	2014 £m
Property, plant and equipment	**-**	85
	-	85

Notes to the Financial Statements continued

19. 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.

20. Investments from Insurance activities

In plain English - what does this note show?

The note shows the value of the financial assets (investments) that are held by our Insurance business. The analysis shows a breakdown of the types of investment that are held and explains how they are valued and accounted for. The note also shows the value of those investments that are deemed to be current (likely to be realised within one year) and those that are non-current.

	2015 £m	2014 £m
Current	**241**	260
Non current	**650**	661
Total investments	**891**	921

The investments as held by CISGIL are analysed as follows:

	2015 £m	2014 £m
Fair value through profit or loss:		
Deposits with credit institutions	**199**	156
Available for sale:		
Listed debt securities	**692**	765
	891	921

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.

Notes to the Financial Statements continued

20. **Investments from Insurance activities** continued

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 classified 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.

Subsequent valuation is at fair value with movements recognised in other comprehensive income as they arise, interest is recognised on the effective interest rate basis in the income statement. 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.

Notes to the Financial Statements continued

20. **Investments from Insurance activities** continued

vii) Impairment of financial assets

Assessment

At the balance sheet date, Co-operative Insurance 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 losses 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 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.

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 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 loaned under reverse repo arrangements are classified as deposits with credit institutions within financial investments at fair value through income or expense on the balance sheet as a result of CISGIL documented risk management policy.

Section C - what are our major liabilities?

This section of the accounts (notes 21 - 24) outlines the key liabilities of the Group at the balance sheet date.

21. Insurance contracts liabilities and reinsurance assets

In plain English - what does this note show?

The note shows the value of our insurance business's liabilities. They are split by type and between those liabilities that will fall due within one year and those that will fall due after more than one year (non-current). The full Insurance contracts note is provided in note 28 and shows the key assumptions that have been made in assessing the Group's insurance liabilities along with associated sensitivity analysis.

a) Analysis of insurance contract liabilities

Note liabilities are denoted positive in the below analysis	**2015 £m**	2014 £m
Non-current		
Reinsurance assets	**(63)**	(67)
Insurance liabilities	**511**	334
Total non-current	**448**	267
Current		
Reinsurance assets	**(6)**	(5)
Insurance liabilities	**235**	404
Total current	**229**	399
Net total	**677**	666

	2015 £m	2014 £m
Gross general insurance contracts:		
– Claims reported	**358**	407
– Claims incurred but not reported	**153**	135
– Claims settlement expenses	**13**	13
– Unearned premiums	**221**	172
– Provision for unexpired risks	**1**	11
Total gross insurance liabilities	**746**	738
Recoverable from reinsurers		
– Claims reported	**(31)**	(39)
– Claims incurred but not reported	**(38)**	(33)
– Unearned premiums	**-**	-
Total reinsurers' share of insurance liabilities	**(69)**	(72)
Net general insurance contracts:		
– Claims reported	**327**	368
– Claims incurred but not reported	**115**	102
– Claims settlement expenses	**13**	13
– Unearned premiums	**221**	172
– Provision for unexpired risks	**1**	11
Total net insurance liabilities	**677**	666

Notes to the Financial Statements continued

22. Interest-bearing loans and borrowings

In plain English - what does this note show?

The note provides information about the value and contractual terms of the Group's interest-bearing loans. This includes information about their value, interest rate and repayment terms and timings. Details are also given about other borrowings and funding arrangements such as Corporate investor shares and Finance leases. All items are split between those that are due to be repaid within one year (current) and those which won't fall due until after more than one year.

	2015 **£m**	2014 £m
Non-current liabilities:		
£450m 6 7⁄8% Eurobond Notes due 2020*	**477**	470
£350m 7 1⁄2% Eurobond Notes due 2026*	**376**	369
£21m 8 7⁄8% First Mortgage Debenture Stock 2018*	**21**	21
£109m 11% final repayment subordinated notes due 2025	**109**	109
£19m Instalment repayment notes (final payment 2025)	**17**	18
Corporate investor shares	**1**	2
Non-current portion of finance lease liabilities	**2**	4
Trading Group interest bearing loans and borrowings	**1,003**	993
£70m 12% Financial Services Callable Dated Deferrable Tier Two Notes due 2025	**68**	-
Total Group interest bearing loans and borrowings	**1,071**	993

On 8 May 2015, CISGIL issued £70m of Callable Dated Deferrable Tier Two Notes due 2025 at par.

	2015 **£m**	2014 £m
Current liabilities:		
Unsecured bank loans	**-**	50
Instalment repayment notes (final payment 2025)	**1**	1
Corporate investor shares	**16**	11
Current portion of finance lease liabilities	**3**	5
Other unsecured loans	**2**	2
	22	69

* These drawn down loan commitments are designated as financial liabilities at fair value through the income statement.

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 30.

Notes to the Financial Statements continued

22. Interest-bearing loans and borrowings continued

Reconciliation of movement in net debt

Net debt is a measure that shows the 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.

For period ended 2 January 2016	**Start of period £m**	**Non cash movements £m**	**Cash flow £m**	**Movement in corporate investor shares £m**	**Transfer to current from non current £m**	**End of period £m**
Interest bearing loans and borrowings						
- current	**(69)**	**2**	**50**	**(5)**	**-**	**(22)**
- non current	**(993)**	**(11)**	**(68)**	**1**	**-**	**(1,071)**
Total Debt	**(1,062)**	**(9)**	**(18)**	**(4)**	**-**	**(1,093)**
Group cash:						
- Group cash (per balance sheet)	**327**	**-**	**78**	**-**	**-**	**405**
- Overdraft (per balance sheet)	**(8)**	**-**	**4**	**-**	**-**	**(4)**
Group Net Debt	**(743)**	**(9)**	**64**	**(4)**	**-**	**(692)**
Comprised of:						
Trading Group Debt	**(1,062)**	**(9)**	**50**	**(4)**	**-**	**(1,025)**
Trading Group Cash	**247**	**-**	**84**	**-**	**-**	**331**
Trading Group Net Debt	**(815)**	**(9)**	**134**	**(4)**	**-**	**(694)**
CISGIL debt and overdrafts	**(8)**	**-**	**(64)**	**-**	**-**	**(72)**
CBG cash and overdrafts	**80**	**-**	**(6)**	**-**	**-**	**74**
Group Net debt	**(743)**	**(9)**	**64**	**(4)**	**-**	**(692)**

For period ended 3 January 2015 (restated*)	Start of period £m	Non cash movements £m	Cash flow £m	Movement in corporate investor shares £m	Transfer to current from non current £m	End of period £m
Interest bearing loans and borrowings						
- current	(1,544)	-	-	15	1,460	(69)
- Non current	(6)	(9)	484	(2)	(1,460)	(993)
Total Debt	(1,550)	(9)	484	13	-	(1,062)
Group cash:						
- Group cash (per balance sheet)	214	-	113	-	-	327
- Overdraft (per balance sheet)	(9)	-	1	-	-	(8)
Group Net Debt	(1,345)	(9)	598	13	-	(743)
Comprised of:						
Trading Group Debt	(1,550)	(9)	484	13	-	(1,062)
Trading Group Cash	150	-	97	-	-	247
Trading Group Net Debt	(1,400)	(9)	581	13	-	(815)
CISGIL debt and overdrafts	(9)	-	1	-	-	(8)
CBG cash and overdrafts	64	-	16	-	-	80
Group Net debt	(1,345)	(9)	598	13	-	(743)

*See general accounting policies section on page 81 for details of the restatement.

Notes to the Financial Statements continued

22. Interest-bearing loans and borrowings continued

Terms and repayment schedule

The 8.875% 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. This also had the effect of increasing the debenture coupon to 8.875% (previously 7.625%). The residual carrying amount of £21m is to be paid to holders upon maturity.

The 6.875% (inclusive of 1.25% coupon step up) Eurobond Issue 2020 has an original value of £450m (carrying amount of £477m) and the 7.5% (inclusive of 1.25% coupon step up) Eurobond Issue 2026 has an original value of £350m (carrying amount of £376m). 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 2 January 2016 the amounts outstanding are final repayments notes of £109m and the instalment repayment notes of £18m.

The unsecured bank loans consist of a £411m Revolving Credit Facility which is undrawn as at 2 January 2016, which was due to terminate on 26 July 2017. The Group subsequently refinanced on 11 February 2016. More details can be found in note 30.

The Group also holds £17m (GBP equivalent) of uncommitted facilities, renewed annually.

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).

Finance lease liabilities

Finance leases have the following maturities in the Trading Group:

	2015 £m	2014 £m
Less than one year	**3**	5
Greater than one year but less than five years	**2**	4
	5	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 Group measures its interest bearing loans and borrowings in two main ways:

1) Fair value through profit or loss. Debt is fair valued at each period with the fair value movement going through the income statement. The Eurobond quoted debt is accounted for this way. This is because the Group has used interest rate swaps to hedge the impact in movements in the interest rate and the movement in the fair value of the quoted debt is partially offset by the fair value movement in the interest rate swap (note 31).

2) Amortised cost. 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.

No interest bearing loans and borrowings are classified as held to maturity.

Notes to the Financial Statements continued

23. Trade and other payables

In plain English - what does this note show?

The note provides an analysis of the liabilities that we owe. It splits them between those that will be paid within one year (current) and those that are non-current. The amounts due include balances owed to suppliers for goods and services that have been invoiced or accrued, taxes that are payable such as VAT and National Insurance, amounts relating to the Group's liability to provide future services for holders of funeral bonds and other sundry payables.

	2015 £m	2014 £m
Current	**1,462**	1,381
Non-current	**967**	841
	2,429	2,222

	2015 £m	2014 £m
Trade payables	**800**	697
Value added tax, PAYE and social security	**34**	34
Accruals and deferred income	**237**	256
Member payments payable	**25**	25
Funeral plans	**805**	676
Deferred consideration	**1**	-
Other payables	**520**	533
Other reinsurance liabilities	**7**	1
	2,429	2,222

Further details on the maturity profile of trade and other payables of the Trading Group can be found in note 30.

Other payables include a payable to the Co-operative Bank Plc of £143m (2014: £181m) in respect of historic group relief. See note 7 for further details.

Accounting policies

Prepaid funeral plans (plans)

Prepaid funeral plans are accounted for in accordance with IAS 18.

At the point of sale, both the initial plan investment and the liability for the funeral delivery are recorded at the plan value. The plan investment is a financial asset, which is recorded at fair value each period through the profit and loss account. The funeral bond contract between the Group and customer conveys certain rights of cancellation or transfer, and as such there is a contractual obligation, in certain circumstances, for the Group to deliver cash in the form of a refund to the customer or preferred provider. This liability is therefore classified as a financial liability and is subsequently measured at the amount contractually repayable on demand.

Notes to the Financial Statements continued

23. Trade and other payables continued

Funeral benefit options (FBOs)

FBOs are attached to Guaranteed Over 50's life insurance plans (GOFs) sold by the Group's third 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.

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.

24. Provisions

In plain English - what does this note show?

The Group recognises a provision when a liability has been incurred but there is some uncertainty as to the timing and or future cost to settle the liability. The note provides an analysis of the Co-op's provisions by type, and shows how the value of each provision has changed during the year. It also details which provisions are likely to be settled within one year (current) and which are non-current.

	2015 £m	2014 £m
Non-current	**352**	375
Current	**87**	146
	439	521

	Uninsured claims £m	**Onerous leases £m**	**Restructuring & integration £m**	**Litigation £m**	**Regulatory/ other £m**	**2015 Total £m**	2014 Total £m
At beginning of the period	**91**	**278**	**111**	**10**	**31**	**521**	500
Credit to income statement	**(7)**	**(7)**	**(3)**	**(4)**	**(7)**	**(28)**	(36)
Charge to income statement	**29**	**18**	**1**	**5**	**3**	**56**	210
Provisions utilised on disposal	**-**	**-**	**-**	**-**	**-**	**-**	(3)
Discounting	**-**	**17**	**-**	**-**	**-**	**17**	11
Payments	**(38)**	**(43)**	**(32)**	**(3)**	**(11)**	**(127)**	(163)
Reclassification	**-**	**-**	**-**	**-**	**-**	**-**	2
At end of the period	**75**	**263**	**77**	**8**	**16**	**439**	521

Critical accounting estimates and judgements

Uninsured claims

This provision relates to potential liabilities arising from past events which are not covered by insurance. It includes a wide variety of known claims and potential claims from accidents in our depots and stores. 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.

Notes to the Financial Statements continued

24. **Provisions** continued

Onerous leases

This provision primarily relates to properties that are no longer used for trading. The provision is estimated on the basis of the minimum amount which could be paid to landlords to exit the lease agreements. This is based on an underlying calculation on a property by property basis by reference to the headlease cost and term, including property holding costs such as business rates, estimated rental income from subletting the properties and assuming that rental streams 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 £149m (2014: £150m) payable over the next five years.

