Co-op Annual Report 2016

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Group revenue

£9.5bn

(2015: £9.2bn)

See page 13

Operating profit

£148m

2015: £112m

See page 14

Loss before tax

£132m

2015: £23m profit

See page 25

Underlying profit before tax

£59m

2015: £81m

See page 25

Net debt

£885m

2015: £692m

See page 26

Number of food stores

2,774

2015: 2,803

Number of funeral homes

1,026

2015: 986

Colleague engagement score

78%

2015: 74%

See page 30

Number of colleagues

69,320

2015: 69,980

See page 29

Active members

4 million

September 2016: 3.4million

See page 35

Amount raised for British Red Cross to help tackle loneliness

£4.5m in 2016

See page 34

Our business model

We are a member-owned organisation which does business in a different way.

The Co-op difference

- We live our purpose, championing a better way of doing business for you and your communities
- Our Ways of Being Co-op – Do What Matters Most, Be Yourself Always, Show You Care and Succeed Together – are at the heart of everything we do
- We're founded on a set of values and principles describing a different, fairer and ethical way of doing business
- We have our own way of doing things – the Co-op Way
- We are owned by the people who use our businesses
- Our members have a direct say in how we do business and how our business is governed
- We exist to meet our members' needs and stand up for the things they believe in
- Members can earn rewards for themselves and their communities every time they buy Co-op branded products and services, and can choose which local causes in their communities benefit

What we need to be successful

- Engaged members, trading with us regularly
- Motivated and engaged colleagues
- Food stores, funeral homes and other opportunities to meet with members (and meet their needs) in the right locations across the UK
- Products and services which are relevant to our members
- A logistics network which can support our current and future needs
- Stable and resilient IT systems to support all our operations
- Good quality data, used securely and transparently
- The right level of financing to support our investment plans

We generate revenue through businesses which our members value

- We are a leading convenience food retailer, with an aim to be number one in the UK
- We provide market-leading funeral services through the UK's number one funeral director
- We are a trusted and responsible insurer, with an offer focused on our members
- We offer easy and straightforward access to legal services
- We are a growing and pioneering digital business

Report from Group Chair
Allan Leighton

"Our aim is to attract a million new members to our Co-op"

Allan Leighton

Back to Being Co-op

There's no doubt that we had a momentous 2016. We went back to Being Co-op and we returned to the ideas that have made us special and different to generations of Co-op members. Once again we're rewarding our members, supporting their communities and campaigning on the issues that matter most to them.

Last year was the second year of our Rebuild programme and with our commercial recovery well underway and our governance changes working well, this was the moment to relaunch our Co-op Membership.

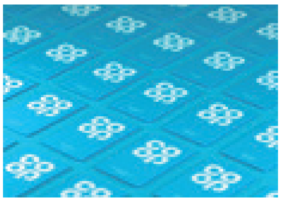
At our Annual General Meeting in May we announced the biggest changes to member rewards for decades with our 5% for you when you buy Co-op branded products and services, and 1% to local community causes.

For the first time we're rewarding our members every time they choose Co-op. By 2018 we're committed to giving back £100m a year to our members and their communities through our new Membership rewards.

To draw maximum attention to the changes we've made to Membership and to mark our return to the values of ethical commerce we're best known for, we chose to change our brand. We've brought back our iconic Co-op cloverleaf, first used in the late 1960s when the public had a far greater understanding of what the Co-op stood for. We want the cloverleaf to once again become a signifier of Co-op value and values.

We're well advanced in the rebrand of our stores, funeral homes, packaging and point of sale material, with our online presence already in the new look.

Five million new Co-op cards



Our colleagues began benefiting from the new rewards in June so by the time we switched them on for all of our members in late September we were familiar with explaining how they worked.

We made it a priority to reconnect with our existing members, sending out five million new Co-op Membership cards during September and October.

In 2017 we've begun a national conversation with the British public to re-introduce our Co-op and explain what makes us different to a new generation of customers. Our aim this year is to attract a million new members, with half of them brand new to our Co-op.

Our relationship with the Co-operative Bank

Since the year end everyone will have seen that the Co-operative Bank ('the Bank'), which we have a 20% stake in, is now in a sale process. We are supportive of the process which the Bank is going through to find a secure home for our members who are also customers of the Bank.

Our new Group Chief Executive

Finally, let me take this opportunity to give our heartfelt thanks to Richard Pennycook who stepped down as our Group Chief Executive on 1 March this year. Richard has handed over to Steve Murrells, previously the CEO of our Food business.

Richard joined us in the summer of 2013 to help with the rescue of the Co-operative Bank and then guided us through our constitutional and governance reforms. Richard and his team then put in place the Rebuild strategy we've been successfully implementing since 2015. Richard was key in leading the team to save our Co-op in very difficult times.

Richard's decision to step down this year enables Steve to take executive leadership as we develop the next phase of our Co-op journey.

Steve joined us in 2012 and has successfully led the transformation of our Food business through the True North programme which itself set the template for much of our broader Rebuild strategy. On behalf of the Board I wish Steve and his team every success.

Allan Leighton
Group Chair

Report from Group Chief Executive
Steve Murrells

"We have the opportunity to show why Britain needs a strong Co-op"

Steve Murrells

Creating value for our members

I'd like to thank Allan and the Board for the trust they've put in me as I take over as Co-op Group Chief Executive.

We're back on our feet again and feeling proud of who we are and what we stand for.

As a co-op we exist to create value for our members by running a successful business that stays true to our ethics and our commitment to commercial responsibility.

In the coming years we have the opportunity to show why the UK needs a strong Co-op. With trust in big business in sharp decline and community life under increasing pressure, our purpose to 'champion a better way of doing business for you and your communities' has never been more relevant or timely.

Our job is to prove that relevance and show our Co-op difference in all we do – through the say we give to our members as co-owners of the business; the products and services we offer; our strengthening of local communities; and our national campaigns. We have a unique story to tell and we must tell it well.

Investing for a strong Co-op

Our Rebuild strategy is now in its third year and the investment we've been making is already benefiting our members. We've introduced improved products and services, smarter stores and funeral homes, and of course the introduction of everyday financial rewards for our members and their communities.

All of our businesses continue to put in place ambitious plans for improvement and growth. Digital, our newest division, is now a top priority and central to our improvement plans and future ambitions.

In 2016 we also invested in our colleagues by creating a unique Back to Being Co-op event. We took colleagues out of the workplace, to inspire and equip them to be our greatest Co-op advocates. We've since seen our highest colleague engagement scores for many years.

This planned period of peak investment means that our profits are down on 2015, despite good performance from all our businesses. This was factored in to our Rebuild budget from the beginning, along with our commitment to keep our debt level below £0.9bn, which we've also achieved. As Allan has indicated in his report, since the year end the Co-operative Bank ('the Bank') has announced its sale process and given the uncertainty around the value of our investment we have reduced the carrying value of the investment to £Nil, which has reduced our profit before tax by £185m. More information about the Bank valuation is in the Our Finance section on page 26.

Join us

As Allan said, our aim this year is to bring our revitalised Co-op to the attention of the whole country and attract at least a million new members through our national *Join us* campaign.

At the beginning of 2017, we began our campaign using cinemas and social media to highlight the relationships we're building with communities through the 1% Co-op Membership rewards.

We've filmed stories of some of the 4,000 local causes we're supporting

We've worked with acclaimed British director Shane Meadows to create beautifully filmed stories of some of the 4,000 local causes we're supporting through the first wave of 1% rewards.

In April we take the Join us campaign onto national TV with the message that 'Great things happen when we work together'. While the TV campaign is running we'll be distributing more than £8m to our first round of local causes. That will give the UK 4,000 local reasons why our Co-op is a different way of doing business.

The next 4,000 causes have already been selected for the second half of 2017.

At our Annual General Meeting in May we'll show how we're returning to our campaigning Co-op heritage by asking our members to vote on motions addressing Modern Slavery, Recycling and Fairtrade. And we'll provide an update on our commitment to Tackling Loneliness.

Looking to the future

There's good reason for us to be excited about the next few years.

We need to see through our Rebuild strategy but we're already looking much further ahead. Having got ourselves match-fit and back on the playing field we're ready to set our ambitions for the longer term as we create a Co-op relevant and vital to a new generation.

I want to make Co-op Membership attractive to younger people to better reflect the nation as a whole. That means using new ways to communicate and explain what our Co-op is all about. I want us to prove that our support for younger people will be a priority for us. We'll do that through increasing our opportunities for apprenticeships and through encouraging a Co-op approach to entrepreneurship.

We should adopt the attitude and actions of the original Rochdale Pioneers, most of who were still in their twenties and thirties when they started the modern co-op movement 170 years ago. Just as they did, we must disrupt and surprise the market for the benefit of our members. We've starting looking at potential new markets where a co-op solution could become a game-changer just as it did in the 19th and 20th centuries.

I'm convinced this is the time when we can really lift our heads again, show how our Co-op is a business you can really trust, and that ethical responsibility and commercial success can go hand in hand.

We know we have fantastic business potential and there's a hunger out there for something different. Our job is to meet that craving with a Co-op response and anticipate where it will go next.

Steve Murrells
Group Chief Executive

Report from President of the National Members' Council

Nick Crofts

> "The National Members' Council – we're at the heart of our Co-op difference"
>
> Nick Crofts

It's a tremendous honour for me to serve as President of our Co-op.

The co-op model is often thought of as complex – but at its heart it's simple. Businesses that are owned by members, run to meet their needs and to deliver benefit to them rather than shareholders. Members elected to our Council play a key role in our Co-op. The Council and its members have unparalleled access to our Co-op's business leaders and opportunities to work alongside and collaborate with colleagues to develop new business ideas. Our Rules codify the role and formal relationship of the Council with the Board and business – but it's the working relationships, trusted constructive challenge, dialogue and passion for being a co-operative business that is shaping how our governance contributes to our co-op difference. Allan Leighton and I have developed a particularly positive working relationship and it has been extremely helpful in delivering on the Council's agenda.

I must thank our former Group Chief Executive, Richard Pennycook, for his service to our Co-op over the last few years. It's no exaggeration to say that his team saved our Co-op from an existential threat. His place in our history is assured. The good working relationships we developed with Richard and his team will, I'm sure, continue to develop under his successor, Steve Murrells. I was delighted to participate in Steve's appointment and I've every confidence that our development will continue under his leadership.

Back to Being Co-op

2016 was the year that we went back to Being Co-op, with the relaunch of our iconic branding and our new Membership – 5% for you and 1% for your community. This is a revolutionary development in the life of our Co-op, and already the influx of new members and the sales performance of the rebranded stores is a testament to its success.

The Council provided robust challenge to the business prior to the launch of the brand to make sure that member views were heard and a constructive set of outcomes achieved. The business responded positively and we have developed new ways of engaging Council as a result. Council will be actively involved in the Renew strategic planning work during 2017.

Holding to account

In 2016, the Council completed work on the new framework to support us in our role of holding the Board to account, the Co-op Compass, a shared way to monitor and measure business performance against four key co-operative lenses – Member Value; Member Voice; Co-operative Leadership and Ethical and Sustainable Leadership. This Council-led work was welcomed and embraced by the Board. I thank them for their constructive input and their openness to developing new ways to strengthen the key role that the Council plays in providing checks and balances. I'm also delighted to have been able to share the learning and core design of our Co-op Compass with other co-operatives to share best practice.

Work has also regained momentum to demonstrate our co-op difference through our stance on a wide range of ethical issues. Council has again played a direct role alongside the business to provide a member perspective as part of our Co-op Way Policy Committee. While there's still a lot of work to do to regain our recent position as a world leader, we've made good progress in putting our co-op difference back at the centre of how we do business.

Building a stronger Co-op

Our business strategy is one of Rebuild. We made significant progress in 2016, both transforming our business and, most importantly, transforming members' benefits and our role in communities. Our new governance model is still in its infancy. We're building rather than rebuilding and we've established strong foundations. Council works alongside the business and Board to make sure that the voice of members is heard in a modern and relevant way, adding value and ideas. I welcome the way that members of the Board have understood and responded to Council thinking on many issues. Directors have been very conscientious in attending Council meetings. The appointment in 2016 of an additional Member Nominated Director to serve on the Group Board has enhanced member voice at the heart of decision-making in our Co-op.

Council is accountable to members and work started in 2016 on improving the ways that we connect and communicate with members, including more member forums, blogs, social media, 'a taste of your Co-op' meetings and the Council newsletter. There remains more work to do here and this is being progressed with the Membership team.

Developing new ways to enable members to participate in their Co-op at local level remains vital to the Council. In 2016, Council proposed the 'Member Pioneer' and local forums model and it's great news that there are plans for Member Pioneers to be appointed in each of the 1,500 communities where we trade.

Finally, I must thank all the Council members for their constructive, passionate and positive work during 2016. Vice Presidents Dan Crowe and Bev Perkins have been a source of terrific support to me and I'm very grateful for their commitment and wisdom. The Council's Secretariat, led superbly by Gill Gardner, is a small team of brilliantly committed individuals who deserve thanks from all our members.

Nick Crofts

Nick Crofts
President of the Council

Our business performance

Introducing our year

2016 was a good year for our Co-op. Our strategy for recovery from our crisis just three years ago is working. Our businesses are getting stronger, as our growing sales show. More people are visiting our stores, in Food we gained market share and there's a buzz about our Co-op again.

We're also rediscovering our ethical heart. Our Co-op's always balanced ethics with profit, going back to when we were founded in 1844. We call it the Co-op Way.

Our plans moved forward at speed in 2016. We launched a new offer to our members across the UK. From September, they got 5% back on Co-op branded products and services and could give 1% to local causes.

This was a key part of the Rebuild plan that's well underway, following on from the initial Rescue. The improvements we're making are becoming easier to see. The relaunch of Membership shows our Co-op difference – how we're giving both financial and social rewards to our members and their communities. This is Co-op delivering on our purpose: championing a better way of doing business for you and your communities.

2016 saw the return of the iconic clover-leaf logo – marking a return to 'Being Co-op'.

Reaction to our new Membership was very positive from existing members and new ones. 2016 also saw the return of the iconic clover-leaf logo – marking a return to 'Being Co-op'. We were pleased to see that our brand scores recovered strongly as a result to levels last seen before our crisis in 2013.

The relaunch of Membership and our new look demanded a huge effort from our colleagues and leaders. Between our September relaunch and mid-October we sent out 250,000 Membership cards a day to our existing members. And during the year more than 5,600 leaders attended 116 Being a Co-op Leader events, while more than 54,000 colleagues attended 4,600 Back to Being Co-op events – reminding colleagues of our history and why we're a different kind of business. All this meant our colleague engagement levels rose from 74% to 78% in the year.

Our results show we're improving

Group revenue 2016:

£9.5bn

Up from £9.2bn in 2015

Our financial results speak for themselves. They show we're slowly growing again. Our Co-op's revenue rose by 3% to £9.5bn, up from £9.2bn in 2015.

Our Food business's like-for-like sales increased by 3.5%, making us the UK's fastest growing food retailer except for the discount supermarkets.

Our Insurance business saw revenues rising more than a quarter as we improved our underwriting capabilities, wrote more motor policies and premiums rose. We were also helped by the elements – there were no major natural disasters in 2016, unlike the storms that struck the North of England and Scotland towards the end of 2015.

Our market-leading Funerals business expanded into new UK communities, refitted funeral homes, rebranded and we grew our market share. Revenues rose by 3% to £307m, compared with £299m in 2015.

Overall our operating profit grew to £148m, up 32%, helped by disposal profits and lower restructuring costs. But because we're reinvesting so much in our businesses, higher sales didn't feed through to underlying operating profits. A reconciliation of operating profit to underlying operating profit is set out below and more detail is provided in Our Finances on page 25.

	2016 £m	2015 £m
Operating profit	**148**	112
One-off items	**21**	62
Property and business disposals	**(20)**	14
Change in value of investment properties	**(16)**	(24)
Underlying operating profit	**133**	164

Underlying operating profit 2016:

£133m

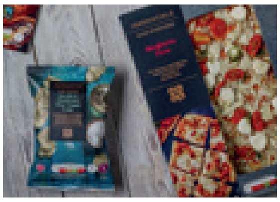
Down from £164m in 2015

Our underlying operating profits fell almost 19% to £133m, down from £164m in 2015. We expected this, knowing that 2016 would be a year of major investment as we improve the businesses for members' benefit. Importantly, our debt remains below the critical £0.9bn guidance level for the Rebuild programme.

To reinvest in our businesses we agreed the sale of our share of the travel joint venture with Thomas Cook, which will raise £82m plus interest in 2017.

We also measure how well we're doing for our members. The number of active members who trade with us regularly rose substantially from 3.4 million before the relaunch to 4 million by the end of the year. We're using digital technology and our Co-op website to keep up to date with what members are thinking, so we can constantly change to keep up with their needs. More than 12,000 members signed up online to tell us about our products and stores. We've hosted 29 'join in' opportunities – engaging members online and in their communities.

Principles and profits



In Food, we relaunched our Irresistible range

It's clear what our Co-op stands for. Our new 5% and 1% Membership says it all. We're in business for the social good of our members living in every community in the UK. Since we relaunched Membership in September, more than 700,000 new members have joined us. In case anyone hasn't been following our progress, our return to the iconic Co-op logo signals we're going back to Being Co-op. Since May, over 600 food stores and 200 funeral homes have rebranded.

In Food we relaunched our Irresistible range and continued to cut prices on fresh fruit and veg. In 2014, we promised to double the number of local suppliers by the end of 2017 and we're on target to do just that. We continued sourcing from local farms and factories, and we're committed to selling only British meat by May 2017.

In Funeralcare we're making funerals more affordable. We became the first business to sign Fair Funerals' new enhanced pledge to tackle funeral poverty, and launched the UK's most affordable national fully-guaranteed funeral plan.

Causes and campaigning

Our commitment to local causes is clear to see. By the end of 2016, almost £3m had been raised from the 1% of Co-op brand sales members can give to their communities and over 4,000 local causes are set to benefit from the first pay-out in 2017.

Over
4,000
local causes are set to benefit from the 1% of Co-op brand sales

And nationally, our colleagues, customers and members also raised £4.5m for the British Red Cross to support the Tackling Loneliness campaign, bringing the total raised to £5m since it was launched in 2015, and beating our £3.5m target. This means we have achieved our target to fund British Red Cross to deliver new services in 39 locations across the UK to tackle loneliness. With the additional money raised we will work with British Red Cross to identify other ways in which our partnership can support even more people experiencing loneliness. Since the end of the year, the total raised has increased to £5.5m and the final total will be announced at our 2017 Annual General Meeting.

£5.5m
raised for
British Red Cross

Within Food we celebrated the 10th anniversary of our partnership with The One Foundation which has raised £7m from sales of Co-op Fairbourne Springs bottled water. Clean water, sanitation and hygiene projects in Sub-Saharan Africa have changed 1.5 million lives.

We want people in our supply chains to be treated well and are joining with the charity City Hearts to help modern day victims of slavery to get back into the work place. More information about this partnership is on page 34.

We're also trying to make communities safer. Co-op Funeralcare colleagues across the UK arranged for 30,000 reflective badges to be given to children, so they could travel safely when the clocks went back. This is part of the road safety charity Brake's 'Be Safe Be Seen' initiative which we have supported for over 10 years.

Renewing our Co-op

2017 will be the third year of Rebuild. It'll set a path towards the Renew phase and completion of our recovery. We'll continue to invest to make our Co-op attractive to customers and members. We'll use digital technology to find new ways of delivering our products and services. And we'll seek to attract 1 million new members through our Join us campaign.

We plan to build a sustainable, profitable and distinctly Co-op business for the future. This remains the right course of action and we're confident in the strength of the co-operative business model.

Food

Shoppers are changing how they shop, and we're helping them. Increasingly, they want to top up their weekly shops little and often. We're making this simpler for them by offering easy shops, friendly people and good food.

For the past two years, we've been making better food available to people where they want to shop, aiming to be the UK's leading convenience food retailer. As part of our strategy called True North, we've invested in improving our food range, opening more convenience stores and permanently lowering prices across our range.

Our efforts are paying off. More people are coming to our stores and they're shopping more often. Our total sales were £7.1bn in 2016 (up from £7.0bn in 2015). Excluding fuel, our sales were up nearly £200m. That makes us the UK's fastest-growing food retailer excluding the discount supermarkets on a like-for-like basis.

Total sales

£7.1bn

▲ Up from £7.0bn in 2015

We invested in refitting stores, increasing colleague pay, improving our infrastructure and strengthening our food range, especially local British produce. Even after making such an investment for our future competitiveness and prosperity, underlying operating profit was only slightly below last year at £182m (£186m in 2015). Operating profit, which includes property and business disposals and the change in value of investment properties, was up from £196m in 2015 to £203m, mainly as a result of making a profit on property and business disposals of £5m compared to a loss of £14m in 2015.

In 2016 we opened

112

new stores

155

stores refitted

We're implementing our strategy of focusing on convenience stores quickly. In 2016, we opened 112 new stores and refitted 155 stores with our latest format. We also rebranded a further 607. We're focusing on the right size of store to give customers the best convenience shopping experience, and so we sold or closed 141 stores that didn't fit with this ambition. By the end of 2016, we had 2,774 stores, a few less than the 2,803 at the end of 2015. It's far more enjoyable to shop at our Co-op now, after we've spent £88m on new stores and £85m on refits.

We're also working behind the scenes to transform our logistics and store operations. Our stores are getting simpler and we're improving how we transport goods to them.

The food we sell is getting tastier and healthier all the time. In 2016 we relaunched our 'Irresistible' luxury range, with 2,500 new or improved products, and we're continuing to reduce the amount of sugar, salt, fat and calories in our products.

In 2014, we promised to double the number of local suppliers by the end of 2017. We continued sourcing from local farms and factories, and we launched a new small business charter. We also awarded contracts to a record number of micro-breweries. We're on target to fulfil our local supplier promise.

We know food provenance really matters to our customers and so have committed to selling only British meat by May 2017. This will make us the only major food retailer to stock 100% own brand fresh British beef, chicken, pork, lamb and turkey, and to use 100% British meat in our chilled ready meals, pies and sandwiches (except those featuring a continental meat such as chorizo).

Even some of our wine is British. In November, we launched a range of English wines, including a sparkling and an own-label white.

But we're also championing food ethics, including redistributing food to local charities (see Our Story). Preventing waste is important to us, and so in 2016 we said we would make 80% of our packaging recyclable by 2020, calling on other retailers to do the same.

Our Fairtrade sales increased by 18.4% compared to 2015 against market growth of 7.6% and our commitment to Fairtrade is also increasing. Since the end of the year we have announced that from May 2017 all the cocoa we buy for our own brand products will be Fairtrade.

Steve Murrells was awarded The Grocer Cup by the IGD

The grocery trade recognises the improvements we're making. It's no surprise that we scooped three major prizes at the prestigious Institute of Grocery Distribution (IGD) awards for our 'food-to-go' product range and 'service rocks' learning and development initiative. What's more, Steve Murrells, who was CEO Food before taking over as Group Chief Executive in early 2017, was awarded The Grocer Cup by the IGD. This is awarded to the individual who has contributed most to the grocery industry over the past year and shown exceptional leadership.

Our customers are increasingly happy with our Co-op. Customer satisfaction scores got better, with the biggest gains in our own brand products, colleagues and availability.

We're continuing with our True North strategy in 2017 but it won't be easy as inflation returns to the UK grocery market after two years of flat or falling prices.

As we continue to focus on convenience stores, we've agreed to sell 298 of our smaller stores while planning to open, refit and rebrand others. This is in line with our strategy as the stores don't fit with our focus on convenience because they don't allow us to provide a sufficiently compelling own brand offer which is essential to our new Membership. We'll continue making our food better, especially the 'food-to-go' range. We're investing in our IT systems to make it easier to plan our range and to manage our stock, while also continuing to make shops simpler and transform logistics.

Above all we'll keep on delivering value to our customers. With the benefits of shopping with the Co-op even clearer after the relaunch of Membership, we're aiming to sign up 1 million new members during the year.

1 Our story

Meals for vulnerable people

Making sure food doesn't go to waste is important to us and we know it's important to our members and customers. That's why we're working with the UK's largest food redistribution charity, FareShare, to send our surplus food to charities and community groups that turn it into nutritious meals for vulnerable people. Towards the end of 2015 Co-op launched a new project to improve the way we do this, aiming to redistribute 500 tonnes of food, which provides 1 million meals, in 2016. By the end of the year we'd redistributed enough food to make 1.2 million meals. More than 1,000 charities and community groups received food from us. Community organisations benefiting included children's breakfast and after-school clubs, youth centres, hostels and supported housing for homeless people, community cafés, older people's services, food banks, and family and children's centres. We sent them food including chilled food items such as yoghurt, meat, fruit, vegetables and ready meals. We're also redistributing food through the Real Junk Food Project in Leeds, giving food to its 'Pay-as-you-feel' cafés, as well as to breakfast clubs at local schools.

Funerals

Everyone has the right to a simple, fair, transparent and affordable funeral. In 2016, we took steps to offer a better deal to people in more than 1,000 communities across the UK.

Total sales

£307m

▲ Up from £299m in 2015

Co-op Funeralcare is a funeral director that's different. Unlike others we're a national group that's also part of local communities, and serves our members where they live. We provide funeral plans for the future (known as 'pre-need') and funerals for when someone dies (known as 'at need'). We're the UK's leading funeral director and are quickly growing our market share.

We invested heavily in 2016 to give people more and cheaper choices, a better service and expand into more communities. This meant that, despite a 1% fall in the death rate, our sales grew to £307m (£299m in 2015) with underlying operating profits remaining stable at £69m (£69m in 2015) – quite an achievement.

Operating profit in 2016 was £99m (£69m in 2015) as this includes the profit on the sale of our crematoria of £30m. After deciding it would be hard to become a major player in this business, we successfully sold our five crematoria for £41m. We're ploughing this money and more back into our funeral homes, as well as providing better products and services. Our 1,000th funeral home was opened in the year, taking us to 1,026 by the end of the year, and over three years we plan to open 200 more.

Opened our 1,000th funeral home and refitted 200 existing ones

As well as opening new homes we refitted 200 existing ones and plan to refit the entire estate by the end of 2019. Our old lilac and purple colours had grown outdated, so we've replaced them with grey and a new warm interior. What's more, we're adding finishing touches including local art.

In contrast to other funeral directors, we cut prices without reducing what we offer. Our Simple Funeral was relaunched with a price cut of about 7%. We also improved the standard of our Simple Funeral, for example offering a higher-quality coffin.

FAIR FUNERALS

We were the first funeral business to sign up to the Fair Funerals enhanced pledge to tackle funeral poverty

We were the first funeral business to sign up to the Fair Funerals enhanced pledge to tackle funeral poverty. Recognising that many people struggle to afford funerals, Quaker Social Action, the anti-poverty charity, launched this national campaign in 2014. At the same time we launched the UK's most affordable national fully-guaranteed funeral plan.

Encouraging over-45's to buy a pre-paid funeral plan to avoid leaving their loved ones a bill we launched a national advertising campaign. Our share of this market grew quickly from 19% to 28% in 2016 – plan sales were 69% up on 2015.

Our support of apprenticeships continued and we signed up an apprentice a day. Apprentices come from all walks of life and all ages, as a former detective sergeant from Canterbury showed. At 67, he joined us after 30 years with the police, becoming our oldest apprentice.

With these improvements it's no surprise that the customer satisfaction data we track continued its upward path with satisfaction scores at a record high of 95.2. In 2017 we plan to continue our mission to bring simple, fair and affordable funerals to more communities. As well as opening more funeral homes and refitting existing ones, we're planning to roll out a new digital service to free up more time for colleagues to care for the families we serve.

❷ Our story

Tackling loneliness in Plymstock

The Plymstock bereavement club, one of over 30 across the country, has become a regular fixture in the diaries of many within the local community. It began with a suggestion from one of our Co-op members who pointed out that there were a lot of lonely people within the community, and that it would be a great opportunity for us to get involved. For regular attendees like Bryan, who lost his wife two years ago, and has been coming to the group ever since, it has become something he relies on and looks forward to throughout the week. Others are dealing with a range of emotions like Beryl who just felt anger that it was her husband who had been taken. She says that it was the evenings when she felt the most alone, but the group has helped her to work through those emotions and has become a vital part of her life. Given that most of the members are over 50, they say how difficult it is at their age to go out and meet new people. So the club has helped them to form new, lasting friendships again; but the best part about it is that they all understand how each other feels. They can give each other that crucial support network, and something constant in their lives while everything else is turbulent.

Insurance

Not many people trust their insurers, but Co-op is the exception. We're working really hard to justify that trust even more by providing high-quality, fair and transparent insurance policies.

Revenues

£439m

▲ Up from £343m in 2015

Starting from a strong base in home and motor insurance, we're transforming our business and passing the benefits on to members and customers. Our knowledge about our members is helping us to give them fair priced insurance premiums.

We can do these things for members and other customers if our business is strong. In 2016 our profitability was the best it has been for many years. Our revenues were 28% higher at £439m (up from £343m in 2015) as we continued to improve our pricing and distribution capabilities and wrote more motor policies.

Higher revenues helped us to make an underlying operating profit of £11m (up from a loss of £13m in 2015), which includes a cost of £15m to reflect the change in the rate we use to calculate some of our longer term claims. The rate, which is set by the government, was changed in February 2017 and in line with the insurance industry we chose to take the cost in our 2016 results. We were also helped by the fact there were no storms like those that struck the North of England and Scotland in 2015 and by favourable development in our claims from previous years. While market conditions in home insurance remain fiercely competitive, motor premiums increased, reflecting inflation in damage claims. The outlook for premiums remains uncertain with the potential for inflationary pressure resulting from Brexit.

Our underlying operating profit excludes the one-off costs associated with our Transformation programme. Including these one-off costs, we made an operating loss in 2016 of £18m compared to a loss of £60m in 2015.

The Insurance business has been on a journey to transform the way it engages with members and customers. This involves separating out the insurance systems from the Co-operative Bank's systems, building a long-term operating model, reducing costs and having a set of systems in place which improves the way it distributes its products and services and broadens its offering.

We have made progress on a number of fronts, particularly in pricing and the use of member data to enhance products and services. In 2016 we implemented a new telephony system that has improved interactions with our policy holders. Great progress has also been made on operational initiatives to improve efficiency and reduce cost and separate our IT system from the Bank.

As part of our Transformation programme there are a set of replacements for our existing systems which are not currently meeting our expected timelines, so a focus of the business is to ensure this is completed in a timely way and we are investigating a number of actions to sustain our change momentum.

We introduced discounts for members taking out motor insurance. Using our data we're able to reward members with discounted pricing and those taking out new policies also received £50 in Co-op Food vouchers.

We joined forces with Neighbourhood Watch, aiming to help them set up new Neighbourhood Watch schemes across the country

But we're also making communities safer. We joined forces with Neighbourhood Watch, aiming to help them set up new Neighbourhood Watch schemes across the country. The partnership will also help our Co-op to reduce loneliness by bringing people in communities together.

Our Young Driver scheme reached its fifth anniversary, helping thousands of young drivers to improve their driving, making roads and communities safer, and helping to cut the cost of insurance for young people. If young people put one of our Smartboxes in their car it monitors how well they drive, so we can reward them for safe driving with lower premiums.

We also launched the Safe Used Car awards to help inform consumers about cars' key safety features when choosing second hand cars.

Championing transparency in insurance is at the heart of our strategy. Our website tool shows customers how their home insurance premium breaks down: how much goes on claims, and how much we spend on running the business. We also created a video showing how we calculate motor insurance premiums to make it easier to understand. Why do they go up or down?

In 2017 we plan to do more for our members as we move further in transforming our technology. When we can, we'll also extend our Membership – returning 5% to members and 1% to local causes when members buy Co-op branded products – to insurance products.

We can only do all this good stuff if we're great at insurance underwriting. That's why we're investing in being an excellent insurer.

3 Our story

Brake the road safety charity

Making roads safer

As part of our long-standing partnership with road safety charity, Brake, we gave 100 year-11 pupils at The Co-operative Academy of Stoke an interactive lesson that highlighted the issues associated with road safety. The session showed how making the wrong driving decision impacts people's lives. For example, we told students how a criminal conviction would hold them back from travelling the world. To capture students' attention we made the lesson interactive. Catching games with students wearing 'beer goggles' showed how alcohol slows reactions. We then set students a mock GCSE English question on persuasive writing based on the contents of the session. Teachers told us that the session got students talking. Nick Lowry, Principal at The Co-operative Academy of Stoke, said: "It was an important lesson for our students and they found it very engaging. It's a fantastic opportunity for the academies to have the Co-op and Brake speaking to students about important issues. Students took the passion that was brought by the speakers and used it in their GCSE English work."

Legal Services

We believe in providing legal services that are easy to access, giving fast and effective legal support at prices that are great value for money. In 2016 we invested in being able to take will, probate and conveyancing instructions online. Our members and clients gave us a vote of confidence and we'll develop more new services in 2017.

Revenues

£22m

▲ Up from £18m in 2015

Buying a house, writing a will, distributing a deceased family member's estate or going through a divorce are all part of life. Our strategy is to make it very easy for people to do these things effectively, in a way that suits them, and to deliver value for money.

While we offer a broad range of legal services, our largest practice areas currently are estate planning and administration – in other words helping people to write their wills and handling probate when loved ones die.

Just as our members and clients are benefiting from our strategy, so it's helping our profitability. In 2016 our revenues rose to £22m (up from £18m in 2015), lifted mainly by more people coming to us for estate planning services, as well as our acquisition of Collective Legal Solutions (now known as Co-op Estate Planning). Higher revenues lifted operating profits to £1.5m (£Nil in 2015).

Buying Co-op Estate Planning at the end of 2015 expanded our physical presence in communities across England and Wales. Co-op Estate Planning had more than 100 associates and support staff up and down the country. We also invested in our platforms, so we're more efficient and can serve people quicker.

Echoing our ethos that principles are more important than profits, our partnership with Remember a Charity passed the £20m milestone. We encourage people to make gifts to charities in their wills by making this an option in our wills service.

We also spoke to more than 17,000 people in 779 communities, educating them about legal events that might affect their lives.

4 Our story

Writing a will from home

Ahead of taking a school trip to China towards the end of last year, a drama teacher from Croydon and his civil servant wife decided it was time to make their wills. They turned to our Co-op for honesty and simplicity. Both in their mid-fifties, they had put off writing a will until then. But by using our online service they completed the whole process from home in two to three weeks, and for a fixed fee. The service was still rigorous, complemented by telephone calls, helping them to allow for all eventualities. Writing their wills gave a sense of relief, they said, knowing their daughter was more secure.

Digital

The internet has changed how people shop, communicate and do business. Our Digital team has spent 2016 helping our Co-op to become fitter for a digital future, and preparing it for Renew.

We've been applying the culture, practices, processes and technologies of the internet era to design and deliver Co-op products and services. Our Digital division is also transforming our business processes. The aim is to make sure we're as smart and efficient as our members expect us to be.

All Co-op businesses are using digital approaches to improve what they do, including Electrical, which merged into Digital early in 2016. Electrical's new website went live early in 2017.

Electrical Revenues

£67m

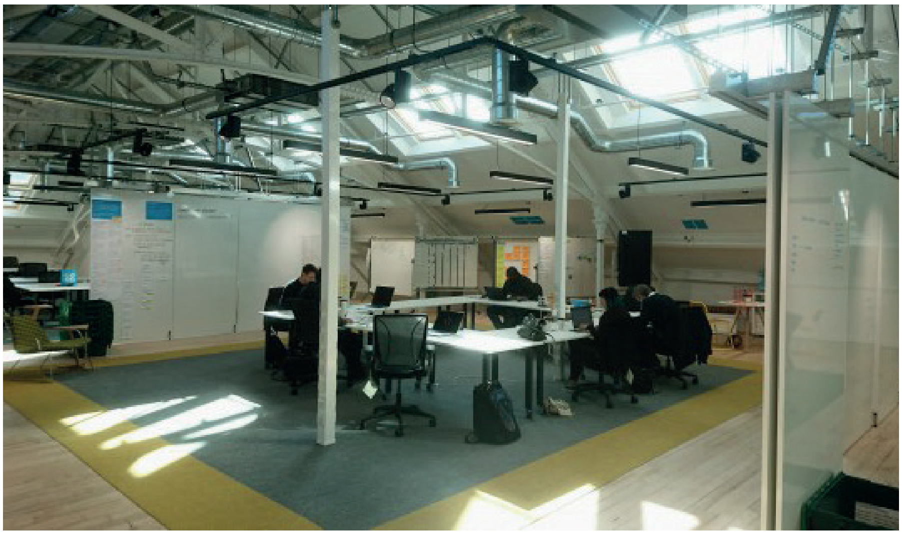
▼ Down from £79m in 2015

Not having an up-to-date website held Electrical back in 2016, a tough year for electrical retailing. Revenues fell to £67m (down from £79m in 2015), and fewer sales led to a larger operating loss of £3m (£1m loss in 2015).

But Electrical stands out for being fair and transparent. We're the only electrical retailer that doesn't make a profit on extended warranties – we sell them for what they cost us. Our customers know that we give them a good deal, as our 97% Feefo rating shows.

Digital is working with Food, Funerals and Legal Services to complete the Rebuild of our Co-op and to prepare for Renew. In Funerals and Legal Services we're harnessing the internet to transform and improve their services. Legal Services' new online wills service makes writing a will much quicker, clearer and simpler.

Food is using digital technology to improve efficiency in a variety of ways. The services team can give customers information more quickly about where products are stocked and a new dashboard trial helped stores to know when deliveries were arriving. We've also been looking into the provenance of goods in our supply chains, seeing if tracking this digitally can give us a competitive edge.



Digital played a key role in our new Membership, launching a web-based Membership platform (see Our Story). This allows members to track the 5% they earn when buying Co-op goods and the 1% for local causes. Members can also exercise their membership votes online.

One of the great things about the internet is it makes connecting with members easier. More than 12,000 members signed up online to tell us about our products and stores. We've hosted 29 'join in' opportunities – engaging members online and in their communities. Members have given over 770 hours of their time. They recommended some wines and sales of these wines then increased by 25%. Listening to members makes our Co-op better for everyone.

What we've done so far is just the start. We're planning to explore using the platforms we're setting up within our Co-op as the beginnings of new digital businesses, and we're investigating new ventures. We've already launched The Federation, an open community of digital businesses and innovators in the heart of Manchester, as a hub for digital businesses in the North.

Looking to 2017, digital thinking will be key in determining our Renew phase. Our Digital team will continue its work with our other Co-op businesses. We'll also get The Federation established and push forward our thinking on partnerships and ventures.

5 Our story

Designing our members' digital platform

When designing our Membership platform, we put our members first. The platform's our backbone – it's how we deliver the services that help our members engage with us. They can choose local causes to support, make the most of rewards, manage their details and lots of other things too. To make sure we got it right we started out by testing services with colleague members in the summer. They used 58,000 cards from June to September and gave us 550 thoughts about what to do better. They said it was difficult to set up an online account; so, we made it easier. And, they showed us that the causes that matter differ from place to place; so, we added more than 4,000 causes in 1,500 communities. After we publicly launched the new card in September members had lots to say too. They didn't know they could choose their own causes to support so we responded by tweaking the page, making the 'see your local causes' link more prominent. This is just the beginning – we'll be tweaking again and again to make our services as user friendly as possible.

Our finances

Loss before tax:

£132m

▼ Down from £23m profit in 2015

The loss before tax for the year was £132m, down from a profit of £23m last year. This has been impacted by the writedown of our investment in the Co-operative Bank ('the Bank') to £Nil, which has led to a cost in our Income Statement of £185m. More detail on this is provided in the Investments in Associates and Joint Ventures section on page 26.

