Co-op Annual Report 2017

Overall contents

Top ten places to look in our annual report if you only have 15 minutes

Strategic report

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Strategic report

Headlines

Profit before tax

£72m

2016: £132m Loss

See page 22

Operating profit

£126m

2016: £148m

See page 22

Underlying profit before tax

£65m

2016: £52m

See page 22

Revenue

£9.5bn

2016: £9.5bn

See page 22

Net debt

£775m

2016: £885m

See page 24

Number of food stores

2,532

2016: 2,774

Number of funeral homes

1,079

2016: 1,026

Colleague engagement score

75%

2016: 78%

See page 26

Active members

4.6 million

2016: 4 million

See page 32

Amount earned by members through "5% for you" reward

£61m

2016: £16m

Amount earned by members for local causes through "1% for your community" reward

£13m

2016: £3m

Our business

The Co-op virtuous circle is a very modern and futuristic idea, never more relevant than today, and it continues to shape our strategic thinking. The better we run our business, the more people will trade with us. And the more trade we do the more good we can do for our members and their communities. Or to put it simply, a stronger Co-op creates stronger communities.

Since 1844 our Co-op has always been a business with a clear social commitment. We exist to create value for our members and the communities in which we trade and can only achieve this by running a successful Co-op.

How we run our business is important to us. We set ourselves high standards for responsible retailing and service. We have a responsibility to be a campaigning business, speaking out on the issues that matter to our members.

The main markets in which we operate – food retail, insurance, funeral services, legal services and life planning – mean there are lots of ways we can meet our members' needs. By offering great products and services we grow our customers and our membership.

For the virtuous circle to work well, all businesses in our Co-op need to be strong. Our products and services must be competitive and the Co-op difference we make to our members and their communities must be clear to see, relevant for today and easy to understand.

We've set ourselves seven goals that will shape activity over the next few years and help us to deliver on our purpose, championing a better way of business for you and your communities.

1. Competitive businesses with a Co-op difference that attract more customers and members
2. New business opportunities that build trust, extend reach and create value
3. A Co-op which is agile, leaner, safer and connected
4. A revitalised membership offer that creates more value for our members and communities
5. Greater impact from our community work
6. A joined-up story that shows what the Co-op difference is all about
7. Colleagues who are proud to work here

Chair's introduction
Allan Leighton

Creating shared value

Our businesses performed well in 2017, and you can find out more about how they did on page 14. But business performance is only one measure of the value we're creating as the UK's biggest consumer-owned co-op. There were many more as you can see below:

- We gave £61m to our members through the 5% member reward.
- We put £13m, earned by our members through the 1% member reward, into the Local Community Fund to support local causes.
- We raised the pay of Food store colleagues by 6.1% keeping us ahead of the government's living wage target.
- We recruited 742 apprentices receiving quality training, permanent contracts and good wages in line with other colleagues.
- We sponsored 11 successful Co-op Academy schools, many in some of the most disadvantaged communities in the country, bringing Co-op values into the classroom to improve children's long-term opportunities.
- We recruited 200 dedicated Member Pioneers to work in their local communities and make great things happen. They'll be working across each of our 1,500 communities by 2020.
- We reached £6.5m in our fundraising to tackle loneliness and, through our partnership with British Red Cross, a network of Community Connectors was created to help young and old return to community life.
- We stepped up our campaigning on modern slavery following a vote by our members.
- We renewed our commitment to Fairtrade, and all the cocoa used in our own brand products is now Fairtrade.
- We gave £1.8m from the sale of bottled water to fund clean water projects in some of the poorest parts of the world.
- We supported British farming with a commitment to spend £2.5bn sourcing own brand British meat, produce and dairy products between 2017 and 2019.
- We held our prices to tackle funeral affordability.
- We extended free children's funerals to include 16 and 17 year olds.

These are just some of the highlights of how we've created shared value for our members and their communities in 2017. You can find out more about our ethics and sustainability performance in our Co-op Way Report which is published alongside this report.

Why are we different to other businesses?

The answer is found in our Values and Principles, the way of working for all co-ops agreed by the international co-operative movement. They provide us with an ethical code that informs all we do. So we run our Co-op, not to make profit for a few shareholders, but to create value in lots of ways for our 4.6 million members who shop with us each week and collectively own the business. We sum it up as 'Championing a better way of doing business for you and your communities'.

That 'better way of doing business' includes giving our members a central role in how we're governed and a say in the major decisions we take. All our directors are members and actively trade with us. They are all subject to election by our members with our four Member Nominated Directors (MNDs) directly chosen through contested elections.

Our Board ensures the interests and concerns of members are represented in our boardroom, with the MNDs having a particular member focus. Through our elected Members' Council, our Board is held to account. Our directors and Council have a strong focus in making sure our Values and Principles are upheld.

How do we create shared value?

We create shared value by running commercially successful businesses that meet the needs of our members in an unmistakably Co-op way.

We've been working in our main markets – Food, Insurance and Funerals – for more than 150 years. We've built up enormous expertise and we've always had to learn and adapt to make sure we continue to be modern and relevant. In recent years we've added more products and services like life planning and legal where we've seen an opportunity to enter new markets where we can make a Co-op difference.

As our Chief Executive, Steve Murrells, sets out in his introduction, now we're ready to do more. At a time when big businesses and national government have lost the confidence of many people in the UK, we believe our Co-op is uniquely placed to rebuild trust and restore confidence in the strength of communities and businesses.

We want to grow our businesses so we can return more to our members and their communities and continue to look at new markets which can benefit our members.

Our suppliers

We've also had the disappointing news this year that the Groceries Code Adjudicator is investigating some of our practices related to suppliers. We need to live our values in our dealings with suppliers and we know we've fallen short. We've already been taking action and have a dedicated team making sure we have great supplier relationships. This area has great focus from our Board and we'll make sure you can be proud of our practices in the future. When you're a co-op, with values at your heart, you must get these things right. And we will.

Our Board and Executive

I'd like to congratulate Steve on becoming our Co-op Chief Executive. His five years leading our Food business and his commitment to co-operative values made him a uniquely qualified candidate and an excellent appointment.

Steve has been building his top team since taking the role in February 2017. Pippa Wicks is now Deputy Chief Executive with executive responsibility for our non-Food businesses, Jo Whitfield has succeeded Steve at Co-op Food, Helen Webb has become our new Chief People Officer, and Helen Grantham has become our permanent Group Secretary and takes on the role of General Counsel. Matt Atkinson started to work with us in the autumn and joined us full-time as Chief Membership Officer in January 2018. For the first time, we have an Executive with more women than men although we recognise this is no reason for complacency on gender issues and we still have work to do.

On the Board we welcomed Gareth Thomas as our latest Member Nominated Director (MND) and said farewell to Ruth Spellman who had served as an MND for two years and chose not to seek re-election. We benefited considerably from Ruth's contributions in the boardroom, as well as the good counsel she's given to the leaders in our business and I'd like to thank her for her service. I'd also like to add my thanks to Peter Plumb who is standing down at the 2018 Annual General Meeting to concentrate on his new role as Chief Executive of JUST EAT plc. His commercial insight and challenge have been invaluable to the Board.

Allan Leighton
Chair

Chief Executive's introduction

Steve Murrells

Stronger Co-op, Stronger Communities

We've made great progress over the last few years and now we're ready to take a big leap in our ambitions.

Over the last three years we've fixed and repaired many parts of our organisation. We've returned membership to the heart of our thinking, we've undertaken a huge rebrand and we've restored pride in our Co-op for our colleagues and our members. While there is still work to do, we've reached the point where we can look confidently to the future and plan for growth.

To make our business plans a success we need to be a forward-looking Co-op – modern, competitive, relevant and innovative. We need to invest in the businesses we have now and open up new opportunities where our Co-op can make a real difference. Our Stronger Co-op, Stronger Communities plan includes all of this, and more.

Closing the Co-op circle

Through our Co-op Membership rewards, the thousands of community causes we've been supporting, through our campaigning, our commitment to academy schools and apprenticeships, and the great products and services we sell, we've been creating that rich and diverse Co-op value.

But the idea of shared value still isn't understood. The Co-op difference isn't quite cutting through. We need to do more to close the 'gap' in the Co-op circle.

It's widely recognised that making communities stronger and more resilient is an urgent priority for the UK. Our member-owned business, our heritage, and community presence makes us uniquely placed to play a significant role in that work. Making this happen will be the outcome of our plans and will turn us into the nation's favourite business.

Our strategy for a stronger Co-op

Much of what we're planning is old-fashioned business logic , building on the plans already in place. Now we're better placed than ever before to give those strategies the fuel they need to succeed. And the return on that investment will be the magic of enriched community life up and down the country.

In **Food** we've recently announced a £50m investment to cut prices across hundreds of everyday purchases. We're going to continue to grow our convenience store estate with hundreds of new openings over the next few years. We're going to continue to work through how we will use digital technology to bring our Co-op closer to our customers and members in other ways too. The Costcutter and Nisa deals (subject to regulatory approval) have the potential to expand the reach of our brand even further.

In **Funeral and Life Planning** we're already the market leader, and we're going to show market leadership too. We'll do that through innovation in our offer, outstanding facilities, and a strong focus on choice and affordability. We're holding our prices in a market that's traditionally seen annual price hikes. This business now encompasses our legal operations which are fully integrated, so we can offer a truly comprehensive offer for later and end of life planning. Our funeral plans are already award-winning, highly competitive and distinctly Co-op in their guarantees. Probate will be the major area of focus for growth and we plan to be the biggest player in this market.

In **Insurance** we have bold and exciting plans to meet more of the insurance needs of more of our members by improving our competitiveness and offering a wider range of insurance products. Our new groundbreaking travel insurance product, which is the first in the UK to offer unlimited, cashless medical expenses for all ages, is a great example of our ambitions for our Insurance business and our Co-op difference.

New opportunities

The markets we're in today will remain central to us, but our ambitions are greater. We're looking at markets using digital platforms that will allow us to learn quickly and build on our existing strengths while keeping our investment modest and limiting our risks.

We're exploring possibilities in Healthcare and Money where we believe we can provide more convenient and accessible services. We'll start small then adapt our offer and learn. Our Members' Council has set up an advisory team which will help shape our thinking as we develop our plans.

Membership

Our new Co-op Membership has attracted more than a million new members since its launch and returned £61m to members during 2017. Over the coming years we'll look to evolve our Membership rewards to create an even stronger offer that drives business growth and community resilience. This year we'll look closely at how to make more of our membership data and build the right technology to support our needs.

Colleagues

Our colleagues have been central to everything we've achieved and it's important we give them the reward and recognition they deserve. Over the next few years, we'll further improve the competitiveness of our pay for our customer-facing colleagues and we'll introduce significant well-being initiatives.

Community

We're looking at how we can build on the incredible work we've done so far through our Local Community Fund. We'll continue to invest in and develop our nationwide network of Member Pioneers so they can act as an important bridge between our Co-op, our members and the communities they live in.

We want to find ways to connect local people and organisations with each other so they can co-operate. Bringing people together to share ideas, skills and resources and really make a difference.

We'll continue to act on things that matter to our members. And we also want to start using our campaigning strength to focus on the issues that really matter locally. In future, we'll be shouting even louder about our campaigns and we'll have an ever more powerful and influential voice.

One Co-op

To achieve all our ambitions we need to make some changes. We've been holding ourselves back through the way we organise ourselves internally and how we work together. From now on we'll be 'One Co-op' in how we think, how we act and how we talk to our customers and members. We'll end duplication within our organisation and make decision-making easier and quicker. By doing this we'll become a Co-op able to respond to fast changing markets and social trends.

To support the huge investment and our growth plans we'll look closely at the cost base in every part of our business. This will form part of the investment we need, while keeping our bank borrowing at sensible levels.

We'll look at three ways of doing this: through organisational changes, better deals on the things we buy to help us run our organisation, and through the creation of the new Co-op Service Centre to look after our back office functions including finance, IT, HR and our customer and member helpdesks.

Ambitious for the future

Stronger Co-op, Stronger Communities is a return to an old Co-op idea with some very up to date Co-op thinking. Our plans address modern needs in a co-operative way that no other business can attempt to match.

The years ahead will be exciting and not without challenges. What's important is that we've been able to create these plans with the confidence that they're achievable as well as necessary.

Steve Murrells
Chief Executive

Report from the President of the Members' Council

Nick Crofts

I'm delighted to present my report as President of the Members' Council. First I must offer my heartfelt thanks to all of the members of the Council for their hard work, their passion, knowledge and commitment to our Society and our Movement. Serving our Society as an elected member is a great honour. In July I was especially privileged to be re-elected by Council to a second term as President.

Business success

Our Co-op had a good 2017. The successful trading of our family of businesses is the key which unlocks our ability to maximise our impact and influence as a leading co-operative society.

We opened over 100 new Food stores to better showcase our increasingly special own brand products. We enjoyed our fourth year of market-beating like-for-like sales growth in our convenience stores. The importance of strong commercial performance cannot be overstated. Our members know the necessity of operating successful co-operative businesses to our continued sustainability – and, indeed, our continued existence.

This success has been delivered by our 64,000 colleagues that work in every corner of the country. It is their work, in every store and funeral home, in every office and distribution centre, that has been steadily putting our Co-op back on track since 2013. The Members' Council and our millions of individual members are tremendously proud of them, and very grateful for their efforts. Thank you to every single one.