Restructuring and integration

No additional provision has been recorded in 2015 in respect of the cost of separating Group IT and other change management systems from the Bank following provisions of £49m recorded in 2014 and £39m in 2013. Other items 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. By the end of 2015, this element of the provision had been fully utilised. The remaining provision relates to costs from a number of other past events that are expected to be incurred within the next one to three years.

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.

Section D - other notes

This section contains additional notes to the accounts. These are either on a stand alone basis or as supplementary detail to the principal disclosures detailed earlier in the accounts. Where this is the case the principal note is reproduced and cross-referenced.

25. Share capital

In plain English - what does this note show?

The note provides an analysis of our Members' share capital which is split between the two constituent types of share that are held: (i) individual shares and (ii) corporate shares. The note gives further details as to the conditions of use and rights attached to those shares.

	Issued and paid-up value Members' share capital	
	2015 £m	2014 £m
Individual shares of £1 and 10p each	**63**	61
Corporate shares of £5 each	**9**	9
	72	70

Individual shares have increased by £2m in 2015 following a transfer of shares from dormant loans to share capital. 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.

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 new 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-operatives UK 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.

Notes to the Financial Statements continued

26. Investments in associates and joint ventures - supporting note 13

In plain English - what does this note show?

This note accompanies note 13 (Investments in associates and joint ventures) and provides additional information to enable a reader to evaluate the nature of, and risks associated with, the Group's interests in other entities. An analysis of the entities' assets and liabilities is also shown, as is the percentage share of those assets and liabilities that the Group has recorded in its Balance sheet. Details of the critical accounting estimates and judgements that have been made in relation to the Group's interest in other entities are also shown, along with details of contingent liabilities and commitments. Finally, additional disclosures are made specifically in relation to the contingent liabilities of the Co-operative Bank Plc.

A breakdown of the investments held and income received is disclosed below:

	2015		2014	
	Income/ (losses) £m	**Investments £m**	Income/ (losses) £m	Investments £m
The Co-operative Bank plc	**(39)**	**185**	(10)	224
TCCT Holdings UK Limited (Travel) - share of income / (losses)	**(5)**	**38**	6	48
NOMA	**1**	**34**	1	31
Other investments (including Windfarms)	**-**	**28**	-	13
	(43)	**285**	(3)	316
Income from dividend guarantee (explained on page 130)	**32**	**-**	-	-
	(11)	**285**	(3)	316

The movements in investments in associates, joint ventures and other investments are as follows:

	2015 £m	2014 £m
At beginning of period	**316**	285
Additions	**3**	31
Transfer from investment property	**15**	-
Share of losses	**(43)**	(3)
Share of other comprehensive income	**-**	14
Dividends received	**(6)**	(5)
Disposals	**-**	(6)
At end of period	**285**	316

Of the dividends received in the above table, £5m (2014: £4m) was received from Travel and £1m (2014: £1m) received from a number of windfarms.

The Co-operative Bank Plc (the Bank)

The Group has impaired its investment in the Bank to £185m in the light of prevailing market conditions that impacted both the Co-op Bank and the wider banking sector in 2015. The lower for longer interest rate environment and increased Payment Protection Insurance ("PPI") claims provisions were key factors bringing downward pressure on the Bank's valuation. The Group has no access to the bank's plans and the valuation is based only on publicly available information. This has caused the Bank investment to reduce by £39m and this decrease has been reported in loss from associates and joint ventures line in the income statement.

The Group equity accounts for this 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, although the Group does not exercise this right. In the prior year, 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 30 May 2014. 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.

Notes to the Financial Statements continued

26. Investments in associates and joint ventures - supporting note 13 continued

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.

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 risk associated with the Group's 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 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 2015 annual financial statements.

TCCT Holdings UK Limited (Travel)

The travel associate made a £17m loss in 2015 of which the Group's 30% share was £5m. The Group has also recognised income of £32m in relation to a minimum dividend guarantee under the terms of the joint venture agreement. Under this agreement with Thomas Cook Plc, the Group is guaranteed a minimum of £37m of dividends within the first 5 years (i.e. by September 2016). During 2015, the final year of the agreement, it became clear that the joint venture would not be able to pay any further dividends beyond the £5m already paid. Consequently the remaining £32m of dividend payable to the Group will come from the guarantee and not the underlying profits of the joint venture. A financial asset of £32m has therefore been recognised (see note 18) reflecting the dividend guarantee. As well as the guaranteed dividends described above, the Group has a guaranteed put / call option with Thomas Cook Plc which allows the Group to sell its investment in Travel at the higher of £50m or four times the associate's EBITDA. The Group has not ascribed any value to the guarantee at the 2 January 2016 on the basis that the fair value of the investment and the guarantee are broadly the same.

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 2014 and 2015 and has the right to appoint two directors to the Board. As a result the Group is deemed to have significant influence, and 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 risk associated with the Group's 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. However, because of the put / call option described above, these risks are mitigated.

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. The financial statements of TCCT Holdings UK Limited are prepared in accordance with Companies Act 2006 as applicable to Companies using FRS 101 'Reduced Disclosure Framework.'

Notes to the Financial Statements continued

26. Investments in associates and joint ventures - supporting note 13 continued

NOMA

On 5 June 2014, the Group completed a 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. During the year the Group contributed £3m to the joint venture to fund investment. NOMA's accounts are prepared under FRS 102.

Twin Rivers Windfarm

On 8 May 2015, the Group completed an agreement with InfraRed Capital Partners to develop a windfarm on Twin Rivers Farm in Goole which was formerly owned by the Group's farming business. The partnership will develop a 14 turbine windfarm for the purposes of generating electricity and it is expected that the site will contribute a third of the Group's ethical plan target of 25% own electricity generation. As decisions about the relevant activities of the windfarm can only take place with unanimous consent of both parties it is considered to be a joint arrangement. As the Group has rights to the net assets of the arrangement it is considered to be a joint venture and the Group therefore equity accounts for its investment in its financial statements. The wind farm was previously held within Investment properties and was transferred into Investments in associates and joint ventures on completion of the joint venture. The Group's risk associated with its interest in the windfarm arises if future energy prices were to fall below projections leading to impairments 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.

Notes to the Financial Statements continued

26. Investments in associates and joint ventures - supporting note 13 continued

Summary financial information in respect of the Group's material joint ventures and associates is as follows:

	Co-operative Bank Plc		TCCT Holdings UK Limited		NOMA	
	2015 £m	2014 £m	**2015 £m**	2014 £m	**2015 £m**	2014 £m
Current assets	**-**	-	**70**	188	**13**	10
Non-current assets	-	-	**219**	227	**86**	81
Current liabilities	**-**	-	**(303)**	(394)	**(10)**	(7)
Non-current liabilities	**-**	-	**-**	-	**-**	-
Financial Services - Assets*	**29,028**	37,583	**-**	-	**-**	-
Financial Services - Liabilities*	**(27,665)**	(35,568)	**-**	-	**-**	-
Net assets (100%)	**1,363**	2,015	**(14)**	21	**89**	84
Group's share of net assets	**275**	407	**(4)**	6	**45**	42
Elimination of unrealised profits	**-**	-	**-**	-	**(11)**	(11)
Fair value adjustments	**(262)**	(476)	**-**	-	**-**	-
Goodwill	**385**	385	**42**	42	**-**	-
Accumulated impairment	**(213)**	(92)	**-**	-	**-**	-
Carrying amount in Group balance sheet	**185**	224	**38**	48	**34**	31
Revenue	**954**	1,249	**318**	316	**2**	3
Profit or loss from continuing operations	**(623)**	(225)	**(15)**	38	**1**	2
Post-tax profit or loss from discontinued operations	**-**	-	**-**	(10)	**-**	-
Other comprehensive income	**7**	84	**-**	-	**-**	-
Interest expense	**(522)**	(707)	**-**	5	**-**	-
Income tax income / (expense)	**(12)**	39	**(2)**	(9)	**-**	-

*Due to the Bank ordering their balance sheet in order of liquidity, the current / non-current split is not available.

NOMA had cash and cash equivalents of £11m at 2 January 2016 (2014: £9m).

Balances relating to other individually immaterial joint ventures and associates were immaterial in both periods.

Critical accounting estimates and judgements

Bank

The unwind of the fair value adjustments arising on the recognition of the Group's investment in the Bank during 2015 increased to a value that was considered to be in excess of its recoverable value. As a result, the Group has recorded an impairment at year end to reduce its investment to fair value. The fair value recorded (IFRS 13 fair value hierarchy 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 2013 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 Group has calculated the Bank’s fair value by estimating the future cash flows that the Group expects to derive from the investment and discounted these cash flows using a post tax discount rate of 13%. The future cashflows are based on public information from the Bank of its expected future total assets, net interest margin and its cost-income ratio. The cashflows have then been extrapolated at a growth rate of 2.5%. The calculation puts the dividend streams into perpetuity after the Bank’s tax losses have expired rather than assuming any proceeds from the ultimate disposal of the investment. A 1% increase / decrease in the discount rate would decrease / increase the investment by £25m. A 1% increase / decrease in the growth rate would increase / decrease the investment by £6m.

Notes to the Financial Statements continued

26. **Investments in associates and joint ventures -** supporting note 13 continued

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.

Travel

As well as the guaranteed dividends described above, the Group has a guaranteed put / call option with Thomas Cook plc which allows the Group to sell its investment in Travel at the higher of £50m or 4 times the associate's EBITDA. The Group has not ascribed any value to the guarantee at 2 January 2016 or in the prior year on the basis that the fair value of the investment and the guarantee are broadly the same.

Contingent liabilities and commitments (Bank)

The tables below provide the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract amounts indicate the volume of business outstanding at the 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, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	2015		2014	
Unaudited	**Contract amount £m**	**Risk-weighted amount £m**	Contract amount £m	Risk-weighted amount £m
i) Contingent liabilities				
Guarantees and irrevocable letters of credit	**21**	**15**	43	18
	21	**15**	43	18
ii) Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)	**2,572**	**314**	2,863	449
	2,593	**329**	2,906	467

Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,558m (2014: £1,787m).

The following sections (Indemnification agreement, Conduct Issues, Consumer Credit Act issues, Proposed sale of Bank's share in Visa Europe (VE), Regulatory and other investigations, Legal proceedings, Mortgage securitisation representations and warranties, Pensions, Tax treatment of separation and Warwick Finance One and Two securitisation representations and warranties) specifically represent the considerations documented in the accounts of The Co-operative Bank plc in respect of contingent liabilities.

Indemnification Agreement

The Bank has an indemnification agreement with CFSMS, accounted for as a guarantee under IFRS 4, in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement (under which CFSMS provides certain assets and services to the Bank). This agreement will remain in place until it is terminated after separation activities with the wider Co-operative Group are fully completed, but this will require the consent of CFSMS.

Notes to the Financial Statements continued

26. Investments in associates and joint ventures - supporting note 13 continued

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 ongoing disputes and legal, regulatory or other investigations or proceedings is currently uncertain.

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. A provision of £124.8m is in place for these matters at the end of 2015, being the best estimate of the liability based on detailed legal analysis of whether breaches of the technical requirements have in fact occurred to date. In the event that such legal analysis and judgements are determined to be incorrect, the Bank could be exposed to further liabilities.

Proposed sale of the Bank's share in Visa Europe Limited (VE)

On 2 November 2015. Visa Inc. announced the proposed acquisition of VE of which the Bank is a member and shareholder. Completion of the deal is subject to regulatory approvals and is not expected to occur before 1 April 2016. In connection with the transaction, the Bank and certain other members of VE have entered into a Loss Sharing Agreement (LSA) pursuant to which the Bank has agreed, on a several and not joint basis, to indemnify Visa Inc. for certain losses which may be incurred as a result of existing and potential litigation relating to the setting and implementation of domestic MIF rates in the UK. This indemnification is up to a maximum amount of the upfront cash consideration to be received by the Bank, being approximately €50m. For any such losses, the new arrangement under the LSA will replace the potential uncapped indemnity under the existing VE Operating regulations, which will otherwise continue for claims outside the UK. The Preference Stock, the LSA and the continuation of the existing indemnity for claims outside the UK work together to provide Visa Inc. with protection against liabilities from MIF litigation in the VE territory. The Preferred Stock serves as a 'first loss' piece, such that the LSA indemnity is only triggered if, amongst other things, either (a) €1bn of losses have first been allocated to the value of the Preferred Stock in respect of liabilities in connection with UK domestic MIF claims, or (b) the value of the Preferred Stock is reduced to zero in respect of liabilities in connection with MIF claims across the VE territory. The potential exists, therefore, for the entire value of the Bank's upfront consideration (cash and Preference Stock) to be eroded by liabilities incurred by Visa Inc. in connection with MIF litigation in the VE territory. However, at this stage, the Bank has concluded that there is no reliable estimate available of value of the potential exposure from existing and future litigation, assuming the deal closes. The fair value of VE shareholding has been remeasured based on the offer by Visa Inc.