As with any organisation in change, there are always lots of non-trading items that affect the numbers, resulting in our operating profit being up by a third to £148m (2015: £112m) but our underlying operating profit being down. A reconciliation of operating profit to underlying operating profit is provided on page 14 and further details of the non-trading items are given below.

Our journey from Rescue to Rebuild and then into Renew is well documented. 2016 was the second year of our Rebuild programme and we indicated that profits would fall as we ramped up activity, most notably in the relaunch of our Membership offer and in revitalising our brand. Although underlying operating profits were lower than 2015, they exceeded our expectations thanks to excellent trading performances from all our larger businesses. Food delivered strong like-for-like sales growth, Insurance grew its profits and Funerals matched 2015's excellent result.

Sales

We saw strong sales growth across Food, Funerals and most notably Insurance where sales were £96m (28%) up year-on-year. On a like-for-like basis our Food sales grew by 3.5% and exceeded the market by 4.2% as measured by the Institute of Grocery Distribution. Funerals sales grew by 3%, with particularly strong growth in sales of funeral plans. As a result, overall group revenue increased by 3% to £9.5bn.

Underlying profit before tax

£59m

▼ £22m lower than last year

Profits

Our key profit measure is underlying profit before tax, which looks at our core trading performance less underlying interest (interest on borrowings). Group underlying profit before tax of £59m was £22m lower than last year, but this was after investing in Rebuild activity.

Most notably, strong sales backed up by good claims experience saw the Insurance business deliver a £24m increase in underlying operating profit to £11m, despite being held back by a charge of £15m as a result of the change in the rate we have to use to calculate some of our longer term claims, which was reduced by the government in February 2017.

Food profit was marginally (2%) lower than in the previous year, reflecting the investments made in lower prices and colleague pay from late 2015 and through 2016.

Costs from supporting functions and Rebuild of £134m were £48m higher than last year due to the increased investment in our Rebuild activities and our Digital capabilities.

We relaunched our Membership in September 2016. The rewards earned by our members (such as 5% back on all Food own brand products) are netted off sales in the accounts. They amounted to £16m in 2016, a figure which will grow significantly in 2017 and beyond. The 1% contribution we make to local community causes is included within operating expenses and amounted to £3m in 2016. We are getting a great response to the new offer, but we need our current members and customers to shop more frequently and to spend more with us, and we also need to attract new customers as members in order for Membership to have a positive impact on our results.

Despite operating profits being up on last year, we are reporting a loss before tax of £132m principally driven by the writedown of our investment in the Bank and an increase in finance costs from the 'mark to market' in the value of our bonds described below. The table shows how we get from reported profit before tax to underlying profit before tax, adding back losses and deducting gains.

	2016 £m	2015 £m
(Loss)/Profit before tax	**(132)**	23
One-off items	**21**	62
Property and business disposals	**(20)**	14
Change in value of investment properties	**(16)**	(24)
Finance income and non-cash finance costs	**35**	(5)
Share of profits and losses from associates and joint ventures	**171**	11
Underlying profit before tax	**59**	81

The main elements are explained below.

One-off items

Where we incur significant costs that are non-recurring, such as major restructuring, we strip these out of normal trading profit in order to present a clearer picture of our ongoing trading performance. One-off items of £21m largely relate to Insurance and supporting functions restructuring costs of £35m, offset by a £14m reduction in the provision for the costs of separating from the Bank's systems. The one-off items in the prior year of £62m related to restructuring costs in our Insurance business and supporting functions.

Disposals

We made a profit on disposals of £20m, £34m higher than the £14m loss in 2015. This included a £30m profit from selling our crematoria for total proceeds of £41m, following a decision to exit this part of our Funerals business, and a £5m profit on the sale of our interest in one of our windfarm joint ventures. These profits were reduced by a £13m net loss on the sale or closure of other properties which included the creation of onerous lease provisions (£20m) on leasehold stores, where we're committed to a lease until the next break period.

Finance income and non finance costs

Non-cash financing costs include a charge of £74m (2015: £14m) arising on the fair value movement on our quoted debt (known as 'mark to market'). In common with other bonds, our bonds increased in value because of falling interest rate yields available elsewhere. In addition our improving credit outlook also served to increase our bond values. As the value of our bond debt liability increases in the accounts, it creates a charge to the income statement.

Finance income includes pensions interest of £45m (2015: £39m), the increase reflecting a higher pension asset at the start of 2016 to which interest is applied.

Investments in associates and joint ventures

We have several joint venture and associate arrangements, most notably a 20% stake in the Bank, accounted for as an associate, and a 30% stake in a travel joint venture with Thomas Cook. The income statement includes a loss of £171m (2015: £11m loss) in respect of associates and joint ventures, although there are several larger elements within the net amount as explained below.

Following our writedown of the 20% investment in the Bank at the half year to £140m, we have reviewed the fair value at the year end and reduced the value to £Nil (£185m reduction from last year end). Given that the Bank is in a sale process the consideration to be received for our share is obviously volatile and potentially has a large range of options. We are a holder of an investment and have limited influence on the sale process or consideration to be received, but it should be noted that the Group, within its planning, does not rely on any cash receipts as a result of holding this investment. We are supportive of the process the Bank is going through to find a secure home for members who use their services.

During the year we recognised profits of £12m in respect of the travel joint venture. This included our share of the travel joint venture's profit of £2m and £10m due to revaluation of our investment. In December 2016 we served notice to exit the joint venture arrangement.

We'll receive £50m plus interest by the end of November 2017 in return for our shares in the joint venture. Thomas Cook will also pay the remaining minimum dividend of £32m under the minimum dividend guarantee in the agreement, with £20m paid on 3 January 2017 and £12m on 3 April 2017. Interest is payable on both instalments.

Financing and cashflow

Group net debt was £885m at year end, up from £692m last year (details of what is included in net debt are provided in note 17). The increase was planned. There was continued investment in our trading estate and in Rebuild with significantly lower proceeds on sales of our properties than last year. We invested over £350m on capital expenditure, including £88m on new Food stores and £85m on refitting existing Food stores. We also invested in our new Membership system and our IT systems in Food and Insurance.

Underlying interest payable fell to £74m from £83m, largely because of the cancellation of a number of interest rate swaps in May. We also benefited from the lower facility charges on the new banking agreement signed in February (a revolving credit agreement of £355m expiring in 2021).

Our Insurance business, a regulated entity, is separately funded from the Trading Group, which includes our other businesses, and so we review our funding position separately as well as on an overall group basis. From January 2016, the Insurance business has operated under the Solvency II regulatory reporting regime which sets out capital requirements for the business. Our Insurance business meets and, based on current plans anticipates continuing to meet, all these regulatory capital requirements for the 2017/18 going concern horizon.

The Trading Group is comfortably within the ratios of debt and interest imposed by our banks and our funding position is strong. Our next refinancing requirement is the £450m Eurobond notes due 2020.

Tax

We won't 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 8 and 13. In 2016 we paid £217m (2015: £208m) to the government in respect of VAT, business rates, Stamp Duty Land Taxes and Employers' National Insurance.

We retained the Fair Tax Mark accreditation in 2016, an important recognition that we put our values, principles and purpose into action in the way we do business. Our tax policy can be found here: **www.co-operative.coop/ethics/tax-policy/.**

Pensions

Our accounts show a surplus of £1,688m (2015: £1,130m) across all our schemes. Our largest scheme, the Pace Complete scheme, has a surplus of £1,783m (2015: £1,226m) with most of the other schemes in a small deficit position and so partially offsetting this. The surplus has increased mainly because we have changed our assumptions on life expectancy for scheme members, reducing this from the assumption we used last year. This is in line with the latest actuarial advice.

These figures are on an accounting basis. On a statutory funding basis, which values pension liabilities on a more prudent basis than the accounting basis, Pace Complete is still expected to be in a small deficit position. It's this statutory funding basis that informs how much cash we will need to pay into the pension pot in the future and the latest funding agreement with trustees is expected to be concluded later in 2017.

The Pace Complete surplus is for the whole scheme, including that portion relating to the Co-operative Bank. Until an agreement has been reached on how to separate this out, this will remain with our balance sheet. This is explained further in note 23.

Balance sheet

Total equity rose by £272m to £3,209m during the year largely because of the increase in the pension accounting surplus explained above.

During the year we agreed to sell 298 of our smaller food stores to McColls Retail Group plc. These are stores which don't fit with our strategy to focus on convenience stores. Although the sale was agreed in 2016, the stores only started to transfer across in early 2017, following clearance from the Competition and Markets Authority, and so at the year end they are shown as assets held for sale, forming the majority of the £106m balance. £37m of goodwill relating to those stores is included within the assets held for sale balance and explains the reduction in the goodwill balance during the year.

The fall in the value of joint ventures comprises the £185m impairment in the value of the Bank investment together with a reduction of £38m following our decision to exit the travel joint venture. The £50m guaranteed proceeds from the travel sale, receivable in November 2017, are included within current trade and other receivables explaining the majority of the increase in that balance.

Non-current provisions have fallen from £352m to £224m in the year largely from the sale of a number of stores and vacant properties in the first half of the year that released £77m of onerous property lease provisions.

Trade and other payables increased by over £150m in the year and this is largely due to very strong funeral plan sales growth which has led to a £110m increase in funeral plan liabilities.

Outlook

2016 saw us make great progress in our Rebuild journey, particularly with the launch of Membership. In 2017 we'll continue with our Rebuild projects but also begin planning for the longer term – a phase we're calling Renew. We'll begin to explore potential new markets and partnerships where we can bring a Co-op solution for the benefit of our members. Membership will remain central to our thinking. We're looking to attract a million new members in 2017 and we want to increase member voice in our decision making and return to our campaigning roots by addressing the issues that matter most to our members.

The wider economic landscape remains challenging and uncertain, particularly as the potential impacts of Brexit emerge, but we are well placed to face this with great trading momentum and a solid platform. There's more to do and this will require more planned investment in 2017. As indicated last year, we made no dividend payments to members in 2016 and we've been clear that this will continue through our Rebuild phase.

Inspiring colleagues

2016 was the year when we proudly went back to Being Co-op – rediscovering what makes us different. Our colleagues were inspired to bring this to life, and they did.

Going back to Being Co-op

Our Annual General Meeting (AGM) on 21 May was all about the relaunch of Membership and showing how we were going back to Being Co-op. In the run up to this momentous meeting we talked to our 5,600 team leaders (such as our food store managers and funeral directors) at face-to-face Being a Co-op Leader events throughout the UK. We explained the new Membership to inspire our leaders and equip them to pass the news on to colleagues.

Our AGM was a catalyst to take that story to the UK, and from 23 May we started a series of unique face-to-face engagement sessions for our 69,000 Co-op colleagues across the country. All were invited to talk with us about going back to Being Co-op. We explained what this meant for Membership, our identity and how we behave – Being Co-op. We introduced our four Ways of Being Co-op – Do What Matters Most, Be Yourself Always, Show You Care and Succeed Together – which describe how we work and how everyone in our Co-op can make a difference, for colleagues, for members and for our communities.

We established an important principle in 2016 – 'colleagues first'. We want to share our new initiatives and activities with colleagues first, to help make sure they feel engaged and involved. This meant that before we launched our new Membership to our members, our colleagues benefited from and tested the offer first. Over the summer they used the new Membership card before it was released to the wider membership, receiving 5% benefit for themselves and 1% for their community.

They gave us invaluable feedback about how the Membership website worked and what they valued, helping prepare us to send out new Membership cards to our existing members on 21 September. What's more, when the cards started to land with members, colleagues could explain the benefits to them first hand.

As the cards were sent out we brought our leaders together again. As well as talking to them about our new Membership, our work in the community and Being Co-op, we wanted to help them develop strong leadership skills. We concentrated on: storytelling (a powerful tool to influence and engage colleagues and members), honest conversations and coaching. All three are vitally important to Being a Co-op Leader. We want leaders to set a clear direction, have honest conversations and empower colleagues to be the best they can be.

There was huge commitment to these events from senior leaders at our Co-op. They led them, and they were designed and delivered by colleagues – sixty store managers were seconded to support events around the UK. Altogether more than 5,600 leaders attended 116 Being a Co-op Leader events, and more than 54,000 colleagues attended the 4,600 Back to Being Co-op events.

We wanted to re-engage our colleagues about what makes our Co-op different and to inspire them to be our greatest member advocates.

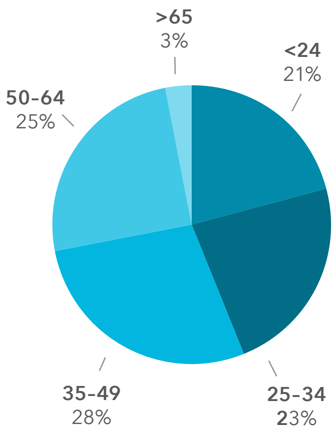
Re-engaging colleagues

Our efforts to re-engage colleagues were successful. As always, colleagues expressed their feelings about our Co-op through the yearly Talkback engagement survey – at 78%, our overall engagement score was the highest since 2010, up 4% since 2015.

Colleagues have more pride, feel more involved in communities and have better feelings about their careers. Those who attended our Back to Being Co-op events felt even more engaged, scoring an average of 80%. However, there is still more work to do, particularly in areas such as performance management and colleague involvement in shaping our future plans. As we enter 2017 we're focused on how we sustain that heightened emotional connection. We'll achieve this by showing the value of Membership, growing our involvement in communities, and continuing to bring Being Co-op to life.

Including everyone

Proportion of employees in each age band



We encourage diversity and inclusion, giving colleagues from all backgrounds the support they need to succeed. Everyone gets fair and equal treatment. That 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. After spending six months researching how to be more inclusive, we developed a long-term strategy that we'll start implementing in 2017.

Stonewall's Workplace Equality Index ranked us 31 in its 2016 index of Britain's top 100 employers actively encouraging 'gay-friendly' places to work, up from 72. We're one of only two retailers to make the list. Our lesbian, gay, bisexual and transgender (LGBT) network, Respect, has around 800 members and 10,800 Twitter followers. In 2016, Co-op supported three Pride events – in Blackpool, Brighton and Liverpool.

Showing we support men and women equally, we've signed the government's 'Think Act Report' initiative, which encourages businesses to treat genders equally in areas such as recruitment and retention. Our colleague network, Aspire, is led by and for female colleagues, although anyone can join. Aspire's membership grew by 16%. It provides career advice, mentoring, networking opportunities, personal development and opportunities to hear more about the career experiences of our senior managers.

	2016		2015	
	Male	**Female**	**Male**	**Female**
Managers	6,352 (58.6%)	4,484 (41.4%)	6,347 (57.9%)	4,610 (42.1%)
All Employees	30,655 (44.2%)	38,665 (55.8%)	30,770 (44.0%)	39,210 (56.0%)

Paying a fair wage

We've always believed that people should be paid a fair wage. Our Co-op has always supported the principle of a statutory floor for basic pay, and campaigned for the introduction of the national minimum wage. We continue to pay above the National Living Wage, introduced by the government in 2015, and apply our rates to all colleagues, unlike many other employers who reduce rates for younger colleagues or apprentices. We offer good benefits to colleagues, and we are starting to introduce new financial, health and wellbeing initiatives in 2017.

Hiring more apprentices

Across our Co-op we're hiring a lot more apprentices. Our schemes have grown to include Food and Digital, building on our established and recognised Funeralcare scheme. In 2016 we were named in the Top 100 employers list by the National Apprenticeships Awards and we're a Top 30 Employer based on feedback from our apprentices.

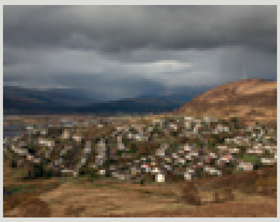
There's a Co-op difference to our apprenticeships. We've no age restriction – with past apprentice ages ranging between 16 and 74 – and our apprentices both join us on a permanent contract and enjoy the same rate of pay as any other colleague in that role. Membership and communities are at the heart of our schemes and our apprentices act as ambassadors for our Co-op through attending recruitment fairs, sharing their experiences with pupils in our Academy Schools and getting involved with our Co-op Young Members Board.

We currently have more than 700 colleagues on apprentice schemes, and in 2017 plan to take on over 1,000 more.

We want our future apprentice schemes to become even more special, by deepening our links with our Academy Schools – encouraging their pupils to become apprentices – and encouraging existing colleagues to start an apprenticeship as a way to build skills and find new opportunities. We expect 75% of our new apprentices to be new recruits and 25% to be existing colleagues.

Showing that there are opportunities everywhere, our Apprenticeship team have recently recruited an apprentice themselves. She was previously working in one of our stores.

6 Our story



Travelling the Highlands and Islands

In the autumn of 2016 our colleague Mark Hedley took our Back to Being Co-op roadshow to Scotland's Highlands and Islands. In just 20 days he delivered six events in places ranging from Tyree, population 650, to Fort William, a relative metropolis. More than 200 colleagues from 15 stores took part in the interactive sessions, learning more about how Co-op values and heritage are relevant today and discussing what Being Co-op meant to them. Mark heard about Samantha from Skye who ran a 10-kilometre obstacle race around Loch Ness for charity and then was back at work by 6am the next day; and Lynne from Braemar who transported newspapers by wheelbarrow for a week in 2015 when the road was flooded. By the end of three weeks Mark had driven 1,020 miles, travelled on ferries for 10 hours and climbed one mountain (Ben Nevis). He'd also equipped our colleagues to pass on the news about our new Membership to one of the remotest, and beautiful, parts of the British Isles.

Getting back to the Co-op Way

Ethics are central to our Co-op. We've always balanced ethics with profit, going back to when we were founded in 1844. We call it the Co-op Way.

As we move into the third year of our Rebuild we can reflect on the fact that, despite the challenges we've faced, we've continued to do much we can be proud of. Our renewed confidence means that in 2016 we could start to look forward and rebuild our ethical heart.

We can change things for the better by aiming to make our business ethical and sustainable. And we can seek to exert even more influence by championing causes that matter. Our members expect us to show responsible leadership. But, as a co-op, we also need to listen to what our members think is important.

In time, we want members to see us as the UK's leading campaigning business working for positive, progressive change.

Re-establishing our ethical heart

In 2016, we refreshed our ethical policies to make sure they were right for our future as we rebuilt our Co-op. Our members' elected representatives helped us to identify the unique difference at the heart of the Co-op Way.

This work was overseen by our Co-op Way Policy Committee ('the Committee'). It's made up of senior management and representatives of our Members' Council, with our Group Chief Executive chairing the Committee.

Together, through the Co-op Way Policy Committee, we identified the nine issues that matter most to us and make clear our Co-op difference:

We've already put five of those in place in 2016, moving on to the rest in early 2017. All will be in place by the time of our Annual General Meeting in May.

Putting ethics first

We started with business ethics and behaviour, because ethics are at the centre of everything we do. Our policy says:

> "In our business, ethical decision-making enables us to demonstrate our Co-op difference. We're owned by our members and we listen to them; we balance commercial with social value; we consider our impact in our communities; and we do this in a transparent, evidence-based way, building trust and enabling our members to understand what, and how, we're doing."

This policy is rooted in the values and principles of the international co-operative movement. It connects us to who we are as a co-operative and helps us get back to Being Co-op. We've turned this policy into a simple tool which will be used throughout our business. This means that ethics is front and centre when we take decisions.

In the following two sections we describe two more policies that put ethics back at the heart of what we do.

Treating people fairly

One of our priorities in 2016 was to be clear that we want people in our supplychains to be treated well – especially in supply chains for our Co-op brand and operations. We're committed to making sure that the people involved in the products and services we buy and sell are treated fairly. And that their basic human rights are protected and respected.

These rights include fair rewards, safe and decent working conditions, and protection from forced labour, modern slavery and harsh or inhumane treatment. When we find that workers are not being treated fairly we ask our suppliers to put things right. But if things go wrong – and in a huge operation like ours they sometimes do – we hold our hands up.

In line with this principle we're campaigning to help the victims of modern day slavery. In 1863 the founders of our Co-op led the movement in Manchester which, at great personal cost, stood in solidarity with the slaves of the United States of America and President Lincoln's anti-slavery forces. Abraham Lincoln wrote that this was an act of "sublime heroism not surpassed in any age or in any country". Standing up for human rights is something our Co-op has been doing for over 150 years.

In 2016 we joined with the charity City Hearts to help modern day victims of slavery to get back into the work place and take back the life stolen from them. Together with City Hearts, we've led the way for the UK in enabling victims of modern slavery to take control of their lives and become survivors with a bright future.

In 2017 we plan to employ about 30 people rescued from modern slavery. Around 3,000 people are rescued each year. So, while we're proud that we will change the lives of 30 people we know this won't solve the problem. But we're setting an example that others may follow, helping these victims become survivors.

Helping healthy living

Healthy living is another area where we can make a difference. We've an important part to play in helping our members, customers and colleagues to lead healthier lives. With stores and funeral homes in communities across the country, we're well placed to promote healthy living.

We do this in four areas:

- We always stock healthy products
- We play a role in the mental and emotional wellbeing of our colleagues and members, as well as our wider communities
- We provide, promote and support opportunities to improve physical well-being
- Our work with communities and experts helps to provide all these opportunities.

Over the years we've led the way on honest labelling and healthy choices, championing the development of nutrition labelling. We're making a range of healthier food options available, to people on all budgets. By 2020 at least half of our food and drink promotions will be for healthier lines.

Loneliness is a national problem across local communities. In fact, one in seven of our members and customers are lonely, based on research we undertook in 2015. So, it was no surprise when 80,000 colleagues and members took part in our vote to campaign on this issue. We started by commissioning our own research into loneliness to plan our campaign. Part of our response was to partner with the British Red Cross to fund new services to tackle loneliness across the UK. Our colleagues and members have raised £5.5m since the campaign was launched in 2015. This will help 12,500 people experiencing loneliness to get back in touch with their communities. Because we've exceeded our £3.5m target we will work with the British Red Cross to identify other ways in which our partnership can support even more people experiencing loneliness.

We also partnered with SORTEDFood, which helps young people to learn how to cook. The Now Cook It! series of YouTube videos teaches them recipes that will give them a healthier diet.

A better way

2016 was a year of rebuilding. We must be a commercially successful business and we must do it ethically. We've always been a campaigning organisation – right back to 1844. Now, we're clear about what we're campaigning for again – we're getting back to Being Co-op.

Where can you find out more

You can find out more about our ethics and sustainability performance in our Co-op Way Report which will be published in May 2017 and will be available on our website: **www.co-operative.coop/ethics**

Key performance indicators

Our key performance indicators (KPIs) are chosen to measure how we are doing in delivering our purpose, championing a better way of doing business for you and your communities. To give more back to our members and their communities, we need to be commercially successful, with colleagues who feel proud to work for our Co-op.

Financial KPIs

Group revenue
£9,472m (2015: £9,201m)

You can find out more about our financial performance on page 24.

Operating profit
£148m (2015: £112m)

Underlying operating profit
£133m (2015: £164m)

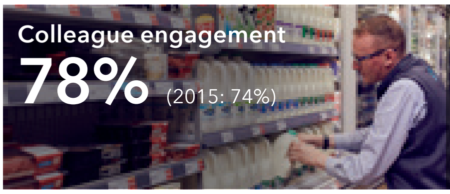
Loss before tax
£132m (2015: Profit £23m)

Underlying profit before tax
£59m (2015: £81m)

Net debt
£885m (2015: £692m)

Capital spend
£358m (2015: £320m)

Colleague KPI



Colleague engagement
78% (2015: 74%)

Colleague engagement is measured by our annual Talkback survey. More information about Talkback can be found on page 30.

Membership and Community KPIs

Our new Co-op Membership was launched in September 2016 and, where relevant, the comparatives shown below are immediately before the launch.

Active members
4 million
at 31 December 2016

(3.4 million at 21 September 2016)

We define 'active members' as members who have traded with us in the last 12 months and we have a target to recruit 1 million new members during 2017. Nearly 400,000 new members joined us between launch and the end of 2016, compared to 150,000 in the first nine months of the year.

Member sales in Food
28% since 21 September 2016
(20% before 21 September 2016)

We are aiming to increase our sales to members to 50% of total sales.

5% reward earned by members during 2016
£16m

Total reward earned by members and for their communities during 2016
£19m

We are aiming to give back £100m a year to our members and their communities by 2018. The first payments to local causes will be made in 2017 and from next year we will include the amount given to local causes during the year as a KPI.

Principal risks and uncertainties

How do we ensure that we are delivering value for our members and the communities we serve?

Put simply, by seeking to manage those things – risks and uncertainties – that are likely to stop us delivering our business plans. We are still in the Rebuild phase of creating our Co-op of the future. We are also strengthening our approach to how we manage the things that will prevent us from delivering for our members and communities. And we are building our capability to better predict those things that are coming down the line, which might affect us.

How are we going about managing our risks and uncertainties?

In 2016 we have:

- Re-established a committee of the executive team to purely focus on understanding and managing the main risks that we face. This Executive Risk Committee meets quarterly.
- Improved the way we provide risk information to the Board and the Risk and Audit Committee.
- Held workshops with our executive leadership teams to think about how best to deliver the business objectives and to come up with actions plans that are built for success.
- Put in place a specific programme of activity to:
  - improve how we are set up to better manage uncertainty across our business;
  - put in place simplified but effective processes that support business operations;
  - assess how technology can support how we carry out our risk management responsibilities;
  - develop an approach to determine how to sustain this in the future.
- Focused on defining risk roles and responsibilities, so that there is clear ownership and more proactive risk management being carried out

Throughout 2017 we will continue this programme of activity to define and build the risk capability and behaviours of our people.

How do we know if we are doing this well?

Twice a year each of the executive teams reviews how well we are managing our risks. This review also takes account of how we are set up to comply with national laws and regulation, for example, Health and Safety and Food Safety standards. At the end of 2015 we found that, while we could see good practice in a lot of areas of the business, this was not being consistently applied in all areas. The assessment at the end of 2016 shows that we have improved, but there is still further progress to deliver. The programme of activity put in place for 2017 will move this forward to deliver a more sustainably controlled environment.

What are the most significant things that can get in the way of delivering our plans and what are we doing about them?

The Board and the Risk and Audit Committee have reviewed and agreed the persistent risk categories facing our business – that's to say those risks that we face as a result of the types of business we undertake. Against these categories of risk, we have looked at risks that could impact the delivery of our plans, and placed them under focused management. Members of the executive team own these specific risks. For each of these risks there are appropriate plans in place and actions are being taken to manage them to an acceptable level. Each of these risks has been reviewed to find out the impact they may have on how the business can continue to perform in the future, should these risks occur. Comfort over the management of these specific risks is provided to the Board and the Risk and Audit Committee.

Details of the risks and the activity underway to manage them are shown on page 38.

Risks that were under focus in 2015 relating to the ability to effectively manage disruption to the business, fraud and financial crime, and recruiting talented colleagues have been removed from the risks under focus as robust controls are now in place that bring these to an acceptable position.

There are also a number of uncertainties that are currently being reviewed to work out how they might affect the delivery of our plans. The most significant ones are:

- Uncertainty in the economy, including the potential impacts of the UK leaving the EU
- The potential sale of the Co-operative Bank ('the Bank'). Given the Bank provides us with banking services, we are spending time to understand all the possible consequences that a change in Bank ownership could have. (see page 26 for more information on this potential sale)
- Preparation for changes to data protection requirements (under the EU's General Data Protection Regulations) being implemented in 2018, and a programme has been set up to manage this
- Talent development and retention

Management of these, and any others that emerge, will continue during 2017.

Risk category	Specific area of focus	What we are doing to manage and / or reduce uncertainty
Strategic and Business	**Delivering our Rebuild Programme**	• Implementation of our group strategy to rebuild our Co-op is progressing as planned. • Ongoing monitoring of key milestones and management of key risks and issues is in place with reports and updates provided to Group Executive and Group Board. • We are embedding disciplined, comprehensive programme and portfolio management to support delivery and realise the targeted benefits.
	Delivery of the Insurance business transformation programme	• A significant programme of activity is continuing that will transform our Insurance business into a contemporary insurer, demonstrating our Co-op purpose with an offer focused on our members, helping make our communities safer and making the most of our unique data, our brand and our distribution reach. This transformation will ensure our Insurance business has a sustainable, competitive and long-term position in the UK market.
	Defining our Future Operating Model	• A plan for how to improve how our Co-op is organised as we move into Renew is being developed. The implementation plan and business engagement strategy is in development through Group HR who will work with each business unit and functional executive team to ensure success in Renew.
	Delivering our Community Plans	• Our Community Vision and Strategy was approved by the Board in 2016 and, working with key Business areas and Group functions, an integrated implementation plan to drive forward the delivery of this strategy is being developed and executed. This will also support the 'Join us' campaign, to recruit 1 million new members in 2017.
	Undertaking successful separation from the Co-operative Bank ('the Bank')	• The Separation programme capability is operating within a defined delivery and governance framework that brings together executive management, key stakeholders and the three lines of defence model. • Key components of the programme were delivered in 2016 including the separation of the Bank and Insurance business shared technology applications. • Completion of the programme is dependent on the Bank completing its 2017 technology plans.
	Delivering good Governance and building our relations with our Council and members	• While there will always be areas for improvement the governance framework introduced from 2015 is embedded and operating well. • The Group Board and Council continue to work closely together and the Co-op Compass has been introduced during 2016 to enhance the Council 'holding to account' role. • Regular Council meetings are held, which directors and the Executive also attend, as well as regular meetings with the President, Vice Presidents and various committees and working groups. • Guidance is given, as required, on respective roles and responsibilities.
Finance and Treasury	**Managing the pressures on profit**	• Regular financial planning processes are performed to project latest views of cost pressures such as National Living Wage and the potential impact of Brexit, together with updated projections of sales and margin. • A cost saving programme is in place throughout the Rescue and Rebuild phases to ensure Group meets its financial objectives by the end of 2017.
	Managing pension scheme risk and funding	• A Pension Strategy Committee has been established to manage our pension risk exposure. • Changes to the investment strategy have been agreed and are being implemented. • Triennial valuations of three of our pension schemes are to be completed in 2017.
	Meeting our banking covenants	• Monthly reporting and monitoring of financial performance is in place to ensure we remain within our banking syndicate covenants. • The impact of key business risks on banking covenants is assessed regularly. • Formal twice-yearly dialogue is held with members of the banking syndicate, bondholders and Standard & Poor to assist their understanding of our financial performance and ensure continued funding.

Table continues

Risk category	Specific area of focus	What we are doing to manage and / or reduce uncertainty
Operational and Customer	**Managing our data effectively**	• A group-wide operating model for data has been defined covering ownership, responsibilities, controls and standards. • A data leaders community has been established to promote the cultures and behaviours needed to implement the model across the business.
	Protecting the IT environment from external threats	• An Information Security Improvement Programme driving improvements to security controls, including security of our members' data, is progressing well and will transition to business as usual during the first half of 2017. • An approved governance structure has been implemented and updated security policies are in place. Regular penetration testing is conducted.
	Misusing or losing our data	• Data protection principles and PCI DSS requirements are covered in appropriate policies. • A PCI compliance programme is being delivered in conjunction with the Barclaycard Risk Reduction programme. • A programme has been set up to deliver changes arising from the new EC General Data Protection Regulations, with third party support.
	Providing a stable and resilient IT platform	• An IT Resilience programme is progressing well, delivering improvement initiatives across critical systems following a detailed review of the IT resilience risk position, reflected in improved stability of core IT infrastructure. This will continue into 2017.
	Managing Health and Safety	• A Health and Safety improvement programme is continuing to enhance awareness, risk capability and management. • Tactical improvements, such as the Safe and Secure programme, have been implemented. • Health and Safety forums have been set up across the organisation.
Brand and Reputation	**Behaving in an ethical way**	• A Co-op Way Policy Committee is in place, including members of the Council, to ensure strategies and policies support our purpose and values. • An ethical framework in place. • Policy Position Statements have been approved by the Co-op Way Policy Committee for seven out of nine key policy areas, of which five are now approved by the Council and Board.

Governance report

Governance report contents

Governance report

Board biographies

Allan Leighton

Chair
Appointed as Independent Chair on 19 February 2015

Committee membership
Nominations Committee (Chair)

Skills and experience
Allan has held a series of high profile roles, including Chief Executive of Asda from 1996 to 2000 and Non-Executive Chairman of Royal Mail from 2002 to 2009. Allan is currently the Chairman of Matalan Ltd, Entertainment One Ltd, Wagamama and Canal & River Trust, and is also Deputy Chairman of Pandora AS.

Steve Murrells

Group Chief Executive
Appointed as an Executive Director on 1 March 2017

Skills and experience
Steve joined as Chief Executive of Co-op Food in 2012 and was made Group Chief Executive on 1 March 2017. He has held senior leadership roles in European and UK-based food retail businesses, including at One Stop, Sainsbury's and Tesco. Steve spent three years as CEO of Danish meat company, Tulip, before joining the Co-op.

Ian Ellis

Chief Finance Officer
Appointed as an Executive Director on 6 April 2016

Skills and experience
Ian joined the Group as Chief Finance Officer in 2015. Previously Ian was CFO for Wilkos for nearly 8 years and previous to that held a number of senior finance positions at Morrisons and Northern Foods Plc. Ian is a member of the Board of Governors at Nottingham Trent University. Ian is also a member of the Executive Committee.

Lord Victor Adebowale CBE

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

Committee membership
Risk and Audit Committee

Skills and experience
Victor is the 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.

Victor is 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. Victor is also Chair of the Collaborate Foundation, a Non-Executive Director for NHS England, a member of the National Employment Panel, the New Economics Foundation Board and the Institute for Fiscal Studies Council. Victor is also on the policy advisory board of the Social Market Foundation, a director of the leadership advisory Leadership in Mind and on the board of the National School of Government. He is also Chair of Social Enterprise UK.

Board biographies continued

Hazel Blears

Member Nominated Director
First appointed as a Member Nominated Director on 16 May 2015 and re-appointed with effect from 13 June 2016

Committee membership
Nominations Committee
Risk and Audit Committee

Skills and experience
Hazel was a Labour Member of Parliament from 1997 to 2015, representing Salford and Eccles. She 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-operative), Chair of the Social Investment Business Foundation and Chair of the Institute for Dementia at Salford University. Hazel is also a Trustee of the Alzheimer's Society and the Social Mobility Foundation.

Simon Burke

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

Committee membership
Risk and Audit Committee (Chair)
Nominations Committee

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

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

Margaret Casely-Hayford

Member Nominated Director
Appointed as a Member Nominated Director on 21 May 2016

Committee membership
Remuneration Committee

Skills and experience
Margaret was Director of Legal Services for the John Lewis Partnership for 9 years and on the Board of the British Retail Consortium for 4 years to 2014. During her term on the Board of NHS England she was one of the directors who promoted and championed 'NHS Citizen' the new listening structure for the NHS that enables proper consultation and collaboration. Margaret is currently Chair of international development Charity, ActionAid UK and a director of Ultra Education Ltd and Web Zebra Limited.

Paul Chandler

Member Nominated Director
Appointed as a Member Nominated Director on 16 May 2015

Committee membership
Risk and Audit Committee

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 in Barclays Bank, he is now focusing on promoting responsible practices in business and financial services, alongside a portfolio of charity and community focused roles. 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, the Bible Society and Interhealth.

Board biographies continued

Sir Christopher Kelly

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

Committee membership
Remuneration Committee
Nominations Committee

Skills and experience
Chris 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 Chris was a senior public servant for many years. Chris 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. Chris has also been a senior official in HM Treasury and was Permanent Secretary of the Department of Health.

Peter Plumb

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

Committee membership
Remuneration Committee

Skills and experience
Peter has been the CEO of Moneysupermarket.com, the leading price comparison service in the UK, since 2009, from which he is due to retire in May 2017. 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.

Ruth Spellman

Member Nominated Director
Appointed as a Member Nominated Director on 16 May 2015

Committee membership
Remuneration Committee
Nominations Committee

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 Board Member of the National Institute for Adult and Community Education, 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 a Trustee of Adviza, a careers advisory company. In her career Ruth has been a CEO of three membership organisations. She 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.

Stevie Spring

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

Committee membership
Remuneration Committee (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 out of home 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. Stevie was appointed to the Board of Ladbrokes Coral Group in September 2016.

Executive biographies

Steve Murrells

Group Chief Executive
See Board Biographies on page 42

Alistair Asher

Group General Counsel
Alistair 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. Alistair was appointed as a Director of The Co-operative Bank Plc on 12 September 2016.

Mike Bracken CBE

Chief Digital Officer
Mike joined the Group as Chief Digital Officer in October 2015. Mike was at the Cabinet Office as Executive Director of Digital and more recently has been the government's first Chief Data Officer. Prior to joining the government, Mike worked at Guardian News & Media as Digital Development Director for nearly four years; co-founded e-democracy site My Society and was a Director/Shareholder at technical services company Wavex. Mike is currently a Director of Public Digital Ltd.

Mike was awarded a CBE in the 2014 New Year's Honours list in recognition of the digital transformation of public services, and for working to develop football in the borough of Hackney.

Rod Bulmer

Director for Renewal Planning
Rod became CEO of Consumer Services in 2014 after seven years with Co-operative Financial Services and the Co-operative Banking Group. From January 2017 he moved to leading the development of our Renewal plan which will be launched in 2018. Before joining the Group, Rod held a number of senior roles including Managing Director of Retail within the UK operation at Santander Group and Director of Branch Network at Abbey National Group.

Ian Ellis

Chief Finance Officer
See Board Biographies on page 42

Helen Grantham

Group Secretary
Helen joined as Group Secretary in January 2016. Helen 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.

Richard Lancaster

CEO Funeralcare and Legal Services
Richard joined the Group in 2015 as CEO of Funeralcare from Poundland plc, where he was trading and marketing director and part of the team who took Poundland to its stock market launch in 2013. Prior to that he was marketing director at Morrisons and Managing Director at Netto UK. He took additional responsibility for the Group Legal Services business in January 2017.

Rufus Olins

Chief Membership Officer
Rufus joined the Group in October 2016 from Newsworks, the marketing body for national news brands, where, as CEO, he led its transformation into a digitally enabled membership body. Starting out in journalism Rufus has also been a senior business correspondent at the Sunday Times, Editor of Management Today and run a series of businesses.

Executive biographies continued

Mark Summerfield

CEO Co-op Insurance*

Mark has over 30 years' experience in the Financial Services sector. He joined the Group in April 2004 having previously worked for Fleming & Co, Prudential plc, MISYS plc and Phoenix Assurance plc, in a variety of general management roles. He became part of the executive team in January 2017 and is a non-executive director of Reclaim Fund Ltd.

* Attends Executive committee meetings

Jo Whitfield

CEO Food

Jo is a Chartered Accountant, having trained with Ernst & Young, and joined the Group as Finance Director, Retail in 2016. For the 8 years prior to this Jo held a number of senior operational, finance, trading, strategy and international leadership positions with Asda and throughout her career has held leadership roles with businesses such as Northern Foods, GE Capital and Matalan.

Jo is an Ambassador for Girls Out Loud, a member of Women in Retail group and an ambassador for the Women of the Future programme. Jo became interim CEO Food in March 2017.

Pippa Wicks

Deputy Chief Executive

Pippa joined the Group in 2014 on an interim basis from the business consultants AlixPartners where she co-founded the firm's European operations in 2003. In April 2016 Pippa joined as permanent Chief Operating Officer (COO) and became Deputy Chief Executive in March 2017. She continues to Chair Alixpartners UK turnaround and restructuring business. Pippa is also a non-executive director of Hays plc. Prior to joining AlixPartners, Pippa 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 Pippa took on a number of interim CEO and COO positions at UK and European companies.