Collaboration

2017 saw the departure of our previous Chief Executive, Richard Pennycook. I took the opportunity at last year's Annual General Meeting (AGM) to thank Richard for his leadership following our 2013 crisis. I must now thank Allan Leighton, the Chair of the Board, who invited me to represent Council and serve as a member of the selection panel tasked to choose Richard's successor.

There are few things I can point to that better demonstrate the transformed relationship between Board and Council and the growing spirit of collaboration between elected members and the Board. I'm pleased to serve as a member of the Nominations Committee and delighted that Steve Murrells was its unanimous choice.

Steve's transition into his new role has been entirely seamless. His years spent transforming our Food business were the perfect preparation for the task of completing our rebuild as we begin to look at new opportunities in the future. Our plans to purchase Nisa and extend the reach of our brand through our proposed deal with Costcutter are an indication of our ambition, and demonstrates finally that our Co-op is now firmly back on its feet after its near-death experience in 2013.

Advisory teams

A significant step in 2017 was the commitment to involve elected members of the Council in exploring ideas and opportunities to feed into our future strategy. In February, Council held a one-day workshop identifying five key areas for further exploration. New 'advisory teams' have been set up to continue this work in 2018.

Strengthening the co-operative movement

Elected members in our Society have always known that our Co-op is part of something much larger and more important than it – a movement that began in the 19th century and now spans the world. Council was particularly pleased when, to celebrate the 150th anniversary of Co-op Insurance, Steve Murrells committed to regain our Society's leadership role in the national and international movement.

This is welcomed, as Council is the guardian of our co-operative Values and Principles and our co-operative business model which sets us apart from our competitors. We must continue to use our Co-op difference to distinguish our Co-op in all areas – our products and services, our role in local communities and our social and ethical responsibility. We know the difference co-operation – and co-operatives – can make to a better, more equal and more just society.

Campaigns and community

This manifests in our Co-op's campaigning work. I was very pleased that our campaign to tackle the scourge of modern slavery won overwhelming support from members at last year's AGM. Campaigning on social issues that matter to our members has always been central to the purpose of our Co-op, all the way back to the Society's pioneering beginnings. Be it modern slavery, Fairtrade, tackling loneliness or ending water poverty, there's so much that we do to make our members proud.

Our Co-op difference needs to thrive locally. I was particularly delighted by the Board's commitment to recruit Member Pioneers across each of our 1,500 communities. Developed by Council, the role of Member Pioneers is to forge links in the community, bringing members together with local good causes and develop opportunities to get involved in our Co-op. It's a fine example of Council and Executive working together.

It's in the nature of co-operation that the work is never finished, and that is true of our Co-op. As the transformation of our businesses continues, there is work to do to revitalise and rebuild member engagement in our democracy. It's testament to the dramatically improved relationships with the Board and Executive that the Council is able to press for faster progress in areas that are important to our members.

We recognise that our ability to communicate the work of our elected members, including our Member Nominated Directors, remains incomplete and this is a high priority for the Council. Similarly, finding innovative and compelling ways for our members to be able to participate in the affairs of the Society which they own is critical. There have been some tremendous successes here – the member-designed Pioneer Pinot Grigio wine being my personal favourite – and Council continues to work with the business to develop more.

I thank Vice Presidents Dan Crowe and Bev Perkins for their support throughout 2017 and Council members for their terrific work and scrutiny in the Senate, committees and working groups of all types.

So we can look forward to further and faster progress in 2018. In no small part, this is due to the terrific work of Council Secretary Gill Gardner and her colleagues from the Council Secretariat. They comprise a very small team of outstanding and committed co-operators who do so much to deliver on the Council's agenda. All of our members owe them a debt of gratitude.

Nick Crofts

Nick Crofts
President of the Council

Our business performance
Food

3.4%

Like for like sales ahead of the market by 1.1%

£7,054m

sales down from £7,064m in 2016

£2.5bn

to spend on British grown farm produce

Shared value

Co-op Food is our biggest business and the most significant way we reach our members and customers. With our 2,532 Co-op Food shops we have a high street presence across the country providing the communities we serve with high quality products responsibly sourced from our suppliers and partners in the UK and around the world.

- We've chosen to spend £2.5bn on British farm produce (2017-19) – all our fresh meat is now British and we're extending our British seasons commitment on fruit and veg
- We're extending our local sourcing to every county in the UK
- We've recruited over 200 apprentices in 2017

The numbers

The investment we've made over the last three years to create award-winning food sold in modern, friendly stores has shown its value through the 16 consecutive quarters of like-for-like sales growth we've seen in our core convenience estate.

Like-for-like store sales remained strong at 3.4% up, ahead of the market by 1.1%. Convenience store like-for-like sales were up 4.3%.

Our sales for the year were £7,054m (2016: £7,064m). This is slightly lower compared to last year because we sold 298 smaller food stores to McColl's Retail Group plc and a number of petrol filling stations, offset by our strong like-for-like performance. The deal with McColl's has helped us to focus our investment in new stores in more appropriate locations for the wider range we want to offer our members and customers, opening 105 new stores in 2017.

Underlying operating profit (which excludes any one-off items, property and business disposals and the change in value of investment properties) was in line with last year at £182m (2016: £182m), a strong performance given that this includes paying our Membership rewards. Operating profit, which includes property and business disposals and the change in value of investment properties totalling £20m (2016: £21m), was £202m (2016: £203m).

The momentum we built throughout 2017 led to a strong Christmas which outperformed the market. We saw a 6.2% jump in like-for-like sales over the two weeks to 1 January, almost double the 3.5% sales growth we reported last year. Overall, our Christmas and New Year sales were up 9%, proof that the public see our Co-op as far more than just an 'emergency' or top-up shop.

The quality of our food was acknowledged through more than 140 major awards including a Gold award for our Les Pionniers NV Brut Co-op champagne beating more well-known global brands costing up to 23 times as much. For the third year in succession we were recognised as the Sandwich Convenience Retailer of the Year at the British Sandwich Industry Awards (known as 'the Sammies').

What's new?

British
In May we announced our decision to spend £2.5bn on British grown farm produce between 2017 and 2019. Just as we believe it's right to champion Fairtrade with our suppliers on the other side of the world, we also want to support our own farmers and their communities here in the UK. We've done this by moving to 100% British fresh meat in all our own label range.

Our investment in British goes well beyond meat. We've extended our British seasons commitment for home-grown fruit and vegetables and increased the British flower varieties we sell. We're also setting up British fish farming groups. In dairy we've put in place British sourcing credentials across our core dairy products and we make sure there's a fair farm gate price for our Co-op Dairy Group supplying our liquid milk.

Fairtrade
At our Annual General Meeting (AGM) in May our members backed our continuing commitment to Fairtrade and we're now using Fairtrade cocoa in all our own brand products. Sales of Fairtrade increased by 15.1% during the year – double the market increase. In 2018 we're switching to Fairtrade tea, banana and coffee as ingredients in our own brand products.

Local products
Our members have been keen to encourage our innovation with local products. From a successful trial in Yorkshire in late 2015, our programme is now being rolled out to every county in the UK with new relationships formed with local butchers, bakers, brewers and ice-cream makers. Unlike some of our competitors, we don't demand exclusivity as we want to see local businesses grow and thrive in our communities, create jobs and benefit the local economy. During 2017 we sold £164m of locally sourced products across the UK.

71% of our food packaging is easy to recycle, up from 46%

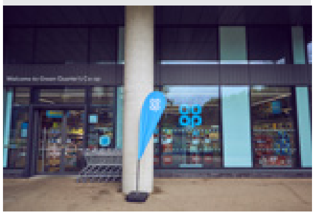
Recycling
At our AGM in May our members voted to make all our food packaging 100% recyclable in the long term, and we're aiming for 80% by 2020. We're on track and making good progress to meet this target. So far we've moved from 46% 'easy to recycle' to 71%. We've got there through making our meat and fish trays from only one plastic, changing the black plastic trays on our Irresistible tomatoes to card and making all our pizza bases cardboard, all of which are easy to recycle in the majority of local council areas. We're also supporting the government's plans for a deposit and return scheme for plastic bottles to reduce plastic waste.

We're now focusing on alternatives to hard-to-recycle plastics, including plastic film, CPET (a type of plastic used mainly for ready meals) and deeper coloured plastic, as well as being the first to trial fully compostable tea bags for our iconic 99 tea brand, which will break down completely in food waste collections.

Colleagues

Developing our colleagues and offering them clear career paths remain top priorities. We've launched the next phase of My Co-op Career giving colleagues in our stores, from Customer Team Member to Store Manager, access to new learning experiences to help them progress their career. My Co-op Career will be rolled out to Logistics this year. 27 Food colleagues were celebrated at the graduation ceremony for our Shining Stars development programme at the end of July. Our first ever Co-op-wide group of 28 Shining Stars started their leadership development journey in September.

100
new stores to open in 2018 as part of **£160m** investment



Looking ahead

Our aim is to get closer to our members and customers:

- Closer to where they are – physically and digitally
- Closer to what they need – good food, friendly people and easy shops
- Closer to what they care about – ethics, values and community

In 2018 we'll open a further 100 new stores as part of £160m investment in new openings and refits, creating an estimated 1,600 jobs.

In January 2018 we announced a £50m price investment to cut the cost of everyday food. Some products have been lowered in price by more than 40% and, on average, more than 600 products now cost 14% less. Based on an average weekly food shop we estimate that our customers could save £120 a year on their food bills.

Wholesale

Critical to taking our brand to more people are our wholesale arrangements with Nisa and Costcutter announced last November. Members of Nisa Retail voted in favour of our offer to buy 100% of the business for up to £137.5m. The deal is subject to regulatory approval due in the spring of 2018.

We also announced an agreement to become the exclusive wholesale supplier to Costcutter Supermarkets Group and the 2,200 Costcutter, Mace, Simply Fresh, Supershop and Kwiksave convenience stores across its network from spring 2018.

This builds on our long standing wholesale experience and the recognition of the quality of our products. Our plans will help expand the reach of our products and increase our buying power with our suppliers.

Products, availability and suppliers

We're continuing to make our products relevant and reflecting the demand for more 'Free From', 'Vegan' and 'Health' ranges. Improved availability and great customer service remain priorities.

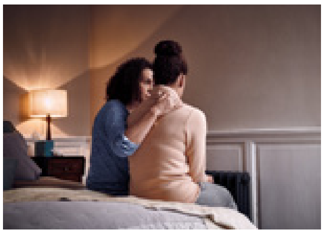
All of this will be supported by ongoing investment to improve our use of data, our product availability, logistics to stores, and the training we give our colleagues.

Following the end of the year, the Groceries Code Adjudicator (GCA) opened an investigation into some of our practices connected to suppliers relating to delisting and the introduction of benchmarking and depot quality control charges. We acknowledge that at times we've fallen short and have been discussing the two issues raised with the GCA for some months. More information can be found on page 87.

Co-op Food is part of the biggest product placement venture that Coronation Street has ever taken on. A Weatherfield Co-op Food store is part of a new area of the Coronation Street set and will appear in episodes from spring 2018. You'll see our store, our bags, and non-speaking artists walking around in Co-op uniform going about their daily business.

Our business performance
Funeral and Life Planning

Shared value



In 2017 we brought together our Funeralcare and Legal Services businesses to create a joined-up set of services and products to our members and customers.

We're now able to offer both an 'at need' (funerals arranged at the time someone dies) and 'pre need' (funerals planned and paid for in advance) funeral service along with power of attorney, will writing and probate services which means families can be supported with greater care and consideration through some of the most difficult of times.

- We're leading the way on funeral affordability and it's our top priority, holding our prices for at need and pre need
- We're bringing more choice and transparency in all we do
- We're offering free funerals for children up to the age of 17

The numbers

£343m
Sales up £14m on 2016

£66m
Underlying operating profit (2016: £71m)

Our Funeral and Life Planning business had sales totalling £343m which was £14m up on 2016. We provided 99,925 at need funerals, up 2.4% on last year, and a growing number of our clients are choosing Simple funerals (our lowest price funeral). Our at need market share was 16.2% while pre need share was 33.2% at the year end (5.2% up on 2016).

Operating profit, which includes property and business disposals, was £66m, down £35m on the previous year mostly due to the sale of our crematoria. Underlying operating profit was £66m (2016: £71m), slightly down on last year due to Membership rewards and the impact of the crematoria sale.

We sold 68,969 funerals plans, an increase of 9,950 on 2016. At the start of 2018 we were awarded the 'Best Funeral Plan Provider' at the Moneynet Personal Finance Awards. We've also received top marks from Fairer Finance – 5 stars for our silver and gold funeral plans.

The number of legal cases we handled was 16,342, up 321 on 2016.

We opened 63 new homes during the year, bringing the total estate to 1,079 funeral homes and a further 100 had rebrands or refits during the year. Our programme to brand our private name funeral homes as 'Co-op' should be completed by the end of 2018.

What's new?

In 2016 we became the first funeral provider to sign up to Fair Funeral's enhanced pledge to tackle funeral affordability. In 2017 we made good on that pledge keeping the price for our Simple funeral unchanged, and launching our most affordable fully guaranteed funeral plan.