Notes to the Financial Statements continued

26. Investments in associates and joint ventures - supporting note 13 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. These include:

- 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 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 UK 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 to reliably 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 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. It is not practicable to provide an estimate of the financial impact of this matter or what effect, if any, that these matters may have upon the Bank's operating revenues, cash flows or financial position in any period.

Notes to the Financial Statements continued

26. Investments in associates and joint ventures - supporting note 13 continued

Tax treatment of separation

Until separation of the Bank from 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.

Warwick Finance One and Two mortgage securitisation representations and warranties

In connection with the Bank's Warwick mortgage securitisation, the Bank makes various representations and warranties relating to the mortgage loans, which include 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.

Other Joint Ventures or Associates

There were no contingent liabilities or capital commitments in respect of the Group's other joint ventures or associates as at 2 January 2016 (2014: £nil).

Significant transactions and outstanding balances with the Bank, NOMA and the Travel investments at the period end can be found in note 33.

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.

27. **Pensions** supporting note 15

In plain English - what does this note show?

This note accompanies note 15 (Pensions). It provides additional information about the Group's pension schemes, as well as the key assumptions that have been made in determining the schemes' assets and liabilities. What's more there is sensitivity analysis about some of the key judgement areas. Further information explains the amounts in respect of pensions that have been recognised in the income statement and balance sheet, and the nature of the plan assets that are held.

The pension assets and liabilities in the balance sheet comprise:

	Assets 2015 £m	Assets 2014 £m	**Liabilities 2015 £m**	Liabilities 2014 £m	**Net 2015 £m**	Net 2014 £m
Schemes in surplus						
The Co-operative Group Pension Scheme (Pace)	**9,185**	9,154	**(7,919)**	(8,025)	**1,266**	1,129
20% (2014: 20%) of Pace attributable to non Group entities	**(1,812)**	(1,831)	**1,557**	1,605	**(255)**	(226)
Asset limitation on non-group portion (IFRIC14)	**1,812**	1,831	**(1,557)**	(1,605)	**255**	226
Somerfield Pension Scheme	**931**	958	**(819)**	(845)	**112**	113
Lothian Borders & Angus Co-operative Society Ltd Employees' Pension Fund*	**-**	69	**-**	(64)	**-**	5
Total schemes in surplus	**10,116**	10,181	**(8,738)**	(8,934)	**1,378**	1,247
Schemes in deficit						
United Norwest Co-operatives Employees' Pension Fund	**493**	492	**(616)**	(641)	**(123)**	(149)
Other former United Co-operative Funds*	**104**	159	**(128)**	(203)	**(24)**	(44)
Plymouth and South West and Brixham Funds*	**86**	89	**(144)**	(151)	**(58)**	(62)
Britannia unfunded obligations	**-**	-	**(3)**	(3)	**(3)**	(3)
Total schemes in deficit	**683**	740	**(891)**	(998)	**(208)**	(258)
Total schemes excluding asset limitation / onerous liability (IFRIC 14)	**10,799**	10,921	**(9,629)**	(9,932)	**1,170**	989
Less asset limitation / onerous liability (IFRIC 14)	**-**	-	**(19)**	-	**(19)**	-
Total schemes	**10,799**	10,921	**(9,648)**	(9,932)	**1,151**	989

*Four schemes merged with Pace during 2015. Further details are provided below.

Notes to the Financial Statements continued

27. **Pensions** supporting note 15 continued

Changes in the present value of the defined benefit obligation (DBO) are as follows:	**2015 £m**	2014 £m
Opening defined benefit obligation	**8,327**	6,615
De-recognised obligation for Britannia Pension Scheme and EFRBS liabilities from the Pace scheme (unfunded)	**-**	(609)
Current service cost	**48**	60
Interest expense on DBO	**302**	293
Participant contributions	**13**	19
Past service costs	**1**	(11)
Remeasurements :		
a. Effect of changes in demographic assumptions	**(25)**	150
b. Effect of changes in financial assumptions	**(274)**	707
c. Effect of experience adjustments	**(25)**	(100)
Benefit payments from plan	**(295)**	(236)
Change in share of Pace attributable to Group from 60% to 80%	**-**	1,439
Closing defined benefit obligation attributable to Group	**8,072**	8,327
IFRIC 14 adjustment **	**1,576**	1,605
Closing defined benefit obligation	**9,648**	9,932

**This is the Co-operative Bank Plc's notional share (20% of the Pace scheme) which is added back to the Group's balance sheet (see below for more details). This IFRIC 14 adjustment excludes schemes which merged with Pace during 2015.

Changes in the fair value of the plan assets are as follows:	**2015 £m**	2014 £m
Opening fair value of plan assets	**9,090**	6,670
De-recognised assets of Britannia Pension Scheme	**-**	(631)
Interest income	**332**	300
Return on plan assets (excluding interest income)	**(227)**	1,336
Administrative expenses paid from plan assets	**(6)**	(6)
Employer contributions	**80**	101
Contributions arising from settlements*	**-**	33
Participant contributions	**13**	19
Benefit payments from plan	**(295)**	(236)
Change in share of Pace attributable to Group from 60% to 80%	**-**	1,504
Closing fair value of plan assets attributable to Group	**8,987**	9,090
IFRIC 14 adjustment**	**1,812**	1,831
Closing fair value of plan assets	**10,799**	10,921

*Within the prior year figures, 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 to Pace with the Group reimbursing Bestway an amount of £3m, creating a profit of £30m within discontinued operations.

**This is the Co-operative Bank Plc's notional share (20% of the Pace scheme) which is added back to the Group's balance sheet (see below for more details). This IFRIC 14 adjustment excludes schemes which merged with Pace during 2015.

Notes to the Financial Statements continued

27. **Pensions** supporting note 15 continued

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 Group's main pension scheme is the Co-operative Group Pension Scheme ('Pace'). The Pace DB section ('Pace Complete') closed to future service accrual on 28 October 2015. This was an important step in making our pension offer fairer to all our colleagues but also affordable for the long term.

The following four schemes merged with Pace on 30 April 2015 as part of an exercise to improve governance and reduce operational costs:

- Lothian Borders & Angus Co-operative Society Limited Employees' Pension Fund;
- Sheffield Co-operative Society Limited Employees' Superannuation Fund;
- Leeds Co-operative Society Limited Employee Pension Fund; and
- Brixham Co-operative Society Limited Employees' Superannuation Fund.

The Group also operates four other funded pension schemes which are closed to future service accrual. These are noted in the table overleaf ordered by size of DB obligation. The Britannia Pension Scheme is no longer a Group scheme since the Co-operative Bank became Principal Employer in 2015 replacing Co-operative Financial Services Management Services Limited ('CFSMS'). The Group no longer has any obligations to the Britannia Pension Scheme.

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 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 marginally since last year. The pension liabilities measured in accordance with IAS19 and the scheme assets have both moved up and down in value during the year. Overall at the year end, the assets are broadly unchanged and the liabilities are marginally lower. This is partly attributable to a small fall in the price of corporate bonds during the year on which measurement of pension liabilities under IAS19 is based; and also adjustments to the IAS19 assumptions for future salary expectations and a more accurate approach to modelling future pension increases.

Although the position under IAS19 is a net surplus, there remains a funding shortfall and a requirement to pay contributions to remove the shortfall. This is predominantly because under the DB scheme funding regime the liabilities are measured with reference to government bond prices and a very prudent funding objective. The prevailing conditions of high government bond prices and unstable equity markets has meant that scheme liabilities have increased by more than the scheme assets.

Notes to the Financial Statements continued

27. **Pensions** supporting note 15 continued

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
United Norwest Co-operatives Employees' Pension Fund ('United Fund')	31 January 2014
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 2014
Lothian Borders & Angus Co-operative Society Limited Employees' Pension Fund ('Lothian Fund')	Merged with Pace on 30 April 2015
Sheffield Co-operative Society Limited Employees' Superannuation Fund ('Sheffield Fund')*	Merged with Pace on 30 April 2015
Leeds Co-operative Society Limited Employee Pension Fund ('Leeds Fund')*	Merged with Pace on 30 April 2015
Brixham Co-operative Society Limited Employees' Superannuation Fund ('Brixham Fund')	Merged with Pace on 30 April 2015

*Other former United Co-operatives Funds

Full actuarial valuations for United Norwest and Yorkshire Funds were concluded during 2015. Any shortfall in the assets directly held by the Group's DB schemes, relative to their funding target, is financed over a period that ensures the contributions are reasonably affordable to the Group. The expected deficit recovery contributions to all pension schemes over the 2016 financial year is £49m. Additional contributions due in respect of Bank's participation in Pace, are paid directly or reimbursed by Bank.

For IAS 19 disclosure purposes, DB obligations are determined following actuarial advice and are calculated using the projected unit method. The IAS 19 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

The Group considers and manages its pension risks through the Pensions Strategy Committee and the Risk and Audit Committee. Where appropriate, recommendations are made by these forums to the 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.

Retirement benefit governance

The Group considers and manages its pension risks through the Pensions Strategy Committee and the Risk and Audit Committee. Where appropriate, recommendations are made by these forums to the 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.

Retirement benefit scheme information

Closed schemes

All pension schemes, apart from Pace, were closed to future service accrual in 2012. Colleagues who were accruing pension linked to final salary in these schemes retained this link in respect of pension accrued through service before closure.

The Pace DB section ('Pace Complete') providing benefits linked to career average earnings since April 2006 closed to future service accrual on 28 October 2015. Colleagues with former scheme benefits linked to final salary in Pace Complete, which were accrued before April 2006, retained this link.

Employer Financed Retirement Benefit Schemes (EFRBS)

There is one unfunded pension arrangement in place for one former Group executive. Benefits provided by the unfunded arrangement 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 the Group's financial commitments to meet guaranteed pension obligations, recent applications for these discretionary benefits have not been approved.

Notes to the Financial Statements continued

27. **Pensions** supporting note 15 continued

Insured DC Scheme

The Leeds Co-operative Society Limited Managerial Staff Pensions Scheme is an insured DC scheme, providing benefits through Royal London (CIS) Ltd. There are no active members.

Material schemes

The Group's two largest pension schemes (Pace and the Somerfield Scheme) make up over 90% of our total DB obligations and therefore represent the greatest pension-related risk to the Group. Additional information regarding the nature of, and risks associated with, these schemes is provided below. The other funded DB 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 and the Somerfield Scheme.

Pace

Nature of Scheme

Pace is a non-segregated, multi-employer, hybrid pension scheme consisting of a DB section ('Pace Complete') and DC section. Pace Complete closed to future service accrual on 28 October 2015. Following closure, all active Pace Complete members at the date of closure started to accrue future service benefits in the DC section.

Pace Complete provided benefits since April 2006 based on a member's average career salary and length of contributory membership before closure on 28 October 2015. Former scheme 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 19 years.

Since 29 October 2015, the DC section was expanded from two to ten contribution tiers as follows:

Employee %	Employee %	Employee %	Employee %
1	1	6	10
2	4	7	10
3	5	8	10
4	8	9	10
5	10	10	10

Contributions are based on the member's basic pay plus any earnings in respect of overtime, commission and shift allowance.

Colleagues who meet automatic enrolment requirements are enrolled into the tier with 1% employee and 2% employer contributions. All colleagues across the Group are able to join the DC section and have the option to move to any other contribution tier.

The Pace DC section provides benefits based on the value of the individual colleague's fund accrued through contributions and investment returns.

Notes to the Financial Statements continued

27. Pensions supporting note 15 continued

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. There are other participating employers which 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 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 recognised as a multi-employer scheme in accordance with IAS 19.

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. There has never been a contractual agreement or stated 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. At completion of the most recent full actuarial valuation in 2014, the Bank agreed to pay £5m of the £25m contributions per annum then due in respect of the funding shortfall identified. In the 2015 financial statements the Group has used this to approximate a notional 20% share (2015: £255m) of the net DB pension asset attributable to the Bank, again restricted to zero. This is consistent with the approach adopted in 2014.

Pace currently shows a net DB pension asset of £1,266m 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 £255m 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. 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 on completion of the actuarial valuation in June 2014 that annual contributions of £25m would be paid from 1 July 2014 until 30 June 2019 to eliminate the funding shortfall. The Group determines the contributions payable by each participating employer in accordance with the scheme rules. The Bank agreed to pay £5m of the annual contributions each year over the period of the recovery plan. This 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 IAS 19 disclosures.

On merger of the Group's four smallest DB schemes into Pace on 30 April 2015, the Group agreed with the Pace Trustee to pay an additional £2.8m per annum to Pace in respect of the funding shortfall in these schemes. During 2015, each participating employer paid the agreed employer contributions in relation to their employed members. This was 18% of pensionable salaries with member contributions at 8% of pensionable salaries.

Notes to the Financial Statements continued

27. Pensions supporting note 15 continued

Governance

Pace Trustees Ltd acts as 'Trustee' of the Pace scheme.