Governance review

Group Chair's Overview

Our approach

Your Co-op is run in a unique way, with members at the heart of it. Our approach combines a Board which is commercially focused and co-operatively minded with a 100-strong Members' Council which holds your Board to account.

Our approach is more complex than that used by listed companies, but it ensures that we remain focused on what is right for our millions of members, customers and colleagues, remaining close to our communities and staying true to the original values and principles set out by the Rochdale Pioneers over 150 years ago.

When making decisions your Board asks itself three fundamental questions:
- Is what we're doing commercial and will it help the business thrive in the market and wider economy?
- Is what we're doing right for both our current and future colleagues?
- Is what we're doing right for our members and will it enhance the co-operative economy of today and tomorrow?

We know that corporate governance is high on the agenda during 2017. We agree with the Prime Minister's view that "good corporate governance is about having the right checks and balances within big business to strengthen decision-making and accountability" and look forward to contributing to the debate in this area.

Your Board and Council have worked closely on a number of key initiatives in 2016 including launching our new brand and Membership, developing our community strategy and working up our Co-op Way policies.

In May 2016 we also saw our second Annual General Meeting (AGM) under the new governance rules using digital communications to reach out to those not able to attend in person. Over 90,000 members voted at the AGM with over 700 voting in person at the meeting itself. Our 2017 AGM will focus on sharing the progress we have made with Council on our Co-op Way policies and I hope that you can join us either in person or online.

Board changes

Your Board has grown and strengthened during the year and is well placed to lead the Group in the future. During the year we welcomed the appointment of an additional Independent Non-Executive Director (INED), Lord Victor Adebowale, and Margaret Casely-Hayford, as an additional Member Nominated Director (MND). Both bring a wealth of experience and complement the existing blend of experience on your Board. Both Victor and Margaret have already made a great contribution and all directors continue to significantly input to the progress being made. Ian Ellis, Chief Finance Officer, was also appointed as an Executive Director in April 2016.

The early part of 2017 also saw Richard Pennycook stand down as Group Chief Executive. In three short years Richard was at the forefront of rescuing and rebuilding our Co-op and restored pride to our colleagues and members. We are fortunate to have Steve Murrells to succeed Richard as our new Group Chief Executive. Steve has transformed our Food business and put it back at the heart of communities across the country. His leadership has seen our Co-op consistently outperform the market in food retailing and he is the right and unanimous choice to now take the whole Group forward for the next phase of our transformation.

Moving forward

We are now into the third year of our Rebuild programme which has seen major progress with our brand, membership and community strategies, as well as a strong performance from our group businesses. We are now planning for our Renew phase which will start in 2018.

I look forward to working with your Board and Council through 2017 and as we move into the Renew phase of our development.

Allan Leighton
Group Chair

Compliance with the UK Corporate Governance Code ('the UK Code')

Our Co-op is registered under the Co-operative and Community Benefit Societies Act 2014, is a consumer co-operative which is jointly owned by its members and has listed debt instruments with the UK Listing Authority. The Group is not required to comply with the UK Code published by the Financial Reporting Council. However we believe in good governance and transparency and choose to report against the UK Code standards so far as they apply to our democratic nature and ownership model. We have generally complied with the UK Code, but given our structure some UK Code provisions cannot be directly applied. Where this is the case we seek to explain what steps we have taken to comply with the spirit of the UK Code.

This report follows the UK Code's basic themes relating to leadership, effectiveness, accountability, remuneration and relations with our members.

We also embrace the spirit of the Corporate Governance Code for Consumer Co-operatives (CGC) and report our compliance with CGC directly to its publisher, Co-operatives UK.

Board composition

Our current Rules were approved by members at the 2015 AGM. As part of our governance reforms, a Board Composition Charter ('the Charter') was also adopted. This set out the desired composition for a Group Board which would be individually and collectively qualified to lead an organisation of the Group's size and complexity. The Board is now fully formed in line with the Charter and currently comprises:

- An Independent Chair
- Five Independent Non-Executive Directors
- Four Member Nominated Directors
- Two Executive Directors

We look at independence in two ways. Whether our directors are independent as defined in the UK Code and also whether they are Independent Non-Executive Directors in line with our Rules and the Charter.

We comply with the UK Code provision which states at least half the Board, excluding the chairman, should be Non-Executive Directors determined by the Board to be independent. Our Board has two Executive Directors out of 12 Board members. All of our INEDs and MNDs are considered to be independent in line with the UK Code. More information is given below about the different categories of directors.

Our Co-op's values and principles are central to all of our thinking and a strong commitment to those values and principles is required of all the directors. All appointed directors are selected for and expected to meet the high standards of competence required of a business of the scale and complexity of the Group. All of our directors must also be members and satisfy membership and eligibility criteria contained within the Rules and the Charter. A waiver may be given for the membership criteria in limited circumstances.

The Board are in the final stages of approving a Board Diversity Policy.

The Nominations Committee has responsibility for making recommendations to the Board in respect of Executive Director and Independent Non-Executive Director appointments and they are put forward for election by members at the next AGM. The Nominations Committee's report is on page 84 of this report.

The way Member Nominated Directors are identified and appointed is different. MNDs are directly elected by members with candidates for this election identified by the Member Nominated Directors Joint Selection and Approval Committee (MNDJC) (a joint Council and Board committee). A member ballot is undertaken prior to the AGM and the results announced at the meeting.

The Council Scrutiny Committee verifies the screening process for the Group Chair and the INEDs and oversees the screening process for the MNDs. The Council Scrutiny Committee's report is on page 94.

Independent Chair

Allan Leighton was appointed as Chair on 19 February 2015 for a two-year term and his term of appointment has recently been extended by a further two years, subject to re-election at the 2017 AGM. In accordance with the relevant UK Code provision, he was determined to be independent on appointment and is classed as an INED under our Rules. More details on the role of the Group Chair can be found on page 52.

Senior Independent Director (SID)

Sir Christopher Kelly was appointed as SID on 14 November 2014 for a two-year term and his term of appointment has recently been extended for a further two years, subject to re-election at the 2017 AGM. More details on the role of the SID can be found on page 53.

Independent Non-Executive Directors

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 were elected/re-elected by members at the AGM on 21 May 2016.

Executive Directors

There are currently two Executive Directors on the Board, Steve Murrells, Group Chief Executive, who was appointed on 1 March 2017, and Ian Ellis, Chief Finance Officer, who was appointed on 6 April 2016. Richard Pennycook, the former Group Chief Executive, was an Executive Director from 13 January 2015 until 1 March 2017. Both Richard and Ian were re-elected/elected by members at our 2016 AGM and Steve will be subject to election at our 2017 AGM.

Member Nominated Directors

There are currently 4 MNDs on the Board. Ruth Spellman and Paul Chandler were elected by members in 2015 and their terms of office expire in 2017. Hazel Blears was also appointed in 2015, but her term of office expired in 2016. She was re-elected, and Margaret Casely-Hayford was elected, by members in May 2016.

What's your Board's responsibility?

Your Board is responsible for the long-term success of the Group, delivered in line with co-operative values and principles. It does this by setting key financial and non-financial goals and monitors performance against those goals. Your Board actively engaged with the Members' Council throughout the year to ensure member, colleague, customer and other stakeholder views were being taken into account and decisions taken were in line with the International Co-operative Alliance Values and Principles.

What decisions can your Board take?

Our Rules give a high-level view of those matters reserved for Board decision and during 2016 your Board adopted a more detailed schedule of matters reserved for its decision, in line with the UK Code and our Rules, which covers:

- Strategy and management
- Structure, capital and borrowing
- Financial reporting and controls
- Internal controls
- Contracts/expenditure
- Communication
- Board membership and other appointments
- Delegation of authority
- Governance and compliance
- Other matters

Within this framework your Board retains a right (permitted by the Rules) to delegate specific powers to one or more directors, Board Committees, officers or colleagues, or to any subsidiary. There is a Delegated Authorities Framework which has been approved by your Board and which is subject to regular review by the Risk and Audit Committee and Board.

Some decisions require consultation or approval of our Members' Council or members at a general meeting.

Board and Board Committee meetings and attendance

Board director biographies are on page 42.

The table below sets out the frequency and attendance of directors at Board meetings and Board Committees during the reporting period:

Director	Group Board	Nominations	Remuneration	Risk and Audit
Allan Leighton	10(10)	4(4)	N/A	N/A
Richard Pennycook	10(10)	N/A	N/A	N/A
Ian Ellis*	7(7)	N/A	N/A	N/A
Lord Victor Adebowale*	6(7)	N/A	N/A	1(2)
Hazel Blears	8(10)	2(4)	N/A	4(4)
Simon Burke	10(10)	4(4)	N/A	4(4)
Margaret Casely-Hayford**	4(5)	N/A	2(2)	N/A
Paul Chandler	10(10)	N/A	N/A	4(4)
Sir Christopher Kelly	9(10)	3(4)	6(7)	N/A
Peter Plumb	7(10)	N/A	3(3)	N/A
Ruth Spellman	10(10)	4(4)	7(7)	N/A
Stevie Spring	10(10)	N/A	7(7)	N/A

* Appointed 6 April 2016

** Appointed 21 May 2016

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

Nick Crofts, the Council President is also a member of the Nominations Committee and attended all of the four meetings he was entitled to attend during 2016.

All directors have Board and Committee papers delivered before meetings through a Board Portal, accessible via their iPad. Directors are generally expected to provide an explanation if they can't attend a meeting and asked to let the Chair know their views before the meeting.

Members of the Executive regularly attended Board meetings and there are also regular meetings involving only Board directors.

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

Board Committees

Your Board has three regular committees: Risk and Audit, Remuneration and Nominations.

Each committee is appropriately resourced to undertake their duties and all directors have access to all committee minutes and papers. The various committee Chairs provide reports to the Board when appropriate.

The Risk and Audit Committee report is on page 57, the Remuneration Committee report is on page 66 and the Nominations Committee report is on page 84.

Your Board also delegates tasks to committees it forms for specific purposes from time to time as allowed by the Rules.

In addition to the main Board Committees, the Group operates committees and working groups with the Members' Council such as the MNDJC, the Stakeholder Working Group (which we tell you more about in our Engagement and Relations with our Members section on page 55) and the Co-op Way Policy Committee.

Governance through our subsidiaries

The Group has direct governance control over all subsidiaries within the Group. There are two subsidiaries which are treated slightly differently due to their regulated status:

- CIS General Insurance Limited, which is separately regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). This subsidiary has its own Board and Committees. The Group retains general oversight for this business, but is not involved in day-to-day operational issues.
- Co-operative Legal Services Limited. As this business provides legal services it is also regulated by the Solicitors Regulation Authority.

The roles of the Group Chair and the Group Chief Executive

The Group Chair

The UK Code says the roles of chairman and chief executive should not be exercised by the same person and a division of responsibilities between these roles should be defined and agreed by the Board.

There is not one single document setting out the division of responsibilities. The role of the Chair is however clearly defined and set out in his terms of appointment and the Chief Executive's role is clearly set out in his terms of appointment and employment contract. The Chair is responsible for leading the Board and setting the Board's agenda together with the Group Secretary (primarily focused on strategy, performance, value creation and accountability), while ensuring that adequate time is available for discussion of all agenda items.

The Chair is expected to promote a culture of mutual respect, openness and debate by giving directors the chance to express their views, as well as making sure members and other stakeholders are given appropriate information.
The Chair also has to make sure the Group's business is run in line with our values and principles and with integrity, decency, good ethical values and with adequate controls in place to make sure these values and principles are applied throughout the Group. The day-to-day running of the Group's businesses is defined in the Rules as being the responsibility of the Group Executive, led by the Group Chief Executive.

In addition the UK Code says the chairman should on appointment meet the independence criteria set out in the UK Code. The Charter however does expect the Chair to become fully engaged in the activities of the Group and therefore does not expect the Chair to be independent for UK Code purposes throughout their term. The Chair is an INED under our Rules.

Allan Leighton was considered independent by the Board on appointment. As part of the process for considering the Chair's reappointment the SID met with the other directors to consider the Chair's performance.

The Group Chief Executive

Steve Murrells was appointed to the Board as Group Chief Executive on 1 March 2017.

The Chief Executive has direct responsibility for the Group on a day-to-day basis and is accountable to the Board for the Group's financial and operational performance. He is responsible for the appointment of the executive team, in consultation with the Board. The Group Secretary is a member of the Executive in line with the Rules.

The main responsibilities of the Chief Executive are set out in his contract of employment. The responsibilities of the executive team and the Group Secretary are set out in the Rules.

Senior Independent Director

The primary role of the SID is to provide a sounding board for the Chair and other directors. The SID also makes sure that any directors wishing to raise or escalate issues relating to the Group's governance, the Board or the Chair's performance can do so if for any reason those matters can't be raised with the Chair. The SID should also make himself aware of issues which members or other stakeholders may have and ensure that the Board is made aware of these views. He is a member of our Stakeholder Working Group and has a key role in working with our Members' Council.

The SID is also responsible for conducting the annual performance appraisal of the Chair.

The Group Secretary

Helen Grantham was appointed as Interim Group Secretary on 11 January 2016.

The appointment and removal of the Group Secretary is a matter for the Board under the Rules. The Group Secretary reports to the Group Chair and is a member of the executive team by virtue of their office. All directors have access to the advice and services of the Group Secretary.

The Rules reserve specific powers and discretions to the Group Secretary. In particular, the Group Secretary advises the Chair and the Board on all governance matters and ensures that Board procedures and the Rules are followed. The Group Secretary also ensures there is a good flow of information between the executive team and the Board and between the Board and Members' Council. The role also includes ensuring that new directors have an individually designed induction programme and that their ongoing training and continuing professional development needs are met. The Chair began a series of individual meetings with directors during 2016 which will pick up any areas of development.

Term of office

INEDs and Executive Directors are appointed for two-year terms, subject to election by members at the first AGM following their appointment. They may then be re-appointed for two subsequent two-year terms, provided the Nominations Committee recommends their re-appointment to the Board and the members approve that re-appointment at the following AGM.

MND appointments are generally for two-year terms. The exception to this was in 2015 when Hazel Blears was appointed for an initial one-year term to ensure that not all MND appointments started and finished at the same time. At that time there were three MNDs on the Board. With the appointment of Margaret Casely-Hayford in 2016, MND terms are now staggered and only two from four MNDs will be required to step down and be subject to re-election by members each year.

With the exception of Hazel Blears, who may serve a maximum of seven years (as explained above), the maximum term of office of any MNDs is six years. INEDs who have held office for a continuous period of six years or more at the date of an AGM are required to retire from office at that meeting. No maximum term applies to Executive Directors.

2016 Elections

The following directors were elected or re-elected at the 2016 AGM:
- Simon Burke (INED)
- Peter Plumb (INED)
- Stevie Spring (INED)
- Lord Victor Adebowale (INED)
- Ian Ellis (Executive Director)
- Richard Pennycook (Executive Director)

Hazel Blears and Margaret Casely-Hayford were elected as MNDs in 2016 following a contested election, the results of which were announced at the 2016 AGM.

2017 Elections

The following directors are standing for election/re-election at the 2017 AGM:
- Allan Leighton (Independent Chair)
- Sir Christopher Kelly (INED – SID)
- Steve Murrells (Executive Director)

Following an assessment of the performance and contribution of the directors offering themselves for election or re-election at the AGM in May 2017, the Nominations Committee has confirmed to the Board that the relevant directors continue to be effective and provide a valuable contribution to the Board. The Board is satisfied that all the directors will continue to be able to devote sufficient time to their duties as directors and recommend their election or re-election as appropriate.

2017 Election of MNDs

The MNDJC has led on the current MND election process. Paul Chandler has indicated he wishes to stand for a further two year term. Ruth Spellman has indicated an intention not to stand for re-election. The Board wishes to express its thanks to Ruth for her contribution during her two years in office. Details of the candidates for the two vacancies are set out in the AGM booklet.

Engagement and relations with our members

The UK Code says that boards should "have a dialogue with shareholders based on the mutual understanding of objectives".

Your Co-op actively encourages engagement with its members through a variety of channels.

Your Co-op's governance model is different to that anticipated by the UK Code and is based on co-ownership by its members. Your Members' Council, comprising 100 elected members, represents the members and acts as guardian of your Co-op's purpose, values and principles and holds the Group Board to account.

The Group Board and Members' Council work together on a number of different topics and both provide reports on their meetings to each other. There are many ways in which the Board, Board Committees, Chairs of the Board and Board Committees and individual directors engage with Council and its committees, working groups and members. In addition questions are raised by the Council verbally or in writing and responded to. There is also regular dialogue between the Group Secretary and Council Secretary.

Members of the executive team attend Council meetings to bring the Council members up to date on developments in ongoing projects. Different members of the Group Board also regularly attend Council meetings to listen and respond to questions raised by Council members. The Stakeholder Working Group, comprising four representatives from the Group Board and four from the Council, also meets on a regular basis to discuss topical issues of interest to members, to listen to points of view of the Board and Council and to provide a forum for open debate.

We have already referred to the work done by the MNDJC.

We have described the role and contribution of our Co-op Way Policy Committee on page 32.

Your Co-op works tirelessly to engage with its members. The creation of the Digital team over the last year has seen great strides in reaching out to members through a variety of communication channels incorporating not only the traditional methods of communication, but also a variety of different technology based routes. The 2016 AGM saw positive steps forward in member engagement and we anticipate that momentum will be maintained at the 2017 AGM.

Your Council is also instrumental in promoting engagement with members and works throughout the year to promote your Co-op, our shared values and principles and to explain the benefits of working in co-operation and collaboration. More on the Members' Council activity is in their report on page 91.

Members are encouraged to participate in the AGM and if they have met the eligibility criteria, which are based on the level of trade they have with our Co-op, they may attend AGMs, vote on motions, or appoint a voting representative to vote on their behalf. Subject to following the required procedure, motions can be put to a Group General Meeting by the Board, the Council, four qualified Independent Society Members or by 100 eligible members.

The Group's federal relationship with the Independent Society Members (ISMs) is formalised through a federal structure, Federal Retail and Trading Services Limited (FRTS), which was incorporated in 2014 and is 75% owned by the Group and 25% owned between the 7 largest ISMs.

Conflicts of interest

The Rules are very clear about what should happen in conflict of interest situations, the fact that any such conflicts must be declared and, if they arise, how they should be dealt with.

Group directors understand and acknowledge they have a duty to avoid conflicts of interests. Prior to appointment, all directors must disclose any other appointments they may have and any potential conflicts of interest. Those matters are assessed to ensure that there are no significant conflicts which mean it would not be appropriate for that director to accept the appointment. The Group Board has assessed the position of all the current directors which could give rise to a conflict of interest and have come to the conclusion there are no significant conflicts of interest which would mean that any director should not serve on the Board.

The Board has adopted a specific Board Conflicts Toolkit which gives guidance in situations which may involve a director having a conflict of interest.

If any specific conflicts of interest arise, the directors must disclose that in advance of any discussion on that particular issue, they will be excluded from that discussion and will not be allowed to vote on the topic in question. All directors generally have access to minutes of all meetings. If a director who is affected by a conflict is excluded from part of a meeting, he or she will only be allowed to see a version of the minutes with the portion recording the discussion whilst he or she was excluded, removed.

Directors' and Officers' liability insurance

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

The Group also gives an indemnity to Group directors and the Group Secretary for certain liabilities that may arise as a result of them doing their job.

Board effectiveness

The Rules require the Nominations Committee to "…conduct a formal and rigorous evaluation of the Board's performance annually…" At the beginning of 2016, the Nominations Committee conducted an internal evaluation and details of that evaluation are contained within the Nominations Committee report on page 84. The Nominations Committee has now started an external Board evaluation process which will be completed in mid-2017. The main themes of that review will be contained in the Nominations Committee report for 2017.

Independent professional advice and Board support

All directors have access to the Group Secretary, Group Secretariat and the executive team. There are also procedures through which all directors can take independent professional advice, at the Group's expense, when needed to enable them to properly undertake their duties.

Annual General Meeting

The AGM is held in accordance with the Rules and the Co-operative and Community Benefit Societies Act 2014. Attendance at and participation in the AGM is open to all eligible members of the Group.

The number of votes for each ISM is calculated based on the amount of trade each ISM conducts with the Group. Individual members vote on the basis of one member, one vote.

Report of the Risk and Audit Committee

Introduction from the Committee Chair

Last year I outlined the programme of work which was underway across a wide range of disciplines to improve the standards of safety, compliance, control and risk management across our Co-op.

I can report to you now that although we had one or two setbacks, overall we have made good progress in all of these areas. This has been another year of major change in the Group, with the Rebuild programme fully underway; nevertheless we have seen wholehearted commitment from the executive team to bring about improvement in all of the areas of concern to the Committee.

In particular, I would highlight the following:

- Very good progress in rebuilding the resilience, controls, and protection of our IT systems and infrastructure; this was one of our biggest concerns last year, and while work remains to be done, we are in a much better place now.
- Much has also been done to improve the safety standards around the Group, both in terms of the fabric of our buildings and the culture of compliance. Colleague safety is vitally important for us, and our work in this area will continue.
- Data security and management have improved, and are much more in focus across all of our businesses.
- Key judgemental areas in the accounts are better understood and our approach agreed well in advance, so there are no 'surprises'.
- After some unwelcome delays, the appointment of a new Chief Risk Officer has seen significant impetus brought to our risk management process, with a strong programme now laid out for the coming year.

We ensure continuing progress in these areas, supported by well-led and effective Internal Audit and Risk teams. We are attentive to areas of particular focus, such as the IT Transformation project in our Insurance business, and the impact on the Group of developments at the Co-operative Bank.

Led by my colleagues Hazel Blears and Paul Chandler, we are working with the sustainability team to develop new and better ways of monitoring and reporting our progress with sustainable sourcing, ethical trading, anti-slavery and other aspects of implementing the Co-op Way in our business activity. We aim to present a radically overhauled report on this activity, as well as measuring our social and economic impact, by next year.

We also oversee our Co-op's compliance with the Groceries Supply Code of Practice and work with our buying teams to improve our standards of performance here.

Our new auditors, Ernst & Young, have completed their first year's audit and have, as hoped, brought a fresh perspective to the role, helping us to better validate our controls, accounting and reporting clarity.

Finally we were delighted to welcome Lord Victor Adebowale to the Committee during the year. His appointment further strengthens our efforts and broadens the perspective we can bring to bear on the issues before us.

Rebuild is transforming our Co-op into a more modern, focused and fit Society, capable of facing the challenges of the markets it trades in, and able to look forward to a time of sustainable success and better business returns. We are proud to be playing our part in ensuring that the benefits of this work are realised for members.

Simon Burke
Chair of the Risk and Audit Committee

Risk and Audit Committee membership and attendance

The Risk and Audit Committee ('the Committee') watches over the Group's financial reporting and how well it's managing risk.

As recommended by the UK Corporate Governance Code ('the UK Code'), the Committee had at least three independent directors serving as members.

The Committee is comprised of directors who are considered by the Board to be independent under the UK Code providing objectivity and independent scrutiny. The Board considers that Simon Burke's relevant and recent financial experience qualifies him to be Chair of the Committee. Two Member Nominated Directors serve on the Committee – Hazel Blears and Paul Chandler – along with Lord Victor Adebowale who was appointed as an Independent Non-Executive Director to the Group in April 2016 and joined the Committee in July 2016. He brings a wealth of experience from the voluntary sector.

Details of attendance by the Committee members at meetings held during 2016 are on page 51.

The Chief Finance Officer, Director of Group Internal Audit, Corporate Finance Director and the external auditors attended all the Committee meetings. As relevant, other key colleagues also attended meetings.The Committee also met the internal and external auditors privately, so they could talk without management being there.

What the Committee does

The Committee works for the Board; its main responsibilities include the following:

Financial and regulatory reporting

- To monitor the integrity of the Group's annual report and accounts and other information on its financial performance
- To review the annual report's fairness, balance and clarity
- To review the financial statements of the significant subsidiaries within the Group and the consolidated financial statements of the Group
- To monitor how the Group is complying with the Groceries Supply Code of Practice

Internal controls

- To keep under review the adequacy and effectiveness of the Group's internal financial controls and internal control system
- To monitor any significant deficiencies or material weakness in the Group's controls and/or disclosure controls and procedures

Internal Audit

- To monitor the effectiveness of the Internal Audit function
- To help set the objectives of the Director of Internal Audit and to review and approve the annual Internal Audit plan
- To review and monitor management's responsiveness to the findings and recommendations of the Director of Internal Audit

External Audit

- To ensure that the Group has followed proper procedures to choose its external auditor, ensure their independence, approve their fees and check their effectiveness

Risk

- To monitor how effective the Group is at managing and controlling risks
- To oversee the Group's risk exposures and proposed improvements to the risk management framework

Other

- To monitor the Group's arrangements for colleagues to raise concerns, in confidence, about possible wrongdoing (whistleblowing) and for appropriate follow-up
- To consider an annual review of the management of the Group's pension schemes
- To review and monitor the Group's approach to sustainability reporting and social impact accounting within the Group's external reporting framework

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How the Committee operates is described in more detail in its terms of reference. They're available on our website: **www.co-operative.coop/investors/rules**

In 2016, the Committee's main activities included reviewing:

- The integrity of the Group's reported financial information, especially our annual and interim reports, and the reasonableness of the key judgements and assumptions
- The effectiveness of the risk and control systems, including Internal Audit's work, plans and reports
- Changes to Group Treasury Policy and Delegations of Authority
- Adherence to the UK Code and if there are areas where we need to improve
- The appointment of Ernst & Young as the Group's new external auditors, reviewing their transitional arrangements and reports
- The approach to key accounting judgements and significant matters
- How we're complying with Health and Safety policies and standards and the progress of the Safety, Health and Environmental Programme, which is a new addition to our Rebuild programme
- How we're delivering a coherent group-wide approach to, and governance of, policies that support and deliver the Co-op Way via our Values and Principles and ethics, and in particular the Group's approach to the development of our sustainability reporting and social impact accounting
- How the Group uses and looks after data and information
- The annual review of the pension schemes
- How the Group makes sure it employs people with the right skills and knowledge
- Reports on whistleblowing
- The update on the current Group priority risks, together with the Risk Management Transformation programme plan

Significant issues relating to the financial statements

When the Committee looked at the 2016 financial statements, it 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
Goodwill and fixed asset impairment The Group's balance sheet includes significant goodwill and property, plant and equipment balances, principally in relation to its Food store estate. There's a risk of impairment particularly given the market conditions in the grocery industry. The 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.
Onerous lease provisions 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 onerous leases.	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.
Insurance liabilities Our Insurance subsidiary, CIS General Insurance Ltd (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 complex area which needs judgement 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.
Pension scheme IAS19 valuation The Group has a number of defined benefit pension schemes which require extensive disclosure. A number of assumptions are made, changes in which can materially affect the valuation.	The Committee assessed the key assumptions which underpinned the pensions calculations. Advice provided by internal and external actuaries, including market benchmarking, was also reviewed.
Bank valuation The Group has an investment in the Co-operative Bank ('the Bank'), holding 20.2% of its shares.	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 to considering the approach taken to the Bank's share of the PACE scheme.
Accounting for Joint Ventures The Group has an investment in the NOMA JV and Thomas Cook. In assessing the carrying value of these investments, the Group considers valuations provided by professional third party valuers.	The Committee reviewed the impact of changes of property valuation and transactions to the carrying value of the investments. It also considered the appropriateness of the accounting treatment adopted by the Group.
Revenue recognition There is an inherent risk of error or fraud in revenue recognition, such as management deliberately misstating the allocation of revenue between periods or a risk that revenue is over-stated.	The Committee reviewed income recognition policies and treatments for the different sources of income from Food, Funeralcare Plans and Insurance.

Annual reporting

The Committee approved the Group's proposed approach to preparing the 2016 Annual Report and our Co-op Way Report, in particular: cutting clutter out of the financial statements; providing new information to help members understand performance; and making the reports more member-focused and written in a style that reflects the new Co-op tone of voice.

Review of the Committee's effectiveness

Towards the end of the year the Committee undertook a review of its effectiveness. The detailed findings of this review are to be analysed by the Committee during 2017, following which an action plan will be created. The high level outcome of the review showed that on the whole, directors felt that the Committee had an appropriate balance between challenge and fostering a positive environment, and that management responded positively to constructive challenge from the Committee. They also agreed that Committee meetings allowed sufficient time for discussions and questions.

External audit activities

The UK Code says that audit committees should have primary responsibility for the appointment, re-appointment and removal of the external auditor, and for assessing how well the external audit process is working.

Change of auditor

The Committee conducted a tender process for a new external auditor that concluded in January 2016. The Committee recommended to the Board that Ernst & Young LLP (EY) be appointed as the external auditor to replace KPMG. The Board accepted this recommendation and EY were appointed by the members at the 2016 Annual General Meeting.

To ensure an effective transition of the audit, EY met with management and reviewed KPMG's 2015 audit files to support the finalisation of their 2016 audit plan. Other elements of the transition plan included formal appointment by each individual subsidiary.

EY have provided the Committee with relevant reports, reviews, information and advice throughout the year.

Independence, objectivity and fees

The external auditor must be judged to be independent for the audit to be objective. So we have an External Auditor Independence Policy. The Group also has a policy about appointing people who used to work for the external auditors and an approach to be taken when using the external auditors for non-audit work.

The Committee must pre-approve all non-audit spend with EY. There is also a cap on non-audit fee spend with reference to the average audit fee over the previous three years.

In line with our External Auditor Independence Policy, the external auditors are not allowed to do a number of tasks including the following:

- Bookkeeping or preparing accounting records or financial statements
- Designing and implementing financial information systems
- Valuation services
- Internal audit services
- Management functions or some human resource services
- Any other services that the Committee decides

The policy was reviewed and updated by the Committee in 2016 when the Group was deciding who to appoint as its external auditor. At each of the Committee meetings in 2016, the Committee was told about the nature and cost of any non-audit work done by the external auditors for the Group. The Committee is satisfied that EY's non-audit work didn't affect their objectivity in doing the audit.

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

Effectiveness of auditors

Whilst the Committee will review the effectiveness of the external auditor, as EY were only appointed as external auditor in 2016, the Committee won't do this formally until later in 2017.

Internal audit

Following on from the work done in 2015, the transformation of Internal Audit (IA) completed in 2016.

IA is an independent function authorised by the Board through the Committee. Its main role is to provide professional, objective assurance while providing insight to improve the way the Group is managed and risks controlled.

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

- the work of IA and the progress it has made against its plan
- the impact on the systems of risk and control from internal audit findings
- whether management's done what it said it would do to fix the issues

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

The Committee also approved the Internal Audit Charter.

Internal control

The Board has overall responsibility to make sure controls are in place to enable the Group to work effectively. The controls used by the Group are based on the globally recognised COSO model, which has five key areas. These are: Control Environment; Risk Assessment; Control Activities; Information and Communication; and Monitoring Activities.

The Committee, on behalf of the Board, is responsible for reviewing how effective the internal controls are. The controls are designed to manage rather than remove the risk of the Group not being able to achieve its objectives. It can only provide some, and not complete, assurance that things won't go wrong.

Each Group Executive member was asked to review how well the controls were working for their 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
- confirmation that the Executive member and their management team has reviewed the systems of risk and internal control for the half year ended 2 July 2016 and the full year ended 31 December 2016.

The Committee's review of the Executive's self-assessments forms an important part of the annual review of the system of risk and control.

Some of the main parts of the internal control framework are set out below:

Control environment

The Group's control environment is designed to create an attitude where colleagues take acceptable business risks but within clearly defined limits. The control environment includes:

- Having the right colleagues in place with everyone knowing what job they have to do, what they can authorise and how they should report, supported by a system that helps colleagues perform to the best of their abilities and so helps the Group deliver its business objectives
- Co-ordinating the way we do things across the Group through regular management meetings and other forums
- Setting policies for how the Group spends its money, and making sure that if we need to spend a large amount of money, the Board gives permission
- The Code of Business Conduct, which sets out how colleagues should conduct themselves in line with the Group's values and principles with customers, members, other colleagues, suppliers, the community and competitors. This code tells colleagues how they can report any serious wrongdoing confidentially. An anti-fraud policy also supports this code.

Risk assessment

Looking at what could go wrong and how we try to stop this happening is important to protect our members' interests and our reputation, and to make sure we comply with regulatory standards and achieve our business objectives.

The Board and executive team are responsible for identifying and evaluating the Group's main business risks. They aim to have systems that manage the risk in an efficient and effective manner.

To do this risk registers are kept that identify the likelihood and impact of risks and what's being done to manage them. The Group Risk department supports risk management across the Group, and reports on risk to the Committee.

In September 2016 the Group appointed a new Chief Risk Officer. During the year, the Committee received updates on the Group priority risks and the Risk Management Transformation programme.

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 reducing the potential cost from loss of assets or fraud. Procedures and reference information on the Group's Rules, accounting policies, insurance, colleagues and Code of Business Conduct are issued to appropriate management.

Information and communication

The Group communicates with colleagues, members, partners and the like in several ways. 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 via our intranet, by conference calls, through increasing use of social media and through face-to-face briefings. We have also introduced an external-facing colleague website, **www.coop.co.uk/colleagues.**

Monitoring

The Group adopts the 'three lines of defence' approach to trying to make sure it does what it says it will do. The first line is the system of internal control, which is the responsibility of line management. The second line comes from various functions, including Group Risk, who monitor and check compliance. IA provides independent assurance, the third line.

The Committee considers that there are no material losses or contingencies that haven't been disclosed.

Whistleblowing procedure

In line with best practice and to ensure the Group does the right thing in line with 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 company, allows colleagues to raise concerns about business practices confidentially should they not wish to talk to someone within the Group. This policy also includes third party organisations which trade with the Group, so that any wrongdoing by our colleagues can be reported as part of our anti-bribery controls.

The whistleblowing policy is included in the Code of Business Conduct, which is available on the colleague intranet and the Group's website.

The Committee considers the whistleblowing procedures to be appropriate for the size and scale of the Group.

Other activities

Health and Safety

The Committee considered how we're complying with Health and Safety policies and standards.

The Committee also assessed the progress of the Safety, Health and Environmental programme, which is a new addition to our Rebuild programme.

Sustainability reporting and social impact accounting

The Committee considered how our Co-op is delivering a coherent group-wide approach to, and goverance of, policies that support and deliver our Co-op Way via our values and principles and ethical, social, environmental and people issues. This included consideration of the prioritisation of policies and issues; oversight of performance measures, benchmarks and reporting; and oversight of policy development.

In particular the Committee considered the Group's approach to sustainability reporting and social impact accounting. The Group publishes a sustainability report known as the Co-op Way Report. The Committee has reviewed the development of this report and has considered changes the Group is proposing to make to its sustainability reporting and social impact accounting.

Report of the Remuneration Committee

Committee Chair's statement

Introduction

I am pleased to introduce to you my second Remuneration Report as Chair of the Remuneration Committee ('the Committee').

We have moved on since the crisis our Co-op faced in 2013 and 2014 and your Committee has been working on an approach to pay which is fit for the Rebuild phase of our recovery, and beyond, and better reflects our values and principles.

Some changes have already been made but much work remains to be done. Getting the balance right in executive pay is not easy and not all members will agree with the choices we make but your Committee continues to focus on what it believes is right and fair for our Co-op.

During the second year of our Rebuild programme, 2016 saw our business focus on members, communities and campaigning on the issues that matter most. We have also focused on proving, once again, that our Co-op is a different way of doing business. We want to play our part in restoring trust in business and showing that ethical responsibility can thrive in our markets and individuals can have a say in how things are run. Our approach, as your Remuneration Committee, supports this focus.

The planned period of peak investment means that our profits are down on 2015, despite good performance from all our businesses. This was factored in to our Rebuild budget from the beginning, along with our commitment to keep our debt below £0.9bn, which we've also achieved. The Committee recognises that the planned investment in the Rebuild programme has had an impact on results.

Background

Pay reform

Pay and reward for executives has remained in the news during 2016 with the key focus being on pay arrangements being too complex and difficult to understand. We are looking at how we can simplify our pay arrangements, which I refer to later in this report.

The government is also looking at this area and has asked for views on how decisions should be taken on pay, who should have input, how to compare executive with other colleagues' pay and what details should be reported. We have sent in our thoughts and are waiting for the government to confirm its plans.

How we report to you

We are a co-op owned by millions of members who are also our customers. We do not have to comply with the rules that apply to large companies with traded shares. However, we believe in being open with our members and we choose to comply where this works for our type of business. We take on board Council's views and those of the wider UK co-op movement.

Other large companies only report on the pay for their directors. However we give you information on our full Executive.

This report contains a lot of information but we've tried to make it clear. It has two sections:

i. Part I – Executive Remuneration Policy. We have included a summary of our pay policy. We asked our members to vote on our policy in 2016 and 90.08% voted for it. We pay our Executive in line with this policy. This section also covers how your Committee is applying it in 2017. We are proposing a small change to this policy to simplify our pay arrangements which I refer to later in this report.

ii. Part II – Annual Report on Remuneration, which covers how we applied the policy in 2016.

We have also included a new section, Pay at a Glance, on page 70 where we pull together the key information we believe you will want to see in a simplified format.

How we have engaged with our members

Our members have given the Committee the role of deciding what we pay our Executive. However, we feel it is right to listen to our members and act on their concerns. In 2016 we had a number of meetings with Council members to hear their views and to explain our approach. We have also welcomed Margaret Casely-Hayford, who was previously Director of Legal Services for the John Lewis Partnership for nine years, as our second Member Nominated Director onto the Committee. Our members also voted on our remuneration report and policy at the 2016 Annual General Meeting (AGM) where I gave an update on our approach and answered their questions.We continue to welcome feedback from you.

Our approach to pay

How we look at pay

I know that pay and reward can be an emotive topic.

We are committed to a reward strategy that is transparent, visible and fair. We need to be able to compete for talented executives with the right skills and values to move our Co-op forward. We also need to reward high performing colleagues for a job well done. We do this in a way we feel supports our purpose and the values of our Co-op.

How our pay links to strategy

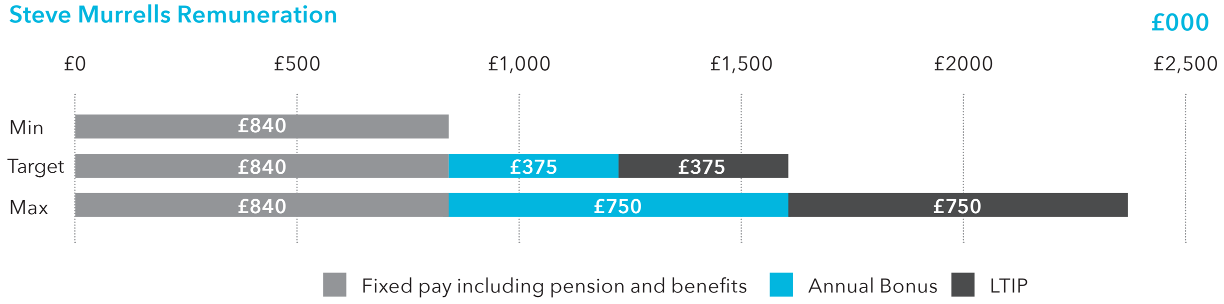
Our aim is to clearly link our pay with our Co-op's strategy. We explain our strategy and business model on pages 13 and 6 and we have shown the clear link between our strategy and 2016 pay in the Pay at a Glance section.

Decisions and Changes

The Committee determined that no annual salary increases were made for our Executive in 2016 and the Committee have decided that there will be no annual salary increases for our Executive in 2017 either.

In February 2017 we announced that Steve Murrells would succeed Richard Pennycook as Group Chief Executive. Despite the increased responsibility of the Chief Executive role, the Committee and Steve agreed that his overall remuneration package would not change on his appointment.