Co-op Commitment
If you choose to pay in instalments over 2-25 years, your plan will include the new Co-op Commitment:

- If you die after the first 12 months of your plan, but before all your instalments have been paid, we'll still deliver all the services provided in your plan, with no more for your family to pay.
- Other funeral plan providers ask for the family to make up the shortfall if the plan hasn't been paid for in full.

Children's funerals
For the last 30 years we've helped approximately 25,000 families who've lost a child under the age of 16 by not charging for our funeral director services. We're not the only funeral providers to do this but in 2017 we decided to go a step further and we no longer charge for funerals for children aged 16 and 17. It was a decision welcomed by the government and others have now followed our lead.

Going digital
We've been investing significantly in new digital technology working with our Co-op Digital team. It's helping us to improve how we record and store information given to us by clients when arranging a funeral. The new platform, called Guardian, moves away from paper and makes the information easier for colleagues to access at each stage of the client journey from our first meeting with a family through to their wishes for the funeral and all the arrangements on the day. We tested it first with families and our colleagues in Edinburgh and Bolton, and by the end of 2017 the new platform was being used in four regions. It's already reducing administration and allowing more time for conversations with families. We'll be using Guardian across the whole business in 2018.

2,000th
apprentice since 2013

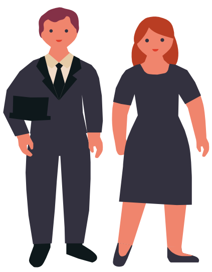
In October we set up a new online hub for colleagues running bereavement clubs around the country so that knowledge and experience could be shared more widely and more clubs could be set up.

Following the success of our online will writing service we've also put our Lasting Powers of Attorney process online.

Colleagues

We made the news in July when we took on our 2,000th apprentice since 2013. By the end of 2017 we had 500 apprentices working in the business and we remain the only national funeral provider to offer apprenticeships. Around a third of our apprentices are over the age of 50. In November 2017 we were awarded the Princess Royal Training Award for our apprenticeship programme.

Looking ahead



Affordable funerals
We've held our prices for both at need and pre need

Our Funeral business is the market leader, and we want to lead the market. We're keeping a strong focus on making our services affordable and there'll be no increase in at need funeral prices in 2018. For our Co-op members we're changing the 5% Membership reward to exclusive member prices at the time of arranging a funeral or buying a funeral plan. We're investing in outstanding facilities like our new mortuary in Edinburgh and improving our funeral homes and car fleet. Our new digital systems will set a global benchmark in funeral administration and allow colleagues to spend more time caring for families.

Choice, affordability, regulation
We'll continue to offer customers and members more choice and affordability through new approaches like 'Direct to Crematorium' (funerals with no service) and we'll help families to celebrate the lives of loved ones in a way they feel appropriate and meaningful.

To encourage long term planning and to know better the funeral wishes of individuals we'll tackle the reluctance to speak about death within families and society as a whole.

We believe in the value of better national regulation of the funeral industry and will work with government to achieve this to make sure there are minimum standards of care. We're also strong supporters of a better regulatory model for pre-need plans to make sure the market works effectively and in the interests of consumers.

Training and business development
We'll invest in new skills and accreditation for our colleagues with more professional qualifications. We want our colleagues to be able to spend more time supporting bereaved families. So we'll complete the organisational changes we started in 2017, and continue the roll-out of the digital Guardian platform which is revolutionising the way we do business.

We'll grow the Life Planning & Legal part of the business organically and through acquisitions. We'll focus on probate and wills and form new partnerships to bring our products to the market. We'll broaden our marketing to the over 50s and provide access to them 24/7 through online, phone and face to face channels across the UK.

Across Life Planning & Legal we'll be growing our own in-house experts – providing a career framework for our colleagues, investing in training our own legal advisors and using online learning.

The rainbow hearse – one of only a handful in the country – is the latest addition to our growing fleet of specialist hearses, including a Land Rover, a 1933 Austin and a Buddhist-themed hearse.

The colourful hearse was a request from a member of the community in Brighton, but is now in demand across the country, as people want to personalise funerals for LGBT+ friends and relatives.

Our research shows that almost half (47%) of UK adults would like their own funeral to be conducted as a celebration and almost a quarter (23%) of Britons say they want to make their last journey in a personalised vehicle.

Our business performance
Insurance

Shared value

Our Insurance business puts the needs of our members first through our customer experience, member pricing and safer communities. In 2017 we celebrated our 150th anniversary and continued to innovate to support our members:

- Our new groundbreaking "cashless" Travel insurance product provides cover that meets the needs of more of our members and has been designed with them
- We're offsetting carbon emissions on our new direct Car and Home policies, as well as on our policies sold through price comparison sites

£331m
Insurance revenue
(2016: £439m)

£11m
Underlying profit
(2016: £11m)

The numbers

Our Insurance revenue was £331m (2016: £439m). From January 2017 we had a new reinsurance contract in place. This supports our capital position but reduces the amount of revenue we recognise, so we expected our revenue to fall. On a like-for-like basis, excluding the impact of this reinsurance, our revenue grew by 8% compared to 2016 reflecting the investment we're making in our pricing capabilities.

Underlying operating profit in 2017 was in line with last year at £11m (2016: £11m). Our operating loss, which includes the one-off costs associated with our transformation plans, was £12m (2016: £18m loss).

At the half year we reported that our contract with IBM to upgrade our IT systems had been terminated and we were exploring alternative technology options. Since the termination of the contract we have made significant progress by investing in more specific IT improvements. In 2017 we started to see the benefits of this through innovations in pricing, an increased focus on customer service, and new product development.

While the insurance market as a whole in the UK remains fiercely competitive, our strategy remains to focus on meeting more of the insurance needs of more Co-op members and offering a wider choice of fairly priced insurance products.

What's new?

In September we tested the UK's first ever car insurance quote chatbot. The Co-op Insurance chatbot gives users an estimate of how much they could expect to pay for their car insurance in as little as 30 seconds. They answer four questions on Facebook Messenger to get an estimate of the cost before completing the full quote on our Insurance website.

Safer communities
We've spent several years helping to make communities safer. We're working with Neighbourhood Watch to understand how we can help vulnerable homeowners who feel anxious at the thought of unexpected callers to their front door. We're also trialling the use of smart-device connected doorbells for customers who've already been a victim of a burglary. The technology allows homeowners to see and speak to anyone at the front door from anywhere, using their smart phone, tablet or PC. We're finding ways to help cut the number of burglaries and make customers and members feel safer.

NEIGHBOURHOOD WATCH

Safer streets and cars
We're continuing to encourage safer driving, partnering with the charity Brake to work in schools to educate on speed awareness. Having pioneered telematics technology to encourage safer driving habits and lower insurance premiums for young drivers, we've been looking at more ways we can help our younger customers.

Brake the road safety charity

We've followed up our research into best used cars with a new award for best 'first' used cars. In June we announced that the 2012 Skoda Citigo as our number one car for Co-op Safe Used First Car Award 2017.

In July we launched Park Smart, a new digital interactive map which aims to help people make informed choices about parking their car. The tool shows the number of vehicle related crimes in the last six months using government crime data. Users can enter their postcode across England and Wales and the Park Smart tool will highlight the risk level in each area based on vehicle theft, theft from a vehicle, and vandalism.

Cutting carbon emissions
In 2017 we became the first major UK insurer to offset as standard a proportion of customers' carbon emissions when they buy a new motor or home policy direct from us. We do this by supporting carbon offsetting projects which help to reduce carbon emissions, a cause of climate change.

The projects we support also have additional social and environmental benefits such as Gyapa cookstoves, which are cleaner and more efficient. We're helping to fund Gyapa stoves for 140,000 people in Ghana. The project, which has been accredited as Gold Standard, not only helps reduce carbon emissions but is also equipping people in Ghana with the skills and knowledge to manufacture, market and sell the stoves, as well as saving money on fuel for families.

Colleagues

Co-op Insurance created 25 new apprenticeships in 2017, including seven students from the Co-op Academies Trust, helping to bring in new talent and grow the next generation of insurance leaders.

Looking ahead

To create a stronger Co-op and stronger communities through our Insurance business we're planning to increase the range and cover of the products and services we offer for members.

Our new groundbreaking travel insurance product, launched in January 2018, is an example of how we plan to do this:

- We've built the product after talking to our members to help understand what frustrates them about other products on the market.
- We're the first UK general insurer to offer unlimited, cashless medical expenses for people of all ages. That means there's no need to pay upfront for medical help when away and then claim it back when you get home.
- Our insurance also gives access to face-to-face video consultation with a UK doctor before and during trips.

Our aim is to create more new products and services in this way – talking to our members, understanding their needs, and working with other experts while still maintaining our Co-op difference.

Megan Frater (16) is one of our first Co-op Insurance apprentices and a former Co-op Academy pupil. She's now studying towards a qualification in customer service:

"I've learned loads since I joined the Co-op Insurance team and although my first time talking to customers was daunting, I've since grown in confidence and now have the skills to answer most insurance queries."

All of the successful candidates have the opportunity to earn qualifications up to degree level and will benefit from a competitive salary, well above the national average for apprenticeships.

Our finances

£72m

Profit before tax
(2016: £132m)

The profit before tax for the year was £72m, compared to the loss before tax in 2016 of £132m. The loss in 2016 was affected by the reduction in value of our investment in the Co-operative Bank ('the Bank') to £Nil, which led to a cost in our income statement of £185m.

As with any organisation in change, there are always non-trading items that affect the numbers. This means our operating profit is down by £22m to £126m (2016: £148m) but our underlying operating profit is up by 10%. The table below shows how the operating profit is adjusted to get to the underlying operating profit (adding back losses and subtracting gains) and further details of the non-trading items are given in the Profits section.

	2017 £m	2016 £m
Operating profit	**126**	148
One-off items	**23**	21
Property and business disposals	**4**	(27)
Change in value of investment properties	**(15)**	(16)
Underlying operating profit	**138**	126

2017 is the first full year of our new Co-op Membership and members have earned £61m through the 5% reward (2016: £16m). £13m was also earned for local community causes through the 1% reward during the year (2016: £3m). The cost of the 5% and 1% rewards is included in arriving at our underlying profit.

£9.5bn

Sales
(2016: £9.5bn)

Sales

Sales of £9.5bn were in line with last year. More information on the performance of each of our businesses can be found on page 14.

Profits

Our key profit measure is underlying profit before tax, which looks at our core trading performance less underlying interest (interest on borrowings). Underlying profit before tax of £65m was 25% up on last year, mainly as a result of cost savings in our support areas. Profits across our businesses were in line with last year, with our Membership rewards being funded from improvements in our underlying performance.

Costs from supporting functions of £118m were, as expected, £16m lower than last year, which was a peak year for investment in our activities to rebuild our Co-op.

The table shows how we get from reported profit before tax to underlying profit before tax, adding back losses and subtracting gains.

	2017 £m	2016 £m
Profit / (loss) before tax	**72**	(132)
One-off items	**23**	21
Property and business disposals	**4**	(27)
Change in value of investment properties	**(15)**	(16)
Finance income and non-cash finance costs	**(11)**	35
Share of (profits) and losses from associates and joint ventures	**(8)**	171
Underlying profit before tax	**65**	52

The main elements are explained on the next page.

One-off items

Where we have significant costs that aren't expected to happen every year, like major restructuring, we strip these out of normal trading profit to present a clearer picture of our ongoing trading performance. One-off items of £23m relate to restructuring costs in our Insurance business. The one-off items last year also related to restructuring costs, both for our Insurance business and our support functions.

Disposals

We made a loss on disposals of £4m, compared to a profit of £27m in 2016. The table below shows how this is made up of the profits and losses from different disposals during the year.

	2017 £m	2016 £m
Crematoria	-	30
NOMA joint venture	**12**	-
Bank investment	**5**	-
Food store sales to McColl's	**7**	-
Other property and business disposals	**(28)**	(3)
(Loss) / profit on disposals	**(4)**	27

More information about the Bank and NOMA disposals is provided in the Investments in associates and joint ventures section.

Finance income and non-cash finance costs

The table below shows what we include in finance income and non-cash finance costs.

	2017 £m	2016 £m
Pension finance income	**42**	45
Fair value movement on quoted debt	**(11)**	(74)
Fair value movement on interest rate swaps	**(12)**	8
Discount unwinds	**(8)**	(14)
Finance income and non-cash finance costs	**11**	(35)

The fair value movement on our quoted debt is also known as 'mark to market'. As the market value of our bond debt liability increases in the accounts, it creates a charge to the income statement. We also have to include the movement in the fair value of interest rate swaps we hold to protect us from changes in interest rates. Both of these items can be either income or costs depending on what happens in the finance markets.

We have to reduce (known as 'discounting') the value of some of our financial assets and liabilities to reflect that when we receive or pay the money in future its value will have reduced, mainly due to inflation. As we get nearer to receiving or paying the money, the difference between the current and future values gets smaller and we call the difference a 'discount unwind'.

Investments in associates and joint ventures

At the end of 2016 we had several joint venture and associate arrangements, most notably a 20% stake in the Bank and a 30% stake in a travel joint venture with Thomas Cook.

During 2017, the Bank went through an exercise to secure additional capital and as a result we saw our shareholding reduce from 20% to 1% in early September. We later sold our remaining shareholding for £5m.

We reported last year that we'd served notice to exit the travel joint venture arrangement and we received £50m (plus interest) from Thomas Cook in December 2017 in return for our shares in the joint venture. We also received £32m during the year under a minimum dividend guarantee.