The Trustee Board comprises 10 Trustee Directors: three Co-op appointed professional independent Trustee Directors, three Co-op appointed Trustee Directors, and four Member Nominated Directors (MNDs) elected by scheme members. The Chair of Trustees is appointed by the Trustee Directors.

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 has a strategy of holding 'liability matching' assets to reduce volatility in the funding level due to changes in inflation and interest rates. The liability matching assets are invested to hedge 70% 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 is due to increase in April 2018 and April 2019 (previously October 2017 and October 2018 respectively) subject to Parliament approval. Pace DC was designed with this legislation in mind. The Group's contributions exceed the minimum level required.

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 DB 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 Co-op 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 the Group's 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.

Liabilities may also arise for the Group as an employer participating in 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

27. **Pensions** supporting note 15 continued

Somerfield Pension Scheme

Nature of Scheme

The Somerfield Scheme is a DB pension scheme, which closed to future accrual in November 2012. Following closure of the Somerfield Scheme, all active members at the date of closure started to accrue benefits in Pace, unless they elected not to join Pace.

All benefits in a historic DC section were transferred out of the Somerfield Scheme in previous years and the DC section completed winding-up during 2015.

The weighted average duration of the DB obligation is approximately 16 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

TCG Southern Trustees Limited is the corporate body that acts as 'Trustee' of the Somerfield Scheme.

The Trustee Board comprises up to nine Trustee Directors: One Group appointed professional independent Trustee Director, up to four Group appointed Trustee Directors, and up to four Member Nominated Directors (MNDs) elected by scheme members. The Chair of Trustees is appointed by the Trustee Directors.

The Trustee is responsible for the development and implementation of appropriate policies for the investment of the assets of Somerfield Scheme. 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 has a strategy of holding 'liability matching' assets 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

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.

Guarantees

The Group is the Principal and a Statutory Employer of the Somerfield Scheme. A Group subsidiary, Co-operative Foodstores Ltd, is also a Statutory Employer to the scheme. The Group provides a guarantee in respect of Co-operative Foodstores Ltd's obligations to the Somerfield Scheme up to a maximum of the debt upon insolvency or winding up of the scheme.

The Group provides 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.

Notes to the Financial Statements continued

27. Pensions supporting note 15 continued

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 IAS 19.

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.

Critical accounting estimates and judgements

The weighted average actuarial valuations of the schemes have been updated to 2 January 2016 in accordance with IAS 19.

	2015	2014
The principal assumptions used to determine the liabilities of the Group's pension schemes were:		
Discount rate	**3.80%**	3.70%
Inflation rate	**3.55%**	3.30%
Future pension increases where capped at 5.0% pa - Retail Price Index	**3.20%**	3.30%
Future pension increases where capped at 5.0% pa - Consumer Price Index	**2.30%**	2.30%
Future pension increases where capped at 2.5% pa - Retail Price Index	**2.20%**	2.50%
Future pension increases where capped at 2.5% pa - Consumer Price Index	**2.30%**	2.30%
Mortality - base table	**101% (107% for females) S1NA YoB tables with CMI 2012**	100% (108% for females) of S1NA YoB tables with CMI 2009
Mortality - future improvements	**1.5% p.a.**	1.50% 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)**	
2 January 2016	**Male**	**Female**	**Male**	**Female**
Pace Scheme	**22.9**	**24.9**	**25.0**	**27.4**
United Norwest Fund	**22.4**	**24.7**	**24.9**	**27.1**
Somerfield Scheme	**22.7**	**24.9**	**24.3**	**26.8**

	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
Somerfield Scheme	22.6	24.9	24.3	26.6

Notes to the Financial Statements continued

27. **Pensions** supporting note 15 continued

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.

Discount rate	This has been selected following actuarial advice received by the Group in respect of all defined benefit schemes operated by the 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 in the discount rate of 0.1% would result in a £180m decrease (2014: £194m) 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 in the inflation rate of 0.1% would result in a £163m increase (2014: £177m) 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 2015 would be 22.9 (25.2) years and the future life expectancy from age 65 for a male (female) non-pensioner member currently aged 45 of 25.2 (27.4) years. An increase in the assumed long-term rate of improvement in mortality by 0.25%pa would increase liabilities by £147m (2014: £159m).

The fair value of the plan assets at the period end were as follows:

	2015 £m	2014 £m
Cash and cash equivalents	**217**	404
Equity instruments	**2,078**	2,023
Debt instruments	**6,956**	6,712
Real estate	**349**	368
Derivatives	**167**	166
Investment funds	**1,032**	1,248
	10,799	10,921

The fair value of the plan assets split between those which have a quoted market price in an active market and those which are unquoted is as follows:

	2015 Quoted £m	**2015 Unquoted £m**	**2015 Total £m**	2014 Quoted £m	2014 Unquoted £m	2014 Total £m
Cash and cash equivalents	**213**	**4**	**217**	416	(12)	404
Debt instruments	**2,078**	**-**	**2,078**	2,023	-	2,023
Debt instruments	**6,956**	**-**	**6,956**	6,396	316	6,712
Real estate	**44**	**305**	**349**	48	320	368
Derivatives	**-**	**167**	**167**	-	166	166
Investment funds	**182**	**850**	**1,032**	284	964	1,248
	9,473	**1,326**	**10,799**	9,167	1,754	10,921

Notes to the Financial Statements continued

27. **Pensions** supporting note 15 continued

	2015 £m	2014 £m
The amounts recognised in the balance sheet are as follows:		
Present value of funded obligations	**(9,618)**	(9,920)
Present value of unfunded liabilities	**(11)**	(12)
Element of Pace attributable to non Group entities	**(255)**	(226)
Asset limitation (IFRIC14)	**236**	226
Fair value of plan assets	**10,799**	10,921
Net retirement benefit asset	**1,151**	989

	2015 £m	2014 £m
The amounts recognised in the income statement are as follows:		
Current service cost	**(48)**	(60)
Past service (cost) / credit	**(1)**	11
Interest expense on defined benefit obligations	**(302)**	(293)
Interest income on plan assets	**332**	300
Interest on impact of asset ceiling	**9**	5
Administrative expenses and taxes	**(6)**	(6)
	(16)	(43)

	Asset £m	**2015 DBO £m**	**Asset ceiling £m**	Asset £m	2014 DBO £m	Asset ceiling £m
Changes in the effect of the asset ceiling are as follows:						
Britannia Pension Scheme						
As at the start of the period	**-**	**-**	**-**	631	(604)	(27)
De-recognised Britannia Pension Scheme	**-**	**-**	**-**	(631)	604	27
At end of the period	**-**	**-**	**-**	-	-	-
Pace						
At the start of the period	**(1,831)**	**1,605**	**(226)**	(2,995)	2,850	(145)
Interest income / (expense)	**68**	**(59)**	**9**	99	(94)	5
Re-measurement of asset ceiling effect	**(49)**	**11**	**(38)**	1,065	(1,151)	(86)
At end of the period	**(1,812)**	**1,557**	**(255)**	(1,831)	1,605	(226)

As Pace is a multi-employer scheme (from 20 December 2013), 20% (2014: 20%) 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

27. **Pensions** supporting note 15 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

28. Insurance contracts liabilities and reinsurance assets supporting note 21

In plain English - what does this note show?

This note accompanies note 21 (Insurance contract liabilities and reinsurance assets) and provides additional information about the key assumptions that have been made in assessing the Group's insurance liabilities along with associated sensitivity analysis. Further information is given to illustrate how insurance liabilities have changed during the year and how claims have developed over time.

a) Analysis of insurance contract liabilities

Note liabilities are denoted positive in the below analysis	**2015** **£m**	2014 £m
Non-current		
Reinsurance assets	**(63)**	(67)
Insurance liabilities	**511**	334
Total non-current	**448**	267
Current		
Interest on impact of asset ceiling	**(6)**	(5)
Administrative expenses and taxes	**235**	404
Total current	**229**	399
Net Total	**677**	666

	2015 **£m**	2014 £m
Gross general insurance contracts:		
– Claims reported	**358**	407
– Claims incurred but not reported	**153**	135
– Claims settlement expenses	**13**	13
– Unearned premiums	**221**	172
– Provision for unexpired risks	**1**	11
Total gross insurance liabilities	**746**	738
Recoverable from reinsurers		
– Claims reported	**(31)**	(39)
– Claims incurred but not reported	**(38)**	(33)
– Unearned premiums	**-**	-
Total reinsurers' share of insurance liabilities	**(69)**	(72)
Net general insurance contracts:		
– Claims reported	**327**	368
– Claims incurred but not reported	**115**	102
– Claims settlement expenses	**13**	13
– Unearned premiums	**221**	172
– Provision for unexpired risks	**1**	11
Total net insurance liabilities	**677**	666

Notes to the Financial Statements continued

28. **Insurance contracts liabilities and reinsurance assets** supporting note 21 continued

a) Analysis of insurance contract liabilities continued

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.

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 28 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 onto 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, issued 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 £23m (2014: £21m) and EIROS discounted reserve amounts to £3m (2014: £4m). Further details around expected settlement patterns for claims arising on these reserves are disclosed within the insurance risk section in note 29.

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 2015 reserves.

Notes to the Financial Statements continued

28. **Insurance contracts liabilities and reinsurance assets** supporting note 21 continued

b) **General insurance contracts – assumptions, changes in assumptions and sensitivity** continued

i) **Basis of assessing liabilities** continued

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 2015 CISGIL held an URP of £1m (2014: £11m).

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, a management margin is added to the 'actuarial best estimate' so that no adverse run-off deviations are envisaged. 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.

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 £349m (2014: £393m) includes a movement of £13m (2014: £11m) arising from a release of reserves, as follows:

	2015 **£m**	2014 £m
Fire and Accident (increase)/release of reserves	**(6)**	(4)
Motor release of reserves	**24**	19
(Increase) in claims handling reserves	**(5)**	(4)
Movement in gross insurance liabilities	**13**	11

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.

Notes to the Financial Statements continued

28. **Insurance contracts liabilities and reinsurance assets** supporting note 21 continued

b) **General insurance contracts – assumptions, changes in assumptions and sensitivity** continued

iii) **Sensitivity analysis** continued

Assumption

	2015			2014	
	Changes in parameter	**Effect on gross provision**		Effect on gross provision	
		£m	**% Effect**	£m	% Effect
Motor					
Average cost of claims for last three years – bodily injury and legal	**10%**	**32**	**8.9%**	47	11.4%
Mean term to settlement – bodily injury and legal	**+1/2 year**	**7**	**2.0%**	8	2.0%
Rate of future inflation – bodily injury and legal	**1%**	**11**	**3.0%**	13	3.1%
Ogden discount rate – bodily injury	**-1/4%**	**2**	**0.6%**	4	0.9%
Other classes					
Mean term to settlement (liability)	**+1/2 year**	**1**	**2.1%**	1	2.1%
Mean term to settlement (non-liability)	**+1/2 year**	**1**	**1.5%**	1	1.5%
Rate of future inflation (liability)	**1%**	**2**	**5.5%**	2	6.4%
Rate of future inflation (non-liability)	**1%**	**1**	**1.4%**	1	1.2%

c) **Changes in general insurance liabilities and reinsurance assets**

i) Change in insurance contract liabilities (net of salvage and subrogation)

	2015				2014			
	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	**555**	**11**	**(21)**	**545**	657	2	(24)	635
Movement in the year	**(31)**	**(10)**	**(6)**	**(47)**	(102)	9	3	(90)
At the end of the year	**524**	**1**	**(27)**	**498**	555	11	(21)	545

Salvage and subrogation is included within assets as part of insurance receivables.

Notes to the Financial Statements continued

28. **Insurance contracts liabilities and reinsurance assets** supporting note 21 continued

c) **Changes in general insurance liabilities and reinsurance assets** continued

ii) Claims and loss adjustment expenses

	2015			2014		
	Gross £m	**Re-insurance £m**	**Net £m**	Gross £m	Re-insurance £m	Net £m
Claims reported	**407**	**(39)**	**368**	495	(23)	472
Claims incurred but not reported	**135**	**(33)**	**102**	145	(32)	113
Claims settlement expenses	**13**	**-**	**13**	17	-	17
At the beginning of the year	**555**	**(72)**	**483**	657	(55)	602
Claims paid during the year	**(318)**	**6**	**(312)**	(390)	8	(382)
Increase/(decrease) in liabilities:						
– arising from current year claims	**301**	**(18)**	**283**	299	(9)	290
– arising from prior year claims	**(13)**	**15**	**2**	(11)	(16)	(27)
Total movement	**(30)**	**3**	**(27)**	(102)	(17)	(119)
Claims reported	**358**	**(31)**	**327**	407	(39)	368
Claims incurred but not reported	**153**	**(38)**	**115**	135	(33)	102
Claims settlement expenses	**13**	**-**	**13**	13	-	13
At the end of the year	**524**	**(69)**	**455**	555	(72)	483

iii) Provisions for unearned premiums

	2015			2014		
	Gross £m	**Re-insurance £m**	**Net £m**	Gross £m	Re- insurance £m	Net £m
At the beginning of the year	**172**	**-**	**172**	207	(2)	205
Increase in the year	**424**	**(30)**	**394**	365	(25)	340
Release in the year	**(375)**	**30**	**(345)**	(400)	27	(373)
Movement in the year	**49**	**-**	**49**	(35)	2	(33)
At the end of the financial year	**221**	**-**	**221**	172	-	172

iv) Unexpired risk provision

	2015			2014		
	Gross £m	**Re-insurance £m**	**Net £m**	Gross £m	Re- insurance £m	Net £m
At the beginning of the year	**11**	**-**	**11**	2	-	2
Increase in the year	**1**	**-**	**1**	11	-	11
Release in the year	**(11)**	**-**	**(11)**	(2)	-	(2)
Movement in the year	**(10)**	**-**	**(10)**	9	-	9
At the end of the financial year	**1**	**-**	**1**	11	-	11

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.