Steve Murrells Remuneration



At the same time Pippa Wicks was appointed as Deputy Chief Executive, and the Committee and Pippa agreed that her overall remuneration package would not change on her appointment.

The following changes have also been made to our executive team:

- Rufus Olins joined the Executive as Chief Membership Officer in October 2016.
- Rod Bulmer has moved to leading the development of our Renewal plan.
- Richard Lancaster joined the Co-op in 2015 as CEO of Funeralcare, and joined the Executive when he took additional responsibility for the Legal Services business in January 2017.
- Jo Whitfield joined the Executive as Interim CEO Food in March 2017.
- Sam Walker was given 12 months' notice of termination in April 2016 and employment terminated on 4 April 2017.

i. Rebalancing of Executive pay:
During the Rescue period executive packages were set ahead of the market. But the remuneration packages for new executives have been benchmarked externally at the middle of the individual's relevant market.

We continue to review our Reward strategy to ensure that our approach to remuneration is suitable for our ownership structure and supports a successful transition from Rebuild to Renew.

ii. The reduction in notice periods for our Executive:
All appointees to the Executive will have a six month notice period. Existing members of the Executive agreed to reduce their 12 month notice period to six months with effect from 1 July 2016.

What about our other colleagues?

Your Committee and Board regularly discuss how we treat and pay our colleagues across our Co-op for the great job they do.

We have continued to pay above National Living Wage (NLW) and apply our rates to all colleagues, which means that, unlike many other employers, we have chosen not to reduce rates for younger colleagues or Apprentices. NLW continues to increase and this will be a major focus for us in the coming years.

Our members have also set us the goal of being a living wage employer (as set by the Living Wage Foundation). This rate is considerably higher than the NLW and would be a considerable additional challenge. We are continuing to review our overall reward strategy to see how and when this could be achieved given that food retailing is a highly competitive market. A small increase in pay can make a big difference in our overall costs and make us less able to compete with other retailers. We need to get the balance right so we can continue to thrive.

We offer a good level of benefits to all colleagues (including a pension scheme considerably better than the government minimum) and we are starting to introduce new financial, health and wellbeing initiatives in 2017.

Pay ratio

We know that some members want to see pay ratios. This is also an area the government is consulting on but rather than wait for the outcome of this review we wanted to share information with you this year.

There is no common way in which this is reported and we have adopted an approach which makes sense to us and we believe will be helpful to members.

The ratio between our highest paid executive and lowest paid colleague in April 2017 is 1:51 on Base Pay only or 1:101 for Base Pay plus on target incentives.

Bonus and Long Term Incentive Plan outturns in 2016

Payments under the 2016 Annual Incentive Plan (AIP) are based on a combination of business and individual performance. Business performance broadly met the targets set.

The 2014-16 Long Term Incentive Plan (LTIP) consisted of three equally weighted targets the performance of which is shown below:

Target	Performance
Ratio of Net Debt/EBITDA	Threshold Not Met
Cumulative Net Cashflow	Stretch
Reputation of the Co-operative Group	Stretch

The Committee determined that the outturn of the 2014-16 LTIP was 2/3rds of the maximum award. See page 70 for more information.

Looking ahead

2017 will see us complete our third year of Rebuild. Having repaired the damage caused by our financial crisis in 2013, and with all our businesses performing well and set for growth, we're now looking to our long term future and exploring potential new markets. The Committee has been reviewing how we reward our Executive in the future to take account of this next phase in our journey and in the light of feedback from members about the way we invest our money in talent. We want to ensure our approach to pay works for our Co-op and its members and is appropriate as we move from Rebuild to Renew.

The Committee will be seeking agreement from the 2017 AGM to authorise the Committee to simplify the incentive arrangements for the Executive by adjusting the balance and design of the annual and long-term incentives provided the total quantum that can be received for annual and long-term incentives does not exceed the amount available under the present arrangements.

Detailed proposals will be developed during the course of this year and discussed with Council representatives prior to implementation in January 2018. The final design will be notified to the 2018 AGM and included in the next vote on Remuneration Policy in 2019.

Governance

Committee

During 2016 I was pleased to welcome two new members to our Committee. Our newly appointed Member Nominated Director, Margaret Casely-Hayford, and Peter Plumb, one of our Independent Non-Executive Directors, were appointed to the Committee in May. They have both made a strong contribution to our work since joining and I know they will continue to ensure that member voice is at the heart of our decisions on pay.

Thanks to all the Committee members for their insight provided through the year.

AGM

Members will be asked to approve the Annual Report on Remuneration at our 2017 AGM and we would welcome your support by voting in favour of it.

I recommend the report to you.

Stevie Spring
Chair of the Remuneration Committee

2016 pay at a glance

This section provides an overview of our pay policy in action and payments made to our executives in 2016. Full details of our policy and what we paid in 2016 are set out on page 72.

Remuneration policy

Our Co-op is committed to a reward strategy that is transparent, visible and fair, allowing us to compete for skills and talent and encourage and reward high performing colleagues, while also reflecting our purpose and values.

How 2016 pay aligned to our strategy

The following table describes how key elements of our strategy link to the way we measured performance in our reward structures in 2016. We are committed to a strong link between how our business performs in key areas and our reward structures as well as a strong connection to our colleagues and our Co-op values and purpose.

Co-op KPI	Incentive scheme	Impact on payments to our executives in 2016
Reputation Following the crisis faced by our Co-op in 2013/14 and the negative publicity surrounding the Co-operative Bank we needed to restore our Co-op's reputation and brand perception to previous levels and beyond.	Long Term Incentive Plan (LTIP)	Stretch performance was achieved under this metric in the 2014-16 LTIP. Performance is reflective of increased good news stories through the launch of our new Membership and rebranding exercise.
Net budgeted profit It is important that our Co-op makes profit to reinvest into the business to support future strategy and purpose.	Annual Incentive Plan (AIP)	Payments are aligned to business success and personal performance. Budgeted Profit broadly met target.
Net debt Maintaining responsible levels of debt has been an important part of our financial strategy. We must manage debt well but not at the expense of profit; this will continue to be a focus in the medium term.	Long Term Incentive Plan (LTIP)	We achieved our commitment to keep our debt below £0.9bn. Planned investment in the Rebuild programme has had an impact on results which resulted in no payment being triggered under this metric in the 2014-16 LTIP.
Net cashflow (cumulative 2014-2016) We needed to improve our cash flow to support our future strategy and purpose.	Long Term Incentive Plan (LTIP)	Stretch performance was achieved under this metric in the 2014-16 LTIP. We have successfully managed to improve our cash flow position over the last 3 years.

2016 pay

We have set out below the key elements of pay for our executive team.

Remuneration Element	Description
Total Pay	Our Executive's pay is made up of the different elements listed below. Salary and benefits are fixed i.e. they do not change with the performance of the business. The AIP and LTIP are variable i.e. the Committee sets targets and the amount of money which an executive receives depends on the performance achieved. For the variable elements, no payment may be made if performance is not good enough. In deciding what we will pay, we look at what other relevant organisations pay. Our aim is that the total amount we pay is equivalent to the middle of the market if they do their job well, although we take our own view on what is right for our Co-op.
Salary	Our Executive receives a salary for performing their core role. The Committee agreed that the executive salaries would not be increased in 2016.
Benefits	The benefits provided to our Executive are in line with what happens elsewhere and could include a car or car allowance, fuel in certain cases, relocation assistance, healthcare cover and life cover.
Pension	Our Executive are able to join the Co-op's pension plan or receive a cash allowance instead to make their own provision.
2016 Bonus (Annual Incentive Plan)	Our Executive may receive a payment under the Annual Incentive Plan (AIP). Payments are based on a combination of business and individual performance. For 2016 our executives were paid between 52.5% and 62.5% of salary under the AIP.
2014-16 Long Term Incentive Plan (LTIP)	Our Executive may receive a payment under an LTIP. All LTIP awards are cash based, have a three-year performance period, and the amount of money paid will depend on the level of performance against measures and targets set at the start of each three-year award cycle. The 2014-16 LTIP consisted of three equally weighted targets, the performance of which is shown below:

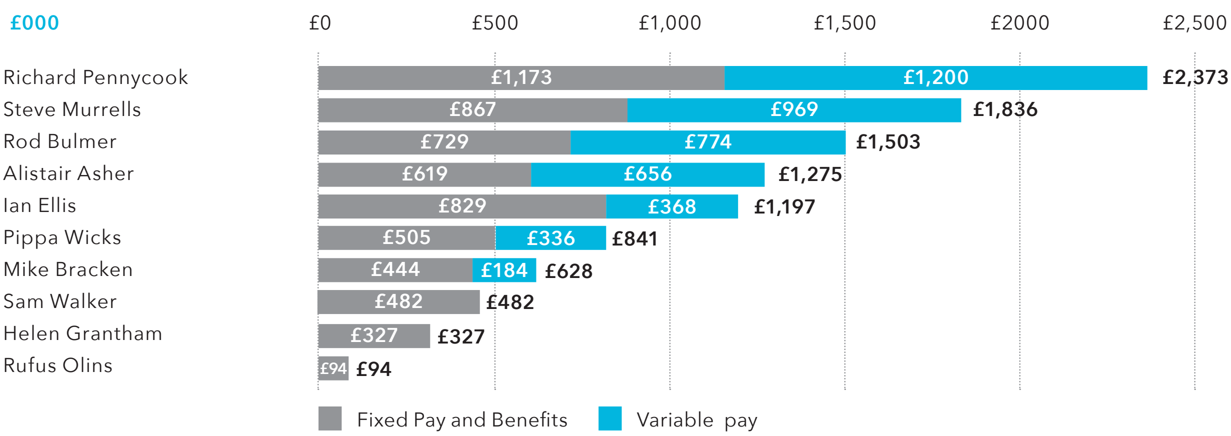
Target	Performance
Ratio of Net Debt/EBITDA	Threshold Not Met
Cumulative Net Cashflow	Stretch
Reputation of the Co-operative Group	Stretch

This performance generated payments which were 2/3rds of the maximum award.

2016 total pay

The chart below shows the total pay which our executives received in 2016 and full details can be found in the Annual Report on Remuneration which starts on page 77.

2016 Remuneration



Notes to chart
1. Pippa Wicks was appointed permanently on 1 April 2016. Her contract requires her to work four days a week and her pay is adjusted accordingly.
2. Helen Grantham was appointed as Interim Group Secretary on 11 January 2016.
3. Rufus Olins was appointed on 17 October 2016.
4. Sam Walker was given 12 months' notice of termination in April 2016 and employment terminated on 4 April 2017.

I Executive remuneration policy

Reward philosophy

Our Co-op is committed to a reward strategy that is transparent, visible and fair which allows us to compete for skills and talent whilst also encouraging and rewarding high performing colleagues. It also must reflect the purpose and values of our Co-op.

This is supported by the following reward principles:

- A market aligned pay position against relevant, competitive benchmarks for fully competent performance
- Incentive plans that clearly reward both performance against stretching objectives and commitment to our Co-op purpose and values
- A benefits package that reflects our purpose and values

Summary of Executive Reward Policy

Our current Executive Reward Policy is summarised below.

Base salary	
Purpose and link to strategy	To set a level of reward for performing the core role that allows us to attract and retain talented leaders.
Summary and operation	We aim to pay market aligned total target remuneration for fully competent performance.
Maximum Opportunity	There is no formal maximum salary. Typically, salaries are reviewed annually. When reviewing salaries, the Committee will take account of: • Experience and personal and business performance. • Appropriate market data with the aim of total remuneration being aligned to the relevant market for fully competent performance. • Increases for the wider colleague population, unless there are exceptional circumstances.
Benefits	
Purpose and link to strategy	To offer a benefits proposition to attract and retain talented leaders.
Summary and operation	The benefits provided to our Executive will be in line with normal market practice and could include a car or car allowance, fuel in certain cases, relocation assistance, healthcare cover and life cover. Executives are also able to take advantage of benefits offered to all colleagues for example childcare vouchers and discounts on certain products and services.
Maximum Opportunity	There is no formal cap on the level of benefits that can be provided however this will represent a small proportion of the total renumeration.
Pension	
Purpose and link to strategy	To provide the same level of pension benefits to all colleagues across our Co-op, that provides an income in retirement.
Summary and operation	Our Executive are able to join the Co-op's Defined Contribution pension plan or receive a cash allowance in lieu of pension provision.
Maximum Opportunity	The following options are available: • Defined Contribution employer pension contributions of up to 10% of salary. • Cash alternative of up to 10% of salary.
Annual Incentive Plan (AIP)	
Purpose and link to strategy	To motivate and reward achievement of key short-term business performance measures.
Summary and operation	Our Executive will be eligible for a payment under an AIP agreed by the Committee. The performance measures and targets for each annual AIP cycle will be set at the start of each year. Payments will be based on a combination of business and individual performance. Payments made under the AIP are subject to the clawback provisions.
Maximum Opportunity	The AIP opportunity for our Executive is 50% of salary at target performance (maximum payout will be 100% of salary at stretch performance). Also see Notes 1 and 3

Table continues

Long Term Incentive Plan (LTIP)	
Purpose and link to strategy	To reward the achievement of longer term performance targets and results, and promote the behaviours considered by the Committee to be key to the success of our Co-op.
Summary and operation	Our 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 participant has joined after the grant date. • The Committee has the discretion to determine the performance measures for each LTIP award, including the weighting and 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 our Co-op and can reduce any payments under the award as it determines appropriate. Payments made under the LTIP are subject to clawback provisions.
Maximum Opportunity	The LTIP opportunity for our Executive is 50% of salary at target performance (maximum payout will be 100% of salary at stretch performance). Performance measures and opportunity levels for our Executive are shown below. Also see Notes 1, 2 and 3

Notes to the table:

Note 1: The Committee will be seeking agreement from the 2017 AGM to vary the approved Remuneration Policy to allow them discretion to simplify incentive arrangements for our Executive by adjusting the balance and design of Annual and Long Term Incentives provided that the current combined total quantum is not exceeded.

Note 2: The performance measures for the 2017-19 LTIP are shown below.

Note 3: The maximum AIP and LTIP opportunities are lower than this for Rufus Olins, Richard Lancaster, Jo Whitfield and Rod Bulmer.

Implementation of the Remuneration Policy in 2017

Base salary

Annual base salaries for our Executive are set out below:

Executive Member	2016[1] (£000)	2017[1] (£000)	Comments
Richard Pennycook[2]	1,250	750	Stepped down from Executive 31 March 2017
Steve Murrells	750	750	Joined Executive 16 July 2012, promoted to Group Chief Executive 1 March 2017
Ian Ellis	700	700	Joined Executive 4 September 2015
Rod Bulmer[3]	650	650	Joined Executive 9 June 2014
Pippa Wicks[4]	560	560	Joined Executive 1 April 2016
Alistair Asher	550	550	Joined Executive 1 July 2013
Richard Lancaster	–	550	Joined Executive 1 January 2017
Sam Walker	425	425	Given 12 months' notice of termination in April 2016 and employment terminated on 4 April 2017
Jo Whitfield[5]	–	418	Interim appointment to Executive 1 March 2017
Mike Bracken	350	350	Joined Executive 30 September 2015
Rufus Olins	350	350	Joined Executive 17 October 2016
Helen Grantham[6]	293	293	Joined as Group Secretary 11 January 2016

Notes to the table:
1. Salaries are as at 1 January or appointment date to our Executive
2. At Richard Pennycook's request, his base salary was reduced from £1,250,000 to £750,000 with effect from 1 July 2016
3. With effect from 1 March 2017, Rod Bulmer's contract requires him to work three days a week and his salary has been reduced to £325,000
4. Pippa Wicks's contract requires her to work four days a week and her pay is adjusted accordingly
5. Jo Whitfield's salary is inclusive of an interim acting up allowance
6. Helen Grantham is employed as Interim Group Secretary and under our constitution the Group Secretary role is a member of our Executive

We benchmark the total remuneration packages of our Executive using market data from a pre-determined comparator group comprising a selection of retail PLCs, mutuals and co-operatives as determined by the Committee. The comparator group was chosen to reflect our Co-op's full range of attributes which includes size, mix of businesses, profitability, sector, ethos and co-operative status.

The Committee has determined that no salary adjustments will be made for 2017 in respect of our Executive.

Benefits

Our Executive will receive benefits in line with the current policy.

Pension

Our Executive will receive pension benefits in line with the current policy.

Annual Incentive Plan (AIP)

The structure of the scheme including target and maximum opportunities for 2017 remains in line with policy.

For Rufus Olins, Richard Lancaster and Jo Whitfield, the AIP opportunity has been set at 20% of salary for on target performance and 40% of salary for stretch performance. Rod Bulmer's AIP is linked to Renew planning activity and his opportunity has been set at 30% of salary for on target performance and 60% of salary for stretch performance.

Underlying profit before tax remains the principal performance measure, and targets are set by reference to internal budgets, with personal objectives underpinning the strategic objectives of our Co-op.

Long Term Incentive Plan (LTIP)

The LTIP awards for our Executive will be a maximum of two times target opportunity which is in line with the normal annual award level.

For Rufus Olins, Richard Lancaster and Jo Whitfield, the LTIP opportunity has been set at 25% of salary for on target performance and 50% of salary for stretch performance.

Rod Bulmer will not participate in the 2017-2019 LTIP scheme.

The performance metrics and weightings for the 2017-2019 LTIP scheme are detailed below:

Performance metric	Weighting (% of maximum award)
Net Debt/EBITDA Ratio as at 31 December 2019[1]	50%
Colleague Engagement Score at the end of 2019	25%
Membership Spend as a % of total sales value at the end of 2019 (average for the year)	25%

Notes to table:

1. Net Debt/EBITDA ratio is the financial underpin and no payment will be made under any element of the scheme if the underpin is not met.

The Committee will take account of the performance at the end of the cycle to determine the outcome of the LTIP scheme. The Committee has discretion to adjust targets, performance outcomes or payments (up to the maximum or down to zero) in the event of exceptional events which they were not aware of at the time of granting the award.

Policy for the recruitment of new members of our Executive

The remuneration package for any new executive will be set using the same policies that apply to current executives, benchmarked externally by role. This means that the Committee would set a total package that is market aligned to an appropriately defined basket of external comparators based on 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 needs to move home to be closer to their place of work or 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 our 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 our 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 six months' notice. Where it is deemed commercially beneficial for an individual to remain under a contract of employment with our 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, our 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 Committee 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.

Comparison of remuneration policies for our Executive and wider colleagues

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

Our Co-op's long term ambition is for all colleagues to be eligible to participate in an incentive scheme. In the medium term we remain focused on increasing pay for our lowest paid colleagues and making sure our salaries remain competitive.

Those at senior management grades able to influence long-term performance are the only colleagues who are eligible for LTIP awards. The level of opportunity varies by grade, with those in our 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 our Co-op's results were materially misstated, should have been assessed materially differently, or where an individual ceases to be employed by our 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 77.

II Annual Report on Remuneration

What did our executives earn in total during the year?

The table below shows the remuneration received by our executives while appointed to our Executive during the 2016 financial year. Pippa Wicks was a member of our Executive on an interim basis for the first three months of 2016, she was then appointed permanently on 1 April 2016, and remuneration paid to her from her appointment date is detailed in table 1 below. Prior to that, Pippa Wicks was engaged by our Co-op through Alix Partners and the total fees paid in respect of her services for the first three months of 2016 were £318,758 excluding VAT.

No executives left our Co-op during 2016.

Table 1 – 2016 remuneration for our executives in post at 31 December 2016

	Date of appointment to the Executive (Note 1)	Date of stepping down from Executive (Note 1)	Basic salary 2016 £000	Taxable benefits (Note 2) 2016 £000	2016 AIP (Note 3) 2016 £000	2014 - 2016 LTIP (Note 4) 2016 £000	Pension benefits (Note 5) 2016 £000	Other (Note 6) 2016 £000	Total 2016 £000	Basic salary 2015 £000	Taxable benefits (Note 2) 2015 £000	2015 AIP (Note 3) 2015 £000	2013-2015 LTIP (Note 4) 2015 £000	Pension benefits (Note 5) 2015 £000	Other (Note 6) 2015 £000	Total 2015 £000
Richard Pennycook	1 Jul 2013	31 Mar 2017	**998**	**30**	**600**	**600**	**100**	**45**	**2,373**	1,250	25	1,125	638	181	377	3,596
Steve Murrells	16 Jul 2012		**750**	**42**	**469**	**500**	**75**	**-**	**1,836**	750	38	675	553	109	78	2,203
Rod Bulmer	9 Jun 2014		**650**	**14**	**341**	**433**	**65**	**-**	**1,503**	650	17	488	–	108	–	1,263
Alistair Asher	1 Jul 2013		**550**	**14**	**289**	**367**	**55**	**-**	**1,275**	550	17	358	404	80	–	1,409
Ian Ellis	4 Sep 2015		**700**	**14**	**368**	**-**	**70**	**45**	**1,197**	213	4	140	–	26	14	397
Pippa Wicks (Note 7)	1 Apr 2016		**420**	**9**	**336**	**-**	**42**	**34**	**841**	–	–	–	–	–	–	–
Mike Bracken	30 Sep 2015		**350**	**14**	**184**	**-**	**35**	**45**	**628**	85	3	–	–	9	11	108
Sam Walker (Note 8)	17 Mar 2014	4 Apr 2017	**425**	**14**	**-**	**-**	**43**	**-**	**482**	425	17	85	91	89	–	707
Helen Grantham (Note 9 and 10)	11 Jan 2016		**288**	**10**	**-**	**-**	**29**	**-**	**327**	–	–	–	–	–	–	–
Rufus Olins (Note 10)	17 Oct 2016		**74**	**3**	**-**	**-**	**7**	**10**	**94**	–	–	–	–	–	–	–

Notes to Table 1:

1. The date of appointment to or stepping down from the Executive may differ from the date service commenced or terminated with our 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. 2014-2016 LTIP payments relate to cash payments made under the 2014-16 Long Term Incentive Plan.
5. Pension includes Co-op Defined Contribution pension plan or cash allowance in lieu of pension provision
6. Other payments in 2016, which were agreed at the date of appointment, include:
   - Payments were agreed under the relocation policy to assist the following executives to stay close to their workplace during the working week. During 2016, Richard Pennycook received £45,000, Ian Ellis received £45,000, Mike Bracken received £45,000, Pippa Wicks received £34,000 and Rufus Olins received £10,000.
7. Pippa Wicks's contract requires her to work four days a week and her pay is adjusted accordingly.
8. Sam Walker was given 12 months' notice of termination in April 2016 and employment terminated on 4 April 2017.
9. Helen Grantham is employed as Interim Group Secretary and under our constitution the Group Secretary role is a member of our Executive.
10. Helen Grantham and Rufus Olins were not eligible to participate in the 2016 AIP. Helen Grantham is an interim appointment, and Rufus Olins joined after the cut off to participate in the 2016 AIP scheme.

Will our Executive receive a salary increase in 2017?

As part of the annual salary review for our executives, the Committee has agreed that our Executive salaries would not be increased in 2017.

What directorships, other than those linked to our Co-op, did the Group Chief Executive hold during 2016?

Richard Pennycook, who was Group Chief Executive throughout 2016, holds the following directorships:

Position	Remuneration in 2016 (£)
Chair, The Hut Group Limited	20,000
Chair, The Institute for Turnaround	–
Chairman, Howdens Joinery Limited	180,000
Senior Independent Director, Persimmon plc	18,000

What LTIP scheme interests do our 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 31 December 2016. Table 2b shows the maximum potential award under each plan held by former executives who left or stepped down from our Executive.

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 our executives in post at 31 December 2016

Name of executive	Award	Notes	Maximum award opportunity at start of the year £	Maximum 2016-2018 award opportunity granted £	Awards vested in year £	Awards lapsed in year £	Maximum award opportunity at the year end £
Richard Pennycook	2016-2018	1,5	–	1,250,000	–	–	1,250,000
	2015-2017	2,5	1,250,000	–	–	–	1,250,000
	2014-2016	3	900,000	–	600,000	300,000	–
Alistair Asher	2016-2018	1	–	550,000	–	–	550,000
	2015-2017	2	550,000	–	–	–	550,000
	2014-2016	3	550,000	–	366,667	183,333	–
Mike Bracken	2016-2018	1	–	350,000	–	–	350,000
	2015-2017	2	263,000	–	–	–	263,000
Rod Bulmer	2016-2018	1	–	650,000	–	–	650,000
	2015-2017	2	650,000	–	–	–	650,000
	2014-2016	3	650,000	–	433,333	216,667	–
Ian Ellis	2016-2018	1	–	700,000	–	–	700,000
	2015-2017	2	544,000	–	–	–	544,000
Steve Murrells	2016-2018	1	–	750,000	–	–	750,000
	2015-2017	2	750,000	–	–	–	750,000
	2014-2016	3	750,000	–	500,000	250,000	–
Sam Walker	2015-2017	2, 6	425,000	–	–	425,000	–
	2014-2016	3, 6	425,000	–	–	425,000	–
Pippa Wicks	2016-2018	1	–	560,000	–	–	560,000

Notes to Table 2a:

1. The 2016-2018 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. Net Debt/EBITDA ratio is the financial underpin for the plan.)
   - Membership spend as a percentage of total sales value (25% weighting)
   - Co-op colleague engagement (25% weighting)
   - Brand health (10% weighting)
2. 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. Net Debt/EBITDA ratio is the financial underpin for the plan.)
   - Membership spend as a percentage of total sales value (25% weighting)
   - Co-op colleague engagement (25% weighting)
   - Brand health (10% weighting)
3. 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.
4. LTIP grants were not made to Helen Grantham or Rufus Olins. Helen Grantham is an interim appointment, and Rufus Olins joined after the grant date and was therefore not eligible to participate in the 2016-18 LTIP scheme.
5. The Committee has determined that Richard Pennycook is a good leaver from both 2015-17 and 2016-18 LTIP schemes. His unvested awards will be prorated to time served as a member of the Executive during the performance period for each scheme. These remain subject to the original performance measures and the original performance periods.
6. Sam Walker was given 12 months' notice of termination in April 2016 and employment terminated on 4 April 2017.

Table 2b – LTIP awards for executives who left the Group

Name of executive	Award	*Notes*	Maximum award opportunity at start of the year £	Maximum 2016-2018 award opportunity granted £	Awards vested in year £	Awards lapsed in year £	Maximum award opportunity at the year end £
Claire Davies	2014-2016	1	117,778	–	78,519	39,259	–
Nick Folland	2014-2016	1	259,722	–	173,148	86,574	–
Paula Kerrigan	2014-2016	1	188,889	–	125,926	62,963	–

Notes to Table 2b:

1. Under the terms of their settlement agreements the former executive members in the table who left our Co-op during 2014 and 2015 retained the parts of their 2014-2016 LTIP that related to the period they were in employment. These remained subject to the original performance measures and the original performance periods. Payments are due on the vesting of these awards following the end of the 2014-2016 performance period.

What pension benefits are our executives entitled to?

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

Comparative figures for 2015 are shown in brackets.

Table 3 – Pension entitlements for executives in post at 31 December 2016

	Date of appointment to the Executive	Years of Group Service	Total Defined Benefit Pension accrued at 31 December 2016 (Note 1,2) £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) £000
Richard Pennycook	1 Jul 2013	3	–	–	100 (181)	100 (181)	–
Alistair Asher	1 Jul 2013	3	–	–	55 (80)	55 (80)	–
Mike Bracken	30 Sep 2015	1	–	–	25 (9)	25 (9)	–
Rod Bulmer	9 Jun 2014	2	35	14 (4)	51 (73)	65 (108)	65
Ian Ellis	4 Sep 2015	1	–	–	70 (26)	70 (26)	–
Steve Murrells	16 Jul 2012	4	–	–	75 (109)	75 (109)	–
Rufus Olins	17 Oct 2016	–	–	–	7 (–)	7 (–)	–
Sam Walker	17 Mar 2014	3	4	43 (11)	– (20)	43 (89)	65
Helen Grantham	11 Jan 2016	–	–	–	29 (–)	29 (–)	–
Pippa Wicks	1 Apr 2016	–	–	–	42 (–)	42 (–)	–

Notes to Tables 3:
1. Total Defined Benefit pension is that which would be paid annually on retirement at normal retirement age based on service to the closure of the Defined Benefit pension accrual on 28 October 2015 and statutory revaluation increases in deferment. There is no additional pension benefit payable in the event of an executive's early retirement.
2. Defined benefit accrual ceased in October 2015 for all colleagues.
3. 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.

Non-executive directors' remuneration

This section of the report includes details of the payments made to the non-executive directors (NEDs) in office during 2016:

What are the fees for the NEDs for 2016?

NED Role	Fees
Group Chair	• The basic fee for the Group Chair role is £250,000 per annum. There has been no change in annual fee between 2015 and 2016. 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: – Senior Independent Director £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.

Since his appointment date, the Group Chair 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. The Group Chair also 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 our 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.

How long are directors appointed to the Board for?

Appointments to the Board are for the following periods:

- The Group Chair and INEDs were appointed for an initial two-year term subject to election and re-election in accordance with the Rules. 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.
- All directors (other than MNDs) 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.
- 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 initially elected for a one year term to ensure not all MNDs had the same term. She was re-elected in 2016 for an additional two-year term. She may serve for a further two terms of two years.

What did the NEDs earn during the year?

The information is provided in two tables covering the period prior to and after the 2015 AGM when our new governance rules came into effect.

Table 4 – Non-executive members of the Group Board

	Notes	Group Board £000	Group Risk and Audit Committee Chair £000	Group Remuneration Committee Chair £000	Senior Independent Director £000	2016 Total £000	2015 Total £000
Allan Leighton (Chair)	1	**See Note 1**	-	-	-	**See Note 1**	See Note 1
Lord Victor Adebowale CBE	4	**44**	-	-	-	**44**	–
Hazel Blears		**60**	-	-	-	**60**	38
Simon Burke	2, 3	**60**	**15**	-	-	**75**	See Note 3
Margaret Casely-Hayford	4	**37**	-	-	-	**37**	–
Paul Chandler		**60**	-	-	-	**60**	38
Sir Christopher Kelly	2, 3	**60**	-	-	**15**	**75**	See Note 3
Peter Plumb		**60**	-	-	-	**60**	31
Ruth Spellman		**60**	-	-	-	**60**	38
Stevie Spring	2	**60**	-	**15**	-	**75**	39

Notes to Table 4:

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 and 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 and Sir Christopher Kelly's total 2015 fee was £75,000.
4. Lord Victor Adebowale CBE was appointed as an Independent Non-Executive Director on 6 April 2016 and Margaret Casely-Hayford was appointed as a Member Nominated Director on 21 May 2016.
5. 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	2016 Group Board	2016 Group Risk and Audit Committee	Group Remuneration and Appointments Committee	Co-operative Food Holdings Limited Board	Co-operative Specialist Business Limited Board	Co-operative Banking Limited	Regional Board and Area Committee Fees	Pension Fund Trustee	2016 Total	2015 Total
		£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Ursula Lidbetter (Former Chair)	2,6	-	-	-	-	-	-	-	-	-	44
Allan Leighton (Chair)	1,3	**See Note 1**	-	-	-	-	-	-	-	**See Note 1**	See Note 3
Marc Bicknell	8	-	-	-	-	-	-	-	-	-	17
Duncan Bowdler		-	-	-	-	-	-	-	-	-	14
Simon Burke	1	**See Note 1**	-	-	-	-	-	-	-	**See Note 1**	20
Eric Calderwood	4,7	-	-	-	-	-	-	-	-	-	15
Martyn Cheatle	5	-	-	-	-	-	-	-	-	-	10
Michael Harriott	9	-	-	-	-	-	-	-	-	-	16
Sir Christopher Kelly	1,6	**See Note 1**	-	-	-	-	-	-	-	**See Note 1**	27
Frank Nelson		-	-	-	-	-	-	-	-	-	12

Notes to Table 5a:

1. Payments in respect of 2016 are reported in table 4.
2. Ursula Lidbetter stepped down as Chair on 19 February 2015.
3. 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.
4. Eric Calderwood was Chair of Group Remuneration Committee.
5. Martyn Cheatle was Chair of Group Risk and Audit Committee.
6. Sir Christopher Kelly and Ursula Lidbetter were members of Group Remuneration and Appointments Committee but not paid any additional fees.
7. Eric Calderwood continued to receive fees for Chair of tCG Pensions Trustees (Scotland) to December 2015.
8. Marc Bicknell was Chair of Co-operative Food Holdings.
9. Michael Harriott was Chair of Co-operative Specialist Businesses Limited Board.
10. All Board members attended Transitional Search Committee meetings but did not receive any additional fees for this Committee.

Table 5b – Former Group Board members receiving payments to AGM on 21 May 2016

	Notes	2016 Group Board	2016 Group Risk and Audit Committee	Group Remuneration and Appointments Committee	Co-operative Food Holdings Limited Board	Co-operative Specialist Business Limited Board	Group Values and Principles Board	Regional Board and Area Committee Fees	Co-operatives UK and Co-operative Press Board	2016 Total	2015 Total
		£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Michael Harriott	1	**4**	-	**1**	-	**9**	-	-	-	**14**	16
Jenny De Villiers	1	**4**	-	**1**	-	**4**	-	-	-	**10**	13

Notes to Table 5b:

1. 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.

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 our Co-op to ensure a consistent approach across our Co-op and its subsidiaries.

Terms of reference

The terms of reference of the Committee are available on our website: **https://www.co-operative.coop/investors/rules.**

Members of the Committee

Details of the Committee members and their attendance at meetings during 2016 are provided on page 51.

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

The Committee members are all non-executive. They have no personal financial interests in the Committee's decisions and they have no involvement in the day-to-day management of our Co-op. The 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 2016 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 £98,924 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 provide independent legal advice to the Committee as required, their services have not been utilised by the Committee during 2016.

Report of the Nominations Committee

Chair's introduction

I have been your Chair for just over two years and during this time I have been delighted to work with our Nominations Committee ('the Committee') to build a strong team of directors to lead our Co-op.

This report covers the work we have done during 2016, the Committee's first full year in operation following the transitional arrangements in 2015, and it has been a year spent setting the Committee's priorities as well as dealing with the appointment of two additional directors.

The Committee needs to deal with a number of routine activities during the year, such as checking the eligibility criteria for directors. The Committee has also done an internal assessment of the Board and begun the process for an external assessment. The results of this review will be discussed by the Committee and the Board in the second half of 2017 and shared with Council. We will use insight from this review to develop the longer term focus for the Committee.

We are delighted to have a diverse Board and believe those with different backgrounds, skills and experiences enrich our decision making. Lord Victor Adebowale and Margaret Casely-Hayford joined the Board during the year, along with Ian Ellis. All have made strong contributions.

The Committee worked on succession planning for the Group Chief Executive during the year and this led to the appointment of Steve Murrells when Richard Pennycook stepped down in early 2017. Looking forward, the Committee will focus on the succession plan for the wider Board, ensuring that it continues to have the necessary mix of skills and experience to enable it to do its job well.

Allan Leighton
Chair of the Nominations Committee

What the Nominations Committee does

- Leads the selection process for Independent Non-Executive Directors (INEDs) and Executive Directors. It may also be asked to lead on other non-Board appointments
- Checks and approves the qualification and commercial experience requirements of INEDs and Executive Directors
- Reviews the effectiveness of the Board and ensures it has a good balance of skills, experience, diversity and gender to provide effective leadership and oversight
- Evaluates the performance of directors both individually and collectively
- Ensures that appropriate succession plans are in place for key roles
- Submits proposals to the Non-Executive Directors' Fees Committee in respect of the remuneration of the Group Chair, INEDs and Member Nominated Directors (MNDs)

The Member Nominated Directors Joint Selection and Approval Committee (MNDJC) has taken responsibility for reviewing and approving the qualification and commercial experience requirements of MND candidates.

The terms of reference for the Committee were reviewed in 2016 and are available on our website: **https://www.co-operative.coop/investors/rules**

Board evaluation

At the request of the Chair, the Senior Independent Director, Sir Christopher Kelly, led an internal assessment review of the Board. We used online questionnaires asking directors to rate different aspects of performance on a five-point scale. To encourage frankness, the responses were anonymous.

The output from the exercise was positive and the results from the review were shared with the Board and the Council. Board meetings were considered to be well run with the right areas being debated, directors worked well together and prepared well for Board meetings, Board debates were good with an open and honest culture and appropriately challenging and the executive team were open and responsive to Board questions.

It was also recognised that the Board was still relatively new. The Board agreed a number of actions aimed at making it more effective and identified some areas for additional training and development including further sessions on key risk areas; co-operative values and principles; membership and colleague engagement and the regulatory environment for its Insurance business.

The process to conduct an external Board evaluation began towards the end of the year, with external firms being invited to tender. Following proposals and interviews, an external firm has been appointed and the evaluation process (involving interviews with all directors and other key stakeholders) commenced in February 2017 and is due to conclude in the summer of 2017. The outcome of the evaluation will be made available when completed.

Appointment of directors

During the year the Committee oversaw the process leading to the appointment of Lord Victor Adebowale as an INED and Ian Ellis, Chief Finance Officer, as an Executive Director. Both appointments were made taking into account the balance of skills, experience and diversity of the Board as a whole. A report on the process for the appointment of Victor was provided to the Scrutiny Committee, who scrutinise decisions made by the Committee relating to INEDs and report to the Council on the fairness, transparency and objectivity of the appointment process. Their report is contained on page 94.

The MNDJC was responsible for the MND election process which led to Margaret Casely-Hayford joining the Board and Hazel Blears continuing as an MND.

Diversity

The Board comprises:
- Men: (8) 66.66%
- Women: (4) 33.33%
- Black, Asian and Minority Ethnic (BAME): (2) 16.6%

The Group needs directors of the highest calibre, with the requisite skills and experience to understand a business of the scale and complexity of the Group. We also recognise the benefits that a diverse Board can bring. We have developed a Board Diversity Policy which is in the final process of adoption by the Board and is in line with our Diversity and Inclusion Policy for colleagues.

Our aim is to continue to drive the benefits of a diverse Board by at least maintaining the current level of women and BAME directors.

Review of directors' qualification and commercial experience

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

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

Committee membership and attendance

Details of the Committee members and their attendance at meetings held during 2016 are provided on page 51.

2017 focus

The Committee's focus in 2017 will be on the following main areas:
- Implementation of the Diversity Policy
- Conducting an external Board evaluation and progressing any actions arising from it
- Completing the Board succession plan.

Directors' report

The directors present their report, together with the audited financial statements for the year ended 31 December 2016.

Results and distributions

The loss before taxation was £132m (2015: Profit £23m). No interim dividend has been paid in respect of 2016 and the members are not being asked to approve any distribution of profits in respect of the year.

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 and the 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 106).

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 page 38.

The directors have determined that a three-year period to 31 December 2019 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.

As part of the strategic planning process the directors make a number of assumptions about business performance. The output of the strategic plan is used to perform central debt and headroom profile analysis and is subject to sensitivity testing by flexing a number of the main financial assumptions in order to assess the impact of principal risks in severe but plausible scenarios.

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 2019.

Post balance sheet events

There have been no material post balance sheet events.

Corporate governance report

The corporate governance report is contained on page 47. 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 Inspiring Colleagues section on page 29.

Our Co-op Way

Information on our Co-op Way can be found on page 32. This section deals with how the Group manages its social, ethical and environmental impact.

Greenhouse gas emissions

Since 2006 our total direct greenhouse gas (GHG) emissions have reduced by 46% as detailed in the table below[1]. Total direct GHG emissions decreased by 9% in 2016, due to a reduction in energy used, as well as a decrease in the GHG intensity[2] of the UK's electricity supply which we use to report our emissions from electricity usage.