Just before the end of the year, we sold our investment in Manchester's NOMA development to our joint venture partner. We started our NOMA joint venture by originally contributing a number of our properties with a book value of £58m. Over the life of the partnership we contributed a further £19m of cash, and we've received £123m cash in return.

We also completed the sale of two of our windfarm investments.

The table below shows our income and losses during 2017 and 2016 from associates and joint ventures.

	2017 £m	2016 £m
Reduction in value of our investment in the Bank	-	(185)
Share of profits or losses made during the year:		
Travel	-	12
NOMA	8	1
Other investments	-	1
Income / (losses) from associates and joint ventures	8	(171)

Financing and cashflow

Net debt was £775m at year end, down from £885m last year (details of what is included in net debt are provided in note 17).

We've continued to invest in our trading estate and in our systems but have also received significantly higher proceeds from our disposals than we did in 2016 – £241m compared to £65m in the previous year, driven by the disposals in our Food business as explained on page 14. We invested £441m on capital expenditure, including £95m on new Food stores, £135m on refitting existing Food stores and £51m on our Funeral and Life Planning business.

Underlying interest payable fell to £73m from £74m.

Our regulated Insurance business is separately funded from the Trading Group, which includes our other businesses, so we review our funding position separately and on an overall group basis. The Insurance business operates under the Solvency II regulatory reporting regime which sets out capital requirements for the business. Our Insurance business meets and, based on current plans will continue to meet, all these regulatory capital requirements.

The Trading Group is comfortably within the ratios of debt and interest agreed with our banks and our funding position is strong. Our £21m debenture stock is due to be repaid during 2018 and we're also due to pay back our £450m Eurobond notes in 2020. We're confident we'll be able to fully replace these facilities and have already started work on this.

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 2017 we paid £201m (2016: £199m) 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 2017, showing that we put our purpose, Values and Principles 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 £1,553m (2016: £1,727m) across all our schemes. Our largest scheme, the Pace Complete scheme, has a healthy surplus of £1,603m (2016: £1,822m) with most of the other schemes in a deficit position and so partially offsetting this.

These figures are on an accounting basis. Pension schemes look at funding on a statutory basis which values pension liabilities on a more prudent basis than the accounting basis. On a statutory basis, Pace Complete has a smaller surplus which was assessed as part of the funding valuation at 5 April 2016. It's this statutory funding basis which informs how much cash we'll need to pay into the pension pot in future. We agreed with the Pace trustee that contributions to Pace Complete would stop with effect from 1 December 2017 to reflect this surplus as it moves towards being self-funded. Discussions are currently taking place about the funding of two of our other schemes that had valuations during 2017.

As part of the arrangements which led to the sale of our investment in the Bank, we agreed principles to split the total pension liabilities of Pace and to remove the Bank's obligation to support our share of the Pace Complete pension scheme liabilities. This agreement means that in our accounts we've reduced the amount of pension surplus we show by around 21% (£374m) and our pension liabilities by £1.9bn. This is explained further in note 23.

Balance sheet

Total equity fell by £153m to £3,088m during the year. This was mainly due to the reduction in the amount of pension surplus recognised as a result of our agreement reached with the Bank as explained above, offset by our retained profit for the year.

Our investments in joint ventures and associates have reduced from £52m to £3m due to the sale of our investments in NOMA and two of our windfarms. The balance relates to one windfarm investment.

Our funeral plan investments have grown over the year to £1,076m (2016: £872m), reflecting our increased sales of funeral plans. An independent actuarial valuation is carried out each year and we're comfortable that we have enough assets to meet the costs of carrying out the funerals in future. More information is provided in note 12.

Outlook

In 2017 we continued the great progress we've made over the last few years. As we move into 2018, we'll continue to invest in our businesses so that we can grow our Co-op, while we explore potential new markets where we believe we can deliver a better solution for the benefit of our members. 2017 was the first full year of our new Membership, and we want to continue to develop this to drive business growth as well as strengthening communities.

Our colleagues

Shared value

We employ 64,000 colleagues across our Co-op in our food stores, logistics depots, funeral homes, life planning customer contact centres in Sheffield and Bristol, and business support functions in Manchester. Our colleagues are our most dedicated and loyal advocates and for many of our members and customers they 'are' our Co-op.

2017 was the year when we started to focus on our colleagues' experience at our Co-op to make it a great place to work.

What's new?

In September we ran our annual Talkback engagement survey for the fifteenth year. This time we asked all colleagues to complete the survey online and saw a rise in responses of 2% to 84%.

75%
Colleague engagement score (2016: 78%)

Engagement has always been important to us as it shows the pride and passion our colleagues have for our Co-op. In 2017 our engagement score remains steady at 75%, a slight dip on the previous year (2016: 78%).

We've started to focus on the things which influence our colleagues' daily experiences at work instead of overall engagement. We want to understand what helps colleagues have a great day every day. We believe there are three areas: 'Our purpose', 'Our work' and 'Our leaders', which will be the focus of our support to colleagues and the areas we'll measure.

Our Colleague Voice forum
Our Talkback survey is great for listening to the views of everyone in our Co-op, but sometimes it helps to have face-to-face discussions too. So in 2017 we trialled a Co-op-wide Colleague Voice forum. This is a group of colleagues from across our Co-op who meet every two months to give a temperature check on how colleagues are feeling. It also plays an important role in making sure that all our people projects are developed with colleagues in mind. We'll expand the forum and make it permanent in 2018.

Thank You for Being Co-op
Every day our colleagues do amazing things for our members, customers and communities and we believe it's important to recognise and celebrate them. In 2017 we introduced new, practical ways for colleagues and managers to simply say 'thank you' for a job well done, and to share the good news with others. In January 2018 we launched the Thank You for Being Co-op awards, to celebrate outstanding achievements.

Colleague wellbeing

We want all our colleagues to feel valued and recognised for the part they play in our success. It's also important they feel healthy, motivated and at their best, not just at work but in everything they do.

In 2017 we began testing a range of ideas to increase our support for colleagues . We've recently rolled out LifeWorks to all colleagues which gives easy access to a whole range of support, including health, wellbeing, family life, work issues and money matters. There's also our Co-op Employee Assistance Programme (which offers a freephone helpline) and discounts and offers from hundreds of high street and online shops.

Inclusive culture

We encourage diversity and inclusion, giving colleagues from all backgrounds the opportunity to succeed. Equality is a founding Co-operative value and we take seriously our responsibilities around age, disability, marriage and civil partnership, pregnancy and parental leave, race, religion and belief, gender, gender reassignment and sexual orientation.

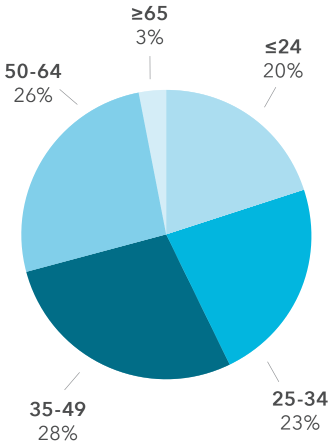
In 2017 we concentrated on four areas: Respect at Work, Visible Leadership, Inclusive Recruitment, Analytics and Benchmarking.

We recruited 81 Diversity and Inclusion Pioneers from among our colleagues who'll help us keep the focus locally around the priority areas.

Respect, our lesbian, gay, bisexual and transgender (LGBT+) network, has a membership of 1,183 (2016: 882) and 11,700 Twitter followers.

Our colleague network, Aspire, is led by and for female colleagues, although anyone can join. Aspire's membership grew from 579 in 2016 to 924 in 2017. Aspire continues to focus on supporting careers, mentoring, networking and personal development. This year Aspire also launched Parent to Parent, a buddy scheme helping parents settle back into work after maternity or adoption.

Percentage of colleagues in each age band



Percentage of male and female colleagues and managers

	2017		2016	
	Male	**Female**	**Male**	**Female**
Managers	6,569 (58.9%)	4,584 (41.1%)	6,352 (58.6%)	4,484 (41.4%)
All colleagues	28,483 (44.8%)	35,162 (55.2%)	30,655 (44.2%)	38,665 (55.8%)

Paying a fair wage

We've always supported the principle of a statutory minimum level for basic pay, and campaigned for the introduction of the national minimum wage. We're increasing our investment in customer-facing colleagues' pay in 2018 to move further beyond the National Living Wage, and we'll continue to apply our minimum rates to all colleagues, unlike many other employers who reduce rates for younger colleagues or apprentices.

We offer good benefits to colleagues, and, as we've referred to earlier, we're introducing new financial, health and wellbeing initiatives in 2018.

Gender pay reporting

Under new legislation, all UK employers with over 250 employees need to publish a gender pay gap report. This is to show if there's any difference in the average pay between all men and all women in an organisation. It doesn't compare what men and women are paid for doing the same job. We published our report on 28 February which gives a snapshot as at 5 April 2017 – **www.co-operative.coop/ethics/gender-pay-gap-report.**

The regulations mean we have to produce data by employer and we have two employers within our organisation – Co-operative Group Ltd which employs most of our colleagues and CFS Management Services Ltd which is mainly made up of our Insurance colleagues. As at April 2017, women were paid on average 18.9% less than men in Co-operative Group Ltd and 24.0% less than men in CFS Management Services Ltd.

Our numbers are better than the national average, but like most large employers we do have a gender pay gap. There are lots of reasons why, but it's mainly due to us having more men in senior positions than women. Equality is one of our Co-op values, so we know we can do better than this. We're working on it but it'll take time.

Our apprentices

In 2017 we expanded our apprenticeship programme with more than 200 apprentices starting in our Food business, including 33 on a Chartered Management Degree apprenticeship programme.

A number of apprentices have joined our Support Centre operations in areas such as PR, Pensions, HR and Digital. In August, seven young people from our Co-op Academies Trust schools also started apprenticeships in our Insurance business.

By the end of 2017 we'd increased the number of apprentices across our Co-op by 60% compared to 2016. We're using the apprenticeship levy to grow our programmes and achieve our ambition of 1,000 apprentices a year.

Looking ahead

We're committed to making our Co-op a great place to work. We'll do this through:

- Supporting our business transformation programmes
- Colleague engagement and recognition
- Leadership development and apprenticeships
- Wellbeing – especially financial wellbeing
- Diversity and inclusion.

We're introducing a debt consolidation service that gives colleagues access to low cost, responsible borrowing and an alternative to sources like payday lending. We'll also look into a Workplace ISA – a tax efficient savings plan – and continue our close relationship with credit unions, which provide savings and lending services to our colleagues.

We'll launch two new networks in 2018 to support young colleagues and black, Asian and minority ethnic colleagues after asking colleagues what they wanted.

We still need to make sure we're getting the basics right for our colleagues with a competitive reward and benefits package – including rewarding our customer-facing colleagues better.

Community, campaigns and sustainability

£20 million

Given to 8,000 local community projects

Shared value

Our Co-op was founded in 1844 to address a social injustice – adulterated food sold at unfair prices. Ever since, ethics and commercial responsibility have influenced every aspect of our work. In each generation we've campaigned on the issues most important to our members. From votes for women, to anti-apartheid, and from climate change to Fairtrade, we've often led the way for social, economic and political reforms. In 2017 we renewed our commitment to Co-op campaigning with our members voting overwhelmingly at our Annual General Meeting to support the victims of modern slavery.

Our support for the local communities where our members live, and where we trade, creates much of the shared value that makes our Co-op a better way of doing business.

In 2017 we:
- Gave £20m to 8,000 local community projects chosen by our members through the Local Community Fund
- Recruited 200 Member Pioneers
- Opened three more Co-op Academy schools
- Raised £1.8m to tackle global water poverty through the sale of bottled water

What's new?

Reporting on our goals
We're publishing our Co-op Way Report alongside this report for the first time this year, showing the importance we place on our progress against our ethical and sustainability goals, as well as our financial performance.

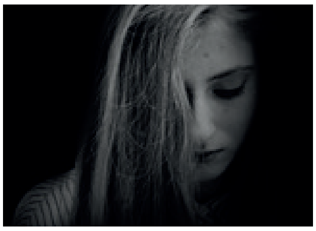
Local Community Fund
Through the 1% member reward members have earned £13m for local causes during the last year. We also put money from the sale of our carrier bags into the Local Community Fund ('the Fund'). During 2017, the Fund gave £20m to over 8,000 local community projects and to celebrate this achievement we brought members, colleagues and local causes together for two celebration days, where we handed over £9m in April and £11m in November.

Supporting communities
We also recruited 200 Member Pioneers. These are a network of people of all ages and from a variety of backgrounds who share our passion to make great things happen locally. Member Pioneers are unique in that their only focus is to bring our colleagues, members and local causes together to find new ways to co-operate and get things done in our communities. They listen and inspire other members in their communities to get involved and help arrange local activities, focusing on the things that matter most where they live. We plan to recruit many more so that we have Member Pioneers supporting each of our 1,500 communities by 2020.

Tackling loneliness
In 2015 our members voted for us to tackle loneliness and social isolation. By May 2017 we'd raised more than £6.5m to help thousands of people reconnect with their communities. Working with the British Red Cross we've created Community Connector services in 39 locations across the UK. Early results from this service are very positive – people have said they feel less lonely.

Through the 1% Local Community Fund we've also supported 1,400 local charities and organisations that are responding to loneliness and promoting social inclusion in their communities.