Notes to the Financial Statements continued

28. **Insurance contracts liabilities and reinsurance assets** supporting note 21 continued

c) **Changes in general insurance liabilities and reinsurance assets** continued

v) Analysis of claims development

	Accident year										
	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	**Total £m**
Gross of reinsurance											
At end of the accident year	419	385	347	326	411	497	502	368	285	286	**3,826**
– One year later	412	388	320	333	455	530	473	347	269	-	**3,527**
– Two years later	403	378	310	341	480	527	473	343	-	-	**3,255**
– Three years later	393	364	300	329	466	518	468	-	-	-	**2,838**
– Four years later	387	367	297	320	456	515	-	-	-	-	**2,342**
– Five years later	388	366	294	320	464	-	-	-	-	-	**1,832**
– Six years later	382	362	294	320	-	-	-	-	-	-	**1,358**
– Seven years later	385	361	295	-	-	-	-	-	-	-	**1,041**
– Eight years later	384	361	-	-	-	-	-	-	-	-	**745**
– Nine years later	384	-	-	-	-	-	-	-	-	-	**384**
– Ten years later	-	-	-	-	-	-	-	-	-	-	**-**
Estimate for cumulative claims	384	361	295	320	464	515	468	343	269	286	**3,705**
Cumulative payments to date	(372)	(350)	(293)	(311)	(439)	(494)	(417)	(278)	(202)	(117)	**(3,273)**
Gross outstanding claims liabilities before discounting	12	11	2	9	25	21	51	65	67	169	**432**
Provision for prior years before discounting											**80**
Discounting											**(1)**
Gross outstanding claims liabilities											**511**

	£m
Gross claims reported	**358**
Gross claims incurred but not reported	**153**
Gross outstanding claims liabilities	**511**

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

28. Insurance contracts liabilities and reinsurance assets supporting note 21 continued

c) Changes in general insurance liabilities and reinsurance assets continued

v) Analysis of claims development continued

	Accident year										
	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	**Total £m**
Net of reinsurance											
At end of the accident year	417	373	335	313	398	481	490	351	276	268	**3,702**
– One year later	409	378	305	321	434	515	456	330	261	-	**3,409**
– Two years later	401	370	296	325	459	517	459	329	-	-	**3,156**
– Three years later	393	358	292	318	445	509	456	-	-	-	**2,771**
– Four years later	386	359	290	310	439	507	-	-	-	-	**2,291**
– Five years later	385	359	287	307	448	-	-	-	-	-	**1,786**
– Six years later	380	355	288	310	-	-	-	-	-	-	**1,333**
– Seven years later	380	354	288	-	-	-	-	-	-	-	**1,022**
– Eight years later	379	354	-	-	-	-	-	-	-	-	**733**
– Nine years later	379	-	-	-	-	-	-	-	-	-	**379**
– Ten years later	-	-	-	-	-	-	-	-	-	-	**-**
Estimate for cumulative claims	379	354	288	310	448	507	456	330	261	268	**3,601**
Cumulative payments to date	(372)	(344)	(286)	(305)	(431)	(488)	(411)	(272)	(197)	(115)	**(3,221)**
Gross outstanding claims liabilities before discounting	7	10	2	5	17	19	45	58	64	154	**380**
Provision for prior years before discounting											**63**
Discounting											**(1)**
Net outstanding claims liabilities											**442**

	£m
Net claims reported	**327**
Net claims incurred but not reported	**115**
Net outstanding claims liabilities	**442**

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 2015 result includes movement on prior year reserves of £2m (2014: £27m).

Notes to the Financial Statements continued

28. **Insurance contracts liabilities and reinsurance assets** supporting note 21 continued

c) **Changes in general insurance liabilities and reinsurance assets** continued

v) **Analysis of claims development** continued

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.

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, which include attributable claims handling expenses, 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 annual report and accounts 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.

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. Unexpired risk provision 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 requirements of the liability adequacy test as set out in IFRS 4 (Insurance Contracts).

Notes to the Financial Statements continued

28. **Insurance contracts liabilities and reinsurance assets** supporting note 21 continued

c) **Changes in general insurance liabilities and reinsurance assets** continued

v) **Analysis of claims development** continued

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.

29. Financial risk management - CISGIL (unaudited)

In plain English - what does this note show?

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 2015

CISGIL has a stand-alone risk management framework which was comprehensively redesigned in 2013. During 2015, a number of enhancements to the framework have taken place:

- Creation of a Governance Map creating clear accountability;
- Established a CISGIL Nomination Committee and Remuneration Committee;
- Suite of risk policies and control standards reviewed and updated as part of a business as usual process;
- Refined risk reporting to the CISGIL Board and Executive Risk Committee;
- Strengthened stand-alone 2nd line risk function;
- Enhancements and further embedding of the risk event reporting and risk acceptance process; and
- Alignment of governance and risk control process, with enhanced Risk and Control Self-Assessment process rolled out.

The following section summarises the risk management structures 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 CISGIL 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 risk and controls and oversee appropriate escalation of breaches, mitigating actions and reporting to the CISGIL Executive Risk Committee and the CISGIL 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.

The prospects of CISGIL as at 31 December 2015 have primarily been assessed using the latest information (the 2015 year end position) and the 2016 - 2020 Strategic Plan, which was approved by the CISGIL Board in December 2015. 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.

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL (unaudited)** continued

Risk assessment of CISGIL - continued

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.

Risk management structure

The CISGIL 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 CISGIL Board. The CISGIL 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 CISGIL Board authority has been delegated to the Board sub-committees and the CISGIL Chief Executive Officer (CEO) who has, in turn, delegated elements of these discretions to appropriate members of the senior management team.

CISGIL has produced a Governance Map which sets 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.

Risk management committees

CISGIL 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;
- Review and approval of CISGIL Own Risk Solvency Assessment (ORSA) basis assumptions, policy and results;
- Delegating authority for oversight of the risk management framework, systems and high-level limits to the CISGIL 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 the CISGIL Board Risk Committee reports on the effectiveness of the risk management framework and systems.

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL (unaudited)** continued

CISGIL Board Risk Committee (BRC)

BRC responsibilities include:

- Providing oversight and advice to the CISGIL 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 CISGIL 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;
- Reporting on the effectiveness of the Risk Management Framework and systems to the CISGIL Board; and
- Advise the Remuneration Committee on the extent of incentive awards or payments under incentive schemes due to Executives including the need for any risk adjustment.

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 CISGIL Board;
- Assisting the CISGIL 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.

Notes to the Financial Statements continued

29. Financial risk management - CISGIL (unaudited) continued

CISGIL Nomination Committee (Nom Co) (established 2015)

Nom Co. responsibilities include:

- Identifying and nominating candidates to fill CISGIL Board vacancies as and when they arise;
- Review the structure, size and composition of the CISGIL Board and make recommendations to the CISGIL Board with regard to any changes;
- Give full consideration to succession planning for Directors and other members of the Executive; and
- Keep under review the leadership needs of the organisation, both Executive and Non-Executive.

CISGIL Remuneration Committee (Rem Co) (established 2015)

Rem Co. responsibilities include:

- Determine the remuneration policy for the CISGIL executive, in conjunction with the Co-operative Group Remuneration Committee, ensuring that this is in line with Group Remuneration policy;
- Have responsibility for setting the remuneration for each of the CISGIL Executives;
- Maintain an awareness of reward and remuneration arrangements for CISGIL employees; and
- Determine the fees payable to the CISGIL Chair.

CISGIL Executive Committee (ExCo)

The ExCo responsibilities include:

- Overseeing the establishment and maintenance of appropriate risk management systems and controls in line with the CISGIL Board agreed Risk Management Framework;
- Supporting the CEO in developing, reviewing and approving detailed risk appetite limits and tolerances as delegated by the CISGIL Board; and
- Ensuring the implementation of the risk strategy set by the CISGIL 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 CISGIL 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.

Notes to the Financial Statements continued

29. Financial risk management - CISGIL (unaudited) continued

CISGIL Executive Risk Committee (ERC)

The ERC responsibilities include:

- Driving the detailed implementation of the CISGIL Risk Management Framework approved by the CISGIL 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 CISGIL Board Risk Committee for review, challenge and approval;
- Supporting the CEO in approving Risk Policies, proposing Risk Appetite limits and tolerances to CISGIL Board Risk Committee for review, challenge and recommendation to the CISGIL Board for approval;
- Reviewing approaches to stress testing, risk management reporting and governance, and referring them to the CISGIL Board Risk Committee for review, challenge and recommendation for approval by the CISGIL Board;
- Supporting the CEO in semi-annually reviewing the effectiveness of the Risk Management Framework, systems and functions and providing a report to the CISGIL 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 CISGIL 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.

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL** continued

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	Transformation risk*	The risk that failure of programme leads to the business failing to re-platform, leading to the need for an alternative strategy to be deployed with cost, time and business sustainability impacts
C	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
D	Conduct risk*	The risk that CISGIL's behaviours, offerings or interactions will result in unfair outcomes for customers
E	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
F	Insurance risk	The inherent uncertainties as to the occurrence, amount and timing of insurance liabilities
G	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
H	Operational risk*	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events
I	People risk*	The risk associated with the recruitment, employment and management of individuals within CISGIL
J	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
K	Credit risk	The risk to earnings and capital arising from a debtor's failure to meet their legal and contractual obligations
L	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
M	Group risk*	The risks that arise through being part of the Co-operative Group

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 CISGIL 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.

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 CISGIL 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 CISGIL Board have defined detailed metrics and limits underpinning these objectives, which are measured, monitored and reported regularly to the ERC and CISGIL Board.

During 2015, the strategic and business risk profile materially improved. CISGIL concluded the issuance of £70m of lower Tier two public debt thereby ensuring that the capital position was within the CISGIL Board approved risk appetite. The outlook on Strategic and Business Risk profile continues to improve as the business performed in line with the annual plan against all key metrics.

B. Transformation risks (unaudited)

During 2015, CISGIL signed a Master Services Agreement with IBM to build and then provide as a managed service an integrated IT platform for the whole business. All 2015 major milestones of the joint plan have been delivered and the programme is entering testing and delivery phase. Transforming General Insurance is one of the 'Winning 10' activities identified within the Co-operative Group Rebuild Programme with dependences being managed across the activities being undertaken.

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL** continued

C. 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, business performance and risk profile across all 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 and the risk is regularly monitored and reported to the Operational Risk Committee, ERC and CISGIL Board.

Throughout 2015, the reputational risk position has continued to improve. There has been reduced Group media coverage with little negative press coverage which has supported the reputation of the Group and has helped to improve reputational risk position. There remains contagion risk from the Co-operative Bank, although there was little impact following recent Bank related announcements.

The implementation of a social media strategy delivered several positive new stories during the year. This is reflected in recent improved Brand perception reports.

D. 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 conduct business in a way that results in fair outcomes for our customers 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 2015, progress was made in implementing the approved Conduct Risk strategy. New reporting was developed to improve oversight of customer outcomes and conduct risk training provided to over 500 customer facing colleagues. A new Product Governance Forum was established to oversee and govern the product throughout its lifecycle. Monthly executive Conduct Risk Steering Committee reviews the identification, measurement, management, monitoring and reporting of conduct risks. Improved customer outcome measures are being developed for reporting to Executive and CISGIL Board.

E. 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 CISGIL Board. The CISGIL Board and subcommittee structure governance documentation was enhanced in preparation for the Senior Insurance Managers Regime and Solvency II with new Non-Executive Directors' appointed to increase CISGIL Board capability for the new strategy and transformation.

Notes to the Financial Statements continued

29. Financial risk management - CISGIL continued

F. 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, either written directly or through brokers. In addition, CISGIL writes some commercial insurance business, which is 100% reinsured, although this book is now in run off. CISGIL continues to manage commercial motor business which is also in run off, but still has liabilities ensuing and a small book of pet insurance. Almost all risks under general insurance policies cover a 12 month duration.

Principal risks under motor policies are bodily injury to third parties, accidental damage to property including policyholders', 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:

- 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;
- Minimising reserve risk volatility through proactive claims handling, the claims provisioning process and robust reserving and modelling approaches; and
- Mitigating risk through the use of appropriate reinsurance arrangements.