Direct greenhouse gas emissions since 2006:

Year	t CO2e
2006 (baseline)	1,204,760
2013	694,725
2014	737,263
2015	714,035[3]
2016	**652,689**

Direct greenhouse gas emissions by source:

Source	t CO2e
Transport	130,288
Electricity	310,439
Fuel	31,225
Refrigerants	180,736
Total	**652,689**[4]

Carbon intensity:

Tonnes CO2-equivalent per £m gross income	63.5

[1] Data presented on GHG emissions has been independently audited by sustainability assurance provider, DNV GL, as part of our 2016 Co-op Way Report, to be published in May 2017.
[2] 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 0.46219 $kgCO_2e/kWh$ for electricity purchased in 2015 to 0.41205 $kgCO_2e/kWh$ for electricity purchased in 2016.
[3] 2015 data restated to remove mileage from our divested Pharmacy business which was incorrectly included, and to include better accounting of emissions from fugitive refrigeration gases.
[4] We report the carbon footprint of our electricity use based on the UK grid average as detailed above. If electricity from renewable sources were accounted as zero carbon, our total direct carbon footprint would instead be 345,111 tonnes.

Political donations

Like many other businesses of a comparable size, our Co-op undertakes an engagement programme with a wide range of political opinion formers and decision-makers, designed to protect, promote and enhance our corporate reputation. On issues of sectoral relevance, we are also an active participant in the work of business trade associations.

Quite separately to this corporate activity, our Co-op is a subscribing member of The Co-operative Party, founded 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.

We made donations totalling £625,600 (2015: £625,600) to the Co-operative Party, which is our financial subscription to the Party for 2016, in line with our members' approval at the Annual General Meeting in 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 our members at the 2017 Annual General Meeting regarding future political donations, including subscriptions.

Compliance with Groceries Supply Code of Practice ('the Code')

We do business differently. The way we treat our suppliers and partners is founded on a set of values and principles describing a fairer and better way of doing business. In our Food business our supplier relationships are also governed by the Code which contains certain rights and obligations on us and our grocery suppliers. One of those obligations is to submit an annual compliance report to the Risk and Audit Committee for approval and then to the Groceries Code Adjudicator and the Competition and Markets Authority.

The Risk and Audit Committee looked at the compliance report on 27 March 2017. The Committee noted that we had remained compliant with the Code and that where allegations of breaches of the Code had been raised by suppliers, all were thoroughly investigated and most resolved. We continue to invest in improving our processes and systems. We have maintained an extensive programme of training for colleagues which is supported by both regular and targeted compliance reviews and audits. Suppliers are encouraged to contact our Code Compliance Officer (**gscop.compliance@coop.co.uk**) if they want more information.

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.

The directors consider that the Annual Report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Group's position and performance, business model and strategy.

Each of the directors listed on page 42 to 44 confirms that, to the best of their knowledge:
- the Group financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
- the Strategic Report and Governance Report contained in the Annual Report and financial statements include a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

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

Ernst & Young LLP were appointed to succeed KPMG LLP as auditors of the Group by resolution at the 2016 Annual General Meeting (AGM) at which the directors were also authorised to determine their remuneration. A further resolution will be proposed at the 2017 AGM to re-appoint Ernst & Young LLP as the Group's auditors and to determine their remuneration for the forthcoming year.

By Order of the Board

Helen Grantham
Group Secretary
5 April 2017

Your Council's annual statement

The National Members' Council has supported our Co-op in what's been an exceptionally active year. We've been looking after members' interests, by holding the Board to account, being consulted, carrying out our decision-making responsibility and safeguarding our Co-op's values and principles.

Giving our Co-op a Compass

In 2016 we needed to create a structured way to review the work of the Board. Our job includes checking the Board's decisions and how well it's delivering its Rebuild strategies. Initiated by President Nick Crofts, we've developed, with the Board, a template to support the process of 'holding the Board to account'. The Council has decided on some ways of measuring performance that are linked to our values and principles. They're also linked to our co-operative difference, which is the thread running through them.

We've called our template the Co-op Compass because we view the Board's performance through four lenses. These are:

- Member value (are members getting financial and social benefits?)
- Member voice (are members being heard, engaging and taking part?)
- Ethical and sustainable leadership (how is our Co-op establishing and carrying out its policies, campaigns and principles?)
- Co-operative leadership (how are we supporting the co-operative movement and championing a better way of doing business?).

Within the Compass's four lenses, we've set out 12 important themes (and associated measures) to help our work. They're in line with co-op values and the need to make our Co-op a strong business. The first Compass report we received related to the half year accounts to 2 July 2016 and Council members questioned directors about the information reported. For example, we explored the link between the fall in underlying profit before tax, planned investments and increases in colleague wages after introducing the national living wage.

In future we'll refine these themes working together with the Board and the Executive. We'll also compare them from year to year, putting us in a good position to report to members. The Board will report against the Co-op Compass every half year. Here are the sample measures we use for the four lenses. Those under the 'Member Value' lens are reported in this report and will be carefully reviewed and challenged with the Board.

Goal: Create sustain and develop Member Value

- Underlying Profit Before Tax
- Total Equity
- The value of the 5% earned by members
- Recorded levels of member feedback

Goal: Members contribute positively and proactively to their society – both economically and democratically

- Brand engagement scores
- The number of active trading members
- Members voting
- The number of members allocating their 1% to a cause

Goal: Demonstrate leadership in ethical and sustainable performance

- Our policies and procedures exemplified under the Co-op way
- Demonstrating our co-operative difference and leadership

Goal: Demonstrate leadership in the UK and international co-operative movement

- Overall colleague engagement core score
- Value of trade with other co-operatives

Co-op Compass is a key tool for the National Members' Council to hold the Board to account and in future we'll be reporting to members in more detail on progress against these priority measures. This is the first year of implementation and the benefit will be seen in benchmarking in years to come.

Reviewing the Board – highlights

Rebranding

Over the year the Council has looked over many of the Board's important decisions. It's been an exciting and positive year with so many major projects being launched. At the beginning of the year, we scrutinised our Co-op's rebranding in line with our role of influencing how our brand's managed. Not only did we look at how the brand's new logo brought us back to Being Co-op, but also we reviewed the outline business case for the transformation, the need for a meaningful membership proposition and how this would fulfil our Rebuild vision. We are enthusiastic about the 5% and 1%, welcoming the benefits for individual members. While we know, like the Board, that the investment brings risks, we share its confidence that the fabulous efforts and creativity behind the rebranding, along with the commitment of our colleagues, will be successful.

We were involved in the mapping of our values and principles into the Back to Being Co-op roadshow for colleagues. This brought to life our co-operative difference, as well as the importance of our member ownership model and member participation.

Reviewing transactions

It's the Council's responsibility to hold the Board to account on strategic and operational initiatives, and several major transactions needed reviewing in 2016. These have included the disposal of Food stores to McColls, and also to Budgens. We asked whether these deals were in line with the Food business's strategy of focusing on convenience stores. In the interests of members, we wanted to be sure that we'd got a good price, and that our colleagues would be treated well. In these and other transactions we looked into we were satisfied, after questioning and review, that the Board upheld our Co-op's values and principles when making such complex commercial decisions. We also monitored and welcomed the reinvestment in new stores and funeral homes.

Influencing and collaborating – The Co-op Way

Council members influence and speak with directors and executives in a variety of ways. There are the formal channels but also informal meetings and briefings. This means we can exchange views and opinions. At Council meetings we've been briefed on finance, the key businesses, new membership rewards, and our work on sustainability. All this lets us understand and influence the work of the Board, and lets us emphasise the vital part that co-operative difference has in the way decisions are shaped.

One important way that Council members are influencing our ethical policies is through the Co-op Way Policy Committee. This has been reviewing and refining nine fundamental ethical statements about how we'll carry on our business and treat our colleagues, suppliers and members. It's a great opportunity for Council to help shape policies that benefit members, in line with shared caring and ethical considerations. Once agreed, the Co-op Way Policy Committee will monitor how the policies are implemented around our businesses.

Community strategy and engaging members

After the governance reforms agreed at the 2015 Annual General Meeting, we've been working with the Board and management to develop a framework for new sub-national structures to promote our purpose. These are to be based in each of our communities. They'll be developed with the help of Member Pioneers, people with a passion for co-operation, promoting community involvement and member engagement. We want our members to feel involved and get engaged. After a trial period, we're ready with the Board to recruit more Member Pioneers (up to 1,500 by 2020). They'll be feeding members' views back to Council, so we'll build digital channels and other ways to make this work.

Reporting on Council activities

Holding the Board to account involves many parts of the businesses, and while the Council is briefed by and questions directors in its plenary meetings, (of which six were held in 2016), this alone is not enough. Additionally, the Senate held nine meetings in 2016, and the sub-committees six meetings each. These committees reflect the Council Compass:

- The Member Value and Business Performance Committee
- The Member Voice and Governance Committee
- The Ethical and Sustainable Leadership Committee.

Members of the Executive and directors attended meetings and they were asked many questions. Among other things, they were asked about remuneration policy, governance, HR policies and colleague wellbeing.

Specific working groups were set up to look at digital developments and community forums. In 2017 there'll be working groups on rule review and member voice and participation.

Training

All Council members must take at least two training units a year. They learn about topics relevant to the Council's roles. These include: our core business strategies, our values and principles, developing an engaged membership, understanding financial information, working together effectively and effective governance. Council members complete a seminar on diversity and inclusion during their term of office.

Wrapping up

Our statement reflects our governance roles that are set out in the Rules. Council members have been extremely committed over the year. They have helped to bring alive our co-operative difference, both in the work they've done within Council and also in their communities. We thank the directors, Executive and management for their time and willingness to work together on our joint vision to secure our Co-op's future success. We thank all our colleagues for their hard work bringing this vision to life. It's been a very positive year.

Report of the Scrutiny Committee

This is the second 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
- approval of Member Nominated Director (MND) candidates

Appointment of Independent Non-Executive Director

In 2016 Lord Victor Adebowale was appointed as an Independent Non-Executive Director. The Scrutiny Committee was supplied with due diligence information and background check information with respect to his appointment. The Scrutiny Committee also questioned a member of the Nominations Committee involved in the appointment. 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 Victor Adebowale were adequate
- that the decision made by the Nominations Committee as regards his appointment was fair, transparent and objective

Selection of MND candidates for the 2016 AGM ballot

In reporting to Council members on the MND candidates selection and approval process conducted in 2016, the Scrutiny Committee noted that the process had been conducted through the newly established Member Nominated Directors Joint Selection and Approval Committee (MNDJC). This is a joint committee of Council and Board members, and chaired by a Council member. The Scrutiny Committee was pleased to note that the 2016 election had been on a contested basis and welcomed the collaborative approach adopted by Council and Board.

The Committee interviewed the Chair of the MNDJC, and noted the long listing, short listing and interview processes organised in conjunction with the appointed recruitment and search agency, Saxton Bampfylde. Having reviewed the candidate information and supporting evidence linked to membership and eligibility criteria, as set out in the MND 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, Margaret Casely-Hayford and David Rodgers were adequate
- that the decisions made by the MNDJC as regards selection of candidates for the 2016 MND election ballot comprised a fair, transparent and objective process

Re-appointment of Independent Non-Executive Directors

The Committee does not have the role of scrutiny of re-appointment of Independent Non-Executive Directors but has noted the process lies with the Nominations Committee which considers the contributions of the individual to the Board and commitment to our Co-op. The Committee is aware that a summary of the Board effectiveness review has been shared with Council's Governance Committee.

Financial statements

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Financial statements

Consolidated income statement
for the period ended 31 December 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 or loss that we have made.

	Notes	2016 £m	2015 (restated*) £m
Revenue	2	**9,472**	9,201
Operating expenses	3	**(9,363)**	(9,132)
Other income	5	**39**	43
Operating profit	1	**148**	112
Finance income	6	**53**	39
Finance costs	7	**(162)**	(117)
Share of losses of associates and joint ventures	22	**(171)**	(11)
(Loss) / profit before tax	1	**(132)**	23
Taxation	8	**(2)**	(8)
(Loss) / profit for the period (all attributable to members of the Society)		**(134)**	15

Non-GAAP measure: underlying profit before tax **

In plain English – what does this show?

The table below adjusts the profit or loss 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	2016 £m	2015 £m
Analysed as:			
(Loss) / profit before tax (as above)		**(132)**	23
Add back losses / (deduct gains):			
One-off items	1	**21**	62
Property and business disposals	1	**(20)**	14
Change in value of investment properties	21	**(16)**	(24)
Finance income	6	**(53)**	(39)
Non-cash finance costs	7	**88**	34
Share of (profit) / losses of associates and joint ventures	22		
- Bank		**185**	39
- Travel		**(12)**	(27)
- Other		**(2)**	(1)
Underlying profit before tax		**59**	81

*See general accounting policies section on page 105 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 31 December 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 pension schemes and certain financial investments.

	Notes	2016 £m	2015 (restated*) £m
(Loss) / profit for the period		**(134)**	15
Other comprehensive income:			
Items that will never be reclassified to the income statement:			
Remeasurement gains on employee pension schemes	23	**464**	105
Related tax on items	8	**(71)**	(9)
		393	96
Items that are or may be reclassified to the income statement:			
Changes in value of available for sale assets		**16**	(9)
Related tax on items	8	**(3)**	-
		13	(9)
Other comprehensive income for the period net of tax		**406**	87
Total comprehensive income for the period (all attributable to members of the Society)		**272**	102

*See general accounting policies section on page 105 for more details of the restatement.

Consolidated balance sheet

as at 31 December 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 2016. It sums up the Co-op's assets and liabilities.

	Notes	2016 £m	2015 (restated*) £m
Non-current assets			
Property, plant and equipment	10	**1,943**	1,965
Goodwill and intangible assets	11	**911**	948
Investment properties	21	**74**	87
Investments in associates and joint ventures	22	**52**	285
Other investments	12	**1,414**	1,431
Reinsurance contracts	24	**47**	63
Derivatives	26	**50**	55
Pension assets	23	**1,939**	1,338
Trade and other receivables	15	**55**	23
Deferred tax assets	13	**221**	230
Reclaim Fund assets	30	**237**	73
Total non-current assets		**6,943**	6,498
Current assets			
Inventories	14	**439**	445
Trade and other receivables	15	**704**	646
Cash and cash equivalents		**283**	405
Assets held for sale	16	**106**	-
Other investments	12	**372**	241
Reinsurance contracts	24	**7**	6
Reclaim Fund assets	30	**332**	488
Total current assets		**2,243**	2,231
Total assets		**9,186**	8,729
Non-current liabilities			
Interest-bearing loans and borrowings	17	**1,141**	1,071
Trade and other payables	18	**1,078**	967
Derivatives	26	**-**	37
Provisions	19	**224**	352
Pension liabilities	23	**251**	208
Deferred tax liabilities	13	**422**	336
Insurance contracts	24	**477**	511
Reclaim Fund liabilities	30	**495**	487
Total non-current liabilities		**4,088**	3,969
Current liabilities			
Overdrafts		**6**	4
Interest-bearing loans and borrowings	17	**21**	22
Income tax payable		**1**	13
Trade and other payables	18	**1,506**	1,462
Provisions	19	**102**	87
Liabilities held for sale	16	**5**	-
Insurance contracts	24	**247**	235
Reclaim Fund liabilities	30	**1**	-
Total current liabilities		**1,889**	1,823
Total liabilities		**5,977**	5,792
Equity			
Members' share capital	20	**72**	72
Retained earnings	20	**3,030**	2,770
Other reserves	20	**107**	95
Total equity		**3,209**	2,937
Total equity and liabilities		**9,186**	8,729

*For more details on the restatement, refer to the general accounting policies note on page 105.

Board's certification

The financial statements on pages 98 to 183 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
5 April 2017

Steve Murrells - Chief Executive

Helen Grantham - Group Secretary

Consolidated statement of changes in equity

for the period ended 31 December 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 2 January 2016 (restated*)		**72**	**2,770**	**95**	**2,937**
Loss for the period		**-**	**(134)**	**-**	**(134)**
Other comprehensive income:					
Remeasurement gains on employee pension schemes	**23**	**-**	**464**	**-**	**464**
Gains less losses on available for sale assets		**-**	**-**	**17**	**17**
Available for sale cumulative gains transferred to the income statement		**-**	**-**	**(1)**	**(1)**
Revaluation reserve recycled to retained earnings		**-**	**1**	**(1)**	**-**
Tax on items taken directly to other comprehensive income	**8**	**-**	**(71)**	**(3)**	**(74)**
Total other comprehensive income		**-**	**394**	**12**	**406**
Contributions by and distributions to members:					
Shares issued less shares withdrawn		**-**	**-**	**-**	**-**
Contributions by and distributions to members:		**-**	**-**	**-**	**-**
Balance at 31 December 2016		**72**	**3,030**	**107**	**3,209**

See note 20 for further details of Share Capital and Reserves.

	Notes	Members' share capital £m	Retained earnings £m	Other reserves £m	Total equity £m
Balance at 3 January 2015 (restated*)		70	2,659	104	2,833
Profit for the period		-	15	-	15
Other comprehensive income:					
Remeasurement gains on employee pension schemes	23	-	105	-	105
Gains less losses on available for sale assets		-	-	(6)	(6)
Available for sale cumulative gains transferred to the income statement		-	-	(3)	(3)
Tax on items taken directly to other comprehensive income	8	-	(9)	-	(9)
Total other comprehensive income / (expense)		-	96	(9)	87
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 (restated*)		72	2,770	95	2,937

*For more details on the restatement, refer to the general accounting policies note on page 105.

Consolidated statement of cash flows
for the period ended 31 December 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	2016 £m	2015 £m
Net cash from operating activities	9	**247**	283
Cash flows from investing activities			
Acquisition of property, plant and equipment		**(330)**	(297)
Proceeds from sale of property, plant and equipment		**60**	161
Purchase of intangible assets		**(23)**	(15)
Acquisition of businesses		**(5)**	(5)
Acquisition of investments in joint ventures and associates		**-**	(3)
Proceeds from sale of investments	22	**5**	-
Disposal of businesses, net of cash disposed		**17**	14
Dividends received from investments	22	**2**	6
Net cash used in investing activities		**(274)**	(139)
Cash flows from financing activities			
Interest paid on borrowings		**(72)**	(80)
Issue of corporate investor shares		**-**	4
Repayment of borrowings including derivatives	17, 26	**(22)**	(50)
Issue of borrowings including derivatives	17	**-**	68
Finance leases repaid		**(3)**	(4)
Net cash used in financing activities		**(97)**	(62)
Net increase in cash and cash equivalents		**(124)**	82
Cash and cash equivalents at beginning of period		**401**	319
Cash and cash equivalents at end of period		**277**	401
Analysis of cash and cash equivalents			
Overdrafts (per balance sheet)		**(6)**	(4)
Cash and cash equivalents (per balance sheet)		**283**	405
		277	401

Group Net Debt	Notes	2016 £m	2015 £m
Interest-bearing loans and borrowings:			
- current	17	**(21)**	(22)
- non-current	17	**(1,141)**	(1,071)
Total Debt		**(1,162)**	(1,093)
- Group cash		**283**	405
- Overdraft		**(6)**	(4)
Group Net Debt		**(885)**	(692)

See note 17 for a full reconciliation of the movement in net debt.

General accounting policies

In plain English – what does this 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
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 31 December 2016. As permitted by statute, a separate set of financial statements for the Society are not included.

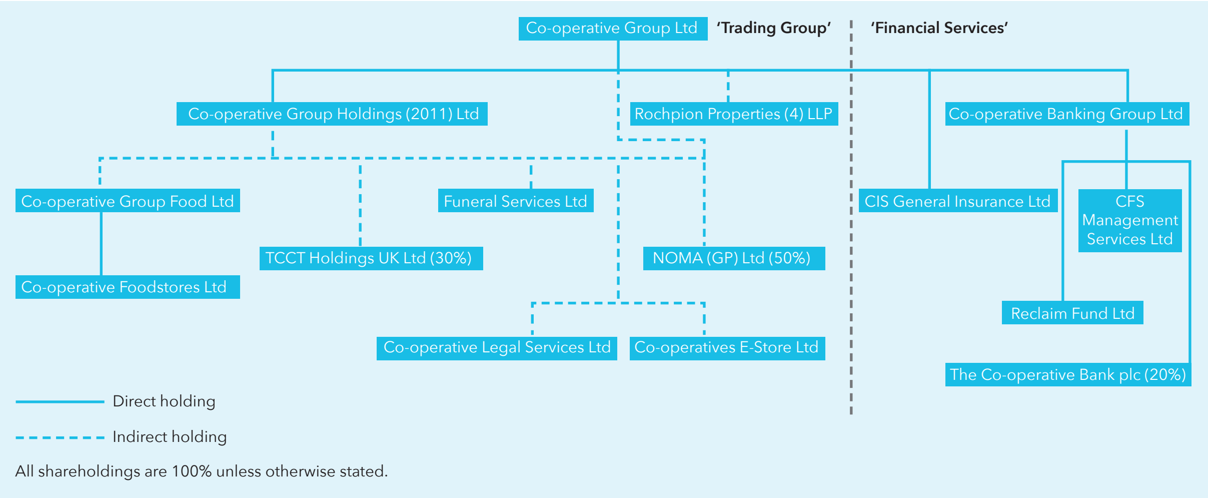
The accounts are presented in pounds sterling and are principally prepared on the basis of historical cost. Areas where other basis are applied are identified in the relevant accounting policy in the notes. For example, the Group fair values its Eurobond Notes which has significantly impacted the Group's profits this year (see note 17). Amounts have been rounded to the nearest million.

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

Basis of consolidation
The financial statements consolidate Co-operative Group Limited ('the Society'), which is the ultimate parent society, and its subsidiary undertakings. 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 29. 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/



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 ('the Bank'). 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 31 December 2016. The Trading Group subsidiaries prepare their accounts for the first Saturday of January unless 31 December is a Saturday. Comparative information is presented for the 52 weeks ended 2 January 2016. Since the financial periods are virtually co-terminus with the calendar years, the current period figures are headed 2016 and the comparative figures are headed 2015.

The Financial Services subsidiaries of the Group have also prepared accounts for the period ended 31 December 2016.

One-off items and non-GAAP (Generally Accepted Accounting Procedures) measures
One-off items 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 4)

General accounting policies continued

- Non-current asset impairment (Notes 10 & 11)

- Accounting for the Group's investment in the Bank (Note 22)

- Pensions (Note 23)

- Inventories (Note 14)

- Provisions (Note 19)

- General Insurance claims and reserves (Note 12 & 24)

The Group has applied all endorsed IFRSs that are effective on a European basis for the Group's financial statements for the period ended 31 December 2016 and the comparative period.

Restatements
The comparative figures presented within these financial statements for the financial year ended 2 January 2016 are consistent with the 2015 annual report with the exception of the restatements noted below:

- pension assets and pension liabilities on the balance sheet have been restated in the prior year by a reduction of £40m and £19m respectively. Retained earnings have been restated by £17m (net of £4m deferred tax) to reflect this adjustment. 2015 opening reserves have decreased by £32m (net of £8m deferred tax) and other comprehensive income in 2015 has increased by £15m (net of £4m deferred tax). For more details on the nature of the restatement, refer to note 23. The restatement is not considered material enough in the context of the Group's reserves of £3bn and a net pension surplus of £1.2bn in the prior year and £1bn in 2014 to warrant a third balance sheet as required under IAS 1.

- monies received from customers in relation to funeral disbursements (third party costs) are no longer shown as equal and opposite values within revenue and cost of sale. Previously this treatment reflected the credit risk carried by Funeralcare, however, given the level of upfront deposits now taken in respect of these disbursements, the credit risk is no longer considered great enough to warrant them being shown in this way and instead they are treated as a pass through cost. An adjustment of £100m has been made to the comparative figures for both Revenue and Operating Expenses. There is no impact on profit.

- certain central costs previously reported within costs from supporting functions as shown in the operating segments (note 1) are now reported within the businesses in line with a change in how such costs are allocated within our internal management reporting. There is no impact on profit.

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 2 - Amendments to clarify the classification and measurement of share-based payment transactions

- IFRS 4 - Amendments regarding the interaction of IFRS 4 and IFRS 9

- IAS 7 - Disclosure Initiative

- IAS 12 - Amendments regarding the recognition of deferred tax assets for unrealised losses

- IAS 40 - Amendments to clarify transfers of property to, or from, investment property

- Annual Improvements to IFRSs 2014 - 2016 Cycle - various standards

General accounting policies continued

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, derecognition 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 and management are currently assessing the potential impact of the new standard on the 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 is 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 still assessing this impact. More information on the Group's operating leases commitments, which are currently off-balance sheet, can be found in note 27.

*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 Our Business Performance on page 13). The Directors have also assessed the financial risks facing the Group, its liquidity position and available borrowing facilities. These are principally described in Note 17 to the accounts. In addition, Notes 17 and 25 also include details of the Group's objectives, policies and processes for managing its capital, its financial risk management objectives and its financial instruments and hedging activities.

In assessing the appropriateness of the going concern basis of preparation, the Directors have firstly considered the going concern position and outlook of the Trading Group and CISGIL 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.

The Trading Group meets its working capital requirements through a number of separate funding arrangements, as set out in detail in note 25, 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 June 2018 (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.

General accounting policies continued

CISGIL is required to comply with a number of regulatory capital requirements. 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.

After considering both Trading Group and CISGIL as described above, and after making all appropriate enquiries, the Directors have a reasonable expectation that the Society and the Group have access to adequate resources to enable them 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 do our profits 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.

	2016				
	Revenue from external customers (f)	Underlying segment operating profit (a)	Operating profit	Additions to non-current assets (e, f)	Depreciation and amortisation (e)
	£m	£m	£m	£m	£m
Food	**7,064**	**182**	**203**	**286**	**(210)**
Funeralcare	**307**	**69**	**99**	**26**	**(19)**
Insurance	**439**	**11**	**(18)**	**64**	**(61)**
Other businesses	**89**	**5**	**5**	**1**	**-**
Federal (g)	**1,573**	**-**	**-**	**-**	**-**
Costs from supporting functions	**-**	**(134)**	**(141)**	**40**	**(22)**
Total	**9,472**	**133**	**148**	**417**	**(312)**

	2015 (restated - see d below)				
	Revenue from external customers (f)	Underlying segment operating profit (a)	Operating profit	Additions to non-current assets (e, f)	Depreciation and amortisation (e)
	£m	£m	£m	£m	£m
Food	6,958	186	196	273	(213)
Funeralcare	299	69	69	16	(20)
Insurance	343	(13)	(60)	55	(47)
Other businesses	97	8	8	-	(1)
Federal (g)	1,504	-	-	-	-
Costs from supporting functions	-	(86)	(101)	22	(29)
Total	9,201	164	112	366	(310)

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 impairments), 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 Chief Operating Decision Maker (CODM) which is the Board 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 and Electricals business and their results have been combined as allowed by IFRS 8. 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 2015 have been to restated to (i) reflect a change in accounting policy such that monies received from customers in relation to funeral disbursements (third party costs) are no longer shown as equal and opposite values within revenue and cost of sale and instead they are treated as a pass through cost (see accounting policies section on page 105 for further details) and (ii) certain central costs previously reported within costs from supporting functions are now reported within the businesses in line with a change in how such costs are allocated within our internal management reporting.

1. Operating segments continued

e) Additions to non-current assets are derived on a cash flow basis. Depreciation and amortisation excludes £7m (2015: £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 £61m (2015: £47m) and additions of £64m (2015: £55m) on deferred acquisition costs are included within 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 £6m (2015: £9m) sales of electrical goods by Co-op Electrical to Food and £2m (2015: £2m) sales of legal cover on insurance policies by Legal Services to Insurance.

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

2016	Food	Funeralcare	Insurance	Other businesses	Costs from supporting functions	Total
	£m	£m	£m	£m	£m	£m
Underlying segment operating profit	**182**	**69**	**11**	**5**	**(134)**	**133**
One-off items	-	-	**(29)**	-	**8**	**(21)**
Property and business disposals	**5**	**30**	-	-	**(15)**	**20**
Change in value of investment properties	**16**	-	-	-	-	**16**
Operating profit	**203**	**99**	**(18)**	**5**	**(141)**	**148**

One-off items include restructuring costs of £29m (2015: £47m) and primarily relate to expenditure incurred in relation to the on-going transformation programme and replatforming work being undertaken within our 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 gain of £8m (2015: £15m charge) relates to a £14m (£nil: 2015) provision release in relation to the costs of separating the Group's IT functions from the Bank (see note 19) and net of costs of £6m (2015: £15m) relating to restructuring activity within our supporting functions.

2015	Food	Funeralcare	Insurance	Other businesses	Costs from supporting functions	Total
	£m	£m	£m	£m	£m	£m
Underlying segment operating profit	186	69	(13)	8	(86)	164
One-off items	-	-	(47)	-	(15)	(62)
Property and business disposals	(14)	-	-	-	-	(14)
Change in value of investment properties	24	-	-	-	-	24
Operating profit	196	69	(60)	8	(101)	112

1. Operating segments continued

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

	Notes	2016 £m	2015 £m
Underlying segment operating profit		**133**	164
Underlying interest payable	7	**(74)**	(83)
Underlying profit before tax		**59**	81
One-off items		**(21)**	(62)
Property and business disposals (see below)	1	**20**	(14)
Change in value of investment properties	21	**16**	24
Finance income	6	**53**	39
Non-cash finance costs	7	**(88)**	(34)
Share of losses of associates and joint ventures	22	**(171)**	(11)
(Loss) / profit before tax		**(132)**	23

Profits / (losses) from property and business disposals	2016 £m	2016 £m	2015 £m	2015 £m
Crematoria sale				
- proceeds	**41**		-	
- less net book value written off	**(11)**		-	
		30		-
Sale of Somerfield Stores Ltd				
- expenses	**(13)**		-	
- payable recognised	**(35)**		-	
- net onerous lease provision release and net book value written off	**53**		-	
		5		-
Sale of Twin Rivers windfarm (see note 22)				
- proceeds	**21**		-	
- less net book value written off	**(16)**		-	
		5		
Sale of other land and buildings				
- proceeds	**69**		161	
- less net book value written off	**(67)**		(137)	
- provisions recognised on closure	**(20)**		(16)	
		(18)		8
Impairment of property, plant and equipment		**(5)**		(22)
CFS Management Services Ltd (CFSMS) retirement liability derecognised		**3**		-
Profit / (loss) on disposal		**20**		(14)

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.

	2016 £m	2015 (restated*) £m
Sale of goods	**7,144**	7,037
Member reward (5%) earned on sale of goods	**(13)**	-
Provision of services	**332**	317
Member reward (5%) earned on provision of services	**(3)**	-
Federal sales	**1,573**	1,504
Gross earned premiums	**467**	374
Premiums ceded to reinsurers	**(28)**	(31)
Net revenue (as shown in the consolidated income statement)	**9,472**	9,201
Value Added Tax	**775**	765
Gross sales	**10,247**	9,966

*See general accounting policies section on page 105 for more details of the restatement.

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. Any rebates, VAT and other sales tax or duty items are deducted from revenue. 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 and Legal Services. Revenue is recognised when the service is rendered and the revenue can be reliably measured. See note 26 for further details of the accounting policies relating to prepaid funeral plans and funeral benefit options (FBO's).

Member rewards
The 5% Member rewards earned as part of the new Membership proposition are recognised as a reduction in sales at the point they are earned with a corresponding liability being held on the balance sheet. The liability is extinguished and the sale recognised when the rewards are redeemed.
The 1% Community reward is recognised as a cost in the Income Statement at the point it is earned.

Gross earned premiums
Gross earned 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 earned 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 earned 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 earned.

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:

	2016 £m	2015 £m
Cost of sales		
- Trading activities	**(6,277)**	(6,160)
- Claims incurred, net of claims recovered from reinsurers	**(294)**	(244)
- Fee and commission expense	**(14)**	(9)
Employee benefits expense (see below)	**(1,279)**	(1,234)
Distribution costs	**(339)**	(330)
Net gain / (loss) on property and business disposals (net of impairments)	**20**	(14)
Net gain on other plant and equipment disposals	**2**	2
Change in value of investment properties	**16**	24
Operating lease rentals	**(154)**	(153)
Depreciation	**(246)**	(256)
Amortisation	**(5)**	(7)
Amortisation on deferred acquisition costs in CISGIL	**(61)**	(47)
Subscriptions and donations	**(5)**	(5)
Community Reward (1%) earned	**(3)**	-

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 note 4 for further details). The operating lease rental charge excludes any charges relating to onerous leases.

Employee benefits expense

	2016 £m	2015 £m
Wages and salaries	**(1,156)**	(1,089)
Social security costs	**(65)**	(60)
Pension costs - defined benefit schemes	**(5)**	(54)
Pension costs - defined contribution schemes	**(53)**	(31)
	(1,279)	(1,234)

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

	2016	2015
Full-time	**25,117**	25,460
Part-time	**45,282**	43,618
	70,399	69,078

Remuneration of key management

For details regarding remuneration of the Group Board and the Management Executive refer to pages 66 to 83.

3. Operating expenses continued

Auditor remuneration and expenses	2016 £m	2015 £m
Audit of these financial statements	**0.6**	0.5
Amounts receivable by the Society's auditor in respect of:		
- Audit of financial statements of subsidiaries in respect of the Society	**0.3**	0.2
- Other services pursuant to such legislation	**-**	-
Services relating to:		
- Audit related assurance services	**0.1**	0.4
- Other tax advisory services	**-**	0.5
- All other services	**1.4**	0.3
Total	**2.4**	1.9

KPMG LLP stepped down as auditor to the Group at the AGM on 21 May 2016 and were succeeded by Ernst & Young LLP. The figures noted in the table above under the heading 2015 relate to KPMG and those under 2016 to Ernst & Young.

No costs in relation to services performed by the auditor were capitalised during the current or prior period.

Non-audit fees incurred with the Group's auditor by the Bank during 2016 were £nil (2015: £0.1m).

Tax services were provided to the Pace pension scheme in the year to the value of £nil (2015: £20,000).

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.

4. Supplier income

In plain English – what does this note show? This note shows the different types of supplier income that we have received. This income is taken off operating expenses in the income statement.

Supplier Income	2016 £m	2015 £m
Long-term agreements	**155**	138
Bonus income	**157**	160
Promotional income	**359**	337
Total supplier income	**671**	635

Percentage of Food's Cost of Sales before deducting Supplier Income		
Long-term agreements	**2.2%**	2.1%
Bonus income	**2.3%**	2.4%
Promotional income	**5.2%**	5.1%
	9.7%	9.6%

These figures do not include income or purchases made as part of the Federal joint buying group.

Accounting policies

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.

Supplier income due to Food from suppliers at the balance sheet date is shown in Trade receivables. See note 15 for further details.

5. 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.

	2016 £m	2015 £m
Investment income	**12**	15
Realised gains arising from financial instruments	**2**	4
Rental income from non-investment property	**11**	11
Rental income from investment property	**1**	2
Fee and commission income	**13**	11
Total other income	**39**	43

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 finanical 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 21.

Fee and commission income
Fees and commission receivable mainly relates to CISGIL fee income, recognised as the related service is provided, and brokerage commission, received through sales of additional aggregator related business, earned over the lifetime of the related policy.

6. 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).

	2016 £m	2015 £m
Net pension finance income	**45**	39
Fair value movement on interest rate swaps (see note 26)	**8**	-
Net interest on funeral investments and liabilities (see below)	**-**	-
Total finance income	**53**	39

Included in the above are interest and bonuses of £23m (2015: £65m) earned in the year on funeral plan investments. These have been offset by a £23m (2015: £65m) increase in the corresponding financial liability. See note 26 for further details of our accounting policy for funeral plans.

7. 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).

	2016 £m	2015 £m
Loans repayable within five years	**(27)**	(7)
Loans repayable wholly or in part after five years	**(47)**	(76)
Underlying interest payable	**(74)**	(83)
Accelerated fee amortisation due to the early repayment of debt	**-**	(2)
Fair value movement on quoted Group debt (see note 17)	**(74)**	(14)
Fair value movement on interest rate swaps (see note 26)	**-**	(1)
Discount unwind of provisions (see note 19)	**(14)**	(17)
Other finance costs	**(88)**	(34)
Total finance costs	**(162)**	(117)

The Group's Eurobond debt is fair valued each period with the fair value movement going through the income statement (see note 17).

Fair value movements on forward currency transactions were immaterial in the current and prior period.

8. 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 was re-accredited with the Fair Tax Mark during 2016, and the additional disclosures are in line with best practice guidance.

	Footnote	2016 £m	2015 £m
Current tax charge - current year	(i)	-	-
Current tax - adjustment to group relief payable owed to Co-operative Bank plc	(ii)	6	17
Current tax credit - adjustment in respect of prior years	(iii)	12	-
Net current tax credit		**18**	17
Deferred tax charge - current year	(iv)	(24)	(38)
Deferred tax credit - adjustments in respect of prior years	(v)	4	13
Net deferred tax charge		**(20)**	(25)
Total tax charge		**(2)**	(8)

The tax on the Group's net profit before tax differs from the theoretical amount that would arise using the standard applicable rate of corporation tax of 20% (2015: 20.25%) as follows:

	Footnote	2016 £m	2015 £m
(Loss) / profit before tax		(132)	23
Tax credit / (charge) at 20% (2015: 20.25%)		26	(5)
Deferred tax reconciliation:			
Expenses not deductible for tax (including one-off costs)	(vi)	(1)	(3)
Depreciation and amortisation on non-qualifying assets	(vii)	(3)	(6)
Non-taxable profits arising on business disposals	(viii)	(2)	-
Impairment of investment - Co-operative Bank plc	(ix)	(37)	(7)
Associated company profits / losses	(x)	2	(2)
Capital gains arising on property disposals	(xi)	(21)	(2)
Adjustment in respect of previous periods	(v)	4	13
Derecognition of tax losses	(xii)	-	(3)
Restatement of deferred tax to blended rate (2015:18%)	(xiii)	12	(10)
Subtotal of deferred tax reconciling items		**(46)**	(20)
Current tax reconciliation:			
Current year tax charge	(i)	-	-
Adjustment in respect of previous periods	(iii)	12	-
Adjustment to group relief payable	(ii)	6	17
Current tax reconciling items		**18**	17
Total tax charge		**(2)**	(8)

8. Taxation continued

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

	2016 £m	2015 (restated*) £m
Actuarial gains and losses on employee pension scheme	**(71)**	(9)
Available for sale assets - Insurance	**(3)**	-
	(74)	(9)

*See general accounting policies section on page 105 for more details of the restatement.

Of the tax taken directly to the consolidated statement of comprehensive income, £74m charge (2015: £9m charge) relates to deferred taxation charge of £84m (2015: £17m) arising on actuarial movement for the year, net of a credit of £13m (2015: £12m) which relates to the restatement of deferred tax rates on the pension scheme surplus. Furthermore, there is a £3m charge representing the movement in deferred taxation on available for sale assets in General Insurance (2015: nil). See note 13 on deferred tax.

The Finance Act 2015 will reduce the main rate of corporation tax to 19% from 1 April 2017 and the Finance Act 2016 will further reduce the main rate of corporation tax to 17% 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 17% or 19%). This results in a blended deferred tax rate of 17.1% at the balance sheet date.

Tax policy

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

Footnotes to taxation note 8:

i) The Group is not taxpaying in the UK in respect of 2016 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 at note 13. An amount of current tax of £253k (2015: £170k) is in respect of wholly owned Isle of Man 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. This is the Group's only non UK resident entity for tax purposes. A full copy of the most recent accounts is available here **https://www.co-operative.coop/downloads/manx-co-operative-2016-accounts.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 Co-operative Bank plc in 2012 and 2013 (see note 18). This group relief payable is intrinsically linked to and held at prevailing tax rates to 17%. As a result of the reduction in corporation tax rates, the total group relief payable has reduced and a credit is required to be booked in the income statement in respect of this item.

iii) 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. Furthermore, 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. Provisions for uncertain tax positions booked in previous years of £6m have been released in the year as a result of the closure of enquiries by HMRC during 2016. The remainder of the Group's provision for uncertain tax positions in respect of open enquiries from HMRC has been reallocated from current tax to deferred tax during 2016. An offsetting charge of £6m is in the prior year deferred tax figure. More detail is provided in Note 13.

iv) 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 13 explains how each deferred tax balance has moved in the year.