We've also been campaigning at a national level to influence government policy on this issue, becoming a founder member of the Jo Cox Commission on Loneliness. As part of this, we launched a report calling on the government to recognise and respond to loneliness as a major issue in society. In January 2018 the government appointed a minster with responsibility for loneliness and accepted the recommendations made in the report, including the need for a UK wide strategy and a national measure of loneliness across all ages.



Modern slavery

We're doing everything we can to make sure slavery has no part in the production, growth or manufacture of the products we sell and services we use. We've put strong policies in place and we're making sure they're enforced throughout our supply chains and our own business operations.

We want to do more for the victims of modern slavery and help them rebuild their lives. Throughout 2017 we've been building up our Bright Future programme, in partnership with City Hearts and other charities, to offer victims of modern slavery paid work experience and the opportunity of a job in our business. We're now calling on other businesses to join us, and provide more opportunities for victims.

We're also campaigning in parliament for better support for victims including lending our support to Lord McColl's and Baroness Young's private members bills. At the same time, we're raising awareness of the issue, to help people understand how to spot the signs of modern slavery and know what to do if they suspect it's happening.

By the end of 2017, we provided 14 placements in our food stores and depots, and saw 12 other businesses – including four of our suppliers and several other co-operative retail societies – adopting our Bright Future model.

In November our work was recognised when we won the prestigious Thomson Reuters Stop Slavery Award.

12

We sponsor 12 academy schools (2016: eight)

Co-op Academies Trust

We're proud to sponsor 12 academy schools (2016: eight) in Greater Manchester, Yorkshire and Stoke-on-Trent through the Co-op Academies Trust, following the addition of Co-op Academy Swinton to the Trust after the end of the year.

It's our vision to inspire a new generation of high-achieving, aspirational, skilled and confident young people. We aim to grow the Co-op Academies Trust over 2018, and provide even more support and advice to the governance of the schools. As well as providing work experience opportunities at our Support Centre in Manchester, we've started to recruit former students of our academy schools into our apprenticeship programmes.

Empowering communities through Fairtrade

We've been a pioneer of fairly traded goods even before the Fairtrade Mark was introduced and we have a host of 'Fairtrade firsts' that we're proud of. We were the first supermarket to sell Fairtrade bananas in the UK and the first to convert an entire own brand range of hot beverages to Fairtrade.

Today we're focusing on the categories which the Fairtrade Foundation says will have the biggest impact on producers: tea, coffee, cocoa, wine, bananas, sugar and flowers.

Respecting animal welfare

In our Food business, respecting animal welfare is a big part of our work on agriculture. In 2017, our agricultural team made 117 site visits to monitor animal welfare at sites such as farms, hatcheries and abattoirs (2016: 127).

Climate change
We've reported on our climate impacts since 2005. Our long-term aim was to halve our direct greenhouse gas emissions by 2020 compared to 2006. After 11 years we've achieved this target three years early, with a 54% reduction since 2006.

We've taken a decision to reach this target the most stretching way, so we haven't accounted for the renewable energy we buy and generate. Instead we've achieved this through drastically cutting the actual energy we use. In 2017, we used half as much electricity and fuel as we did in 2006.

Water
In 2017 we donated £50,000 from sales of Co-op bottled water to help restore water and sanitation facilities for our banana-growing communities in the Dominican Republic devastated by Hurricanes Irma and Maria. And we donated a further £50,000 to the Disasters Emergency Committee Rohingya appeal to support refugees fleeing conflict in Myanmar over the border into Bangladesh where water and sanitation provision is lacking.

We significantly increased the amount we give to the One Foundation in 2017 by donating 3p from every litre of Co-op branded water we sell (previously, donations were only made for sales of Fairbourne Springs Water). This means we've increased our total donation to an estimated £1.2m a year (an increase of 30%) to fund water projects in Africa.

We also became UK founder members of the newly launched Global Investment Fund for Water, and will donate 1p per litre of branded water sold through our shops a further estimated donation of £900,000 a year to fight water poverty across the developing world).

The Co-op Foundation
The Co-op Foundation is our Co-op's own charity. It helps disadvantaged communities work together to make things better. In 2017 the Foundation launched 'Belong', a new programme helping young people beat loneliness, complementing our Co-op's wider campaigning on loneliness. The Foundation partnered with the #iwill campaign to create a £2m fund to tackle loneliness through youth social action.

Looking ahead

We're looking at how we can bring co-operative thinking to communities in ways that build on our Local Community Fund. We'll continue to invest in and develop our nationwide network of Member Pioneers so they can act as an important bridge between our Co-op, our members and the communities they live in. By 2020 we hope to have a Member Pioneer across all 1,500 Co-op communities working with members, colleagues and causes locally.

We're also looking at creating a digital platform that will provide local communities with some of the tools needed to create more co-operative solutions to strengthening community life.

Our continuing commitment to tackling social isolation will be seen through the launch in 2018 of the Loneliness Action Group. This will bring leading charities and organisations together to collaborate on developing new insight and action across society, and will hold the government to account on its policy promises. We are also supporting an All Party Parliamentary Group on loneliness to provide cross party parliamentarians with a forum to engage on the issue.

On Fairtrade, all the tea, coffee and bananas we use in Co-op branded recipe production will return Fairtrade premiums to producers. All roses we source from Africa – whether marked as Fairtrade or not – will be bought on Fairtrade terms, in a programme we're developing with the Fairtrade Foundation. This will deliver an estimated £228,000 in Fairtrade premiums to African producers.

An important goal over the next few years is to measure the social and economic impact of the work we're doing in ways that go beyond counting our financial investment so that the true long-term value is better understood.

You can find a more comprehensive review of our community, campaigning and sustainability work in our Co-op Way Report.

Key performance indicators (KPIs)

Financial KPIs

Why are these measures important?
A profitable business and financial stability is essential in helping our Co-op meet its plan for Stronger Co-op, Stronger Communities which our Chief Executive talks about on page 9. It's important to get the right balance between the returns to members and reinvesting in our Co-op for future growth.

More information on our financial performance can be found on page 22.

Underlying profit before tax
£65m
▲ 2016: £52m

Underlying operating profit (see below) less underlying interest

Total revenue
£9.5bn
▶ 2016: £9.5bn

Net revenue as shown in the consolidated income statement (page 96)

Underlying operating profit
£138m
▲ 2016: £126m

A measure of underlying profit before one-off items and gains or losses on disposals of assets (see note 1 for more details on how it's calculated)

Operating profit
£126m
▼ 2016: £148m

Operating profit as shown in the consolidated income statement (page 96). Includes the underlying operating profit of our businesses as well as one-off items and gains or losses on disposals of assets

Net debt
£775m
▼ 2016: £885m

Bank loans and borrowings less the cash we hold

Profit / (Loss) Before Tax
£72m
▲ 2016: (£132m)

Total profit (or loss for the year) before taxation

Colleague KPI

Why is this measure important?
Having colleagues who are engaged is really important in helping our Co-op achieve our goals and serve our members and customers. High levels of engagement show the pride and passion our colleagues have. More information on colleague engagement can be found on page 26.

Colleague engagement
75%
▼ 2016: 78%

Colleague engagement is measured by our annual Talkback survey.

Membership and Community KPIs

Why are these measures important?
Membership and community are at the heart of what we do as a co-op. What we measure shows us how well we're doing at connecting with members and providing them with products and services they really value. The returns made to members and their communities through the 5% and 1% are one way in which our Co-op shares value.

Active members
4.6 million
▲ 2016: 4 million

We define 'active members' as members who have traded with us in the last 12 months

5% reward earned by members
£61m
▲ 2016: £16m

The amount members earned for themselves through the 5% Membership offer on own brand products

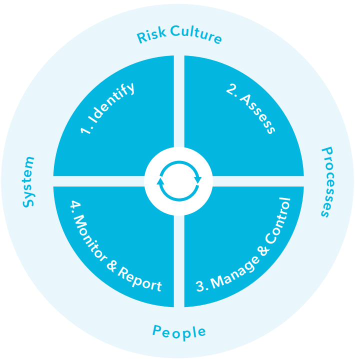
1% reward earned for communities
£13m
▲ 2016: £3m

The amount members earned for local communities through the 1% Membership offer on own brand products

Member sales in Food
33%
▲ 2016: 28%

The percentage of sales in our Food business that are made to members

Principal risks and uncertainties



Our key risk categories

Strategic and business
- Member value
- Earnings
- Strategic Objectives
- Market

Finance and treasury
- Funding and Liquidity
- Credit
- Pension
- Insurance
- Asset management

Operational and customer
- People
- Technology
- Information Management
- Information Security
- Data Protection
- Financial Crime
- Third Party Supplier Management
- Physical Assets and Security
- Business Disruption
- Health and safety
- Product
- Change
- Financial Control and Reporting

Regulation and compliance
- Legal
- Regulatory Compliance

Brand and reputation
- Reputation
- Ethical behaviour

Our approach to risk

Dealing with risk in the right way means we can continue to create value for our members and communities. To achieve our vision of Stronger Co-op, Stronger Communities we need to be informed and agile in how we deal with risks in our activities.

We're using our enterprise risk management (ERM) programme to develop our approach to managing risk and strengthening our framework, processes and training around risk management. As 'One Co-op' we're creating a culture where all colleagues share responsibility for identifying and responding to risk, and make decisions that fit with our Co-op values and ethical stance.

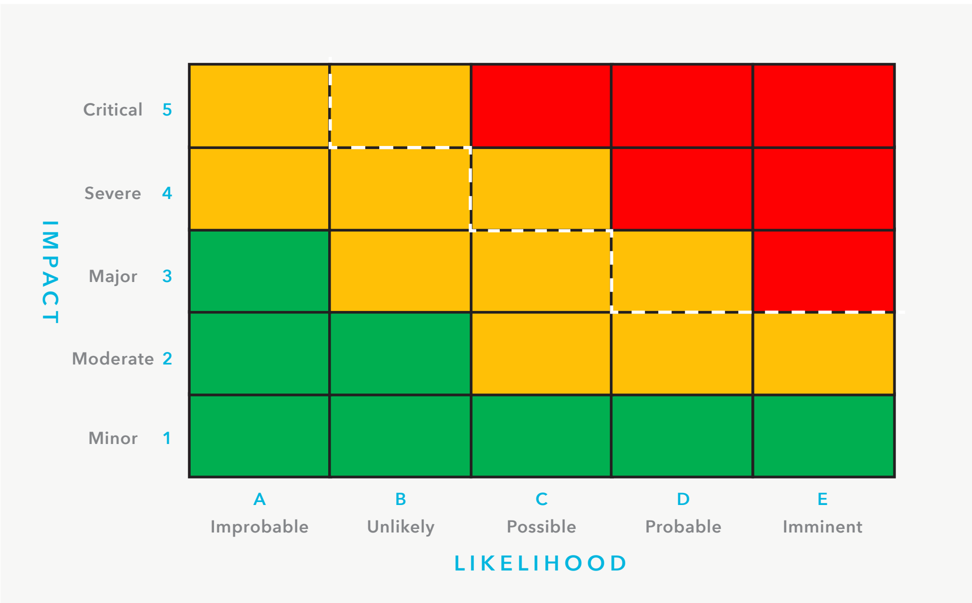
Our risk management framework

We have a four-step approach which supports our leaders and colleagues to recognise and manage risk as part of their day-to-day roles. This means we're always reviewing our response to the risks that our business and operations face.

We use a 5 x 5 'heat map' to judge both the likelihood and impact of any risk materialising. The impact means the potential outcome, financial and non-financial to our strategy, performance, operations, customer, brand, reputation, and compliance with laws and regulation.

The Board, Executive and senior leaders manage the impact of risks to our business model, members and colleagues by making sure that the appropriate response and resource is in place or developed to reduce or avoid the effect on our organisation.

The risks across our businesses fit into our key risk categories. These are the basis of our policies, standards and procedures to guide colleagues. Each risk category is owned by a senior leader with the expertise to understand what's expected and regularly monitor progress.



Our risk appetite

Risk appetite is the amount and type of risk we're willing to take to meet our strategic objectives.

Through our ERM programme, we're working towards a common understanding and measurement of risk appetite across our Co-op. This will help us make sure the decisions we make about our strategy fit with our Co-op values and don't put it at risk.