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 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 2015 CISGIL had three main reinsurance programmes in place: catastrophe excess of loss cover, motor excess of loss cover and cover to protect against a significant deterioration in prior years reserves. Other reinsurance arrangements include the 100% reinsurance of the commercial insurance business being written by CISGIL, mentioned above.

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL** continued

G. 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 (reverse repo transactions). 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 creditworthiness 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.

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. The investment mandate setting limits of investments types and duration is assessed using the capital model and approved by the CISGIL Board. During 2015 the mandate was set to reduce the market risk exposure during the transformation of CISGIL.

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.

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL** continued

Mean durations are:

	2015 **years**	2014 years
Opening defined benefit obligation	**2.84**	2.84
De-recognised obligation for Britannia Pension Scheme and EFRBS liabilities from the Pace scheme (unfunded)	**1.83**	2.35

	2015 Amount £m	Duration years
Periodical payments		
Insurance liabilities	**22.1**	18.4
Financial assets	**36.0**	15.9
EIROS claims		
Insurance liabilities	**2.2**	10.0
Financial assets	**2.5**	9.6

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 Individual Capital Assessment (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 no 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 £13m (2014: £23m). 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 £11m net of tax (2014: £18m). The impact of a decrease of 100 basis points in credit-spreads would have similar but opposite effect.

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 11% (2014: 24%) using the CISGIL capital model.

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL** continued

H. Operational risk (unaudited)

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events over which CISGIL has limited controls. 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 RFO 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 CISGIL Board.

Following the legal separation from The Co-operative Bank, a programme continues to separate shared IT systems. This work increases the complexity in managing the business through to final physical separation in 2016. A separate work area recovery has been developed with improved disaster recovery capability for key systems due to complete in Q1 2016. In addition, CISGIL is developing a new Network and infrastructure alongside the IBM led IT systems replacement. All these developments raise the risk arising from change to the existing systems and operations. The nature of the contract with IBM for such a major development requires investment and financial commitments which will enable significant improved business capability and efficiency. There is a risk that the development does not deliver and stress testing of appropriate contingency plans to ensure sufficient capital is available to manage the business in such extreme circumstances has been undertaken.

CISGIL has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach which includes employers liability.

I. People risk (unaudited)

People Risk is the risk associated with the recruitment, employment and management of individuals within Co-operative Insurance. Co-operative Insurance has no appetite for breaches of employment law, regulations or contracts of employment and closely monitors the people risks that have the biggest impact on achieving Co-operative Insurance's strategy.

During 2015, Group-wide changes to grading, terms & conditions and the pensions closure were communicated along with changes in roles as a result of the transformation programme. In addition, an improved remuneration offering following market benchmarking has reduced attrition within Operations. During this period of significant transformation there is an increased risk of attracting and retaining staff, with the key skills critical to deliver the programme.

29. Financial risk management - CISGIL continued

J. 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 CISGIL 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 UK 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 UK windstorm as £106m (2014: £136m), giving a minimum requirement for £21m (2014: £27m) of liquid assets against actual liquid assets of £734m (2014: £674m). 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 CISGIL Board. This includes monthly reporting of liquid assets against risk appetite limits including forecasts for 2016 to ensure cost of transformation is also available.

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 of insurance contract liabilities below is £24m (2014: £47m) of discounted reserves relating to Periodic Payment Orders and EIROS.

2015	Carrying value £m	Gross nominal outflow £m	Up to 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
Insurance contract liabilities	746	746	433	115	64	38	23	73
Financial liabilities at amortised cost:								
- Subordinated debt	68	150	8	9	9	8	8	108
- Other reinsurance liabilities	7	7	7	-	-	-	-	-
- Insurance and other payables	67	67	67	-	-	-	-	-
Cash and cash equivalents	4	4	4	-	-	-	-	-
	892	974	519	124	73	46	31	181
Other liabilities								5
Total recognised liabilities								897

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL** continued

2014	Carrying value £m	Gross nominal outflow £m	Up to 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
Insurance contract liabilities	738	738	404	115	69	45	29	76
Financial liabilities at amortised cost:								
- Subordinated debt	1	1	1	-	-	-	-	-
- Insurance and other payables	30	30	30	-	-	-	-	-
- Cash and cash equivalents	8	8	8	-	-	-	-	-
	777	777	443	115	69	45	29	76
Other liabilities								16
Total recognised liabilities								793

K. 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. Co-operative Insurance 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 due from customers and insurance intermediaries. Exposure to insurance intermediaries is managed in line with Co-operative Insurance credit risk policy.

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 2015	**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)	**-**	**-**	**199**	**-**	**-**	**199**
Available for sale assets:						
- Listed debt (fixed rate)	**94**	**321**	**148**	**-**	**-**	**563**
- Listed debt (variable rate)	**10**	**17**	**86**	**16**	**-**	**129**
Reinsurance assets	**-**	**30**	**37**	**-**	**2**	**69**
Insurance receivables and other assets	**2**	**2**	**4**	**-**	**184**	**192**
	106	**370**	**474**	**16**	**186**	**1,152**
Assets not subject to credit risk						**68**
						1,220

Notes to the Financial Statements continued

29. Financial risk management - CISGIL continued

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)	93	228	233	49	-	603
Listed debt (variable rate)	7	18	91	45	-	161
Loans and receivables at amortised cost	-	32	37	-	3	72
Reinsurance assets	2	2	5	2	127	138
Insurance receivables and other assets						
	102	436	366	96	130	1,130
Assets not subject to credit risk						44
						1,174

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 £191m (2014: £144m) is held as part of a reverse repo with a cash balance of £199m as at 31 December 2015 (2014: £147m). 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 following table shows exposure to European countries arising from corporate bonds. CISGIL has no exposures to European countries as a result of repo arrangements.

2015	Up to 1 year £m	1-5 years £m	5-10 years £m	Total
France	**7**	**-**	**-**	**7**
Germany	**-**	**30**	**-**	**30**
Netherlands	**-**	**23**	**-**	**23**
Spain	**-**	**16**	**-**	**16**
Sweden	**3**	**67**	**-**	**70**
	10	**136**	**-**	**146**

2014	Up to 1 year £m	1-5 years £m	5-10 years £m	Total
France	-	7	-	7
Germany	-	30	-	30
Netherlands	9	39	-	48
Spain	-	22	-	22
Sweden	-	70	-	70
	9	168	-	177

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL** continued

L. 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 pension scheme is treated as a defined contribution scheme due to the multi-employer exemption. CISGIL is exposed to potential future increases in required contributions and capital requirements allow for this. The impact 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 2015, following Group-wide consultation, the Pace Defined Benefit scheme was closed. This resulted in ending any future accruals and reducing the risk in the longer term.

M. 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 and 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.

During 2015, ownership of CISGIL transferred from the Co-operative Banking Group to the Co-operative Group, recognising that the Insurance business is at the centre of the Group Strategy and under Solvency II categorising Group as a 'Mixed-activity Insurance Holding Company'. Changes to the Group target operating model (TOM) and demands from the Group Rebuild programmes have required CISGIL resources and any associated dependencies have been incorporated within the latest plans.

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.

c) Borrowed funds

Fair value measurement is calculated on a discounted cash flow basis using prevailing market interest rates.

d) Receivables and payables

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.

Notes to the Financial Statements continued

29. **Financial risk management - CISGIL** continued

The table below shows a comparison of the carrying value and fair values of financial instruments for those liabilities not disclosed at fair value.

Financial liabilities	**Carrying value 2015 £m**	**Fair value 2015 £m**	Carrying value 2014 £m	Fair value 2014 £m
Borrowed funds	**68**	**71**	-	-

The table below analyses financial instruments by measurement basis as detailed by IAS 39 (Financial Instruments: Recognition and Measurement).

2015	**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	**199**	**-**	**-**	**-**	**199**
Available for sale assets	**-**	**-**	**692**	**-**	**692**
Other financial assets	**-**	**191**	**-**	**-**	**191**
Total financial assets	**199**	**191**	**692**	**-**	**1,082**
Non-financial assets					**138**
Total assets					**1,220**
Liabilities					
Borrowed funds	**-**	**-**	**-**	**68**	**68**
Overdrafts	**-**	**-**	**-**	**4**	**4**
Other financial liabilities	**-**	**-**	**-**	**66**	**66**
Total financial liabilities	**-**	**-**	**-**	**138**	**138**
Non-financial liabilities					**759**
Total liabilities					**897**
Capital and reserves					**323**
Total liabilities and equity					**1,220**

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					
Other borrowed funds					
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

29. **Financial risk management - CISGIL** continued

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 IFRS 7 (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 can not 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

2015	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Assets				
Financial assets at fair value through income or expense	**-**	**199**	**-**	**199**
Available for sale assets	**-**	**692**	**-**	**692**
Total financial assets at fair value	**-**	**891**	**-**	**891**
Liabilities				
Other borrowed funds	**-**	**71**	**-**	**71**
Total financial liabilities at fair value	**-**	**71**	**-**	**71**

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

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:

	2015 £m	2014 £m
Carrying amount	**692**	765
Fair value	**692**	765
Amortised cost	**684**	748

Notes to the Financial Statements continued

30. Financial risk management - Trading Group

In plain English - what does this note show?

The following disclosures outline the principal financial risks facing the Trading Group and what is done to manage those risks. These include: credit risk, interest rate risk, foreign currency risk and liquidity risk. Sensitivity analysis is also provided to help readers judge these risks, with further information provided regarding guarantees and fair values. Our Insurance business (CISGIL) is separately regulated and funded to the Trading Group and so its financial risks are also managed separately (see note 29 for further details).

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 33 to 35.

Introduction

The Trading Group meets its working capital needs through a number of facilities totalling £1,376m of which £1,359m are committed facilities. During 2015 the Group repaid in full a £50m Bilateral Facility Co-operative Bank loan and slightly reduced its Revolving Credit Facility with its Bank Syndicate from £450m to £411m following the agreed allocation of proceeds arising from business disposals. The Group's remaining committed facilities of £948m are Capital Market's debt which 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 (excluding Funeral bonds)

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. For Funeral bond investments credit risk, refer to note 23.

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 18. The carrying value of all balances that attract a credit risk, which represents the maximum exposure, is set out below:

	Carrying amount 2015 £m	Carrying amount 2014 £m
Trade and other receivables (excluding prepayments and accrued income)	**365**	338
Interest rate swaps	**55**	67
Cash deposits	**331**	247

Notes to the Financial Statements continued

30. Financial risk management - Trading Group continued

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 2 January 2016 was 83% (at 3 January 2015: 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 3 January 2015: 3.27% to 5.46%). At 2 January 2016, the Trading Group had interest rate swaps with a notional contract amount of £893m (at 3 January 2015: £895m).

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 2 January 2016 was a net asset of £18m (2014: net asset £19m) comprising assets of £55m (2014: £67m) and liabilities of £37m (2014: £48m). These amounts are recognised as fair value derivatives.

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:

	2015						
	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	**0.375%**	**190**	**190**	**-**	**-**	**-**	**-**
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%**	**(18)**	**-**	**-**	**-**	**-**	**(18)**
Other unsecured loans	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Effect of interest rate swaps	**4.189%**	**-**	**368**	**-**	**-**	**(143)**	**(225)**
Corporate investor shares	**1.386%**	**(17)**	**(15)**	**(1)**	**(1)**	**-**	**-**
Finance lease liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**-**
		(775)	**18**	**(1)**	**(1)**	**(239)**	**(552)**

Notes to the Financial Statements continued

30. **Financial risk management - Trading Group** continued

	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%	151	151	-	-	-	-
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)	-
		(872)	(68)	(3)	(4)	(169)	(628)

Notes to the Financial Statements continued

30. Financial risk management - Trading Group 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 2 January 2016, the Trading Group had forward currency transactions in Euro and NZ Dollars with a notional contract amount of £9m (2014: £7m).

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 2 January 2016, the Trading Group had available borrowing facilities totalling £1,376m (2014: £1,465m), which comprised uncommitted facilities of £17m (2014: £16m) and committed facilities of £1,359m (2014: £1,449m). These are detailed below:

Bank facilities as at 2 January 2016

		2015		2014
	Expiry	**£m**	Expiry	£m
Uncommitted facilities	**August 2016**	**17**	August 2015	16
Syndicate Revolving Credit Facility	**July 2017**	**411**	July 2017	450
Bilateral Facility		**-**	March 2015	50
		428		516
Debenture	**December 2018**	**21**	December 2018	21
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**	**18**	December 2025	19
Eurobond issue - 2026	**July 2026**	**350**	July 2026	350
		1,376		1,465

On 12 February 2016, the Trading Group successfully completed the refinancing of its £411m Syndicated Revolving Credit Facility expiring July 2017. This has been replaced by a new £355m Syndicated Revolving Credit Facility that expires in February 2021.