8. Taxation continued

v) In addition to the adjustments arising between prior year estimates and submissions to HMRC and the uncertain tax adjustments detailed at footnote (iii), during 2016 the Group re-assessed the methodology used to calculate certain historic deferred tax balances, primarily arising on land and buildings and pensions. More detail is provided at note 13.

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 2016 the Group disposed of its shareholding in Twin Rivers Wind Farm Limited, NewCo Crematoria Limited, NewCo Crematoria 2 Limited, NewCo Crematoria 3 Limited and Somerfield Stores Ltd. 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.

ix) Tax relief is not available on the impairment of the investment held in the Co-operative Bank plc.

x) This represents the share of post-tax profits from associated companies that are not included in the Group's tax charge, as tax is already included in the accounts of the associate.

xi) During the year a number of assets were sold, where the tax value is in excess of the accounting profit. In addition, the proposed sale of 298 food stores to McColls Retail Group plc became unconditional for tax purposes during 2016, and as such tax legislation states that the gain arising on the future disposal of these stores is taxable during 2016.

xii) In 2015, part of the deferred tax asset for tax losses was derecognised, as it was considered that these losses will not be able to be utilised in future periods. No such derecognition has been made in 2016.

xiii) 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 18% to 17% deferred tax balances have been reduced, 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.

9. Reconciliation of operating profit to net cash flow from operating activities

In plain English – what does this note show? This note shows how our operating profit figure, as reported in the consolidated income statement, is reconciled to the net cash from 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 generated from operating activities.

	2016 £m	2015 £m
Operating profit	**148**	112
Depreciation and amortisation charges (excluding deferred acquisition costs)	**251**	263
Non-current asset impairments	**5**	27
Profit on disposal of businesses and non-current assets	**(25)**	(13)
Change in value of investment properties	**(16)**	(24)
Retirement benefit obligations	**(45)**	(38)
(Increase) / Decrease in inventories	**6**	(11)
Increase in receivables	**(160)**	(130)
Increase in payables and provisions	**71**	98
Net cash flow from operating activities before asset and liability movements in Financial Services	**235**	284
Fair value through profit and loss movement	**(27)**	(43)
Assets available for sale movement	**21**	66
Movement in deferred acquisition costs	**(3)**	(8)
Reinsurance assets	**15**	3
Loan receivables at amortised cost	**(6)**	(3)
Insurance and other receivables	**36**	(68)
Insurance and participation contract provisions	**(24)**	15
Insurance and other payables	**-**	37
Asset and liability movements in Financial Services	**12**	(1)
Net cash from operating activities	**247**	283

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.

The increases in receivables and payables noted above for the Trading Group include increases on funeral plan assets and liabilities of £109m (2015: £129m) and £109m (2015: £130m) respectively.

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.

Section B - what are our major assets?

This section of the accounts (notes 10 - 16) 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 31 December 2016	Property £m	Plant and equipment £m	Total £m
Cost or valuation:			
At 2 January 2016	1,548	2,052	3,600
Additions	21	315	336
Reclassified as assets held for sale (see note 16)	(35)	(73)	(108)
Disposals	(55)	(78)	(133)
At 31 December 2016	1,479	2,216	3,695
Depreciation:			
At 2 January 2016	549	1,086	1,635
Charge for the period	23	223	246
Impairment	5	-	5
Reclassified as assets held for sale (see note 16)	(13)	(47)	(60)
Disposals	(15)	(59)	(74)
At 31 December 2016	549	1,203	1,752
Net book value:			
At 31 December 2016	930	1,013	1,943
At 2 January 2016	999	966	1,965
Capital work in progress included above	30	141	171

The impairment charge of £5m (2015: £27m) relates to charges against loss making stores in Food (2015: £20m) and has been recognised to the extent that the carrying value of individual stores exceeds their recoverable amount. The recoverable amount is assessed as the greater of fair value less costs to sell and value in use. For these loss-making stores the fair value has been assessed as their estimated disposal proceeds (less costs to sell) as at 31 December 2016 using internal valuations based upon the expected rental yield of the property. In the prior year a further £7m of impairment charges related to non-trading properties.

10. Property, plant and equipment continued

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	(2)	-	(2)
Fully written down assets	(2)	(609)	(611)
At 2 January 2016	1,548	2,052	3,600
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)	(609)	(611)
At 2 January 2016	549	1,086	1,635
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 (restated)	27	77	104

Plant and equipment includes assets held under finance leases as follows:

	2016 £m	2015 £m
Cost	**39**	38
Accumulated depreciation	**(34)**	(26)
Net book value	**5**	12

No other assets of the Group are held under a finance lease.

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' three-year plan and discounting the cash flows associated with that asset at a post tax rate of between 8-10% dependent on the business. Cash flows beyond three 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 & 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.

10. Property, plant and equipment continued

Lease payments in respect of operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense and the aggregate benefit is recognised as a reduction of rental expense over the lease term on a straight-line basis.

For any leases where the Group is the lessor, the aggregate cost of incentives is recognised as a reduction of rental income over the lease term on a straight-line basis.

Sale and leaseback
A sale and leaseback transaction is one where a vendor sells an asset and immediately reacquires the use of that asset by entering into a lease with the buyer. The accounting treatment of the sale and leaseback depends upon the substance of the transaction and whether or not the sale was made at the asset's fair value. For sale and finance leasebacks, any apparent profit or loss from the sale is deferred and amortised over the lease term. For sale and operating leasebacks, generally the assets are sold at fair value, and accordingly the profit or loss from the sale is recognised immediately in the income statement. Following initial recognition, the lease treatment is consistent with those principles described above.

11. Goodwill and intangible assets

In plain English – what does this note 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) intangible assets still to be constructed and (iv) deferred acquisition costs representing costs associated with generating new insurance business . 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 31 December 2016	Goodwill £m	Computer software £m	Assets in course of construction £m	Total £m
Cost:				
At 2 January 2016	**1,268**	**63**	**17**	**1,348**
Additions	**16**	**-**	**23**	**39**
Transfers	**-**	**29**	**(29)**	**-**
Reclassified as assets held for sale (see note 16)	**(58)**	**-**	**-**	**(58)**
Disposals	**(16)**	**-**	**-**	**(16)**
At 31 December 2016	**1,210**	**92**	**11**	**1,313**
Accumulated amortisation and impairment:				
At 2 January 2016	**372**	**56**	**-**	**428**
Charge for the period	**-**	**5**	**-**	**5**
Disposals	**-**	**-**	**-**	**-**
At 31 December 2016	**372**	**61**	**-**	**433**
Net book value:				
At 31 December 2016	**838**	**31**	**11**	**880**
Deferred acquisition costs (see overleaf)				**31**
At 31 December 2016				**911**

For period ended 2 January 2016	Goodwill £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

11. Goodwill and intangible assets continued

Deferred acquisition costs

	2016 £m	2015 £m
At the beginning of the financial year	**28**	20
Deferred acquisition costs	**64**	55
Amortisation	**(61)**	(47)
At the end of the financial year	**31**	28

All amounts in the current and prior year are expected to be recovered within one year.

Goodwill

The components of goodwill are as follows:

	2016 £m	2015 £m
Food	**809**	866
Other businesses	**29**	30
	838	896

The components of Food goodwill include £565m (2015: £610m) that is allocated to the group of cash generating units (CGUs) that is Food as a whole; £74m (2015: £85m) allocated to stores acquired with the Alldays group and £170m (2015: £171m) 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.

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 three-year plans approved by the Board. The discount rate is based on the post tax cost of capital of the business of 8.3% (2015: 8.1%). Business-specific growth rates are used to extrapolate cash flows beyond the three-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 1-4% (2015: 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 8.3% (2015: 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.

11. Goodwill and intangible assets continued

For other Food individual stores / smaller groups such as Alldays, annual cashflows have been inflated for growth by between 1% and 4% (2015: 1-3%) per annum (dependent on the size of the acquisition group and in-line with the three-year plan) taken into perpetuity and discounted to present value also using an 8.3% (2015: 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 three-year plan. Cash flows have been projected based on the three-year plan and into perpetuity from year four and discounted back to present value using a discount rate of 8.3% (2015: 8.0%). Sensitivity analysis has been performed with both the growth rate and discount rate adjusted by +/- 1%, and under these sensitivities significant headroom is maintained.

Accounting policies

Goodwill
Goodwill represents amounts arising on business combinations. In respect of business acquisitions that have occurred since 11 January 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Assets and liabilities accepted under a transfer of engagements are restated at fair value, including any adjustments necessary to comply with the accounting policies of the Group.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortised but is tested annually for impairment. In respect of associates, the carrying value of goodwill is included in the carrying amount of the investment in the associate. Where impairment is required the amount is recognised in the income statement and cannot be written back.

Negative goodwill arising on an acquisition is recognised directly in the income statement.

For transfers of engagements on or after 3 January 2010, considerations transferred have been valued by reference to the fair value of the Group's interest in the aquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting to perpetuity using a discount rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Acquisition costs since 3 January 2010 are now expensed to the income statement when incurred.

Computer software
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 noted below.

11. Goodwill and intangible assets continued

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
- Insurance deferred acquisition cost assets: Up to 1 year

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 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. Other investments

In plain English – what does this note show?

The note shows the value of other financial assets (investments) that are held by our businesses, mainly in Funerals and Insurance. 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.

	2016 £m	2015 £m
Current	372	241
Non-current	1,414	1,431
Total investments	**1,786**	1,672

Other investments held by the Group are as follows:

	2016 £m	2015 £m
Fair value through profit or loss:		
Funeral plan investments (see below)	872	781
Deposits with credit institutions (Insurance)	226	199
Available for sale:		
Listed debt securities (Insurance)	688	692
	1,786	1,672

Funeral plan investments:

	2016 £m	2015 £m
At start of period	781	661
New plan purchases	135	115
Plans redeemed or cancelled	(67)	(60)
Interest and bonus applied	23	65
At end of period	**872**	781

The expected maturity profile of the plan liabilities is shown in note 25.

Accounting policies

See note 26 Financial Instruments for the accounting policies relating to other investments.

13. 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 8. 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 17.1% (2015: 18.8%).

Net deferred tax comprises:		2016 £m	2015 (restated*) £m
Deferred tax asset		**221**	230
Deferred tax liability		**(422)**	(336)
Net deferred tax liability		**(201)**	(106)
Comprised of:	Footnote:		
Other temporary differences	(i)	**11**	13
Retirement benefit obligations	(ii)	**(287)**	(214)
Capital allowances on fixed assets	(iii)	**200**	186
Unrealised gains on investment properties, rolled-over gains and historic business combinations	(iv)	**(126)**	(114)
Claims equalisation reserve and available for sale assets	(v)	**(7)**	(5)
Tax losses	(vi)	**8**	28
		(201)	(106)

		2016 £m	2015 (restated*) £m
At beginning of the year		**(106)**	(73)
Income statement charge/(credit):			
Group		**(20)**	(24)
Transferred to assets held for sale	(vii)	**5**	-
Disposals	(viii)	**(6)**	-
Charged to equity:			
Retirement benefit obligations	(ii)	**(71)**	(9)
Available for sale assets - Insurance		**(3)**	-
At end of period		**(201)**	(106)

*See general accounting policies section on page 105 for more details of the restatement.

The Finance Act 2015 will reduce the main rate of corporation tax to 19% from 1 April 2017 and the Finance Act 2016 will further reduce the main rate of corporation tax to 17% 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 17% or 19%) by reference to forecast taxable profits for the Group. This results in a blended deferred tax rate of 17.14% at the balance sheet date, as the majority of the deferred tax provisions will be required and utilised in periods after April 2020.

13. Deferred taxation continued

Footnotes:

i) Certain expenses that have not yet been incurred are able to be 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.

ii) This amount represents the theoretical amount of tax that would be payable by the Group on the wind up of the Pension Scheme. A £27m credit has been recognised during 2016 as a result of an assessment of the future tax rates dropping to 17%. £13m of this credit has been recognised in OCI and £6m has been recognised in the prior year deferred tax credit in the income statement and a credit of £8m has been recognised within the current year deferred tax credit in the income statement.

iii) 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 4 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. The Group expects to utilise these allowances against future trading profits. A credit of £19m has arisen during 2016 in respect of differences in prior year estimated provisions and submissions made to HMRC in respect of our 2014 and 2015 accounting periods during 2016.

iv) 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 historic mergers and transfers of engagements (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. During 2016 the Group has re-assessed the basis of calculating the deferred tax arising on fair valued historic mergers on a 'dual basis' methodology, which has required a more detailed analysis of the records that support the future expected taxable gains. These reviews have created a net £11m deferred tax charge which is included in the prior year deferred tax movement in note 8.

v) 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. From 1 January 2016 this balance no longer has to be held, and will be released equally over six years, starting in 2016. It also includes the amount of tax that is expected to be due on assets available for sale that are currently held on the balance sheet.

vi) The Group incurred trading losses and interest losses that were in excess of taxable profits in the past. These losses can be utilised against future trading profits and capital gains which are included in future tax forecasts for the Group. An amount of £6m included in this balance in respect of a re-allocation of provisions in respect of uncertain tax positions from current tax to deferred tax. In addition, this provision has been increased to £8m during 2016, which is in respect of enquiries HMRC have opened in respect of March 1982 valuations used for capital gains purposes. In the event of an adjustment to the valuations used an offset would arise in losses held by the Group.

vii) 298 food stores that will be sold to McColls Retail Group plc are held within assets held for sale (see note 16). The associated deferred tax liabilities relating to capital allowances have been transferred to assets held for sale. 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.

13. Deferred taxation continued

Footnotes:

viii) A deferred tax asset in respect of capital allowances was de-recognised and included in the profit and loss on disposal arising on the sale of Somerfield Stores Limited.

ix) The net effect of the prior year adjustments in each of the above items is a credit of £4m, comprising of credits of £6m on pensions rate change drops and £19m on capital allowances, offset by charges of £10m in respect of uncertain tax positions under HMRC review and £11m in respect of changes arising on the review of deferred tax arising on future capital gains and rollover relief.

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.

14. 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:

	2016 £m	2015 £m
Raw materials, consumables and work in progress	**10**	5
Finished goods and goods for resale	**429**	440
	439	445

The period end inventory provision is £16m (2015: £17m) and relates largely to the Food business. A net credit of £1m (2015: £5m 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.

15. 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).

	2016 £m	2015 £m
Non-current	**55**	23
Current	**704**	646
	759	669

15. Trade and other receivables continued

	2016 £m	2015 £m
Trade receivables	**492**	471
Prepayments and accrued income	**70**	83
Other receivables	**197**	115
	759	669

Trade receivables are stated net of an impairment provision of £8m (2015: £10m). £2m (2015: £2m) has been charged to the income statement during the period offset by a credit of £3m (2015: credit of £1m). Within trade receivables is £135m (2015: £128m) of supplier income that is due to Food from suppliers. As at 5 April 2017, £130m (2015: £127m) of the current year balance had been invoiced and settled.

Included within other receivables is a £32m (2015: £32m) financial asset in respect of dividends still to be received from the Travel associate and £50m (2015: £nil) in relation to the exit payment following the Group serving notice of its intention to exercise the put option as per the Shareholders Agreement on its investment in Travel. See note 22 for more details.

Refer to the financial risk management note (note 25) for more information on the credit risk behind these balances.

Trade receivables include amounts totalling £29m (2015: £27m) which are overdue but not considered to be impaired, age analysed as follows:

	2016 £m	2015 £m
Amounts overdue:		
Less than 3 months	**21**	17
3 to 6 months	**1**	4
More than 6 months	**7**	6
	29	27

Amounts overdue but not impaired typically comprise high volume / low value balances for which the individual trading businesses do not seek collateral but continue to work with counterparties to secure settlement. No other receivables are overdue.

Accounting policies

Refer to note 26 Financial Instruments for details on accounting policies on trade receivables.

16. 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 and liabilities separately as held for sale.

	2016 £m	2015 £m	**2016 £m**	2015 £m
	Assets held for sale		**Liabilities held for sale**	
Total	**106**	-	**(5)**	-

Assets and liabilities classified as held for sale	**2016 £m**	2015 £m
Property, plant and equipment	**48**	-
Intangible assets	**58**	-
Deferred tax	**(5)**	-
	101	-

The majority of the assets held for sale relate to 298 food stores that will be sold to McColls Retail Group plc. Following regulatory approval from the Competition and Markets Authority in December 2016 the transaction is expected to be completed in 2017. Assets are recorded at their current carrying value unless this exceeds any expected net proceeds of sale in which case the assets are impaired. As the proceeds from the sale to McColls are expected to be above carrying value, no impairment has been incurred. The intangible asset comprises £54m of goodwill that arose on the acquisition of Somerfield and that is allocated to Food as a whole and £4m arising on other individual acquisitions.

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.

Section C - what are our major liabilities?

17. Interest-bearing loans and borrowings

This section of the accounts (notes 17 - 20) outlines the key liabilities that the Group holds at the balance sheet date.

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.

Non-current liabilities:	2016 £m	2015 £m
£450m 6 7⁄8% Eurobond Notes due 2020*	511	477
£350m 7 1⁄2% Eurobond Notes due 2026*	416	376
£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)	16	17
Corporate investor shares	-	1
Non-current portion of finance lease liabilities	-	2
Trading Group interest-bearing loans and borrowings	**1,073**	1,003
£70m 12% Financial Services Callable Dated Deferrable Tier Two Notes due 2025**	68	68
Total Group interest-bearing loans and borrowings	**1,141**	1,071

Current liabilities:	2016 £m	2015 £m
Instalment repayment notes (final payment 2025)	1	1
Corporate investor shares	16	16
Current portion of finance lease liabilities	2	3
Other unsecured loans	2	2
	21	22

* These drawn down loan commitments are designated as financial liabilities at fair value through the income statement.

** The tier two notes were issued by CISGIL on 8 May 2015.

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 26.

17. 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 31 December 2016				
	Start of period	Non-cash movements	Cash flow	Movement in corporate investor shares	End of period
	£m	£m	£m	£m	£m
Interest-bearing loans and borrowings:					
- current	(22)	-	1	-	(21)
- non-current	(1,071)	(74)	3	1	(1,141)
Total Debt	(1,093)	(74)	4	1	(1,162)
Group cash:					
- Group cash (per balance sheet)	405	-	(122)	-	283
- Overdraft (per balance sheet)	(4)	-	(2)	-	(6)
Group Net Debt	(692)	(74)	(120)	1	(885)
Comprised of:					
Trading Group Debt	(1,025)	(74)	3	1	(1,095)
Trading Group Cash	331	-	(123)	-	208
Trading Group Net Debt	(694)	(74)	(120)	1	(887)
CISGIL debt and overdrafts	(72)	-	(1)	-	(73)
Co-operative Banking Group Ltd (CBG Ltd) cash and overdrafts	74	-	1	-	75
Group Net Debt	(692)	(74)	(120)	1	(885)

	For period ended 2 January 2016				
	Start of period	Non-cash movements	Cash flow	Movement in corporate investor shares	End of period
	£m	£m	£m	£m	£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 Ltd cash and overdrafts	80	-	(6)	-	74
Group Net Debt	(743)	(9)	64	(4)	(692)

Details of the Group's bank facilities are shown in note 25.

17. 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 £511m) and the 7.5% (inclusive of 1.25% coupon step up) Eurobond Issue 2026 has an original value of £350m (carrying amount of £416m). 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 31 December 2016 the amounts outstanding are final repayments notes of £109m and the instalment repayment notes of £17m.

The unsecured bank loans consist of a £355m Revolving Credit Facility which expires in February 2021. The facility is undrawn as at 31 December 2016.

Corporate investor shares

Corporate investor shares represent borrowings the Group has with other co-operative societies. The rate of interest payable on the borrowings is determined by reference to the London Interbank Offered Rate (LIBOR). The borrowings are split into Variable Corporate Investor Shares (VCIS) and Fixed Corporate Investor Shares (FCIS). The VCIS are money at call and the rate of interest that is charged is fixed across all Societies based on a policy of Base minus 0.5% with a minimum of 0.25%. The FCIS are fixed term borrowings at fixed rates of interest (currently 1%). 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.

Finance lease liabilities

Finance leases have the following maturities in the Trading Group:

	2016 £m	2015 £m
Less than one year	**2**	3
Greater than one year but less than five years	**-**	2
	2	5

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 (notes 6 and 26).

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.

For more general information on accounting policies on financial instruments, refer to note 26.

18. 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 Value Added Tax and National Insurance, amounts relating to the Group's liability to provide future services for holders of funeral bonds and other sundry payables.

	2016 £m	2015 £m
Current	**1,506**	1,462
Non-current	**1,078**	967
	2,584	2,429

	2016 £m	2015 £m
Trade payables	**819**	800
Value Added Tax, PAYE and social security	**23**	34
Accruals and deferred income	**229**	237
Member payments payable	**25**	25
Funeral plans	**915**	805
Deferred consideration	**13**	1
Other payables	**553**	520
Other reinsurance liabilities	**7**	7
	2,584	2,429

Further details on the maturity profile of trade and other payables of the Trading Group can be found in note 25.

Other payables include a payable to the Bank of £137m (2015: £143m) in respect of historic group relief. See note 8 for further details.

Accounting policies

Refer to note 26 Financial Instruments for details on accounting policies on trade payables.

19. 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 Group'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.

	2016 £m	2015 £m
Non-current	**224**	352
Current	**102**	87
	326	439

	Uninsured claims £m	Onerous leases £m	Restructuring & integration £m	Regulatory / other £m	2016 Total £m	2015 Total £m
At beginning of the period	75	263	77	24	439	521
Credit to income statement	(15)	(77)	(19)	(6)	(117)	(28)
Charge to income statement	25	20	1	11	57	56
Discounting	-	14	-	-	14	17
Payments	(21)	(26)	(15)	(5)	(67)	(127)
At end of the period	64	194	44	24	326	439

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.

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 with reference to the head lease cost and term. The calculation also takes account of property holding costs (such as business rates) and 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. Payments under lease commitments, net of amounts receivable under sub-lettings, will be approximately £75m (2015: £149m) payable over the next five years. A credit of £77m has occurred in 2016 mainly related to the disposal of Somerfield Stores Limited.

Restructuring and integration
Provisions of £49m (2014) and £39m (2013) were made in respect of the cost of separating Group IT and other change management systems from the Bank. During the year £14m (2015: £nil) of this provision has been released following a review of the likely future costs of the programme. 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.

Regulatory/other
The provision relates to costs from a number of past events that are expected to be incurred within the next one to three years.

19. Provisions continued

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 to the accounts

This section (notes 20 - 30) contains additional notes to the accounts.

20. Share capital and Reserves

In plain English – what does this note show?

The note gives further details on the Group's share capital including explaining what types of share capital are held and the conditions of use and rights that are attached to those shares. Details are also given as to the movement in the number of active members that the Society has in comparison to the prior year. Further detail is also given about Other Reserve balances and the Group's overall approach to capital management.

	2016 £m	2015 £m
Individual shares of £1 and 10p each	**63**	63
Corporate shares of £5 each	**9**	9
Share Capital	**72**	72
Other Reserves	**107**	95
Retained Earnings	**3,030**	2,770
Total Retained Earnings and Other Reserves	**3,137**	2,865
Total Capital Resources	**3,209**	2,937

Members' share capital (Issued and paid-up value)

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. IFRIC 2 determines the features that allow shares to be classified as equity capital. 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. Under the Society's current rules, voting for corporate members is in proportion to trade with the Society with corporate members totalling 21.9% (2015: 21.9%) of the vote at the Annual General Meeting. Each individual member has one vote with individual members totalling 78.1% (2015:78.1%) of the vote at the Annual General Meeting.

For individual shares, new members are required to contribute a minimum of £1 when they join the Society. Each member has 1 individual share although contributions of up to £20,000 per member are allowed. No interest is currently earned on member capital. Members can withdraw money from their share account upon request (to a minimum of £1) or they can withdraw their £1 when they leave the Society. Share capital increased by £0.2m in the period being the net of new member contributions of £0.5m and withdrawals of £0.3m. There are 13.9m (2015: 13.4m) individual member records on the share register.

20. Share capital and Reserves continued

Other reserves

	Reclaim Fund £m	Revaluation Reserve £m	Available for Sale Investments £m	Total £m
Balance at 2 January 2016	**74**	**11**	**10**	**95**
Gains less losses on available for sale assets	**-**	**-**	**17**	**17**
Available for sale assets cumulative gains transferred to the income statement	**-**	**-**	**(1)**	**(1)**
Revaluation reserve recycled to retained earnings	**-**	**(1)**	**-**	**(1)**
Tax on items taken directly to other comprehensive income	**-**	**-**	**(3)**	**(3)**
Balance at 31 December 2016	**74**	**10**	**23**	**107**

	Reclaim Fund £m	Revaluation Reserve £m	Available for Sale Investments £m	Total £m
Balance at 3 January 2015	74	11	19	104
Gains less losses on available for sale assets	-	-	(6)	(6)
Available for sale assets cumulative gains transferred to the income statement	-	-	(3)	(3)
Balance at 2 January 2016	74	11	10	95

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. Further details of the balance sheet items can be found in note 30.

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.

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.

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-operatives UK Limited to be used and applied in accordance with co-operative principles.

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 (2015: £nil) to its stakeholders and invested in future growth through capital expenditure additions of £353m (2015: £312m). Total member funds increased during the period by £412m (2015: £72m).

Financial Services mainly compromises the Insurance business. CISGIL 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.

21. 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 revalued 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.

	2016 £m	2015 £m
Valuation at beginning of period	**87**	99
Additions	**2**	3
Disposals	**(31)**	(26)
Transfers (net) from property, plant and equipment	**-**	2
Revaluation gain recognised in income statement	**16**	24
Transfers to investments in joint ventures (see note 22)	**-**	(15)
Valuation at end of period	**74**	87

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 as determined by independent valuers each year in accordance with the RICS Appraisal and Valuation Manual. Fair value is based on current prices in an active market for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in the income statement.

Other disclosures required by IAS 40 are not deemed to be material.

22. Investments in associates and joint ventures

In plain English – what does this note show? This note 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 Bank.

A breakdown of the investments held and income received is disclosed below:

	2016		2015	
	Income / (losses) £m	**Investments £m**	Income / (losses) £m	Investments £m
The Co-operative Bank plc	**(185)**	**-**	(39)	185
TCCT Holdings UK Limited (Travel) - share of income / (losses)	**12**	**-**	(5)	38
NOMA	**1**	**39**	1	34
Other investments (including windfarms)	**1**	**13**	-	28
	(171)	**52**	(43)	285
Income from dividend guarantee (explained overleaf)	**-**	**-**	32	-
Total	**(171)**	**52**	(11)	285

The movements in investments in associates, joint ventures and other investments are as follows:

	2016 £m	2015 £m
At beginning of period	**285**	316
Additions	**5**	3
Transfer from investment property	**-**	15
Share of losses	**(171)**	(43)
Dividends received	**(2)**	(6)
Disposals	**(65)**	-
At end of period	**52**	285

Of the dividends received in the above table, £nil (2015: £5m) was received from Travel and £1m (2015: £1m) received from a number of windfarms and £1m from NOMA (2015: £nil). The principal place of business for all of the Group's investments in associates and joint ventures is the United Kingdom.

22. Investments in associates and joint ventures continued

The Co-operative Bank plc (the Bank)
The Group has fully impaired its investment in the Bank to £nil (2015: £185m). The impairment charge of £185m (2015: £39m) has been reflected in the share of losses of associates and joint ventures line in the income statement. During 2016, the Bank reported a net loss of £419m and then announced on 26 January 2017 that its CET1 ratio will fall and remain below 10% over the medium term. The Bank then announced on 13 February 2017 that it was commencing a sale process and considering options to build capital. Given these significant uncertainties we have determined, using appropriate estimates and assumptions, that the recoverable amount of our investment requires full impairment at the year end. Whilst it is important to acknowledge the Group may ultimately realise some value for its investment as part of any sales process, it would be inappropriate to recognise any potential value in our accounts at 31 December 2016.

The Group continues to be a going concern without needing to realise any cash proceeds from its investment in the Bank. The Group's risk associated with its interest in the Bank is minimal as the Group does not rely on dividend payments from the Bank to fund its other operations. There is no requirement for the Group to invest more capital into the Bank which could adversely impact its investment in other areas.

The principal activity of the Co-operative Bank plc is banking and its principal place of business is the United Kingdom. In October 2016, Alistair Asher, Group General Counsel was re-appointed onto the Bank Board. By retaining the right to appoint a director to the Bank Board, the Group can still continue to promote the adoption of the Co-operative's ethical agenda into the Bank's activities and strategy. The Bank's year end date is 31 December as the Bank works to a monthly reporting cycle. For further information on the Bank's commitments and contingent liabilities, see below.

The Bank has the following significant restrictions to transfer funds to the Group in the form of cash dividends, or to repay loans or advances made by the Group. The Bank may, by ordinary resolution, declare a dividend to be paid to the members, according to their respective rights and interests in the profits. When considering whether or not to pay an interim dividend or to recommend the payment of a final dividend, the Bank Board shall take into account such factors as the Bank's capital and financial position, cash requirements, 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 Bank splits its risks into three main areas: credit risk, liquidity risk and market risk which have all been relevant in the context of the Group's valuation of its investment in the Bank. 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 2016 annual financial statements.

TCCT Holdings UK Limited (Travel)
On 29 November 2016, a deed was signed with Thomas Cook that determined when the additional outstanding dividend amount of £32m had to be paid by and in addition confirmed that the value payable for the Group's shares in the JV in the event of exit in 2017 would be £50m, in line with the terms of the Shareholders' Agreement.

Of the outstanding dividend, £20m was received on 3 January 2017 and the remaining £12m is due on 3 April 2017. This amount was recognised by the Group in 2015 and the balance as at 31 December 2016 is also within trade and other receivables.

22. Investments in associates and joint ventures continued

On 6 December 2016 the Group served notice to Thomas Cook of the decision to exit its investment in the Travel JV under the put option granted to it in the Shareholders' Agreement. This means that Thomas Cook Retail Ltd has to buy the Group's 30% interest by 30 November 2017. Upon giving notice, the Group lost all voting rights to the associate meaning it is no longer able to demonstrate significant influence over the entity. Therefore, the book value of the investment in Travel has transferred to trade and other receivables and is treated as a disposal in the above table.

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 £5m (2015: £3m) to the joint venture to fund investment.

Twin Rivers Windfarm

The Group sold its investment in the Twin Rivers windfarm on 2 December 2016 for £21m. At the time of the sale the book value of the investment was £16m.

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	
	2016	2015	**2016**	2015	**2016**	2015
	£m	£m	**£m**	£m	**£m**	£m
Current assets	**-**	-	**-**	70	**15**	13
Non-current assets	**-**	-	**-**	219	**85**	86
Current liabilities	**-**	-	**-**	(303)	**(13)**	(10)
Non-current liabilities	**-**	-	**-**	-	**-**	-
Financial Services - Assets*	**27,588**	29,028	**-**	-	**-**	-
Financial Services - Liabilities*	**(26,630)**	(27,665)	**-**	-	**-**	-
Net assets (100%)	**958**	1,363	-	(14)	**87**	89
Group's share of net assets	**194**	275	**-**	(4)	**44**	45
Elimination of unrealised profits	**-**	-	**-**	-	**(5)**	(11)
Fair value adjustments	**(142)**	(262)	**-**	-	**-**	-
Goodwill	**385**	385	**-**	42	**-**	-
Accumulated impairment	**(437)**	(213)	**-**	-	**-**	-
Carrying amount in Group balance sheet	-	185	**-**	38	**39**	34
Revenue	**827**	954	**-**	318	**3**	2
Profit or loss from continuing operations	**(419)**	(623)	**-**	(15)	**2**	1
Post-tax profit or loss from discontinued operations	**-**	-	**-**	-	**-**	-
Other comprehensive income	**14**	7	**-**	-	**-**	-
Interest expense	**(518)**	(522)	**-**	-	**-**	-
Income tax income / (expense)	**58**	(12)	**-**	(2)	**-**	-

*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 31 December 2016 (2015: £11m).

Balances relating to other individually immaterial joint ventures and associates were immaterial in both periods.

22. Investments in associates and joint ventures continued

Critical accounting estimates and judgements

Bank

The Group has recorded an impairment charge of £185m (2015: £39m) in the year to reduce its investment to £nil (2015: £185m). A range of methodologies have been used to assess the recoverable amount of our investment. These have included value in use calculations based on guidance disclosed within updates to investors and using appropriate market multiples for the banking industry, adjusted for the risks appropriate to the Bank's circumstance and risk profile. It has also assessed fair value less cost of sale by analysing trades and performing peer comparison valuations. After considering the range of estimates of the recoverable amount indicated by both our value in use and our fair value less cost of sale models, the Group concluded that it would be inappropriate to hold any value in relation to our investment.

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.

Unaudited	2016		2015	
	Contract amount £m	Risk-weighted amount £m	Contract amount £m	Risk-weighted amount £m
i) Contingent liabilities:				
Guarantees and irrevocable letters of credit	**12**	**5**	21	15
	12	**5**	21	15
ii) Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)	**2,277**	**296**	2,572	314
	2,289	**301**	2,593	329

Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,376m (2015: £1,558m).

The following sections (Indemnification Agreement, Conduct Issues, Sale of the Bank's share in Visa Europe Limited (VE), Regulatory and other investigations, Legal proceedings, Mortgage securitisation representations and warranties, Pensions, Separation from the Co-operative Group and Warwick Finance One and Two securitisation representations and warranties) specifically represent the considerations documented in the accounts of the Bank 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 Group are fully completed, but this will require the consent of CFSMS.

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.

22. Investments in associates and joint ventures continued

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 may also be other regulatory investigations and action against the Bank in the future 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 outcome of any ongoing disputes and legal, regulatory or other investigations or proceedings is currently uncertain.

Sale of the Bank's share in Visa Europe Limited (VE)
The sale of the Bank's share in VE completed on 21 June 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. (VI) for certain losses which may be incurred as a result of existing and potential litigation relating to the setting and implementation of domestic Merchant Interchange Fee (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 VI. with protection against liabilities from MIF litigation in the VE territory. Overall losses would in the first instance be recovered by VI from the banks in the form of cancelling the preference shares issued as part of the consideration above. The potential exists, therefore, for the value of the Bank's consideration in the form of preference shares (Preference Stock) to be eroded by liabilities incurred by VI. in connection with MIF litigation in the VE territory.

Regulatory and other investigations
There are a number of 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. The investigation will review the conduct of relevant authorities (regulators and government) and the institution itself 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 (FRC) 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, which focuses on the role of the previous auditors and individual accountants. The FRC concluded its investigations into the then CEO during 2016, and the investigation in relation to previous auditors and the audit of the 2012 and prior financial statements of the Bank is ongoing.

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 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 operating results, 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.

22. Investments in associates and joint ventures continued

Mortgage securitisation representations and warranties

In connection with the Bank's mortgage securitisations 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.

Separation from Group

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. 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.

NOMA

In 2016, the Group committed to fund the NOMA JV £26m for its share of the development works needed on the buildings. The development works will take place over the course of 2017 and 2018. £5m of this had been invested into the JV as at year end.

22. Investments in associates and joint ventures continued

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 31 December 2016 (2 January 2016: £nil).

Significant transactions and outstanding balances with the Bank and NOMA investments at the period end can be found in note 28.

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.

23. Pensions

In plain English – what does this note show?	This note 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.

Defined benefit (DB) plans
The Group operates a number of DB pension schemes, the assets of which are held in separate trustee-administered funds to meet future benefit payments. The Group's largest pension scheme is the Co-operative Group Pension Scheme ('Pace') which accounts for approximately 85% of the Group's pension assets. The DB section of Pace ('Pace Complete') closed to future service accrual on 28 October 2015. The Group operates four other funded DB pension schemes which are also closed to future service accrual. Pace is a multi employer scheme and there are currently ongoing discussions with the Bank on separating their share of the liabilities.

Further information about Pace is set out below.

Defined contribution (DC) plans
Since the closure of the DB schemes, the Group continues to provide all employees with DC pension benefits. Colleagues are able to select the level of contributions that they wish to pay. The contribution paid by the Group varies between 1% and 10% of pensionable salary depending on the contribution tier that the member has selected.

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% colleague and 2% employer contributions. All colleagues across the Group are able to join the DC section and have the option to change their contributions at any point.

The Pace DC section provides benefits based on the value of the individual colleague's fund accrued through contributions and investment returns.

The Group pays these contributions into a separate entity and has no legal or constructive obligation to pay contributions beyond those specified above. There is therefore no balance sheet items for DC pension benefits except for any accrued contributions.

Balance sheet position for DB plans
The table below summarises the net surplus in the balance sheet by scheme:

	Net 2016 £m	Net 2015 (restated) £m
Schemes in surplus		
The Co-operative Group Pension Scheme (Pace)	**1,783**	1,226
Somerfield Pension Scheme	**156**	112
Total schemes in surplus	**1,939**	1,338
Schemes in deficit		
United Norwest Co-operatives Employees' Pension Fund	**(173)**	(123)
Yorkshire Co-operatives Limited Employees' Superannuation Scheme	**(21)**	(16)
The Plymouth and South West Co-operative Society Limited Employees' Superannuation Fund	**(51)**	(58)
Other unfunded obligations	**(6)**	(11)
Total schemes in deficit	**(251)**	(208)
Total schemes	**1,688**	1,130

23. Pensions continued

Recognition of accounting surplus
Any net pension asset disclosed represents the maximum economic benefit available to the Group in respect of its pension obligations. The Group has always recognised the entire net pension asset in respect of Pace and the Somerfield Scheme since it can recoup a surplus via a refund. There is no requirement in Pace that a surplus has to be shared amongst participating employers. Furthermore, during 2016, the Group has carried out a review of the provisions for the recovery of surplus in its smaller pension schemes. This review concluded that these schemes can recoup surplus via a combination of refunds and reductions in contributions and this is reflected in the balance sheet position.

Restatement
The net pension surplus on the balance sheet has been restated in the prior year by £21m for two items that partially offset. Firstly, the pension assets were overstated by £40m as the pension benefits for certain members of Pace had historically been understated. This has been partially offset by a £19m overstatement in pension liabilities. Legal advice obtained in 2016 confirms that the Group can recognise a surplus on the United, Yorkshire and Plymouth schemes. This has meant that the Group did not need to provide the £19m IFRIC 14 onerous liability remeasurement in 2015.

Pace - nature of scheme
As Pace represents 85% of the Group's pension assets, further information has been included on Pace below. As all of the DB schemes will be exposed to similar risks to Pace, we have not provided additional commentary on each scheme.

Benefits accrued in Pace between 6 April 2006 and 28 October 2015 are calculated based on an individual's average career salary. Benefits accrued prior to 6 April 2006 are linked to final salary until members cease pensionable service.

Pace - funding position
A valuation of Pace Complete was carried out 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. An updated valuation of Pace Complete has been carried out as at 5 April 2016. This valuation is expected to be completed during 2017.

Pace - Multi-employer provisions
The Bank, an associate of the Group and CFSMS, a 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, but these do not have a material share.