How we manage risk

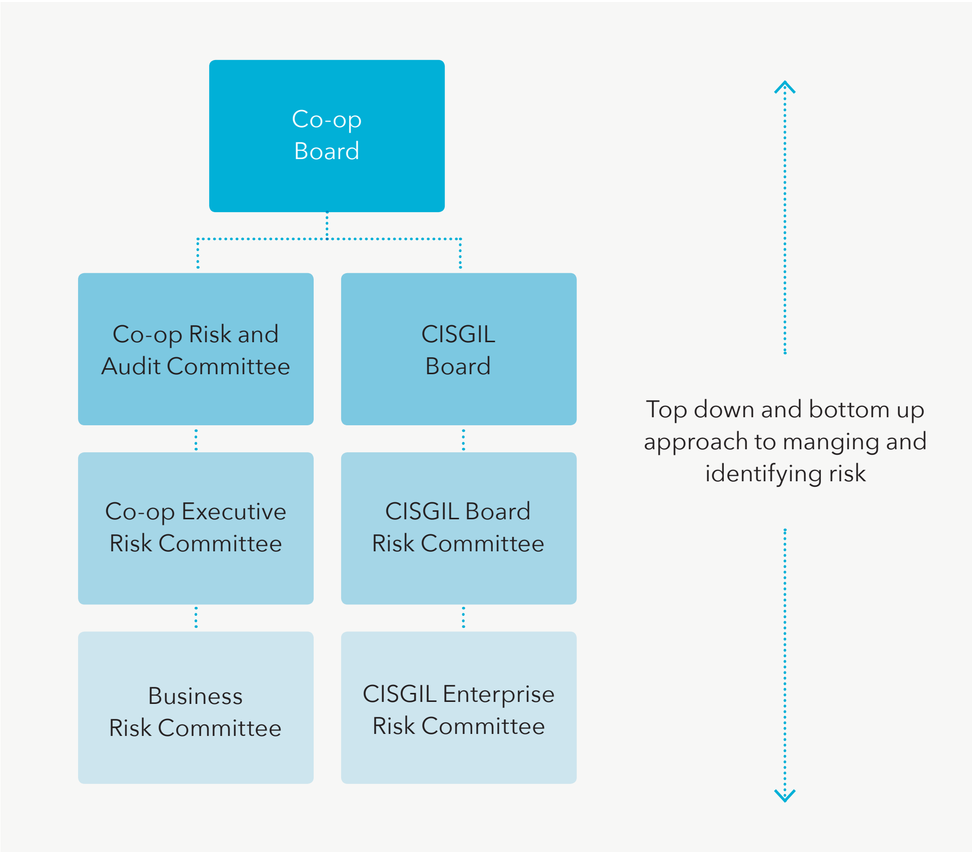
Our formal risk governance structure is shown below. The Board regularly looks at the principal risks and monitors management's progress. In 2017, the Risk and Audit Committee (RAC) and Executive Risk Committee (ERC) met regularly to look at the risks affecting how we give back to our members through our plans.

The ERC considers the principal risks to our strategy as part of our annual planning exercise. The impacts of the principal and potential risks are regularly reviewed by the ERC and actions are monitored.

Members of the senior management team are each given responsibility for a principal risk and these risks are considered at each meeting of the ERC.

In 2017 we created a Business Risk Committee made up of senior leaders which will meet regularly to monitor risks across our Co-op, the progress against reducing these, and involving the ERC when necessary.

In business and support function senior leadership meetings, risk is always on the agenda.



Critical risks and uncertainties

We face a range of critical risks and uncertainties. Some we can control and others come from external factors such as legislation, macro-economic conditions, consumer trends and competition.

Below are the most critical risks to achieving our objectives and what we're doing to minimise the impact they have on our organisation.

Risk description	Reasons for risk	Where we are	What we're doing
Change [V]			
Transformational change is not done effectively **Potential consequences** Failing to realise the planned benefits in full	• Number and complexity of change programmes • Available resources for programmes • Dependencies between programmes	• Our plans are ambitious and as a result of there being a number of complex programmes this risk profile remains high.	• Set up a Transformation Steering Group with Executive oversight and sponsorship • Regular review of all our programmes and rationalisation by the Portfolio Co-ordination Board • Governance at an individual programme level and across all our programmes • Training colleagues in our approach to managing change
Misuse and/or loss of data			
Personal data is inappropriately accessed, shared and/or not managed in line with our expectations **Potential consequences** Customer and member confidence is affected, financial loss, regulatory fines, and reputational damage	• Member, colleague and customer confidence • Data privacy and GDPR regulations • Information processed on our behalf by third parties	• Our GDPR programme is in place to help make sure our Co-op is ready for changes to data protection law that come into force in May 2018.	• Revised data protection operating model • Expanded data protection team led by our Data Protection Officer • Revised policies and standards • Inventory of all personal information, its uses and how long it's held • Information retention framework • Use of IT to support GDPR compliance • GDPR training and awareness • Managing third party contracts and processes • Payment Card Industry (PCI) framework
Market and economic conditions [V]			
Changing market and economic conditions may threaten our objectives and business model **Potential consequences** Changes to our consumers' spending patterns and choices, availability of labour, increased cost of funding and disruptions to parts of our supply chain	• Consumer behaviour • Pressure on margins • Structural impact of Brexit • Economic downturn • Competitors • Political landscape • Currency fluctuation	• Continuing uncertainty around Brexit and its potential impact on the economy and consumer spending means that this risk remains high.	• Scenario analysis and planning • Monitoring of leading economic indicators • Establishing early warning triggers • Brand strategy • Market research and analysis • Strategic ventures to strengthen our brand • Currency hedging
Revenue targets [V]			
We don't meet our sales growth targets **Potential consequences** Not achieving our planned sales growth would affect the sustainability of our business model and mean we can't invest in communities	• Consumer confidence • Changes in spending patterns • Price competition in all of our markets • Customer experience	• We're a market leading funerals business, have great food store locations, great products, a good reputation and loyal customers.	• Continuous review of our products and services • Expanded wholesale offering through our proposed acquisition of Nisa • Management of our locations and online services
Fuel for growth [V]			
We don't achieve our 'fuel for growth' targets making our organisation more costly Potential consequences If we don't find ways to save money and become more efficient our profitability will be lower than planned	• Market cost pressures • Inefficiencies in our operations • Complexity	• We have many projects looking at cutting costs and making us more efficient that are managed through the programme governance explained above.	• Programme governance structure with Executive oversight and sponsorship • Continuous review of individual savings and progress to savings targets

Risk description	Reasons for risk	Where we are	What we're doing
★ **Brand and ethical framework**			
Failure to create a brand and ethical framework that strengthens our Co-op Way **Potential consequences** We don't successfully balance profit and ethics	• Our Co-op values • Members' expectations • A Co-op that makes our colleagues proud	• Our business model is Stronger Co-op, Stronger Communities • Ethical framework in place • Award-winning sustainability report • Leading global campaigns like modern slavery	• More focus on our social impact supported by external assessments and benchmarking • Continued improvement to our sustainability reporting • Our Co-op Way plan
→ **Managing health and safety**			
Weaknesses in our health and safety practices and procedures could put customers and colleagues at risk **Potential consequences** An unsafe environment for our colleagues and customers	• Keeping our colleagues, members and customers safe • UK Health and Safety Regulation and Approved Codes of Practice • Avoidable accidents • Complexity of our business	• Our health and safety programme is creating a better controlled and safer place to work which can be seen through less events being reported and the organisation's increased awareness.	• Making sure our colleagues understand our health and safety culture and how it links with our Ways of Being Co-op • Training and awareness at all levels including the Executive • Health and safety operating model with clear roles and responsibilities • Policies and control standards • Putting a new accident management system in place • Safety governance framework
★ **Regulatory compliance**			
Non-compliance with laws and regulations may increase our cost of doing business **Potential consequences** Our Co-op is subject to various laws and regulations across its businesses. Failure to respond to changes in regulations or stay compliant could affect profitability through fines and sanctions from our regulators	• Regulations from our primary regulators • Codes and regulations that apply to our Food business including the Groceries Supply Code of Practice and product safety regulations • Solicitors Regulation Authority regulations applicable to our Funeral and Life Planning business • Financial Conduct Authority and Prudential Regulation Authority applicable to our Insurance business • Increased enforcement activity	• In our Food business we're doing a full review of processes and ways of working to make sure we fully understand, execute and monitor our performance against regulatory compliance. • The Groceries Code Adjudicator has opened an investigation into some of our practices relating to suppliers. • Our regulated Insurance business has well established regulatory risk and compliance teams.	• Regular engagement with primary authorities and regulatory bodies • Executive oversight of compliance activity • Horizon scanning by our in-house Legal team • Continued focus on product quality and safety • Dedicated Food policy and Code Compliance Team • Colleague training and awareness
→ **IT security and cyber threats**			
A cyber-attack or data security breach could lead to downtime of critical IT services and/or a loss of sensitive personal or commercial data **Potential consequences** Our ability to serve our customers is highly dependent on our IT systems. Any prolonged downtime or data breaches could prevent us from providing our products and services to our customers and members.	• Data privacy and GDPR regulations • Colleague, member and customer confidence • Processing of data through third parties • Worldwide spread of cyber threats • Increasingly sophisticated and diverse threat landscape	• The continuous evolution of cyber threats means that this risk remains critical.	• Strengthened Information Security team in place • Information Security governance framework in place • 24/7 security monitoring • Enhanced patching, encryption, user access controls and incident detection

Key

→ Stable profile   ↑ Increased profile   ↓ Reduced profile   ★ New Risk

V Considered in our Viability Assessment (see page 84 for more details)

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 Entertainment One Ltd, Wagamama, Canal & River Trust and Element Ltd.

Steve Murrells

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

Skills and experience
Steve became Chief Executive in March 2017 having previously led our Food business since 2012. 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 our Co-op.

Ian Ellis

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

Skills and experience
Ian joined our Co-op as Chief Finance Officer (CFO) in 2015. Previously Ian was CFO for Wilkos for nearly eight years and before 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.

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 CEO of the charitable social enterprise Turning Point Health & Social Care. He has been involved in a number of independent commissions advising governments on, mental health, learning disabilities, the role of the voluntary sector, policing and stop and search, policing and mental health, housing policy, the future of public services and employment/skills and race and equalities.

He is currently Founding Chair of Collaborate CIC, Director of Leadership in Mind Ltd, Non-Executive Director of NHS England, Director of IOCOM UK Ltd, Chair of charity Urban Development Music Foundation, Chair of Social Enterprise UK, a Visiting Professor and Chancellor of University of Lincoln and member of the Court of Governors of the London School of Economics.

Victor has a Masters in Advanced Organisational Consulting from City University and The Tavistock Institute.

Board biographies continued

Hazel Blears

Member Nominated Director
First elected as a Member Nominated Director with effect from 16 May 2015 and re-elected in June 2016 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 Chair of the Social Investment Business Foundation and Chair of the Institute for Dementia at Salford University. Hazel is also an Ambassador for the Alzheimer's Society and a Trustee of 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 of our subsidiary, Co-operative Food Holdings Ltd. Simon was appointed Chair of the Risk and Audit Committee on 25 June 2015.

Simon is a Chartered Accountant and is currently Senior Independent Director at the BBC, and is chairman of Bakkavor PLC, The Light Cinemas (Holdings) Limited and Blue Diamond Limited. Simon was previously Chair of BathStore and Hobbycraft, and CEO for Virgin Retail, Virgin Cinemas and Virgin Entertainment Group.

Margaret Casely-Hayford

Member Nominated Director
Elected as a Member Nominated Director with effect from 21 May 2016

Committee membership
Remuneration Committee

Skills and experience
Margaret is a qualified lawyer of 30 years, was the Director of Legal Services for the John Lewis Partnership for nine years and on the Board of the British Retail Consortium for four 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, Chancellor of the University of Coventry, Chair of the Carnegie and Kate Greenaway children's book awards diversity review, a director of Ultra Education Ltd and Chair of The Shakespeare's Globe Trust.

Paul Chandler

Member Nominated Director
First elected as a Member Nominated Director with effect from 16 May 2015 and re-elected with effect from 20 May 2017

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 Chair of the William Leech Foundation and Durham Cathedral Council, a director of Shared Interest, the Vice Chair, Treasurer and a Fellow of St Chad's College in Durham University, Vice-Chair of the County Durham Community Foundation and a Trustee of the Bible Society.

Board biographies continued

Sir Christopher Kelly

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

Committee membership
Remuneration Committee
Nominations Committee

Skills and experience
Chris chaired our independent review which considered the events leading up to the re-capitalisation plan for The Co-operative Bank plc in 2013. He currently chairs the King's Fund (the health and social care think tank) and the Responsible Gambling Strategy Board. He is also a Non-Executive member on the Oversight Board of the Office for Budget Responsibility and a Trustee of the Canal and River Trust. Previous roles include chairing the Committee on Standards in Public Life, the Financial Ombudsman Service and the NSPCC. For many years he was a senior public servant, mostly in HM Treasury but latterly as 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 was appointed as CEO of JUST EAT plc from 18 September 2017. Before that, Peter was the CEO of Moneysupermarket.com, the leading price comparison service in the UK, since 2009, from which he retired in May 2017. Peter studied civil engineering at Birmingham University and gained an MBA from IMD in Switzerland. He was UK Managing Director of dunnhumby, the engine room of Tesco's Clubcard, and has also held senior leadership roles in consumer businesses including Disney, Dyson and PepsiCo.

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. She was previously 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 also includes chairing the technology company Kino-mo, chairing the remuneration committee for LCG plc, and advisor of ITG, an international retail software company. Stevie was named in the Sunday Telegraph/Debretts 2017 list of Britain's 500 most influential people and in 2017 was awarded a CBE for services to charity.

Gareth Thomas

Member Nominated Director
Elected as a Member Nominated Director with effect from 20 May 2017

Committee membership
Remuneration Committee
Nominations Committee

Skills and experience
As Retail Director for John Lewis for ten years, Gareth led the business through huge cultural change. After completing a 30 year career at John Lewis, he worked for no financial reward for several years as a Trustee in the not for profit sector, including as Deputy Chairman of Save the Children, Trustee at TATE, Chairman of Tate Enterprises Ltd and a Trustee of the American Museum in Britain. He is also Non-Executive Director of Share plc Group, Independent Director of Shoppers Stop, India and a Chairman of Waterside Holiday Group Ltd.