Notes to the Financial Statements continued

30. Financial risk management - Trading Group continued

The following are the maturities of financial liabilities as at 2 January 2016:

	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	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Sterling Eurobond 2020	**(477)**	**(450)**	**-**	**-**	**-**	**(450)**	**-**
Sterling Eurobond 2026	**(376)**	**(350)**	**-**	**-**	**-**	**-**	**(350)**
Final repayment subordinated notes - 2025	**(109)**	**(109)**	**-**	**-**	**-**	**-**	**(109)**
Instalment repayment subordinated notes - 2025	**(18)**	**(18)**	**-**	**(1)**	**(1)**	**(4)**	**(12)**
Finance lease liabilities	**(5)**	**(5)**	**(1)**	**(1)**	**(2)**	**(1)**	**-**
Funeral plans	**(805)**	**(805)**	**(41)**	**(38)**	**(78)**	**(259)**	**(389)**
Trade and other payables	**(1,447)**	**(1,447)**	**(1,174)**	**(102)**	**(25)**	**(34)**	**(112)**
Derivative financial liabilities							
Interest rate swaps used for hedging	**(37)**	**(37)**	**-**	**-**	**-**	**(14)**	**(23)**

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)	-
Funeral plans	(675)	(675)	(24)	(80)	(102)	(145)	(324)
Trade and other payables	(1,391)	(1,391)	(1,138)	(42)	(29)	(69)	(113)
Derivative financial liabilities							
Interest rate swaps used for hedging	(48)	(48)	2	-	-	(23)	(27)

The amounts above only include the maturities of the principal of the financial liabilities. Due to the terms of some of the Trading Group's debt instruments, the contractual cash flows from interest payments are variable dependent on the Trading Group meeting certain financial credit standing / performance criteria.

Notes to the Financial Statements continued

30. Financial risk management - Trading Group continued

Sensitivity analysis

Interest rate risk

The valuations of the Trading 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 2 January 2016 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 £56m (2014: GBP £63m) higher and GBP £61m (2014: GBP £70m) 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 2 January 2016 and 3 January 2015, 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.

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 2 January 2016 the total amount of guarantees / bonds outstanding is £59m (2014: £44m).

Notes to the Financial Statements continued

30. Financial risk management - Trading Group continued

Fair values of the Trading Group

The following table shows the carrying amounts and fair values of financial assets and liabilities, including their levels in the fair value hierarchy. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value (e.g. trade and other receivables).

			2015			2014
	Quoted market prices in active market	**Valuation techniques using observable inputs**	**Valuation techniques using**	Quoted market prices in active market	Valuation techniques using observable inputs	Valuation techniques using unobservable inputs
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	Level 1 £m	Level 2 £m	Level 3 £m
Non financial assets held at fair value						
Investment properties	**-**	**-**	**87**	-	-	99
Financial assets						
Trade and other receivables	**-**	**664**	**-**	-	574	-
Cash and cash equivalents	**-**	**331**	**-**	-	247	-
Investments in funeral plans	**-**	**-**	**781**	-	-	661
Derivative financial assets and liabilities						
Interest rate swaps:						
Assets	**-**	**55**	**-**	-	67	-
Liabilities	**-**	**(37)**	**-**	-	(48)	-
Non-derivative financial liabilities						
Secured debt:						
- First mortgage debenture 2018*	**(21)**	**-**	**-**	(21)	-	-
Unsecured bond issue:						
- Fixed-rate sterling eurobond	**(853)**	**-**	**-**	(839)	-	-
Unsecured subordinated notes:						
- Final Repayment Subordinated Notes	**(109)**	**-**	**-**	(109)	-	-
- Instalment Repayment Subordinated Notes**	**(18)**	**-**	**-**	(19)	-	-
Unsecured bank facilities						
- Other unsecured loans	**-**	**(2)**	**-**	-	(52)	-
Corporate investor shares		**(17)**			(11)	
Finance lease liabilities	**-**	**-**	**(5)**	-	-	(9)
Trade and other payables (excluding accruals and deferred income)	**-**	**(2,037)**	**-**	-	(1,847)	-

* 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

30. Financial risk management - Trading Group 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.

Investments in funeral plans

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. The plan investment is a financial asset, which is recorded at fair value each period through the profit and loss account. Investments are held in insurance policies or cash based trusts and attract interest and bonus payments throughout the year dependent upon market conditions. The funeral bond contract between the Trading Group and customer conveys certain rights of cancellation or transfer, and as such there is a contractual obligation, in certain circumstances, for the Trading Group to deliver cash in the form of a refund to the customer or preferred provider. This liability is therefore classified as a financial liability and is subsequently measured at the amount contractually repayable on demand.

Derivatives

Forward exchange contracts, such as the Trading 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:

	2015	2014
Derivatives	**0.72% - 2.07%**	0.63% - 1.91%
Loans and borrowings	**3.97% - 10.23%**	3.88% - 10.16%

Notes to the Financial Statements continued

31. Derivatives

In plain English - what does this note show?

The Trading Group uses derivative financial instruments (interest rate swaps) to hedge against interest rate risks. The note below shows the value of these swaps at the year end as well as explaining how these items are valued.

Derivatives held for non-trading purposes for which hedge accounting has not been applied are as follows:

	2015			2014		
	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	**893**	**55**	**(37)**	895	67	(48)
Total recognised derivative assets / (liabilities)	**893**	**55**	**(37)**	895	67	(48)

Interest rate swaps and forward currency transactions are measured at fair value (IFRS 13 level 2 hierarchy) through the income statement (see notes 5 and 6).

Accounting policies

The Trading Group uses derivative financial instruments to provide an economic hedge to its exposure to 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, valuation techniques such as discounted cash flow models are used. For further details refer to note 30.

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

32. Commitments and contingent liabilities

In plain English - what does this note show?

The note shows the value of capital expenditure that the Group is committed to spending in the coming year, as at the balance sheet date, as well as showing what the Group's future commitments under operating leases (mainly in relation to Food store rents) is over the coming years.

a) Capital expenditure not accrued for, but committed by the Group at the year end was £4m (2014: £5m). 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. The commercial terms of the Group's operating leases vary, however they commonly include either a market rent review or an index linked rent review. The timing of when rent reviews take place differs for each lease. At 2 January 2016, the future minimum lease payments under non-cancellable operating leases were:

	2015		2014	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Within one year	**191**	**5**	176	10
In two to five years	**680**	**4**	631	9
In over five years	**1,436**	**-**	1,540	-
	2,307	**9**	2,347	19

The total of future minimum sublease payments expected to be received under non-cancellable subleases less than 50 years is £198m (2014: £206m).

CISGIL has entered into a long term software service contractual agreement. This contract will end no earlier than 2023. The estimated value of the remaining commitment is £153m (2014:£nil). These amounts have not been provided for in the financial statements.

33. Related party transactions and balances

In plain English - what does this note show?

Related parties include people (such as the directors and key management personnel) as well as entities (such as subsidiaries or associates like The Co-operative Bank Plc). The note outlines the nature of the relationship of any related parties and the extent of material transactions and balances with them.

		2015	2014
	Relationship	**£m**	£m
Sales to associated undertakings and joint ventures on normal trading terms	**(i)**	**0.2**	0.6
Subscription to Co-operatives UK Limited	**(ii)**	**0.7**	0.7

i) Details of the Society's associates and joint ventures are set out in notes 13 and 26.

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 25. The sales to corporate members, on normal trading terms, were £1,504m (2014: £1,479m) and the amount due from corporate members in respect of such sales was £113m at 2 January 2016 (3 January 2015: £83m). No distributions have been made to Corporate members based on their trade with the Group in either the current or prior years.

Notes to the Financial Statements continued

33. **Related party transactions and balances** continued

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. At the balance sheet date, one related party is a guarantor to an annual residential tenancy agreement with the Group to the value of £6,000. Another related party bought a funeral plan to a value of £4,000 during the year. The transactions are on equivalent terms to those that would prevail on an arms length basis. Other than the compensation set out in the Remuneration Report, there were no other transactions greater than £1,000 with the Group's entities (2014: £nil). Total compensation paid to key management personnel is shown below.

Key management personnel compensation	**2015 £m**	2014 £m
Short-term employee benefits	**10.3**	11.8
Post-employment benefits	**0.7**	0.7
Other long-term benefits	**2.9**	-
Termination benefits	**0.8**	4.4
Total	**14.7**	16.9

Of the above, £1.3m (2014: £0.9m) was paid via a management entity.

Transactions with associates and joint ventures

The following balances are outstanding with the Co-operative Bank Plc for the period ends in which it has been an associate:

	2015 £m	2014 £m
Loans	**(1)**	(51)
Intercompany assets	**6**	126
Bank balance	**105**	247
Intercompany liabilities	**(156)**	(163)

Net interest and fees paid to the Co-operative Bank Plc were £3m (2014: £5m).
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 Liability Management Exercise (LME), when the Bank ceased 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.

Notes to the Financial Statements continued

33. **Related party transactions and balances** continued

Pensions Undertaking

On 4 November 2013,The Co-operative Group and the Bank entered into an undertaking whereby The Co-operative 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). Good faith discussions have not yet concluded and no Pace separation terms have been agreed. The Bank has expressed an intention to conclude negotiations over its exposure, the scale of contributions and its role in the longer-term scheme. The aim is to conclude these discussions during 2016.

Britannia Pension Scheme

On 23 December 2015 the Bank entered into a deed of Amendment, Cessation, Substitution of Principal Employer, Apportionment, Augmentation and Release (The "Deed") relating to the Britannia Pension Scheme with CFSMS and other parties. Under the Deed, the Bank agreed to become Principal Employer and Sponsor of the Britannia Pension Scheme in place of CFSMS with effect from 25 December 2015. In addition, the Bank was released from previous guarantees given in favour of the Scheme Trustees and for the benefit of the Scheme.

IT separation costs agreement

The Bank and the Group entered into an IT Costs Separation Agreement on 22 January 2015. In consequence of the Bank's IT outsourcing agreement with IBM for enterprise computing services, the Bank is not progressing the proposed revised IT Service Agreement (ITSA) and Professional Services Master Service Agreement (PSMSA) which were described in the 2013 Annual report and accounts. A number of service contracts under the PSMSA have now been terminated and services repatriated to the Bank, with the intention that all will be terminated by the end of Q1 2016 except pensions and membership. Under the IT costs separation agreement, the Group will 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. As part of this, the Bank entered into an amendment agreement on 21 December 2015 to the Third Party Access agreement that is in place between the Bank, IBM and the Group governing how the Group delivers services on behalf of the Bank in the Bank's target IT infrastructure. Further, the Group undertake that any notice to terminate the existing IT services agreement and the CFSMS-Bank Framework Agreement 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 Group's own costs of keeping the wider Group's existing IT infrastructure stable and operable during and following the Bank's separation of its IT infrastructure; to this end, the Group undertook to contribute a maximum of £95m towards such 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 Group project falls 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 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 to the Bank £2.9m, and a further £5.2m was paid in 2015. The Bank entered into a simultaneous agreement with Cardtronics UK Limited for the sale of these ATMs in Group premises.

Tax loss share

As part of the negotiations relating to the separation of the Bank from the Group, the Bank and the Group also agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in the Group tax group. A deed sets out the basis of the agreement by the Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 2013. The deed also addresses the terms of the payment by the Group to the Bank for those tax losses. The Group has recognised a creditor of £143m (2014: £181m) with the Bank for this. The Bank receives payment from the Co-operative Group when the Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised.

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.

Notes to the Financial Statements continued

33. **Related party transactions and balances** continued

CFSMS-Bank Framework

On 16 February 2006, the Bank and CFSMS entered into the CFSMS-Bank Services Agreement pursuant to which CFSMS provides assets such as office equipment, materials and office space, 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.

The Bank and CFSMS 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), the transfer of assets to the Bank (see 'Tangible and Intangible Assets' below) and the Bank entering in to numerous contracts with third party suppliers to replace those previously provided through CFSMS or the wider Group. These activities continued into 2015, in particular in respect of the Bank's transition of enterprise services to IBM.

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. The employment of a further tranche of IT security personnel took place in November 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 Limited (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 Group. Whilst no services are currently being provided, the Bank and the Group entered in to an agreement to provide a framework for future services on 28 November 2014. Following the TUPE transfer of IT security personnel from CFSMS to the Bank in November 2014, the Bank entered into a letter agreement with CFSMS that regulated the terms on which certain IT security personnel would have transferred from CFSMS to the Bank, and the terms on which the Bank would provide an IT security service that the transferred IT security personnel used to provide, in relation to the IT infrastructure which the Bank and CFSMS share. This service is provided by a small number of people who are provided to CFSMS by way of secondment.

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. In 2013, the Directors of the Bank concluded these assets met the accounting criteria to be shown as assets for the Bank, and therefore reported them on the balance sheet. Legal title of these assets transferred to the Bank in 2014. 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 carrying value of these assets on the balance sheet at 31 December 2015 is £nil (2014: £126m).

Travel

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.