Prior to the completion of the Bank's Liability Management Exercise (LME) in 2013, Pace was recognised under IAS 19 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 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 colleagues of other participating employers. At present, and subject to ongoing separation discussions (see below) there is no contractual agreement or stated policy for charging the net DB obligation, or surplus, to participating employers. Furthermore there is no contractually agreed share of pension liabilities between the Group and the Bank and the Group, as Principal Employer of the scheme, is entitled to any surplus of the scheme in full (by way of refund). Pace currently shows a net DB pension asset of £1,783m and as no participating employers are entitled to a share of the surplus under the rules of the scheme, the net DB pension asset is recognised fully by the Group, being the Principal Employer and the most significant participant in the scheme. This is consistent with the approach adopted in prior years. This means that at present, and subject to the ongoing separation discussions referred to below, the Group accounts for 100% of the PACE scheme on a DB basis, with contributions from other participating

23. Pensions continued

employers being reflected as income. 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 their income statements 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.

During 2016, the Bank continued discussions with Group and the Pace Trustee, with the aim of separating its liabilities in the scheme from those of other participating employers. Discussions are still ongoing.

At completion of the most recent full actuarial valuation in 2014, the Bank annually agree to pay £5m of the £25m contributions then due in respect of the funding shortfall identified.

Legislative framework for DB schemes – Pension scheme governance
As required by UK legislation, the Group's five DB schemes are run by Trustee boards which operate independently from the Group. The Trustee is responsible for the development and implementation of appropriate policies for the investment of the scheme assets and for negotiating scheme funding with the Group. The Trustee consults with the Group in developing investment strategy and delegates the responsibility for implementing and monitoring the strategy to an Investment Committee.

Each Trustee board has at least one professional Trustee and there is a also requirement for the boards to have some member representation. As an example, the Trustee Board for Pace comprises nine Trustee Directors: three Co-op appointed professional independent Trustee Directors, three Co-op appointed Trustee Directors, and three Member Nominated Directors (MNDs) elected by scheme members. The Chair of Trustees is appointed by the Trustee Directors.

Legislative framework for DB schemes - Scheme funding regime
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 DB pension liabilities are valued for funding purposes differs to the basis required under IAS 19. The Group may therefore be required to pay contributions to eliminate a funding shortfall even when a surplus is reported in the IAS 19 disclosure.

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 2017 financial year is £50m. The average duration of the liabilities is 20 years. The benefits expected to be paid from the Schemes take the form of a cash lump sum paid at retirement followed by a stream of pension payments. Additional contributions due in respect of Bank's participation in Pace, are paid directly or reimbursed by Bank.

The effective date of the last full valuations of the schemes are shown below:

The Co-operative Pension Scheme ('Pace')	5 April 2016
Somerfield Pension Scheme ('Somerfield Scheme')	31 March 2016
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 2016
Yorkshire Co-operatives Limited Employees' Superannuation Fund ('Yorkshire Fund')	31 January 2014

Discussions are currently underway in relation to the 2016 funding valuations.

23. Pensions continued

Risks associated with DB pension schemes

The liability associated with the pension schemes is material to the Group, as is the cash funding required. The Group and Trustees work together to address the associated pension risk - in particular, steps have been taken to significantly reduce the investment risk in the schemes.

The key risks in relation to the DB schemes are set out below, alongside a summary of the steps taken to mitigate the risk:

Risk description	Mitigation
Risk of changes in contribution requirements When setting the contributions that are paid to a scheme, the Group and Trustee are required to consider the funding level at a specified valuation date. The funding level at future valuation dates is uncertain and this leads to uncertainty in future cash requirements for the Group.	The closure of the DB schemes has reduced the exposure of the Group to changes in future contributions. Furthermore, the Group and Trustee have taken steps to reduce the volatility of the funding level (as set out below). The Group monitors the funding level of the schemes in order to understand the likely outcome of valuations and the Trustee is required to obtain agreement from the Group to funding assumptions and deficit recovery contributions.
Interest rate risk Pension liabilities are measured with reference to yields on bonds, with lower yields increasing the liabilities. The schemes are therefore exposed to the risk of falls in interest rates.	All of the schemes invest in liability driven investment LDI products which increase (decrease) in value when yields on Government bonds fall (rise), thus providing protection against interest rate risk. Across all schemes, approximately 75% of the liability is currently protected from movements in yields on Government bonds, with the protection expected to increase further during 2017. LDI involves investing in assets which are expected to generate cashflows that broadly mirror expected benefit payments from the scheme. These are typically government bonds and gilts, and index-linked corporate bonds.
Risk associated with volatility in asset value The market value of the assets held by the pension schemes, particularly the assets held in return seeking assets such as equity, can be volatile. This creates a risk of short term fluctuations in funding level.	This risk has been mitigated by reducing the exposure of the pension schemes to those asset classes which have the most volatile market values. In particular, the schemes have limited allocation to return seeking assets such as equity.
Inflation risk Many of the benefits paid by the schemes are linked to inflation. Therefore, the pension liabilities reflect expectations of future inflation with higher inflation leading to higher liabilities.	All of the schemes invest in liability driven investment products which increase (decrease) in value when expectations of future inflation rates increase (fall), thus providing protection against inflation risk. Across all schemes, approximately 75% of the liability is currently protected from movements in inflation, with the protection expected to increase further during 2017.
Risk associated with changes in life expectancy Pensions paid by the schemes are guaranteed for life, and therefore if members are expected to live longer, the liabilities increase.	The schemes' funding targets incorporate a margin for prudence to reflect uncertainty in future life expectancy.

Critical accounting estimates

For IAS 19 disclosure purposes, DB obligations are determined following actuarial advice and are calculated using the projected unit method. The assumptions used are the best estimates chosen from a range of possible actuarial assumptions which may not necessarily be borne out in practice.

Financial assumptions

	2016	2015
Discount rate	**2.74%**	3.80%
RPI Inflation rate	**3.45%**	3.30%
Pension increases in payment (RPI capped at 5% p.a.)	**3.26%**	3.20%
Future salary increases	**3.70%**	3.55%

The discount rate has been derived by reference to market yields on sterling-denominated high quality corporate bonds of appropriate duration consistent with the schemes at that date.

23. Pensions continued

Demographic assumptions

The Group has used best estimate base mortality tables which reflect the membership of each scheme. Allowance has been made for future improvements in line with the CMI 2015 projections and a long term future improvement rate of 1.25% p.a. (2015: CMI 2012 1.50% p.a.).

For illustration, the average life expectancy (in years) for mortality tables used to determine scheme liabilities for Pace is as follows. These are broadly similar to the life expectancies used for other schemes.

	2016	2015
Male currently aged 65 years	**22.1**	22.9
Female currently aged 65 years	**23.8**	24.9
Male currently aged 45 years	**23.8**	25.0
Female currently aged 45 years	**25.7**	27.4

Sensitivities

The measurement of the Group's DB 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. It should also be noted that because of the interest rate and inflation hedges, changes in the liability arising from a change in the discount rate or price inflation would be expected to be partially mitigated by a change in assets.

	2016	2015
Change in liability from a 0.1% increase in discount rate	**(229)**	(180)
Change in liability from a 0.1% increase in RPI inflation	**171**	163
Change in liability from a + 0.25% increase in long-term rate of longevity improvements	**212**	147

Changes in the present value of the defined benefit obligation (DBO)

	2016 £m	2015 (restated*) £m
Opening defined benefit obligation	**9,669**	9,992
De-recognition of Britannia Pension Scheme (unfunded)	**(3)**	-
Current service cost	**-**	61
Interest expense on DBO	**355**	361
Participant contributions	**-**	16
Past service costs	**-**	1
Remeasurements :		
a. Effect of changes in demographic assumptions	**(550)**	(28)
b. Effect of changes in financial assumptions	**2,432**	(331)
c. Effect of experience adjustments	**(290)**	(29)
Benefit payments from plan	**(466)**	(354)
Closing defined benefit obligation	**11,147**	9,689

*See restatement section at start of note for more detail.

23. Pensions continued

Changes in the fair value of the plan assets

	2016 £m	2015 £m
Opening fair value of plan assets	**10,799**	10,921
Interest income	**400**	400
Return on plan assets (excluding interest income)	**2,056**	(271)
Administrative expenses paid from plan assets	**(5)**	(6)
Employer contributions	**51**	93
Participant contributions	**-**	16
Benefit payments from plan	**(466)**	(354)
Closing fair value of plan assets	**12,835**	10,799

The fair value of the plan assets at the period end were as follows. The assets have been split to show those which have a quoted market price in an active market and those which are unquoted.

	2016 Quoted £m	2016 Unquoted £m	2016 Total £m	2015 Quoted £m	2015 Unquoted £m	2015 Total £m
Cash and cash equivalents	**1,944**	**-**	**1,944**	213	4	217
Equity instruments	**564**	**-**	**564**	2,078	-	2,078
Debt instruments	**9,188**	**-**	**9,188**	6,956	-	6,956
Real estate	**294**	**5**	**299**	44	305	349
Derivatives	**-**	**74**	**74**	-	167	167
Investment funds	**177**	**589**	**766**	182	850	1,032
	12,167	**668**	**12,835**	9,473	1,326	10,799

Of the £9,188m (2015: £6,956m) of debt instruments above, £7,793m (2015: £6,017m) relates to Pace. Within Pace, £6,440m (2015: £5,115m) is held in liability driven investment products (see risk section above). The remainder held in Pace is in high quality corporate bonds (BBB+) which are diversified across sectors and spread between different managers.

	2016 £m	2015 (restated*) £m
Amounts recognised in the balance sheet		
Present value of funded obligations	**(11,141)**	(9,658)
Present value of unfunded liabilities	**(6)**	(11)
Fair value of plan assets	**12,835**	10,799
Net retirement benefit asset	**1,688**	1,130

*See restatement section at start of note for more detail.

	2016 £m	2015 £m
Amounts recognised in the income statement and other comprehensive income		
Current service cost	**-**	(48)
Past service cost	**-**	(1)
Interest expense on defined benefit obligations	**(355)**	(361)
Interest income on plan assets	**400**	400
Administrative expenses and taxes	**(5)**	(6)
	40	(16)
Amounts recognised in other comprehensive income	**464**	105
	504	89

23. Pensions continued

Accounting policies

The Group operates various defined contribution and defined benefit pension schemes for its colleagues as stated above. A defined contribution scheme is a pension plan under which the Group pays pre-specified contributions into a separate entity and has no legal or constructive obligation to pay any further contributions. A defined benefit scheme is a pension plan that defines an amount of pension benefit that a colleague 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 reflects the present value of the economic benefits that will arise from the suplus 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 contributions within the period.

24. Insurance contracts liabilities and reinsurance assets

In plain English – what does this note show? This note provides 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.

	2016		2015	
	Gross insurance liability	Reinsurance asset	Gross insurance liability	Reinsurance asset
	£m	£m	£m	£m
At the beginning of the year	**746**	**(69)**	738	(72)
Claims paid during the year	**(347)**	**9**	(318)	6
Increase / (decrease) arising from current year claims	**370**	**(6)**	300	(18)
Increase / (decrease) arising from prior year claims	**(59)**	**12**	(13)	15
Increase / (decrease) in unearned premiums	**15**	**-**	49	-
Increase / (decrease) in unexpired risk provision	**(1)**	**-**	(10)	-
	724	**(54)**	746	(69)
Comprising:				
- Claims reported	**349**	**(29)**	358	(31)
- Claims incurred but not reported	**128**	**(25)**	153	(38)
- Claims settlement expenses	**11**	**-**	13	-
- Provision for unearned premiums	**236**	**-**	221	-
- Provision for unexpired risks	**-**	**-**	1	-
	724	**(54)**	746	(69)
Non-current	**477**	**(47)**	511	(63)
Current	**247**	**(7)**	235	(6)
	724	**(54)**	746	(69)

i) Basis of assessing liabilities

CISGIL has access to historical data and trends relating to the general insurance business of Co-operative Insurance Society Ltd (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.

24. Insurance contracts liabilities and reinsurance assets continued

i) Basis of assessing liabilities continued
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.

Discounted reserves in respect of periodic payment settlements are £22m (2015: £23m) and historic liability claims from the electric industry discounted reserve amounts to £3m (2015: £3m). Further details around expected settlement patterns for claims arising on these reserves are disclosed within the insurance risk section in note 25.

The historic liability claims from the electric industry reserve was based on a report produced for the industry at the end of 2015 by Towers Watson, an actuarial consultant. This gave Towers Watson's estimate of both the undiscounted and discounted incurred but not reported (IBNR) reserves as at the end of June (2015). This was the most recent report available when CISGIL calculated its year end 2016 reserves.

In respect of business yet to be earned, the adequacy of the premium to cover future claims costs and expenses was assessed to determine the requirement for an Unexpired Risk Provision (URP) by comparing the discounted premium and outgoings. As at the end of 2016 CISGIL held an URP of £nil (2015: £1m).

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 CISGIL's 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) 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.

24. Insurance contracts liabilities and reinsurance assets continued

Assumptions

	Changes in parameter	2016 Effect on gross provision £m	2016 % Effect	2015 Effect on gross provision £m	2015 % Effect
Motor					
Average cost of claims for last three years – bodily injury and legal	10%	31	8.4%	32	8.9%
Mean term to settlement – bodily injury and legal	+1/2 year	8	2.1%	7	2.0%
Rate of future inflation – bodily injury and legal	1%	11	2.9%	11	3.0%
Ogden discount rate - bodily injury	+1/4 year	(2)	(0.6%)	(2)	(0.6%)
Other classes					
Mean term to settlement (liability)	+1/2 year	-	1.9%	1	2.1%
Mean term to settlement (non-liability)	+1/2 year	1	1.6%	1	1.5%
Rate of future inflation (liability)	1%	1	7.3%	2	5.5%
Rate of future inflation (non-liability)	1%	1	1.4%	1	1.4%

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 contracts' and 'Trade Receivables' respectively.

24. Insurance contracts liabilities and reinsurance assets continued

For statutory accounts the outstanding reserves are discounted in respect of periodical payments and a portion of liability type claims from the electric industry 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).

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.

25. Financial risk management

In plain English – what does this note show? The following disclosures outline the principal financial risks facing the Group and what is done to manage those risks. These include: credit risk, interest rate risk, foreign currency risk, liquidity risk and insurance 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 some disclosures, where material, have been separated out in the CISGIL section.

The principal financial risks facing the 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 36 to 39. Due to its business being funded separately, a separate section on financial risks facing the Insurance business has been prepared below.

Credit risk

Credit risk arises from the possibility of customers and counterparties failing to meet their obligations. 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 Group does not require collateral in respect of financial assets. The majority of businesses in the Group have cash-based rather than credit-based sales hence customer credit risk is relatively small.

Investments in the Trading Group 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.

Funeral Plan funds are invested in Whole of Life Insurance Policies. Any provider of such policies to the Trading Group must be authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. There are also some funds relating to plans taken out prior to 2002 that are held in interest-bearing bank accounts in accordance with Trading Group treasury policies.

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 15. The carrying value of all balances that attract a credit risk, which represents the maximum exposure, is set out below:

	Carrying amount 2016 £m	Carrying amount 2015 £m
Trade and other receivables (excluding prepayments and accrued income)	**505**	365
Interest rate swaps	**50**	55
Funeral bond investments	**872**	781
Cash deposits	**208**	331

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 31 December 2016 was 59% (at 2 January 2016: 83%). 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 and have fixed swap rates ranging from 5.63% to 6.25% (at 2 January 2016: 3.27% to 6.25%). At 31 December 2016, the Trading Group had interest rate swaps with a notional contract amount of £390m (at 2 January 2016: £893m).

25. Financial risk management continued

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 31 December 2016 was a net asset of £50m (2015: net asset £18m) comprising assets of £50m (2015: £55m) and liabilities of £nil (2015: £37m). These amounts are recognised as fair value derivatives.

Foreign currency risk
The Trading Group is exposed to foreign currency risk on purchases that are denominated in a currency other than sterling. The currency giving rise to this is the Euro.

The Trading Group uses forward exchange contracts to hedge its foreign currency risk. The Trading Group hedges at least 80% of all trade payables denominated in a foreign currency and 80% of its estimated foreign currency exposure. 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 31 December 2016, the Trading Group had forward currency transactions in Euros with a notional contract amount of £14m (2015: £9m).

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 31 December 2016, the Trading Group had available borrowing facilities totalling £1,302m (2015: £1,376m), which comprised uncommitted facilities of £nil (2015: £17m) and committed facilities of £1,302m (2015: £1,359m). These are detailed below:

Bank facilities as at 31 December 2016

	2016		2015	
	Expiry	£m	Expiry	£m
Uncommitted facilities	**August 2016**	**-**	August 2016	17
Syndicate Revolving Credit Facility	**Feb 2021**	**355**	July 2017	411
		355		428
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**	**17**	December 2025	18
Eurobond issue - 2026	**July 2026**	**350**	July 2026	350
		1,302		1,376

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.

25. Financial risk management continued

The following are the maturities of financial liabilities as at 31 December 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)**	**-**
Sterling Eurobond 2020	**(511)**	**(450)**	**-**	**-**	**-**	**(450)**	**-**
Sterling Eurobond 2026	**(416)**	**(350)**	**-**	**-**	**-**	**-**	**(350)**
Final repayment subordinated notes - 2025	**(109)**	**(109)**	**-**	**-**	**-**	**-**	**(109)**
Instalment repayment subordinated notes - 2025	**(17)**	**(17)**	**-**	**(1)**	**(1)**	**(4)**	**(11)**
Finance lease liabilities	**(2)**	**(2)**	**(1)**	**(1)**	**-**	**-**	**-**
Funeral plans	**(915)**	**(915)**	**(33)**	**(109)**	**(139)**	**(197)**	**(437)**
Trade and other payables	**(1,492)**	**(1,492)**	**(1,360)**	**(58)**	**(16)**	**(18)**	**(40)**
Derivative financial liabilities							
Interest rate swaps used for hedging	**-**	**-**	**-**	**-**	**-**	**-**	**-**

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)	-
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 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.

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 31 December 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 £47m (2015: GBP £56m) higher and GBP £56m (2015: GBP £61m) lower respectively, mainly arising from the revaluation of the Group'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 31 December 2016 and 2 January 2016, 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.

25. Financial risk management continued

Guarantees
In the course of conducting its operations, the Trading Group is required to issue bank guarantees and bonds in favour of various counterparties. These facilities are provided by the Trading Group's banking syndicate and as at 31 December 2016 the total amount of guarantees / bonds outstanding is £45m (2015: £59m).

Insurance risk - CISGIL
Insurance risk comprises the risk of loss resulting from premiums not yet written or earned, from future claims events other than catastrophes (Premium Risk), from adverse change in the value of insurance liabilities (Reserve Risk) and from natural or man-made catastrophe events (Catastrophe Risk).

The main classes of business written are UK 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.

Key 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. The reduction in the discount rate used to calculate these claims which was announced in February 2017 has increased the likely cost of cash settlement and has been reflected in the 2016 closing claims reserves. Periodic Payment Orders (PPO's) are being used to settle injury claims in the UK. Compensation is paid to claimants at regular intervals, rather than in a single lump sum award. This introduces further risk to the insurer as the term of the payments is dependent upon life expectancy and the payments increase with care worker future inflation.

Key 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.

At the balance sheet date there were no significant concentrations of insurance risk. CISGIL manages insurance risk in accordance with its overall aims to achieve acceptable profits and return on equity. This is achieved by:

- Ensuring that insurance risks are carefully selected in accordance with risk appetite, underwritten in accordance with risk strategy and priced to reflect the underlying risk
- Minimising reserve risk volatility through proactive claims handling, the claims provisioning process and robust reserving and modelling approaches
- 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 Chief Financial Officer (CFO) in their responsibility to formally review 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 Internal Model to inform decision making.

25. Financial risk management continued

Insurance risk - CISGIL continued
In 2016, 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 noted above. For 2017, CISGIL have entered into a quota share arrangement of both its Motor and Home business and the new programme provides additional solvency protection and still offers a significant amount of risk transfer.

Credit risk - CISGIL
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:
- Reinsurance counterparties failing to meet financial obligations or entering into restructuring arrangements that may adversely affect reinsurance recoveries;
- Default or delay of repayment of loans and receivables; and
- Insurance counterparties failing to meet financial obligations.

CISGIL manages credit risks associated with cash and corporate bonds as part of market risk.

Where reinsurance is used to manage insurance risk, there is a risk that the reinsurer fails to meet its obligations in the event of a claim. CISGIL places limits over exposure to a single reinsurance counterparty, or counterparty group, based upon their credit-worthiness. These limits apply when reinsurance is initially placed, usually annually, and then regularly monitored by the Capital, Liquidity, Investment and Pension Committee. Where concern exists over reinsurer credit quality, a review will be undertaken to determine the most appropriate management action.

Insurance receivable and other assets are primarily premium debtors due from customers and insurance intermediaries. Exposure to insurance intermediaries is managed in line with CISGIL's credit risk policy.

Co-op Insurance has a credit exposure of up to £60m with a trading counterparty that provides administrative services including the collection of premiums. This exposure to credit risk was reduced during 2016 and is expected to fall further during 2017.

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 using the Markit iBoxx Rating methodology.

As at 31 December 2016	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)	-	-	226	-	-	226
Available for sale assets:						
Listed debt (fixed rate)	102	330	131	-	-	563
Listed debt (variable rate)	16	28	77	5	-	126
Reinsurance assets	-	25	25	-	1	51
Insurance receivables and other assets	2	3	4	-	152	161
	120	386	463	5	153	1,127
Assets not subject to credit risk						71
						1,198

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

25. Financial risk management continued

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 £177m (2015: £191m) is held against short term deposits which have been placed into a reverse repo transaction of £175m as at 31 December 2016 (2015: £199m). In addition £26m was placed into a delivery by value transaction (DBV) on 31 December 2016, this balance was 100% covered by collateral received in the form of gilts. These short term deposits sit with approved credit institutions within financial investments at fair value through income or expense on the balance sheet.

Liquidity risk - CISGIL

Liquidity risk is the current and prospective risk to earnings or capital arising from an inability to meet obligations when they come due without incurring unacceptable losses. CISGIL's objective is to meet all policyholder and other funding obligations as they fall due primarily through the use of cash and highly liquid UK government and corporate bonds.

The Board's risk appetite is that liquid assets should be at least equal to 20% of the ultimate cost of a 1-in-100 year UK windstorm loss before reinsurance recoveries. The ultimate cost is calculated based upon the catastrophe component of CISGIL's Internal Model.

The latest model assesses the ultimate cost of a 1-in-100 year UK windstorm as £104m (2015: £106m), giving a minimum requirement for £21m (2015: £21m) of liquid assets against actual liquid assets of £773m (2015: £734m).

Liquid assets are considered to be:

Asset type:		Value Included as liquid assets
Gilts		100%
Cash		100%
Corporate bonds:	AAA	85%
	AA	85%
	A	50%
	BBB	50%
All other investments		0%

The level of cash and other assets held are monitored regularly and managed through the Capital, Liquidity, Investment and Pension Committee, with oversight by the ERC and Board. This includes monthly reporting of liquid assets against risk appetite limits including forecasts for 2017 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 £45m (2015: £44m) of discounted reserves relating to PPOs and EIROS.

2016	Carrying value	Gross nominal outflow	Up to 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m	£m
Insurance contract liabilities	488	488	198	102	59	37	23	70
Financial liabilities at amortised cost:								
Subordinated debt	68	140	8	8	8	8	8	100
Other reinsurance liabilities	7	7	7	-	-	-	-	-
Insurance and other payables	73	73	73	-	-	-	-	-
Cash and cash equivalents	6	6	6	-	-	-	-	-
	642	714	292	110	67	45	31	170
Other liabilities								7
Total recognised liabilities								649

25. Financial risk management continued

2015	Carrying value £m	Gross nominal outflow £m	Up to 1 year £m	1 to 2 years £m	2 to 3 years £m	3 to 4 years £m	4 to 5 years £m	More than 5 years £m
Insurance contract liabilities	525	525	212	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	-	-	-	-	-
	671	753	298	124	73	46	31	181
Other liabilities								5
Total recognised liabilities								676

26. Financial instruments, derivatives and fair values of financial assets and liabilities

In plain English – what does this note show? The 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. It also shows how other investments and liabilities around the Group are valued.

Derivatives

Derivatives held for non-trading purposes for which hedge accounting has not been applied are as follows:

	2016			2015		
	Contractual/ notional amount	Fair value assets	Fair value liabilities	Contractual/ notional amount	Fair value assets	Fair value liabilities
	£m	£m	£m	£m	£m	£m
Interest rate swaps	390	50	-	893	55	(37)
Total recognised derivative assets / (liabilities)	**390**	**50**	**-**	893	55	(37)

During the year the Group closed or terminated certain fixed and floating rate swap instruments. This was part of a strategic exercise to rationalise and simplify the Group's swap portfolio following a review of the Group's overall interest rate risk strategy in relation to its current capital requirements and rebuild and renewal plans.

Fair values of financial assets and liabilities

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the annual report and accounts:

a) **Financial instruments 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.

Investments in funeral plans

Where there is no active market or the investments are unlisted, the fair values are based on commonly used valuation techniques.

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.

Fixed rate sterling Eurobonds

The fixed rate sterling eurobond 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.

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) **Interest-bearing loans and borrowings - amortised cost**

These are shown at amortised cost which presently equate to fair value or are determined in whole by using quoted market prices. Fair value measurement is calculated on a discounted cash flow basis using prevailing market interest rates.

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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.

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 2016 £m	Fair value 2016 £m	Carrying value 2015 £m	Fair value 2015 £m
Interest-bearing loans and borrowings	**194**	**203**	195	198

The table below analyses financial instruments by measurement basis as detailed by IAS 39 (Financial Instruments: Recognition and Measurement).

2016	Designated at fair value £m	Loans and receivables £m	Available for sale £m	Other amortised cost £m	Total £m
Assets					
Other investments	**1,098**	**-**	**688**	**-**	**1,786**
Derivative financial instruments	**50**	**-**	**-**	**-**	**50**
Trade and other receivables	**-**	**678**	**-**	**-**	**678**
Cash and cash equivalents	**-**	**-**	**-**	**283**	**283**
Total financial assets	**1,148**	**678**	**688**	**283**	**2,797**
Liabilities					
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**
Interest-bearing loans and borrowings	**948**	**-**	**-**	**212**	**1,160**
Trade and other payables	**-**	**-**	**-**	**2,355**	**2,355**
Funeral plans	**915**	**-**	**-**	**-**	**915**
Overdrafts	**-**	**-**	**-**	**6**	**6**
Total financial liabilities	**1,863**	**-**	**-**	**2,573**	**4,436**

2015	Designated at fair value £m	Loans and receivables £m	Available for sale £m	Other amortised cost £m	Total £m
Assets					
Other investments	980	-	692	-	1,672
Derivative financial instruments	55	-	-	-	55
Trade and other receivables	-	597	-	-	597
Cash and cash equivalents	-	-	-	405	405
Total financial assets	1,035	597	692	405	2,729
Liabilities					
Derivative financial instruments	37	-	-	-	37
Interest-bearing loans and borrowings	874	-	-	214	1,088
Trade and other payables	-	-	-	2,192	2,192
Funeral plans	805	-	-	-	805
Overdrafts	-	-	-	4	4
Total financial liabilities	1,716	-	-	2,410	4,126

26. Financial instruments, derivatives and fair values of financial assets and liabilities 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, 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.

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

Valuation of financial instruments

2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Financial assets at fair value through income or expense				
- Funeral plan investments	-	-	872	872
- Derivative financial instruments	-	50	-	50
- Insurance investments	-	226	-	226
Available for sale assets	-	688	-	688
Total financial assets at fair value	-	964	872	1,836
Liabilities				
Financial liabilities at fair value through income or expense				
- Derivative financial instruments	-	-	-	-
- Fixed-rate sterling eurobond	-	927	-	927
- First mortgage debenture	-	21	-	21
- Funeral plan liabilities	-	-	915	915
Total financial liabilities at fair value	-	948	915	1,863

2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Financial assets at fair value through income or expense				
- Funeral plan investments	-	-	781	781
- Derivative financial instruments	-	55	-	55
- Insurance investments	-	199	-	199
Available for sale assets	-	692	-	692
Total financial assets at fair value	-	946	781	1,727
Liabilities				
Financial liabilities at fair value through income or expense				
- Derivative financial instruments	-	37	-	37
- Fixed-rate sterling eurobond	-	853	-	853
- First mortgage debenture	-	21	-	21
- Funeral plan liabilities	-	-	805	805
Total financial liabilities at fair value	-	911	805	1,716

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:

	2016 £m	2015 £m
Carrying amount	**688**	692
Fair value	**688**	692
Amortised cost	**664**	684

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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:

	2016 £m	2015 £m
Derivatives	**0.40% - 1.22%**	0.72% - 2.07%
Loans and borrowings	**3.65% - 9.41%**	3.97% - 10.23%

Accounting policies

The Group classifies its financial assets as either:
- available for sale; or
- financial assets at fair value through income or expense; or
- loans and receivables.

i) Recognition of financial assets
Financial assets are recognised 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 originated.

ii) Derecognition of financial assets and financial liabilities
Financial assets are derecognised when they are qualifying transfers and:
- the rights to receive cash flows from the assets have ceased; or
- the Group 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
The Group classifies the holdings in debt securities as available for sale. Initial measurement is at fair value, being purchase price upon the date on which the Group 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 vi). An effective interest rate for each holding is calculated on initial recognition and subsequently recognised in the income statement over the lifetime of the bond. 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.

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

v) Financial investments and instruments at fair value through income or expense

Insurance

Investments, other than those in debt securities, are designated as financial assets at fair value through income or expense.

For CISGIL, this is 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.

Funeral plans

For 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.

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.

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.

Interest rate swaps in the Trading Group

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.

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.

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

vi) Impairment of financial assets
Assessment
At the balance sheet date, the Group 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).

Bad and doubtful debts in the Trading Group
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 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.

vii) Gains less losses arising from financial assets
Gains less losses arising from financial assets represents realised gains/losses on available for sale assets.

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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.

27. 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 (2015: £4m). 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 31 December 2016, the future minimum lease payments under non-cancellable operating leases were:

	2016		2015	
	Land and buildings	**Other**	Land and buildings	Other
	£m	**£m**	£m	£m
Within one year	**171**	**8**	191	5
In two to five years	**606**	**11**	680	4
In over five years	**1,318**	**-**	1,436	-
	2,095	**19**	2,307	9

The total of future minimum sublease payments expected to be received under non-cancellable subleases less than 50 years is £182m (2015: £198m).

CISGIL entered into a long term software as a service contractual agreement. This contract will end no earlier than 2023. The estimated value of the remaining commitment is £148m (2015: £153m), these amounts have not been provided for in the financial statements.

Commitments relating to associates and joint ventures are disclosed in note 22.

28. 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.

	Relationship	2016 £m	2015 £m
Sales to associated undertakings and joint ventures on normal trading terms	(i)	**0.2**	0.2
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 note 22.
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 20. The sales to corporate members, on normal trading terms, were £1,573m (2015: £1,504m) and the amount due from corporate members in respect of such sales was £124m at 31 December 2016 (2 January 2016: £113m). No distributions have been made to Corporate members based on their trade with the Group in either the current or prior years.

Transactions with directors and key management personnel
Disclosure of key management compensation is set out in the Remuneration Report. A number of small 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 Group. At the balance sheet date a related party held a funeral plan to the value of £5,000. The transaction is 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 (2015: £nil). Total compensation paid to key management personnel is shown below.

Key management personnel compensation	2016 £m	2015 £m
Short-term employee benefits	**9.0**	10.3
Post-employment benefits	**0.5**	0.7
Other long-term benefits	**1.9**	2.9
Termination benefits	**0.4**	0.8
Total	**11.8**	14.7

Of the above, £0.3m (2015: £1.3m) was paid via a management entity.

Termination benefits in 2016 relate to LTIP awards vested in the year in respect of Executives who left the Group in previous years. See table 2b of the Remuneration Report (page 79).

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:

	2016 £m	2015 £m
Loans	**-**	(1)
Intercompany assets	**1**	6
Bank balance	**118**	105
Intercompany liabilities	**(140)**	(156)

Net interest and fees paid to The Co-operative Bank plc were £2m (2015: £3m).

28. Related party transactions and balances continued

The Group owns 20.2% of the Bank'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 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. These commitments were satisfied with the final tranche paid by the Group in December 2014.

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. Through 2016, the parties continue to discuss the separation of Pace and agree the Bank's proportion of employer contributions in Pace.

Britannia Supplementary Pension & Life Assurance Plan (BSPLAP)
On 23 June 2016, the Bank entered into a Deed of Substitution, Removal and Appointment of Trustee and Cessation of Participation relating to the BSPLAP with CFS Management Services Limited (CFSMS, a subsidiary of the Group) and the Group. Under the Deed, CFSMS was released from its obligations and liabilities as the sole sponsor, principal employer and trustee of the BSPLAP and the Bank replaced it as sole sponsor, principal employer and trustee.

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 Group currently provides IT services to the Bank under an IT Services Agreement (ITSA) dated 5 July 2012. The services are provided on at 'at costs' basis and the Bank manages the Group as a provider of material services. The most recent amendment to the ITSA was made on 21 December 2016 permitting termination, in part for convenience, and a framework to manage the process of exit of services from the ITSA to the Bank's new chosen suppliers. The Bank is now using this framework to exit progressively from the ITSA as services are transitioned from the Group to new suppliers. At this stage the Bank anticipates completing exit of the IT Services Agreement during 2018.

The Bank and the Group entered into an IT Separation Costs Agreement on 22 January 2015 as amended by a letter dated 20 June 2016 to support Separation of the legacy shared infrastructure. The IT Separation Costs agreement assessed the Bank and Group's respective costs to deliver Separation. Co-operative Banking Group Limited (a 100% subsidiary of the Co-operative Group and parent of CFSMS) undertook to contribute a maximum of £95m towards 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 the project falls between £76m and £120m. The Group and CSFMS undertook not to terminate the existing ITSA prior to 31 December 2017 to provide the Bank sufficient time to separate its IT infrastructure from that of the Group.

28. Related party transactions and balances continued

Transitional Services Letter (TSA)
The Group and the Bank entered into a TSA on 21 December 2016 whereby the Group agreed to provide certain services to the Bank into the IBM environment to ensure a successful separation of the Bank's IT infrastructure from the Group.

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's 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 and the terms of the payment by the Group to the Bank for those tax losses. The Group has recognised an undiscounted creditor of £137m (2015: £143m) with the Bank for this. The Bank receives payment from the 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 (which in turn is a wholly owned subsidiary of Co-operative Group Ltd) and continues to undertake the provision of supplies and services on behalf of the Bank. Further details of the CFSMS – Bank Framework agreement are disclosed below.

CFSMS - Bank Framework
On 16 February 2006, 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 employment of the majority of the staff to the Bank and the transfer of assets to the Bank. The Bank entered into numerous contracts with third party suppliers to replace those services previously provided to the Bank through CFSMS or the wider Group. By the end of 2016 all known staff transfers had been completed and the vast majority of contracts re-established as 'Bank-only'. The remaining contracts will be transferred as they come due over the balance of the IT Separation period.

IT Security
The Bank's specialist IT security team provide an IT security service to the Bank and CISGIL in relation to the shared IT infrastructure which the Bank and CISGIL share until such infrastructure is separated. This service comprises a small number of people.

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.

NOMA
The Group has transacted in both periods with the NOMA joint venture in relation to the head lease 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.

29. Principal subsidiary undertakings

In plain English – what does this note show? The table shows the principal subsidiaries of the Group, the Group's percentage shareholding in those subsidiaries and the nature of their business.

All of the principal subsidiary undertakings are registered in England and Wales and their principal place of business is the United Kingdom. See General accounting policies on page 103 for a Group structure diagram.

	Society holding %	Nature of business
Financial Services:		
Co-operative Banking Group Ltd	100	Holding society
CIS General Insurance Ltd	100	General insurance
CFS Management Services Ltd	100	Service company
Reclaim Fund Ltd	100	Reclaim Fund
Trading:		
Co-operative Group Holdings (2011) Ltd	100	Property management
Co-operative Group Food Ltd	100	Food retailing
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 22.

Notes

i) All of the principal subsidiaries are audited by EY 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.

iii) All transactions between entities are in the usual course of business and are at arms length.

iv) S206374 Properties Limited (Somerfield Stores Limited) was sold to HUK 65 Limited on 25 July 2016.

Significant restrictions

CISGIL is a regulated business and as such CISGIL may only recommend the payment of a dividend to the Group if it has sufficient capital to do so having regard to CISGIL's regulatory requirements and the CISGIL Board's risk appetite.

30. 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 RFL's assets and liabilities.

	2016 £m	2015 £m
Non-current		
Investment securities	**237**	73
Current		
Cash	**297**	488
Investment securities	**35**	-
Reclaim Fund assets	**569**	561
Non-current		
Provision for reclaims of dormant account balances	**342**	305
Provision for future distributions to Big Lottery Fund	**153**	182
Current		
Trade and other payables	**1**	-
Reclaim Fund liabilities	**496**	487

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.

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 rate method.

Independent auditor's report to the members of Co-operative Group Limited

Our opinion on the financial statements

In our opinion:

- Co-operative Group Limited's ('the Society' / 'the Group') financial statements give a true and fair view of the state of the Group's affairs as at 31 December 2016 and of the Group's loss for the 52 week period then ended;

- The Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and

- The Group financial statements have been prepared in accordance with the requirements of the Co-operative and Community Benefit Societies Act 2014.

What we have audited

We have audited the financial statements of Co-operative Group Limited for the period ended 31 December 2016 which comprise:

- Consolidated income statement for the period ended 31 December 2016
- Consolidated statement of comprehensive income for the period ended 31 December 2016
- Consolidated balance sheet as at 31 December 2016
- Consolidated statement of changes in equity for the period ended 31 December 2016
- Consolidated statement of cash flows for the period ended 31 December 2016
- Related notes 1 to 30 to the financial statements

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union and in accordance with The Co-operative and Community Benefit Societies Act 2014.

Overview of our approach

Risk of material misstatement	• Carrying value of the investment in the Co-operative Bank *(Group)* • Valuation and completeness of Insurance Contract Liabilities *(Insurance)* • Supplier Income *(Food)* • Completeness and valuation of Provisions *(Group)* • Accounting for defined benefit pension schemes *(Group)* • Revenue recognition – cut-off *(Group)* • Impairment of PPE and Goodwill *(Food)* • Inventory Valuation *(Food)*
Audit scope	• We have performed a full scope audit on the Food, Funeralcare, Corporate and Insurance components and the Reclaim Fund. We performed specific procedures on accounts within the Legal, Electrical, Properties and Head Office components which include the results of the Group's investments in Joint Ventures and Associates • The components where we performed full or specific audit procedures accounted for 100% of Adjusted Revenue, 100% of Loss Before Tax and 100% of Total Assets
Materiality	• Overall Group materiality of £40m represents 0.5% of Adjusted Revenue

Our assessment of risk of material misstatement

We identified the risks of material misstatement described below as those that had the greatest effect on our overall audit strategy, the allocation of resources in the audit and the direction of efforts of the audit team. In addressing these risks, we have performed the procedures below which were designed in the context of the Financial Statements as a whole and, consequently, we do not express any opinion on these individual areas.