Executive biographies

Steve Murrells

Group Chief Executive
See Board Biographies

Matt Atkinson

Chief Membership Officer
Matt joined us full-time in January 2018 as Chief Membership Officer (CMO) having started to work with us in the autumn. Before joining, Matt was CMO for SAGA where he helped transform them into a digital organisation, winning new customers and entering new markets. Before SAGA Matt held senior marketing and digital roles at Tesco, P&G and a variety of global media agencies.

Ian Ellis

Chief Finance Officer
See Board Biographies

Helen Grantham

Group Secretary and General Counsel
Helen joined as Group Secretary in January 2016 and took on the additional role of General Counsel in July 2017. Helen qualified as a solicitor in 1989 and before joining our Co-op she practised as both a General Counsel and Company Secretary for listed companies working at Board level, most recently for Dixons Carphone PLC.

Helen Webb

Chief People Officer
Helen became Chief People Officer in April 2017 having previously been the HR Director for Food.

Before joining our Co-op, Helen held a variety of senior roles for FTSE 100 companies including Sainsbury's, Marks and Spencer and Aviva. She's passionate about diversity and is a strong women's advocate, winning an 'Everywoman Retail Ambassador' award in 2015.

Jo Whitfield

CEO Food
Jo joined our Co-op as Finance Director Retail in 2016 and has now been appointed Chief Executive, Food. Before this, Jo was with Asda for eight years and held roles as Finance Director for George, Vice President for George Operations, International and Strategy and finally Vice President for Asda General Merchandise, Money and Mobile.

Jo is a qualified Chartered Accountant having trained with Ernst & Young and subsequently moved into industry. Throughout her career she has worked across various industry sectors and held leadership roles with businesses such as Northern Foods, GE Capital and Matalan.

Jo is an ambassador for Girls Out Loud and sponsors our colleague women's network, Aspire.

Jo became interim CEO Food in March 2017 and took this role up permanently on 17 July 2017.

Pippa Wicks

Deputy Chief Executive
Pippa joined our Co-op in 2014 on an interim basis from the business consultants Alix Partners 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 Alix Partners UK turnaround and restructuring business. Before joining Alix Partners, 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 Alix Partners Pippa took on a number of interim CEO and COO positions at UK and European companies.

Governance review

Chair's overview

Our approach
Our Co-op is unique. We're the largest consumer co-operative in the UK with a governance structure tailored for us.

It's built on co-operative Values and Principles while making sure we have a management team and Board with the skills and judgement necessary to run a business of our size and complexity.

You, our members, remain at the centre of everything we do. We ask what you think and we listen to what you say. We also have a 100-strong Members' Council who meet with us regularly to hold the Board to account.

This system is more complex than that used by listed companies and is also different to other co-operatives, but it works well for us.

We've had a look at our Rules during the year, along with Council, and are proposing some changes to make sure we can get the best out of our Member Nominated Directors (MNDs) and Independent Non-Executive Directors (INEDs).

We're also planning to make changes relating to members who have not traded with us for a long time – we need our members to trade actively with us as a co-op.

Shared value
I told you last year that the Board asks itself three questions when taking decisions. Those questions continue to work for us, which we look at with our Values and Principles in mind:
- 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 our colleagues now 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've reviewed our ambition and strategy over the year and have pulled together our plans under Stronger Co-op, Stronger Communities. This is underpinned by our purpose – Championing a better way of doing business – and our Ways of Being Co-op – Do what matters most, Be yourself always, Show you care, Succeed together.

As a co-op we want strong, profitable businesses which can compete in their markets, but this is not all we care about. We also want to generate shared value – giving back to our members and our communities, sharing the Co-op difference.

Member engagement
The relationship between our Board and the Members' Council has continued to grow and we've worked closely together on a number of initiatives throughout 2017 including developing our strategy, a continuing focus on community and the review of our Rules.

2017 also saw another successful Annual General Meeting (AGM) where you voted overwhelmingly to champion a better way of doing business by:

- Raising awareness and campaigning for greater support for victims of modern slavery.
- Backing our push towards an ultimate target of 100% easy to recycle packaging.
- Continuing to support Fairtrade values, suppliers and producers

Our campaigning work in 2017 has made a real difference. We've been at the forefront of the debate on modern slavery and on loneliness through our partnership with the British Red Cross. We will continue to make our voice heard in 2018.

At this years' AGM we'll be asking you to vote on the usual areas of reporting, directors, auditors and political donations. We'll also be asking you to approve some changes to our Rules, a change to our Executive Remuneration Policy, and to vote on a joint Board and Council motion on plastics. You can also have your say on a Members' Motion on our advertising policy. Full details are available at **www.co-operative.coop/agm**. We hope as many of you as possible will vote either in person on the day or online before the event.

Board changes

Steve Murrells took over from Richard Pennycook as our CEO in March 2017 and we had just one other change to our Board during the year, with Ruth Spellman choosing not to stand for re-election as a Member Nominated Director (MND) and the election of Gareth Thomas who joins us after a 30-year career at John Lewis Partnership, the final ten years as Retail Director. Gareth brings enormous experience from the employee owned sector as well as from additional Non-Executive roles and the not-for-profit sector. We were also very pleased that Paul Chandler was re-elected for his second term as an MND. 2018 will bring further change as Peter Plumb stands down from the Board at the 2018 AGM to pursue his new role as CEO of JUST EAT plc.

The future

We've shared with you our ambition for the future – Stronger Co-op, Stronger Communities – and I'm looking forward to working with your Board and Council as we move into the next phase of our development.

Allan Leighton
Chair

Compliance with the UK Corporate Governance Code published by the Financial Reporting Council ('the UK Code')

Because our Co-op is registered under the Co-operative and Community Benefit Societies Act 2014, it doesn't need to comply with the UK Code. We're a consumer co-operative which is owned by its members and have listed debt instruments with the UK Listing Authority.

We choose to report against the UK Code standards in the spirit of transparency and good governance, though not all of the UK Code provisions can be directly applied to our democratic model.

We set out in this section where we've complied directly with the UK Code and explain in areas (which aren't applicable) what we've done to comply with the spirit of the UK Code.

To help understanding we follow the UK Code's themes of leadership, effectiveness, accountability, remuneration and relations with our members.

Separately we report our compliance with the Corporate Governance Code for Consumer Co-operatives directly to its publisher, Co-operatives UK.

Make-up of the Board

We look at independence in two different ways, as defined within the UK Code and also under our Rules and Board Composition Charter (BCC). The BCC sets out our requirements for individual and collective qualification for our Board. And the UK Code states that at least half the Board, excluding the chairman, should be Non-Executive Directors determined by the Board to be independent.

We have membership and eligibility criteria which our directors need to meet. Central to everything we do are co-operative Values and Principles – all directors need to show a strong commitment to them. It's also a vital part of our BCC that directors meet the high standards of professional competence needed to run a business which is the size and complexity of our Co-op.

All of our directors have been appointed in line with our Rules and the BCC and we comply with the UK Code as we have two Executive Directors and ten Non-Executive Directors. We have two categories of Non-Executive Directors – all are considered to be independent in line with the UK Code. We have Independent Non-Executive Directors and Member Nominated Directors.

INEDs are appointed directly by the Board on recommendation from the Nominations Committee which has responsibility for the recruitment process. An independent search firm is used to support the committee's work. Following the Lord Davies recommendations we have made sure that the recruitment process is designed to achieve a better gender balance. Looking forward and following the Parker Review recommendations we will also make sure that selection criteria are designed to encourage candidates from a diverse ethnic background.

The Nominations Committee also has responsibility for making recommendations to the Board for Executive Director appointments.

All newly appointed INEDs and Executive Directors are put forward for election by members at the AGM following their appointment. They are then subject to re-election.

The Nominations Committee's report is on page 80.

The process for appointing MNDs is different. They are directly elected by members. We have the Member Nominated Directors Joint Selection and Approval Committee (MNDJC), which is a joint Board and Council committee and which finds candidates following a selection screening process. The selected candidates are then put forward into a membership ballot before the AGM and the results announced at the meeting.

MNDs may currently serve three, two-year terms (with the exception of Hazel Blears who is permitted to serve for an extra year). At this years' AGM, we'll ask members to vote on a motion which will extend two-year terms for MNDs and extend the maximum amount of time that both INEDs and MNDs can serve.

The Council Scrutiny Committee (whose report is on page 93) verifies the processes for the appointment of the Group Chair and INEDs and oversees the MND screening process.

Diversity

Diversity in all its forms is embraced by the Board. During the year the Board adopted a Board Diversity Policy, which is published on the website at **www.co-operative.coop/investors/rules**. Lord Davies has made recommendations for women on FTSE Boards and Sir John Parker has made recommendations on the appointment of ethnic minority directors to FTSE Boards.

In line with our Values and Principles, our Co-op believes strongly in equity and equality and has always made appointments based upon the best candidate for the role and not by quotas. Applying those principles the make-up of the Board has been ahead of both recommendations, with four women on its Board (until Ruth Spellman stepped down as an MND and the member election of Gareth Thomas) and two Black, Asian and Minority Ethnic (BAME) directors. While continuing to promote diversity and equality (and making sure any recruitment processes specifically consider such candidates), appointments will seek the best candidates for the roles in question.

Independent Chair

Allan Leighton was appointed as Chair on 19 February 2015 for an initial two-year term and extension of his appointment for a further two years was confirmed 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 Chair can be found on page 48.

Senior Independent Director (SID)

Sir Christopher Kelly was appointed as SID on 14 November 2014 for a two-year term and extension of his appointment for a further two years was confirmed at the 2017 AGM. More details on the role of the SID can be found on page 49.

Independent Non-Executive Directors

In addition to the Group Chair and the SID, there are currently four INEDs. These are Simon Burke, Peter Plumb, Stevie Spring and Victor Adebowale. Simon, Stevie and Victor will all be standing for re-election at the AGM on 19 May 2018. Peter will be standing down at this meeting.

Executive Directors

There are currently two Executive Directors on the Board, Steve Murrells, Co-op Chief Executive, who was appointed on 1 March 2017, and Ian Ellis, Chief Finance Officer, who was appointed on 6 April 2016. Ian's appointment was confirmed at the 2016 AGM and he will stand for re-election at the 2018 AGM. Steve's appointment was confirmed at the 2017 AGM.

Member Nominated Directors

There are currently four MNDs on the Board. Paul Chandler was elected by members in 2015 and re-elected for a further two-year term in 2017. Gareth Thomas was elected for a two year term in 2017. Hazel Blears was originally elected in 2015 for a one-year term and her initial term of office therefore expired in 2016. Hazel was re-elected for a two- year term in 2016 and Margaret Casely-Hayford was also elected for a two-year term in May 2016. Both Hazel and Margaret will stand for re-election in 2018.

What does our Board do?

Our Board's main responsibility is the long term success of our Co-op. It has to make sure that the major decisions taken are both commercially sensible and in line with co-operative Values and Principles. It does that by agreeing the strategic direction for our Co-op and then holding the Executive to account in the delivery of those aims. To do that, it monitors and assesses key financial and non-financial goals. It does not take that view in isolation. It has regular engagement with our Members' Council.

What decisions can our Board take?

The Board has the authority to take a wide range of decisions some of which need discussion with or approval of the Members' Council or approval by Members at a general meeting in line with our Rules and Regulations.

It isn't the Board's function to take day-to-day operational decisions which are delegated to our Executive. The Board hold the Executive to account for the performance of our Co-op. The Board has reserved a number of matters for its own decision in line with the UK Code.

The Board can delegate decisions for other matters to, for example, a director or directors, committees and subsidiaries. Areas covered for Board decision include:

- 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 (including for example approving certain major policies)

We also have a Delegated Authorities Framework which is reviewed regularly by the Risk and Audit Committee and approved by the Board.

Board and Board committee meetings and attendance

Board director biographies are on page 39. Members can see copies of the directors' appointment letters by asking the Group Secretary.

The table below sets out the frequency and attendance of directors at scheduled Board meetings and Board committees during the reporting period, with the number in brackets showing the number of meetings the individual was entitled to attend. Extra ad hoc meetings were held as required, but these are not included in the numbers.

Director	Board	Nominations	Remuneration	Risk and Audit
Allan Leighton	10(10)	4(4)	N/A	N/A
Victor Adebowale	9(10)	N/A	N/A	4(5)
Hazel Blears	10(10)	4(4)	N/A	5(5)
Simon Burke	9(10)	4(4)	N/A	5(5)
Margaret Casely-Hayford	10(10)	N/A	5(5)	N/A
Paul Chandler	10(10)	N/A	N/A	5(5)
Ian Ellis	10(10)	N/A	N/A	N/A
Sir Christopher Kelly	10(10)	4(4)	5(5)	N/A
Steve Murrells*	8(8)	N/A	N/A	N/A
Richard Pennycook**	2(2)	N/A	N/A	N/A
Peter Plumb	10(10)	N/A	4(5)	N/A
Ruth Spellman***	5(5)	2(2)	2(2)	N/A
Stevie Spring	10(10)	N/A	5(5)	N/A
Gareth Thomas****	5(5)	1(1)	3(3)	N/A
Council President: Nick Crofts*****	N/A	4(4)	N/A	N/A

* Appointed 1 March 2017
** Resigned 1 March 2017
*** Stepped down 20 May 2017
**** Appointed 20 May 2017
***** Nick Crofts is not a director, but is the Council President and a member of the Nominations Committee.