NOMA

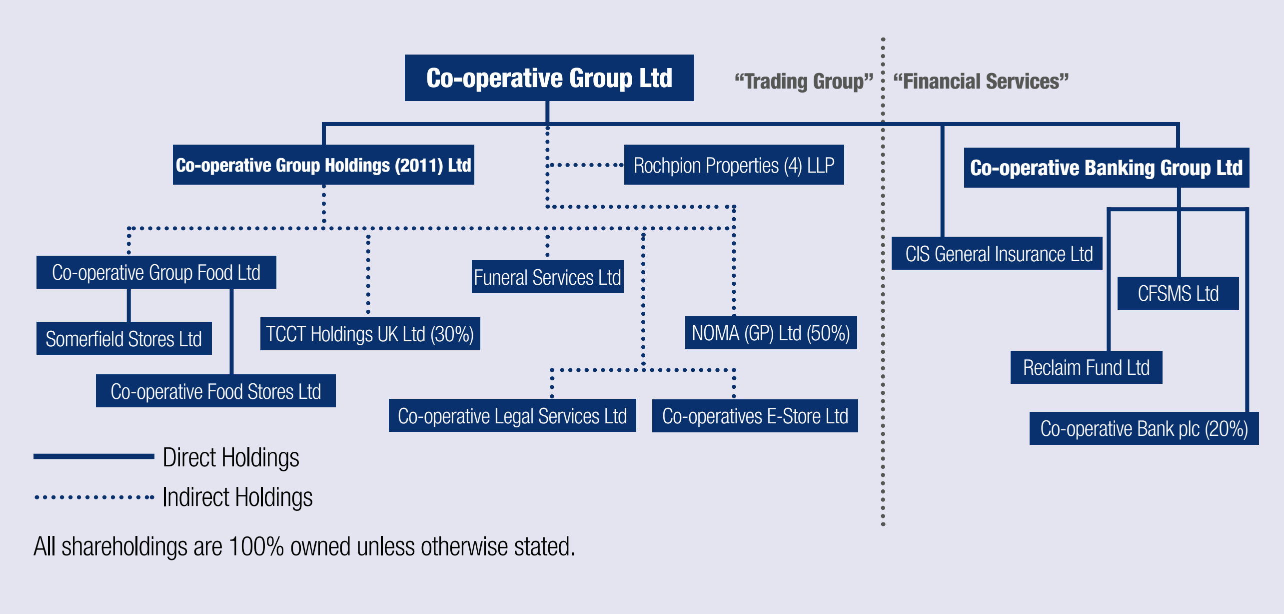
The Group has transacted in both periods with the NOMA joint venture in relation to the headlease of the CIS Tower in Manchester. The Group has sublet this lease onto the Bank and CISGIL who occupy it. These transactions were all at arms length.

Notes to the Financial Statements continued

34. Principal subsidiary undertakings

In plain English - what does this note show?

The diagram shows the composition of the Group and its principal subsidiaries, joint arrangements and associates.



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.

Financial Services:	**Society holding %**	**Nature of business**
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. A full list of subsidiaries that make up the Group for the purposes of these financial statements can be found at:

http://www.co-operative.coop/corporate/aboutus/oursubsidiaries/

Notes to the Financial Statements continued

34. **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 2015 and 2 January 2016 are not significant to the Group.

iii) All transactions between entities are in the usual course of business and are at arms length.

iv) During the year, the Group undertook a corporate reorganisation that saw Co-operative Banking Group Ltd sell its investment in CIS General Insurance Ltd to Co-operative Group Ltd.

v) As part of a corporate realignment within the Food business, 412 stores and a number of non trading properties were sold from Somerfield Stores Ltd to Co-operative Foodstores Ltd and Rochpion Properties (4) LLP.

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 Group Ltd if it has sufficient capital to do so having regard to CISGIL's regulatory requirements and the CISGIL board's risk appetite.

35. Reclaim Fund assets and liabilities

In plain English - what does this note show?

The Group is required to consolidate Reclaim Fund Limited ('RFL') as it is a 100% owned subsidiary of the Group and the Group is 100% liable for funding RFL. However, the Fund is a not-for-profit organisation whose surplus is held entirely for the benefit of Big Lottery Fund ('BLF'). 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 it is separately disclosed within the Group balance sheet. The note provides an analysis of Reclaim Fund's assets and liabilities.

	2015 £m	2014 £m
Non-current		
Investment securities	**73**	73
Current		
Cash	**488**	407
Reclaim fund assets	**561**	480
Non-current		
Provision for reclaims of dormant account balances	**305**	267
Provision for future distributions to Big Lottery Fund	**182**	139
Reclaim fund liabilities	**487**	406

RFL administers the collection of funds from dormant savings accounts in UK financial institutions and passes them to the BLF for distribution. The Group recorded a surplus of £74m upon initial recognition of RFL in 2011 which principally was the net difference between the amount received in respect of dormant accounts and the provisions for distributions to be returned to account holders and / or the BLF. The surplus created is for provision of regulatory capital to the fund and is held in a separate, non distributable reserve (other reserves). If the Group were to derecognise RFL as a subsidiary then a loss, equivalent to this surplus, of £74m would be incurred on disposal.

Notes to the Financial Statements continued

35. **Reclaim Fund assets and liabilities** continued

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 BLF. This represents amounts which the RFL intends to pay over to the BLF 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 BLF for ongoing distribution to the benefit of the community. Distributions to the BLF 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.

36. Capital resources

In plain English - what does this note show?

The note shows the Group's total capital resources at the balance sheet date and describes the Group's approach to capital resource management.

	2015 £m	2014 £m
Share capital	**72**	70
Retained earnings and other reserves	**2,882**	2,795
Total capital resources	**2,954**	2,865

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 businesses, Trading Group and Financial Services, 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 and making member payments to stakeholders. As the Group is currently in Rebuild, it has had to prioritise capital expenditure over member payments. As such, the Group made member payments of £nil (2014: £nil) to its stakeholders and invested in future growth through capital expenditure additions of £312m (2014: £294m). Total member funds increased during the period by £89m (2014: an increase of £829m).

Financial Services mainly compromises the General Insurance business. CIS General Insurance Ltd is a regulated entity. Its submissions to the regulators in the period have shown that this entity's individually regulated operations have complied with all externally imposed solvency requirements throughout the period.

Independent Auditor's Report to 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 Co-operative Group Limited ('the Society' or 'the Group') for the 52 week period ended 2 January 2016 set out on pages 75 to 190.

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 state of the Group's affairs as at 2 January 2016 and of the income and expenditure of the Group for the 52 week 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:

Classification and carrying value of the Group's investment in The Co-operative Bank plc ('the Bank') £185m (2014: £224m)

Refer to page 49 (Report of the Risk and Audit Committee) and notes 13 and 26 (accounting policy and financial disclosures)

The risk:

The Group's investment in The Co-operative Bank plc is classified as an associate on the basis of its shareholding of 20.2% and as the Group has the right to appoint a director to the Bank's Board of Directors.

The classification of the investment as an associate or financial investment is based on whether the Group is determined to have significant influence over the Bank, which 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 at fair value using an estimate of the Group's share of the fair value of the Bank's net assets and liabilities at the date of recognition. As this fair value 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.

Given recent trading results of the Bank, there is subjectivity in determining the recoverable amount of the investment in the Bank and whether any impairment in the Group's investment in the Bank has arisen, which could be 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 has over the Bank. In making our assessment, we considered the Group's percentage shareholding in the Bank and the level of Board representation held.
- 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, to critically assess the 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 Co-operative Group Limited Only continued

Recoverable amount of goodwill £896m (2014: £889m) and property, plant and equipment £1,965m (2014: £1,998m)

Refer to page 49 (Report of the 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 cash flow forecasts are based, and the principles and integrity of the Group's cash flow forecasts, 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, the allocation of central costs and discount rate. Our evaluation included comparing the growth rates used to historic like for like sales growth and externally available data, 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 applied within the cash flow forecasts 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.

Going concern

Refer to page 49 (Report of the Risk and Audit Committee) and page 84 (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 84 to 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 and 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 forecast cash flows for the period to 30 April 2017, 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 forecast proceeds from property and business disposals, the success of central cost saving initiatives and the timing of expected cash flows. 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 directors 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 2 January 2016 and forecast for the periods to 30 April 2017. 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 property and business 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 critically assessed the likelihood of CBG meeting its commitments from its available resources.

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

- 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 also assessed whether the disclosures provided in respect of the Group's assessment of the going concern position appropriately reflected the related uncertainties and judgements.

Provisions £439m (2014: £521m)

Refer to page 49 (Report of the Risk and Audit Committee), and note 24 (accounting policy and financial disclosures)

The risk:

The Group has recorded a number of provisions for anticipated expenditure, including in relation to uninsured claims (for example accidents in the Group's stores or depots), 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).

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 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 KPMG 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 £746m (2014: £738m)

Refer to page 50 (Report of the Risk and Audit Committee), and notes 21 and 28 (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.

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.

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

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 of £9,185m (2014: £9,154m), liabilities of £7,919m (2014: £8,025m) and a net accounting surplus of £1,266m (2014: £1,129m))

Refer to page 49 (Report of the Risk and Audit Committee), and notes 15 and 27 (accounting policy and financial disclosures)

The risk:

The Pace scheme is the most significant of the Group's schemes, and is recognised as an asset on the Group's balance sheet as the scheme is in surplus on an IAS 19 basis. 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 in respect of the valuation of the Pace scheme 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.

Inventory £445m (2014: £434m)

Refer to page 49 (Report of the Risk and Audit Committee), and note 17 (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 for the quantity of inventory held included testing the design and effectiveness of the Group's controls over inventory counts. This included the upload and reconciliation 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 to assess their effectiveness, 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, we 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.

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

Supplier income £635m (2014: £612m)

Refer to page 49 (Report of the 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 cost of sales. 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 to enable that Supplier income to be 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; and inspecting supplier statements for evidence of deductions being disputed.

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

We continue to perform procedures over accounting for, and disclosure of business disposals, However, given there has not been any significant business disposals in the financial year, we have not assessed this as one of the risks that had the greatest effect on our audit (as we did in 2014) and, therefore, it is not separately identified in our report this year.

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 £10m (2014: £14m), determined with reference to a benchmark of the Group's net assets of which it represents 0.3%. In 2014 materiality for the Group financial statements was set with reference to profit before taxation, excluding finance costs and normalised to exclude one-off items and profits and losses on property and business disposals, being £243m, of which it represented 5.8%.

The change in benchmark for 2015 was made as a result of the reduced level of profit being generated by the Group during its Rebuild phase, which does not represent the scale of underlying trading activities of the Group.

We report to the Risk and Audit Committee any corrected or uncorrected identified misstatements exceeding £0.5m (2014: £0.5m), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Audits for Group reporting purposes were performed at all of the Group's twelve (2014: sixteen) reporting components. These audits covered 100% (2014:100%) of total Group revenue, total Group assets and 100% of the Group's profit before tax. The work on one (2014: two) of the components was completed by the Group audit team and the remaining eleven (2014: fourteen) components were audited by component auditors.

The Group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above, and the information to be reported back.

Two (2014: 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 £9m (2014: £4m to £10m), having regard to the mix of size and risk profile of the Group across the components.

The Group team visited nine (2014: thirteen) component locations to assess the audit risk and strategy. Video and telephone conference meetings were also held with these component auditors and certain others that were not physically visited. At these visits and 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 40 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 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 70 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 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 those matters we are required to state to it 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 it 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 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

6 April 2016

Independent Sustainability Assurance Statement Summary

Co-operative Group Limited ('the Co-op') commissioned **DNV GL Business Assurance Services UK Limited** ('DNV GL) to undertake independent assurance of sustainability reporting within the Co-operative Group Limited Annual Report ('the Report') for the year ended 2 January 2016. The scope of the assurance includes the information reported in the Sustainability Review section of the Report and also sustainability related aspects of the Business Review and Co-op People sections. This forms the first stage of a two-stage assurance engagement that will also include assurance over additional online sustainability performance reporting.

We performed our work using DNV GL's assurance methodology VeriSustain™, which is based on our professional experience, international assurance best practice including the AA1000 Assurance Standard, International Standard on Assurance Engagements 3000 (ISAE 3000), and the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines. We evaluated the Report for adherence to the VeriSustain™ Principles of stakeholder inclusiveness, materiality, responsiveness, completeness, neutrality and reliability.

We also evaluated the performance data using the reliability principle together with the Co-op's data protocols for how the data are measured, recorded and reported. The areas of performance data/ KPIs in scope are identified with a ◊ symbol in the text.

The full assurance statement with DNV GL's scope of work, findings and conclusions can be found online here: www.co-operative.coop/sustainabilityperformance

DNV·GL

Co-operative Group Limited
Registered society, registered in England and Wales under the Co-operative and Community Benefit Societies Act
Registered office: 1 Angel Square, Manchester M60 0AG
Registered number: 525R
www.co-operative.coop