Risk	Our response to the risk	Key observations communicated to the Risk and Audit Committee
Carrying value of the investment in The Co-operative Bank plc The Group holds a 20.2% share in The Co-operative Bank plc ('the Bank') which is accounted for as an equity accounted associate. In order to continue to apply equity accounting for the Group's investment in the Bank, the Group must be able to exert significant influence. The determination of the extent of influence requires management judgement. The carrying value of this asset as at 2 January 2016 was £185m. Given the ongoing and material uncertainties in relation to the appropriateness of the Going Concern basis of preparation in the Bank's Annual Report and Accounts we identified significant risk in relation to the valuation of this investment, and whether impairment had arisen as at 31 December 2016. **Refer to the Audit Committee Report (page 61); Accounting Policies (page 151); and note 22 of the Consolidated Financial Statements (page 145)**	• We obtained Management's paper setting out their rationale for the classification of this investment as an equity accounted associate. We understood the Board's rationale for this conclusion in the context of the requirements of IAS 28: Investments in Associates and Joint Ventures in order to demonstrate the Group has the ability to exercise significant influence over the Bank. We tested this assertion based upon the interactions of the Group with the Bank. • As the Bank is equity accounted, we designed procedures to enable us to obtain assurance over the reported results of the Bank for the year ended 31 December 2016. These procedures included review of the Audit Committee papers issued to the Bank's Audit Committee by the Bank's Auditors. We met with the Bank's Senior Statutory Auditor to understand the key judgements impacting upon their audit opinion for the year ended 31 December 2016. • We obtained and documented our understanding of the impairment assessment performed by the Group in relation to their Investment in the Bank. We tested this assessment against the requirements of IAS 39: Financial Instruments: *Recognition and Measurement*. • With the assistance of our valuation specialists we tested the impairment assessment prepared by Management under IAS 36: Impairment of Assets and considered the appropriateness of the various valuation methodologies considered. We corroborated underlying data used as the basis for this assessment to source documents. • We engaged EY valuation specialists to test the significant assumptions applied within the Dividend Discount Model (DDM) used by the Group to determine recoverable amount. We agreed underlying data within the DDM to financial information included within the Bank's 2016 Annual Report and Accounts. We applied sensitivity analysis to significant assumptions which included the discount rate, effect of future capital injections and discounting for low market liquidity. • We re-calculated the discount rate. We re-performed this valuation using a corroborative model developed by EY valuation specialists. • We benchmarked the Fair Value less Costs to Sell of the investment to other indicative sources including over-the-counter trading values and volumes, fund values and the price to book ratio of comparable banks. • We reviewed the disclosures included within the Group's Annual Report and Accounts in the context of the Bank's 2016 Annual Report and Accounts and the Announcement to Investors.	We agree with the treatment of the Group's investment in the Bank as an equity accounted associate in accordance with the requirements of IAS 28. Following their impairment assessment, Management have recognised an impairment charge in the period of £185m in relation to their investment in the Bank, reducing its value in the balance sheet as at 31 December 2016 to £nil. We agree with this adjustment in the context of the requirements of IAS 36.
Valuation and completeness of Insurance contract liabilities The Group's balance sheet includes significant liabilities in relation to the Insurance division. The gross liability recognised on the balance sheet as at 31 December 2016 was £724m (2015: £746m) of which the most subjective element relates to the calculation of reserves for claims that are Incurred But Not Reported ('IBNR'), £128m as at 31 December 2016 (2015: £153m)	Supported by our actuarial specialists: • We understood and tested the design and operational effectiveness of key controls over the process applied by Management in setting the liabilities. • We compared the methodology and assumptions applied by Management against our knowledge of the sector. • We performed independent actuarial projections for over 90% of the best estimate reserve. We tested the data used for our independent projections to ensure its consistency with that in the underlying incurred claim administration systems. In response to weaknesses identified in the IT control environment we performed substantive testing to gain assurance that the information contained in the claims administration system agreed to supporting evidence.	Management's adopted reserve including the reserving margin, both gross and net, sits within our view of a reasonable range.

The calculation of IBNR is inherently uncertain and, given the quantum of the balance, has a material impact on the reported results.

In addition to the subjectivity in projecting the IBNR, Management carries a reserving margin over the projected best estimate. The setting of the best estimate and the reserving margin are both inherently judgemental and susceptible to management override.

Refer to the Audit Committee Report (page 61); Accounting Policies (page 161); and note 24 of the Consolidated Financial Statements (page 159)

- We understood the rationale for the quantum of the margin at the reporting date, compared the movement year on year, assessed consistency with the stated Risk Appetite and considered whether the margin recognised moved the adopted reserve outside of our reasonable range.
- We tested, on a sample basis, that the reinsurance recoveries were recorded in line with underlying contracts.

Supplier Income

The Group receives material discounts from suppliers. There are three streams being Bonus Income, Long Term Agreements and Promotional Income (as described in note 4) in relation to which total income for 2016 was £671m (2015: £635m). The terms of agreements with suppliers can be complex or varied and may also include performance conditions. Estimation uncertainty is present in relation to supplier income, in particular where promotional periods span the year end. There is opportunity through management override or error to misstate the allocation of supplier income between periods.

There is also a risk that supplier income earned jointly with other independent societies through the Federal joint buying group is not allocated and accounted for appropriately.

Refer to the Accounting Policies (page 114); and note 4 of the Consolidated Financial Statements (page 114)

- We focused our audit procedures on the areas where Management apply judgement, where the processing is either manual or more complex and where the quantum of agreements is high.
- We performed a walkthrough of the three different arrangement types (Bonus Income, Long Term Agreements and Promotional Income) presented in note 4 to the accounts. We were able to take a controls reliance approach over certain aspects of the process in relation to Bonus Income and Long Term Agreements. We performed analytical review procedures to understand movements in income statement and balance sheet accounts period on period, including ageing analysis and corroborated unusual and material variances to underlying source documentation.
- We have tested a sample of items within the income statement for each supplier income type to confirm occurrence and measurement.
- We selected a sample of suppliers to send confirmations across all deal types to confirm key deal input terms. Where we did not receive a response from the supplier, we performed alternative procedures, including obtaining evidence of initiation and settlement of the deal. We recalculated income recognised in the period, for a sample of suppliers, based on agreed arrangement terms and volumes confirmed by the supplier.
- We selected a sample of year end balances from the trade receivables ledger, and requested third party balance confirmations. In all instances where suppliers did not respond to our audit request, we agreed the balance to either post year end cash receipts or settlements to verify existence at the balance sheet date. We tested the settlement of a sample of supplier arrangements recognised in the income statement, which included settlement in cash or by off-set to amounts payable.
- Using data extracted from the accounting system, we tested the appropriateness of journal entries and other adjustments to supplier arrangements.
- We reviewed Management's disclosure in respect of supplier arrangement amounts recorded in the income statement and balance sheet.

Supplier arrangement amounts are appropriately recognised in the income statement and balance sheet and the disclosures included are appropriate.

Completeness and valuation of Provisions Provisions recognised on the balance sheet as at 31 December 2016 are £326m (2015: £439m). Provisions inherently include both estimation uncertainty and management judgement in relation to the existence of an obligating event and the quantum and timing of future cash outflows. There is risk that provisions could be misstated if inappropriate assumptions, such as discount rates, are applied by Management. Within this balance we have focused our testing on significant and judgemental provisions including: Litigation £10.6m (2015: £8.2m), uninsured claims £64m (2015: £75m), Bank separation £38m (2015: £68m) and onerous leases £194m (2015: £263m). **Refer to the Audit Committee Report (page 61); Accounting Policies (page 141); and note 19 of the Consolidated Financial Statements (page 140).**	**Onerous leases:** • We evaluated the reasonableness of the discount rate applied and performed sensitivity analysis to the cash flows to test the appropriateness of the valuation. • We evaluated the reasonableness of assumptions adopted with respect to sublease income and future dilapidations cost by gaining an understanding of the review process taken by Management. We selected a sample of properties from the provision and from that sample agreed revenues and costs to underlying contractual documentation to test these assumptions. • We confirmed stores identified as loss making were captured within the provision. For a sample of stores included in the model, we traced key data to underlying systems to confirm integrity of information. **Litigation:** • We met with the Group's legal team and obtained the legal claims register maintained by the Group to test the completeness of the provision. We reviewed the register and compared this to amounts included within the provision. We inspected the legal expenses in the income statement to validate that legal costs paid correlated with the cases held on the legal register. • We evaluated the reasonableness of assumptions used to derive the valuation of the provision, including comparison to the conclusions of external and internal legal counsel. **Uninsured claims:** • We tested known claims through agreement to supporting documentation including loss adjustor reports and inspected amounts relating to own costs to establish if appropriate to include. • We obtained the actuarial report prepared by Management's external experts and discussed the basis for the provision with the Group's external actuarial valuation experts. We engaged EY actuarial experts to assist in testing the reasonableness of assumptions which form the basis for the provision, to determine the appropriateness of the valuation methodology applied and to benchmark the key assumptions used in the valuation of liabilities. **Bank Separation:** • We evaluated the progress of separation against plan. • We tested the amounts held within the provision in the context of the obligations created by the requirements of the separation agreement to assess the appropriateness of provisions held. We agreed certain future costs to third party documentation. For the provisions described above we re-performed manual calculations to confirm clerical accuracy of the provision model and evaluated the adequacy of the Group's disclosures in respect of provisions in accordance with IAS37.	Provisions are held on the balance sheet in accordance with the requirements of IAS 37: Provisions, Contingent Liabilities and Contingent Assets
Accounting for defined benefit pension schemes The Group operates a number of defined benefit pension schemes, of which the principal scheme is PACE. The net surplus recognised on the balance sheet as at 31 December 2016 was £1,688m (2015: £1,130m). The valuation of Pension scheme assets and liabilities and the assumptions linked to valuation methodologies includes a significant degree of estimation uncertainty and gives rise to a risk of management override	• EY pensions specialists met with the Group's in-house pensions team and external actuaries to assess the appropriateness of the valuation methodology applied and benchmarked the key assumptions used in the valuation of liabilities. • We tested a sample of pension asset valuations, including property and unlisted debt instruments, with support from our valuations specialists to evaluate the reasonableness of the assumptions used to value the assets. • We inspected scheme documentation to understand the 'last man standing' obligation with the Bank. We considered the wider implications for the Group in the scenario of this clause being invoked including any impact on the going concern assumption. • With support from EY actuarial specialists we read the internal legal advice prepared by the Group to check this complied with the Scheme Rules, to enable us to conclude on the treatment of historical liabilities recognised in relation to minimum funding requirements to cover shortfalls on the smaller schemes, and the corresponding prior period adjustment.	The assets and liabilities have been valued in accordance with group policy and relevant accounting standards. Prior period adjustments as set out in note 23 have been recognised appropriately in the context of the requirements of IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors.

The overall position is a net surplus and, as the principal employer, the Group has the sole right to any surplus recognised. There are on- going discussions with the Bank to agree separation terms in respect of the pensions scheme. We have considered in particular the risks relating to:

- Any separation arrangement entered into between the Group and the Bank in relation to the PACE scheme.
- The completeness of liabilities in respect of the pension equalisation process within in the PACE scheme.
- The application of the principles of IFRIC 14: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.
- The valuation of assets and liabilities.

Refer to the Audit Committee Report (page 61); Accounting Policies (page 158); and note 23 of the Consolidated Financial Statements (page 152)

- We understood the process undertaken by Management to establish the appropriate adjustment required in respect of pensions equalisation. We engaged EY actuarial specialists to test the valuation of the equalisation prior period adjustment recorded by Management.

Revenue recognition – cut-off

The timing of when revenue is recognised is relevant to the reported performance of the Group. There is opportunity through management override or error to misstate the allocation of revenue between periods. This timing of revenue recognised, in particular around year end, is a focus for all material Group revenue streams. Our testing has focused upon the following judgemental areas where there is an opportunity to materially overstate revenue:

Funeralcare: Prepaid Plan Accounting

- An element of revenue related to pre-need funeral plans is recognised upfront upon plan inception and a Member discount is also deducted on day one. There is a risk that revenue is overstated through management override.

Funeralcare: Disbursement Revenues

- Historically the business has recognised as principal certain disbursement revenues. A risk arises that revenue and related costs are overtstated should the business be acting as agent.

Insurance: Earned Premiums

- Revenue recognised is related to the premium earnings pattern. The risk is that the earnings pattern is inappropriate and the application of the earnings pattern to underlying policy data is operating inaccurately.

Applicable to all material revenue streams:

- We gained an understanding of, and documented the processes used to record revenue and tested the design effectiveness of key controls.
- We performed analytical procedures by comparing revenue balances for the year against expectation and obtaining support for significant variances. In particular, we performed detailed procedures in the month preceding and subsequent to the year-end.
- We performed detailed cut-off testing of revenue transactions during the period either side of the balance sheet date with reference to service delivery documentation and we also considered sales credit notes issued in the same period.
- We tested whether the Group's revenue recognition policy is in line with the criteria set out in IAS 18: Revenue.
- To address the risk of management override, we examined manual journal entries that were posted to revenue accounts and obtained source documentation to ensure these are appropriately recorded in the general ledger.

Funeralcare: Prepaid Plan Accounting:

- We corroborated significant costs of funeral plan delivery to Management's forecasts, historic results and other relevant information to assess the appropriateness of the proportion of revenue recognised at plan inception and the related allocation of discounts.

Funeralcare: Disbursement Revenues:

- We understood Management's assessment as to whether the business is acting as agent or principal.
- We evaluated Management's assessment as to which party assumes the risks and rewards of service delivery.
- We tested a sample of transactions to corroborate the nature and value of the revenue and cost.

Insurance: Earned Premiums:

- We obtained a download of all policies issued in the year from the Policy Administration System (PAS) and reconciled this to the general ledger.

Revenue has been recognised appropriately in the period ended 31 December 2016

It was concluded that the business is acting as an agent in relation to Funeralcare disbursement revenues. As such the costs and revenues should be presented net within the income statement, with no associated profit impact. Refer to 'Restatements' in the 'General Accounting Policies' note for further details.

Food • Revenue recognised in the Food business at the year end date is based upon polling returns from stores. These submissions occur over a number of days subsequent to the year-end date. A risk arises that revenues are overstated as a result of management override. **Food: Federal joint buying group** • Revenue is recognised in respect of sales to independent societies. The risk is that revenue is reported in the wrong period due to management override. **Refer to the Audit Committee Report (page 61); Accounting Policies (page 111); and note 2 of the Consolidated Financial Statements (page 111)**	• In response to weaknesses in the IT control environment we performed substantive sample testing of policy records back to cover notes to confirm that the relevant attributes (such as class of business, inception date and Premium amount) were consistent between the data in PAS and the customer documentation. • We tested the earnings pattern applied to the business written and using the information contained in PAS we independently recalculated the earned and unearned portions. **Food:** • We tested journals submitted on 1-4 January 2017 and aggregated these to a store level. • We compared these journals on a store by store basis to the data polled in this period and to the average weekly store sales. • We investigated variances outside our expectations through obtaining Management explanations and agreed back to source documentation. • We tested all store sales by agreeing to weekly sales reconciliations. Further testing was performed to validate this reconciliation. **Food: Federal joint buying group:** • We tested a sample of deliveries two weeks either side of the year end agreed back to proof of delivery. • Goods are delivered direct from supplier prior to delivery to Members and the invoice is generated automatically by Electronic Data Interchange. We tested these transactions to despatch note and reconciled to proof of delivery.	

Impairment of Property Plant and Equipment and Goodwill
The Group's most significant Goodwill and Property, Plant and Equipment (PPE) balances are predominantly within the Food division. In line with the requirements of IAS 36: Impairment of Assets, Management test these balances annually for impairment, with a particular focus on loss making stores. At the year-end Management recognised an impairment of £4.7m
We have identified a significant risk in relation to the impairment of PPE and goodwill due to the sensitivity of the impairment assessment and model to the assumptions underlying both discount rates and forecast information applied, both of which give rise to a risk of management override.
Refer to the Audit Committee Report (page 61); Accounting Policies (pages 123 and 127); and notes 10 and 11 of the Consolidated Financial Statements (pages 121 and 125)
	• We walked through the process in respect of impairment of goodwill and PPE and evaluated the design effectiveness of the key controls.
	• We obtained Management's impairment workings. We tested the integrity of the underlying data in the model by, for a sample of stores, tracing key data to source documentation.
	• We reviewed the amount of goodwill de-recognised as a result of disposal of stores to ensure in line with our understanding and expectations.
	• We understood and assessed the reasonableness of the rationale, assumptions and conclusions in relation to stores not deemed to have indications of impairment in the model, including:
	  • the assessment in relation to stores near break-even.
	  • the assessment in respect of turn-around situations. We performed hindsight assessment on previous turnaround stores to corroborate Management's assumptions.
	  • Visited flagship stores to confirm they met the criteria determined by Management.
	  • Obtained corroborative support for forecast disposal proceeds where stores were earmarked for disposal.
	• We benchmarked the discount rate calculation applied, using our internal valuation experts to assist in our review of whether Management's assumptions are within an acceptable range based on comparative market data.
	• We compared growth assumptions to external benchmarks.
	• We performed analysis on key inputs including growth, discount rates and perpetuity assumptions to determine the sensitivity of the impairment calculation to these inputs.
		We have concluded that the impairment charge has been appropriately calculated and the valuation of PPE and Goodwill is in accordance with the requirements of IAS 36.

Inventory Valuation The Group holds a significant level of inventory at the year end, mainly in the Food business. Inventory held on the balance sheet as at 31 December 2016 was £439m (2015: £445m) which is net of a provision of £16m (2015: £17m). Inventory is held in both distribution warehouses and within a large number of individual retail stores. Management apply a number of valuation techniques which range in complexity and rely on a large number of inputs which gives rise to a risk of management override. **Refer to the Accounting Policies (page 133); and note 14 of the Consolidated Financial Statements (page 133)**	• We walked through the inventory valuation and provision process, and tested the design effectiveness of key controls. • We assessed the appropriateness of the inventory valuation methods applied in line with the criteria set out in IAS 2: Inventories. • We performed integrity testing on the year-end system generated calculations for depot and store inventory valuation. • We understood and tested the flow of transactions through the various inventory systems. • We interrogated the ledger to identify any large or unusual items in the inventory valuation listing. We understood the basis for these items and considered whether they were in line with our understanding. • We obtained Management's provision and re-performed the calculation to ensure clerical accuracy. • We compared the leakage provision against post year end leakage rates and the consistency with prior year leakage estimates. • We tested a sample of inventory and compared to sales price to confirm that the inventory was held at the lower of cost or net realisable value.	We are satisfied the valuation of inventory and related inventory provisions held at depots and at retail stores is materially appropriate.

The scope of our audit

Tailoring the Scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of Group-wide controls when assessing the level of work to be performed at each entity.

In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts of the components of the Group in the Group financial statements, we performed a full scope audit on the Food, Funeralcare, Corporate and Insurance components and the Reclaim Fund, which represent the principal business units within the Group based on their size and risk profile. For the Legal, Electrical, Properties and Head Office components, which include the results of the Group's investments in Joint Ventures and Associates, we performed audit procedures on specific accounts which we considered to have the greatest impact on the significant accounts in the financial statements due to their risk profile and coverage.

The components where we performed audit procedures accounted for 100% of the Group's Adjusted Revenue, 100% of the Group's Loss Before Tax and 100% of the Group's Total Assets. The full scope components contributed 99% of the Group's Adjusted Revenue, (25)% of the Group's Loss Before Tax and 95% of the Group's Total Assets. The specific scope components contributed 1% of the Group's Adjusted Revenue, 125% of the Group's Loss Before Tax and 5% of the Group's Total Assets. The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage of significant accounts tested for the Group.

Involvement with Component Teams

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken at each of the components by us, as the primary audit engagement team, or by component teams under our instruction. Four full scope components and three specific scope components were performed by component audit teams. One full scope component and work on specific balances in a number of corporate components including the Group's investments in Joint Ventures and Associates was carried out by the primary team. We determined the appropriate level of involvement with the component teams to enable us to determine that sufficient audit evidence had been obtained as a basis for our opinion on the Group as a whole.

At the start of the audit, a Group wide Team Planning Event was held with representatives from all full and specific scope component teams in attendance. The primary team interacted regularly with the component teams where appropriate during various stages of the audit, reviewed key working papers and were responsible for the scope and direction of the audit process. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

The Group has a 20.2% investment in the Co-operative Bank which is an equity accounted associate. We performed certain audit procedures to enable us to obtain sufficient audit evidence in relation to the carrying value of the Group's investment in the Bank. During the current period's audit cycle, the Senior Statutory Auditor held discussions with the Bank's Senior Statutory Auditor.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We have set group materiality at £40m, based on 0.5% of adjusted revenue. Adjusted revenue was calculated as total Group revenue less income generated by the Federal joint buying group.

We considered revenue to be the most appropriate performance metric on which to base our materiality calculation because the nature of underlying trading businesses within the Group means revenue is one of the key financial metrics used by stakeholders as their relevant performance measure, revenue is a key performance indicator used by Management to monitor the Group's performance and profit or loss before tax has historically been volatile.

Performance Materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50% of our planning materiality, namely £20m, consistent with our approach on initial audits.
Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £4m to £20m.

Reporting Threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Risk and Audit Committee that we would report to them all uncorrected audit differences in excess of £2m which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Scope of the audit of the financial statements

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 89, the Society's directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report is made solely to the Society, in accordance with Section 87 of the Co-operative and Community Benefit Societies Act 2014 and our engagement letter dated 26 July 2016, and in respect of the reporting on corporate governance and those matters which we have agreed to state to them in our report, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Matters on which we are required to report by exception

ISAs (UK and Ireland reporting)	We are required to report to you if, in our opinion, financial and non-financial information in the Annual Report is: • materially inconsistent with the information in the audited Group financial statements; or • apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or • otherwise misleading In particular, we are required to report whether we have identified any inconsistencies between our knowledge acquired in the course of performing the audit and the Directors' statement that they consider the Annual Report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy; and whether the Annual Report appropriately addresses those matters that we communicated to the Risk and Audit Committee that we consider should have been disclosed.	We have no exceptions to report
Co-operative and Community Benefit Societies Act 2014	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 require for our audit.	We have no exceptions to report
Additional requirements as set out in our engagement letter	In addition to the audit of the financial statements, the directors have engaged us to review their Corporate Governance Statement on page 47 as regards the Society's compliance with provisions 43, 123 – 130 and 135-152 of Co-operatives UK Limited's Corporate Governance Code for Consumer Co-operative Societies issued in November 2013 ('the Code').	We have no exceptions to report

Statement on the directors' assessment of the principal risks that would threaten the solvency or liquidity of the entity

ISAs (UK and Ireland) reporting	We are required to give a statement as to whether we have anything material to add or to draw attention to in relation to: • the Directors' confirmation in the Annual Report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity; • the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated; • the Directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and • the Directors' explanation in the Annual Report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosure drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or draw attention to

Alistair Denton (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Manchester

5 April 2017

Notes:

1. The maintenance and integrity of the Co-operative Group Ltd website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Jargon buster (unaudited)

There are lots of technical words in our accounts. Due to legal and accounting reasons, we have to use these. However, hopefully the below can help you understand some of the difficult phrases accountants like to use. There is also an "In plain English" introduction to every note to the accounts describing in simple terms what the note is trying to show.

When the word is in bold in the table below that means you can also find the definition of that word in this table.

Accelerated fee amortisation	We have to pay fees to bankers when we take a loan out. We spread the costs of the fees over the life of the loan. If we repay the loan early, we have to write off these costs.
Accounting surplus (pensions)	When a pension scheme has more **assets** now than its predicted **discounted liabilities** in the future then it is an accounting surplus
Accrued income	When we have performed a service, but haven't billed the customer, we will hold that income on the **balance sheet** until we have. The balance is then moved to **receivables.**
Actuarial best estimate	In Insurance, this is the average of all future claims and cost scenarios. It is calculated using historical data and judgement. A best estimate will normally be designed to be neither too optimistic or, conversely too cautious.
Amortisation	Similar to **depreciation,** but for intangible **assets**
Asset	This is an amount on our **balance sheet** where we can expect to get some sort of benefit in the future. It could be a building, some cash or when a customer owes us money.
Assets held for sale	Sometimes we have to sell things. When the Exec or Board has approved a large disposal before the year end but it has not been sold yet, we have to show it in this line on the **balance sheet** and **impair** if necessary.
Assets in the course of construction	These are **assets** that we're in the middle of building. They're on our **balance sheet** as we have spent money already building them, but they are not ready yet so are not **depreciating** them.
Associate	When we have significant influence over a company (usually by owning 20-50% of a company's shares and / or having a seat on its Board), we call that company an associate.
Available for sale **assets**	These are large long term investments mainly held by our insurance business in bonds and other such low risk investments. It doesn't sound like they are available for sale, but that is what the accounting rules tell us to call them as we could sell them if we wanted to. Any change in their values are shown in **other comprehensive income.**
Balance sheet	This shows our financial position. What **assets** we have and what **liabilities** we owe.
Benefit payments (pensions)	This is the amount the pension fund pays out to pensioners
Capital expenditure	When we spend money on items that will become **assets** (e.g. property, IT systems) this is shown as capital expenditure and the costs are not shown in the **income statement** of the year it is spent, but the costs are spread over the life of the **asset** by **depreciation** or **amortisation.**
Cash flow statement	This shows how much cash we have made in the year from our operations and what we've done with it.
CISGIL	CIS General Insurance Limited. This is the society that deals with our insurance business.
Claims incurred	This is the amount of insurance claims we have paid in the year plus any change in our estimation of future claims not have happened.
Claims paid	This is the amount of insurance claims we have paid out in the year
Claims reported	This is the amount on our **balance sheet** where we know what the claim is and know how much is going to be paid out.
Commitments	This is an amount where we have committed to a certain spend (e.g. building projects), but we have not put the amount on the **balance sheet** as we are not technically liable for it yet. We disclose these amounts in the commitments note.
Comprehensive income	This is our profit for the year plus **other comprehensive income.**
Consolidated	As this report is based on the financial performance and position of many societies and companies around **the Group**, we have to add up all those entities and the total is the consolidated position.

Contingent **asset**	This is an amount that we might get in the future. Unless it's almost certain that we'll get the amount, we're not allowed to put it on the **balance sheet**. We do however disclose the amount in the contingent **assets** and liabilities note.
Contingent liability	This is an amount that we might have to pay in the future. If it is more than likely that we won't have to pay the amount, then we will not show the amount on the **balance sheet.** We do however disclose the amount in the contingent **assets** and liabilities note.
Corporate investor shares	This is money that other societies may give to us and we pay them interest back. The societies can get their money back at any time.
Credit	This is an increase in income / reduction in costs on the **income statement** or an increase in a liability / reduction in an **asset** if on the **balance sheet.**
Current	An **asset** or **liability** that has a duration of less than a year.
Current service cost	This is an amount that shows us what pension benefits we have promised to our colleagues within the year
Current tax	This is the amount we expect to pay for tax for the year based on the profits we make.
Debenture	A fancy word for a loan that we have issued and are paying interest on.
Debit	This is a decrease in income / increase in costs on the **income statement** or a decrease in a **liability** / increase in an **asset** if on the **balance sheet.**
Debt	Loans that we've issued and are paying interest on.
Deferred acquisition costs	These are amounts where our insurance business pays to secure business. It then holds these costs on the **balance sheet** and amortises over the length of the insurance period.
Deferred consideration	This is an amount we will be paying to a seller for businesses we've bought or an amount we'll be getting off a buyer for businesses that we've sold.
Deferred tax	Sometimes our **assets** and liabilities are worth more or less on our **balance sheet** than our tax returns. The tax on the difference in value is called deferred tax and can be **assets** or liabilities depending on if it's worth more or less when we do our tax returns.
Defined benefit schemes	This is a pension scheme where an amount is paid out to an employee based on the number of years worked and salary earned.
Defined contribution schemes	This is a pension scheme where an amount is paid into the scheme and at retirement, the employee draws on the amount that has been invested over the years.
Deposits with credit institutions	When customers pay us premiums, we put the money in safe corporate bonds so that if an insurance policy needs to pay out, we have the money there. The amount we hold in these corporate bonds are these deposits.
Depreciation	Some **assets** the Co-op will have for a while (e.g. vehicles) and when we've used them, they usually won't be worth much. Depreciation spreads the cost of that usage so that the cost of the **asset** is spread evenly over years in the **income statement.**
Derivatives	An extravagant word for a financial product that's value goes up or down based on an underlying **asset** such as currency, a commodity or interest rate
Discontinued operations	When we sell a large business, we put its profits further down the **income statement** so it doesn't cloud the reader's view of the performance of **the Group**'s other operations that are staying.
Discount rate	This is the amount that we are discounting by. It's a percentage and varies based on future views on interest rates or inflation.
Discount unwind	Every year that £1,000 **discounting** is going to be worth more as we get nearer to paying / receiving it. We have to put that increase in value through our **income statement**
Discounting	When we have to pay or receive cash in the future, accountants like to take off part of the amount if it's a big amount (like on our **onerous leases**). This is because say £1,000 in the future is going to be worth less than £1,000 now – mainly because of inflation.
Disposals	When we have sold an **asset**
EBITDA	Stands for earnings before interest, tax, **depreciation** and amortisation. This is **operating profit,** but also excluding any **depreciation** or **amortisation.**
Equity	This is the difference between the **assets** we own and the liabilities we owe. Theoretically, how much money our members have left once every **asset** is sold and every **liability** is paid.

Eurobond Notes	This is our largest, fixed interest debt that we pay interest on to fund our businesses' operations.
Fair value movement	Accountants like to value some things every year. This includes most of our debt, **investment properties** and our pension schemes. The change in value is called fair value movement.
Fee and commission income	Our insurance business makes additional money on selling insurance products that it then passes onto a third party.
Finance costs	These are usually the interest we pay on our debt, but can also be other things such as the **fair value movement** on our debt or the **discount unwind** of **liabilities.**
Financial instruments	A collective term for debt or **derivatives** that we have.
Financial Services	This is a group of companies within **the Group** that provide financial products such as insurance or banking.
First Mortgage Debenture Stock	This is a small debt we owe that is secured against some properties. A bit like a mortgage.
Funeral plan investments	When a customer gives us money for their funeral in the future, we invest this money. The balance of these investments is held on the **balance sheet.**
Goodwill	When we buy a business or a group of **assets**, sometimes we pay over what its **assets** less **liabilities** are worth. This amount we pay over is called goodwill and we put it on our **balance sheet.**
(the) Group	This is Co-operative Group Limited and all companies and societies that it owns.
Hedging	Sometimes we want to protect ourselves in case we have to pay more in the future for something. This could happen if the value of the pound falls so we have to pay more when buying something abroad or if interest rates go up. We take out **derivatives** to protect us from this.
IAS	International Accounting Standards. **The Group** use these as the accounting rules. There are many different IASs that cover various accounting topics (e.g. IAS 38 is for **intangible assets**)
IFRIC	International Financial Reporting Interpretations Committee. These are interpretations of IASs or IFRSs that **the Group** also has to abide by.
IFRS	International Financial Reporting Standards. Similar to IAS, but cover different subjects.
Impairment	Sometimes our **assets** take a tumble. If a store, branch, business or investment is not doing as well, we have to re-value it and put the downward change in value as a cost in our **income statement**
Income statement	This not only shows our income as the name suggests, but also what our costs are and how much profit we have made in the year.
Intangible **asset**	We have **assets** at the Co-op that we can't see or touch so are shown separately to other **assets**. These include things like computer software and **goodwill.**
Interest expense	This is the interest that we pay in the year on our debt
Interest income	This is the interest that we receive in the year on our cash balance or pension **asset.**
Interest rate swaps	We like to know what interest we're going to be paying in the future so we can manage our businesses effectively. We enter into arrangements with banks so that we can do this. The value of these can go up or down depending on how the market sees interest rates in the future.
Inventories	This represents what goods we are trying to sell. The cost of this is shown on our **balance sheet.**
Inventory provision	If some of our stock isn't selling, we write those costs off to the **income statement** and hold a **provision** against those goods on the **balance sheet.**
Investment properties	Properties that we don't trade out of and which we might rent out or hold for capital appreciation are called investment properties.
Joint ventures	When we own 50% of a company we call it a joint venture. Sometimes **associates** are called joint ventures commercially as they're ventures with other parties (e.g. the Travel JV with Thomas Cook), but are called **associates** for accounting purposes.
Liability	This is an amount on our **balance sheet** which we will have to pay out in the future.
Like-for-like sales	The measure of year-on-year sales growth for stores that have been opened for more than one year.
Listed debt securities	People can trade some of our debt such as the **Eurobonds fair.** When this is the case, it is a listed debt security.

Member payments	This is an amount we have paid our members in the year that has been approved at the AGM such as dividends.
Net assets	Same as **equity**
Net debt	This is the debt we have less any cash that we might have.
Net operating **assets**	**Net assets** less investments, funeral bonds, **deferred tax, pension surplus** and drawn debt.
Non-controlling interest	The **equity** in a **subsidiary** not attributable to **the Group** i.e. we might own 60% of a company. The other 40% is the non-controlling interest.
Non-current	An **asset** or **liability** that has a duration of over one year.
One-off items	Items that are not regular in size or nature and would otherwise cloud the underlying profitability of **the Group** are stripped out. This could include a large IT project or a large restructuring exercise.
Onerous leases	When we close a store which we pay rent on, sometimes we still have to pay rent until the lease runs out. When this happens, we have to show the full rent for all those years in the **income statement** in the year we close the store. This amount is then held on the **balance sheet** until we finish the rent payments.
Operating profit	This is our profit before we have to pay any interest to our lenders or tax to the tax authorities.
Operating segments	This is an accounting term for the different businesses we have. When a large business' financial performance is reviewed by **the Group** Board, we call that business an operating segment and it's sales and profit is disclosed in note 1.
Other comprehensive income	Sometimes we have big **fair value movements** on long term **assets** and **liabilities.** So not to cloud the **income statement** which is meant to show the year's performance, accountants have to put this down the pecking order and have it shown outside our profit and in other comprehensive income.
Parent	This is the owner of a **subsidiary.**
Past service cost	When **the Group** or the pension scheme decides to give its pensioners more pension payments in the future, this is a past service cost.
Payables	A **liability**
PAYE	Pay as you earn. A tax which is paid on wages.
Pension interest	This is the interest that we are allowed to show in our **income statement** and is the **discount rate** used to **discount** the pension **liabilities** multiplied by the pension surplus or deficit last year
Prepaid funeral plans	A member may not want his or her family to pay a large single sum for a funeral when he or she dies. Therefore, the member can pay for it gradually or in lump sums over a number of years and **the Group** will invest that money.
Prepayment	When we pay for a cost which relates to services that will be received over a year (e.g. rent, insurance), we hold that cost on our **balance sheet** and then spread the cost over the period of the service.
Present value	This is the value of a future cost or income at today's money.
Provision for unearned premiums	When we have an insurance policy, some of the premium we have received won't be in respect of this year. Therefore, we have to put this on the **balance sheet** as a **liability.**
Provisions	This is a liability, but one in which we are unsure what the final amount that we have to pay will be. We use our best estimate of the costs and hold that on the **balance sheet.**
Realised gains	This is when we sell an **asset** at a profit.
Receivables	When someone owes us some money, we hold that amount as a receivable on our **balance sheet.**
Reclaim Fund	This is an entity owned by the Co-op that helps money in dormant bank accounts be used for charitable purposes.
Reinsurance **assets / liabilities**	When we sell an insurance policy, we might want to resell that policy to another insurance company in case a really big claim comes in. When we're owed money from the other insurer then this is shown as an **asset** and vice versa if we re-insure another insurer.
Related party	This is usually a company or person that is closely linked to the Co-op. It's usually a member of Board / Exec and his or hers close family plus companies such as our **associates** and **joint ventures.**

Jargon buster continued

Remeasurement gains / losses on employee pension schemes	There are lots of complicated assumptions that are used when valuing pensions. If those assumptions change in the year this can have a big effect on the size of the pension **asset** or **liability.** So not to cloud the **income statement**, this effect is shown in this line in **other comprehensive income.**
Repayment notes	Another fancy word for a loan
Reserves	This is a collective word for **equity**, but excludes **share capital.**
Retained earnings	This is all the profits we have made since the beginning of time for the Co-op that have not yet been paid out to members
Retirement benefit obligations	An elegant term for our pension liabilities
Return on plan **assets**	This is the amount we've made on our pension **assets** in the year
Revaluation reserve	When we value a property upwards, we're not allowed to put this **unrealised gain** through our **income statement** or within **retained earnings** as law dictates that this cannot be distributed to members until the property is sold. It's then ring-fenced as a specific reserve.
ROCE (Trading Group)	Return on capital employed. This is the profit we make in the year less any pension interest earned divided by the **net operating assets** we have.
Sensitivity analysis	When an item on our **balance sheet** varies in value year on year based on some estimates that we make, we show a sensitivity analysis which shows you how much the **asset** or **liability** would change by if we were to change the estimate.
Share capital	This is the amount of money that our members have paid into the Co-op to become members less any that have been repaid when they cancel their membership.
Subsidiary	This is a company or society that is owned by another company.
Supplier income	Sometimes a supplier will give us money off the goods purchased if we sell a certain amount.
Syndicate Revolving Credit Facility	This is money that our lenders have agreed we can dip into if need be. It works a bit like an overdraft.
Trading Group	This is **the Group** less any **Financial Services** companies.
Underlying profit	So to show the true trading performance of the Group, this is a measure of profit which strips out **one-off items** or large gains or losses we might have made on selling **assets.**
Unrealised gains	An **asset** may have gone up in value, but we've not sold it. If this is the case, the profit from the gain is "unrealised" as we've not sold the **asset** yet.

Five year summary (unaudited)

£m	2016	2015	2014	2013	2012 (i)
Revenue					
Food	7,064	6,958	7,041	7,193	7,398
Funerals	307	299	272	277	270
Insurance	439	343	371	476	580
Federal	1,573	1,504	1,503	1,479	1,479
Other	89	97	104	99	98
Total revenue	**9,472**	**9,201**	**9,291**	**9,524**	**9,825**
Underlying profit before tax					
Food	182	186	181	186	211
Funerals	69	69	57	53	51
Insurance	11	(13)	(1)	36	13
Other	(129)	(78)	(54)	(106)	(58)
Underlying segment operating profit	133	164	183	169	217
Underlying interest	(74)	(83)	(113)	(100)	(106)
Underlying profit before tax	**59**	**81**	**70**	**69**	**111**
EBITDA (ii)					
Underlying segment operating profit (above)	133	164	183	169	217
Depreciation	249	256	257	259	268
Amortisation	5	7	9	-	-
Underlying segment EBITDA (ii)	**387**	**427**	**449**	**428**	**485**
Other performance items					
Dividend	-	-	-	(55)	(104)
5% Member reward	(16)	-	-	-	-
1% Community reward	(3)	-	-	-	-
(Loss) / profit after tax	(134)	15	216	(2,301)	(557)
Trading Group ROCE (ii)	6.5%	9.5%	9.7%	6.6%	8.5%
Balance sheet items					
Total assets	9,186	8,729	8,485	8,623	8,713
Group net debt	(885)	(692)	(808)	(1,400)	(1,686)
Total equity	3,209	2,937	2,865	2,037	4,525
Net debt : EBITDA ratio	2.29	1.62	1.80	3.27	3.48
Total pension assets	12,835	10,799	10,921	9,665	8,998
Total pension liabilities	(11,147)	(9,669)	(9,932)	(9,465)	(8,791)
Total net surplus	1,688	1,130	989	200	207
Business specific measures					
Total Food like-for-like sales increase	3.5%	1.6%	0.4%	-0.2%	-0.7%
Number of Food stores	2,774	2,803	2,796	2,779	2,816
Total Food sales area ('000 sq ft)	8,797	9,185	9,606	9,916	10,090
No. of at need Funerals sold	97,607	97,147	92,058	98,241	100,507
No. of pre need Funerals sold	58,999	34,904	27,771	29,288	29,992
Number of Funeral homes	1,026	986	961	926	910
No. of insurance policies in force ('000s)	1,416	1,426	1,294	1,463	1,588

(i) 53 week year
(ii) See Jargon buster on page 193 for definition

Co-operative Group Limited
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