All Board and committee papers are uploaded and available for directors to read well before meetings via iPad. Meetings are scheduled taking into account directors' availability, but if for any reason a director can't attend a meeting they are expected to let the Group Chair know as soon as possible along with any particular views on items which are going to be discussed at the meeting. Executive members regularly attended Board meetings by invitation and the Non-Executive Directors meet after the conclusion of each Board meeting in the absence of the Executive Directors.

Board committees

Risk and Audit, Remuneration and Nominations are the three regular Board committees.

Each committee has its members selected by the Board (with the Nominations Committee having certain members by virtue of their office) and all committee minutes and papers are available to all directors, unless there is a potential conflict of interest. The various committee Chairs report regularly to the Board on the activities of their committees.

The Risk and Audit Committee report is on page 53, the Remuneration Committee report is on page 61 and the Nominations Committee report is on page 80.

As well as the regular committees, the Board sometimes forms committees to deal with specific issues with minutes circulated to the full Board and reports provided as appropriate.

While not formal Board committees, our Co-op also has discussion forums with the Members' Council such as the Stakeholder Working Group and the Co-op Way Policy Committee. As mentioned above, we also have the MNDJC, on which Board and Members' Council members sit. This deals with the selection of MND candidates who are then put forward to members for election.

Our subsidiaries

Our subsidiaries are influenced by the strategy and direction set by our Board and are subject to Co-op-wide rules, policies and procedures (particularly governance requirements), but are otherwise run as independent businesses. CIS General Insurance Limited (CISGIL) and Co-operative Legal Services Limited (CLSL) are treated slightly differently to other subsidiaries as both are regulated (CISGIL by the Financial Conduct Authority and Prudential Regulation Authority and CLSL by the Solicitors Regulation Authority). This means that while our Co-op oversees the businesses they need to have more responsibility for their own independent conduct and day-to-day operational decisions.

Details of key roles

Group Chair

The UK Code says the Chair and Chief Executive should be distinct and separate roles, agreed by the Board and done by two different people.

Our Co-op has this division of responsibility, but we don't have one single document setting out how this works. Our Chair's role is clearly set out in his terms of appointment and the Chief Executive's role is clearly set out in his employment contract and terms of appointment. The Chair has a wide brief and is responsible for leading the Board and setting the Board's agenda (with the help of the Group Secretary – mainly focused on strategy, performance, value creation and accountability), while making sure 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, and making sure members and other stakeholders are given appropriate information. The Chair also has to make sure our business is run in line with co-operative Values and Principles and with integrity, decency and aligned to good ethical values, while giving proper consideration to risks facing the business and making sure adequate controls are in place so these Values and Principles are applied across our Co-op.

The UK Code says the Chair should, on appointment, meet the independence criteria set out in the UK Code. The BCC expects the Chair to become fully engaged in the activities of our Co-op and therefore doesn't 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.

Group Chief Executive

Our Rules say the day-to-day running of our Co-op's business is the responsibility of the Executive, led by the Co-op Chief Executive – currently Steve Murrells.

He has direct responsibility for the things the business does on a daily basis and is accountable to the Board for the Group's financial and operational performance. He is also responsible for the appointment of the executive team, in consultation with the Board, with the exception of the Group Secretary, who is a member of the Executive as stated in our Rules, but is appointed by the Board.

The main responsibilities of the Chief Executive are set out in his contract of employment.

Senior Independent Director

Sir Christopher (Chris) Kelly is the current SID. His main role is to provide a sounding board for the Chair and other directors. The SID is also available to deal with any directors wishing to raise or escalate issues relating to the Group's governance, the Board or the Chair's performance if for any reason those matters can't be raised directly with the Chair. The SID also makes himself aware of member and other stakeholder issues and makes sure that the Board is made aware of these views. He is a member of our Stakeholder Working Group (SWG) (which we tell you more about in our 'Engagement and relations with our members' section below) and has a key role in working with our Members' Council.

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

Group Secretary

Helen Grantham was appointed as Interim Group Secretary on 11 January 2016 and took up the permanent role of Group Secretary and General Counsel with effect from 1 July 2017.

Helen reports to our Co-op Chair (as Group Secretary), is a member of the executive team and all directors have access to her advice as Group Secretary. The appointment and removal of the Group Secretary is a matter for the Board under our Rules.

The Group Secretary has specific reserved rights and discretion under the Rules. In particular, the Group Secretary advises our Chair and the Board on all governance and procedural matters. The Group Secretary is also instrumental in making sure there is a good flow of information between the executive team and the Board and between the Board and Senate and the Members' Council. The role also includes making sure that new directors have an individually designed induction programme and that their ongoing training and continuing professional development needs are met.

Terms of office

Executive Directors are appointed by the Board. They don't have a maximum term of office, but are subject to re-election at the AGM by our Members, currently every two years.

INEDs are subject to election by members at the first AGM following their appointment and are currently subject to re-election by our Members every two years after that. This is subject to the Board and the Council having the right to agree otherwise to avoid a situation where more than half of the other directors (excluding the MNDs) would be retiring from office at the AGM in a particular year and provided the Nominations Committee recommend their re-appointment to the Board. All INEDs must also retire if they have been in office for a continuous period of six years or more at the date of the Annual General Meeting.

MND appointments are currently for two-year terms. The exception to this was in 2015 when Hazel Blears was elected for an initial one-year term (at a time when there were three MNDs on the Board), to ensure that not all MND appointments started and finished at the same time. MND terms are now staggered and only two from four MNDs are required to step down and put themselves forward for re-election (should they choose) by members each year.

With the exception of Hazel Blears, who can serve a maximum of seven years, MNDs can serve a maximum of three terms of two years subject to the Member Nominated Director Election Regulations.

At our 2018 AGM we're asking our members to vote on changes to our Rules which will extend the maximum term of office for INEDs and MNDs to nine years and extending the period MNDs are elected for to three years.

2017 elections
The following directors were elected or re-elected at the 2017 AGM:

- Allan Leighton (Independent Chair)
- Sir Christopher Kelly (INED – SID)
- Steve Murrells (Executive Director)

Gareth Thomas was elected as an MND and Paul Chandler was re-elected as MND in 2017 following a contested election. The results of the election were announced at the 2017 AGM.

2018 INED and Executive Director elections
The following directors are standing for re-election at the 2018 AGM:

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

The Nominations Committee has confirmed that all directors standing for re-election have met the required Membership and Eligibility Criteria and shown continued commitment to our Values and Principles. 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 re-election.

2018 MND elections
The MNDJC has led on the current MND election process. Hazel Blears and Margaret Casely-Hayford have both said they wish to stand for re-election and the MNDJC has approved their inclusion on the ballot form. Details of all 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'.

Our Co-op's governance model is different to that anticipated by the UK Code and is based on co-ownership by its members. Our Members' Council, made up of 100 elected members, represents our members and acts as guardian of our Co-op's purpose, Values and Principles and holds the Board to account.

The 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, Chair and individual directors engage with Council and its committees, working groups and members. 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.

Directors regularly attend Council meetings to listen and respond to questions raised by Council members, so Council can hold them to account, and executive team members attend Council meetings to bring the Council members up to date on developments within our Co-op.

The Stakeholder Working Group (SWG), made up of four Board members and four from the Council (including the Council President, two Vice Presidents and one other Senate member), also meets on a regular basis to have an open debate on topical issues of interest to members, to consider any contentious issues and to better understand the views of Council and Board on specific topics.

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

We reach out to our wider members and other stakeholders in a number of ways, including "traditional" methods such as in writing, at the AGM, through our website, by email, and social media, including Facebook and Twitter.

In 2017 colleagues have worked with Board and Council members looking at ways we can engage further with members focused on five themes:

- Community – supporting Member Pioneers to work collaboratively with members in shaping local community plans
- Business – creating an online tool where members can share their ideas and suggestions with us
- Democracy – improving the ways members can connect and engage with their elected representatives
- Co-op relations – using participation techniques to increase members' understanding and involvement in co-ops and co-operation
- Campaigns – encouraging members to get involved in our campaigning work. More information on the work carried out by the Community and Campaigns team is on page 29

Your Members' Council is also active in promoting our Co-op and engaging with members. They communicate through our website, blogs, videos and social media, and in 2017 held 20 Shape Your Community events across the country which were attended in person by over 1,100 members and customers with 1,800 joining online.
All had the opportunity to listen to presentations, speak to local causes and ask our senior colleagues and Board directors questions. More information on the work done by the Members' Council is in its report on page 89.

Members are also encouraged to come to the AGM where — provided they have met the required eligibility criteria — they can vote on motions which are ether put forward by our Board, the Members' Council or by members themselves.

Dialogue with the Independent Society Members (ISMs) is formalised through Federal Retail and Trading Services Limited, which was incorporated in 2014 and is 75% owned by our Co-op and 25% owned between the seven largest ISMs.

Conflicts of interest
Director conflict of interest situations are clearly dealt with in the Rules, including the need for directors to declare any actual or potential conflicts and how they should be dealt with if they arise. All our directors have a duty to avoid conflicts of interests and must disclose any other appointments they may have and any potential conflicts of interest before being appointed and on an ongoing basis.

Checks are made in relation to those appointments and/or conflicts to make sure it remains appropriate for the director to be appointed. All current directors have been checked by the Board to make sure there are no significant conflicts of interest which would prevent a director from serving on the Board.

The Board refers to a Board Conflicts Toolkit which gives guidance on what to do in potential conflict of interest situations.

In the event of a specific conflict of interest, the directors must disclose that ahead of any discussion on the topic. They won't be allowed to take part in the discussion and won't be allowed to vote on it. If a director is excluded from part of a meeting because of a conflict, they are given a version of the minutes which only has the portion when they were in the meeting.

Directors' and Officers' liability insurance
We annually take out Directors' and Officers' liability insurance to cover directors against any legal action taken against them when doing Co-op business. Our Co-op also gives an indemnity to directors and the Group Secretary for defined liabilities which may arise as a result of them doing their job.

Board effectiveness
The Nominations Committee needs to conduct an evaluation of the Board's performance annually and this must be done by an external firm every second year unless the Nominations Committee and the Chair both agree a good reason why that shouldn't happen. In 2017, the Nominations Committee asked Independent Audit Limited to carry out an external Board evaluation, which they completed in the early autumn. The main themes of that review and the areas of focus for the Board are in the Nominations Committee report on page 80.

Independent professional advice and Board support
All directors have access to the Group Secretary, Secretariat and the executive team. There are also procedures for directors to take independent professional advice, at our expense, if needed to help them with their role.

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 our Co-op on a one member, one vote basis, with the exception of ISM's, whose number of votes is calculated based on how much they trade with us.

Report of the Risk and Audit Committee

Introduction from your Committee Chair

The Risk and Audit Committee ('the Committee') has had a busy year. Our Co-op has made good progress in improving the safety regime in all areas of the organisation, refining internal control and assurance, and building a stronger risk management framework.

Colleague and customer safety
The number of accidents (and their severity) has reduced during the year, and we're making good progress in refurbishing our buildings to bring them up to modern safety standards. Like many retailers, an area of concern has been the notable increase in crime incidents and we're keeping this under close review.

Internal audit reviews
The outcomes of internal audit reviews are improving, though not as fast as we'd like, and the clear-up rate is getting much better thanks to strong executive support. However, not all parts of our operations are wholly effective. This still represents very substantial progress for our Co-op and we're satisfied that the direction and ambition are right.

Risk management
Risk management has made significant strides during 2017. We now have a framework of key risks and mitigations and are well on the way to establishing levels of risk appetite and identifying residual risk outside that appetite. Further work remains to be done, but the process of recognising and managing risk is becoming well-embedded across the business.

Sustainability reporting
For over a decade we've been committed to providing members with a comprehensive report on our ethics and sustainability performance. The Committee recently took on formal responsibility for this on behalf of the Board. We are still on a journey here but I hope you will see the progress in our Co-op Way Report for this year.

Other areas of focus
- Groceries Supply Code of Practice ('the Code') compliance – we've had some challenges in this area which are being addressed by the Food team. On 8 March 2018, the Groceries Code Adjudicator announced her intention to investigate some of our practices relating to delisting and the introduction of benchmarking and depot quality control charges. There is a strong intention from the Executive to make our Co-op one of the best performing retailers covered by the Code.
- IT infrastructure and cyber security – the work done here is very impressive, and the resilience and protection of our systems has improved greatly, but cyber attack will always remain a significant threat and we must keep this under constant review.
- IT projects – top of our list is Retail Business Transformation where we're monitoring project management, key milestones and the governance structure.
- Data management and integrity – especially in the context of the forthcoming General Data Protection Regulation.
- The Co-operative Bank restructuring and related matters – such as pension sectionalisation and the separation of IT and other shared services.

Once again the Committee has benefited from great input and support from my colleagues, Hazel Blears, Victor Adebowale and Paul Chandler. We're all pleased to be supporting the continued progress of our Co-op and helping to safeguard members' interest in its financial wellbeing.

Simon Burke
Chair of the Risk and Audit Committee

Risk and Audit Committee membership and attendance

Our Board has a committee known as the Risk and Audit Committee which is responsible for watching over our Co-op's financial reporting and how well it's managing risk.

The UK Corporate Governance Code ('the UK Code') recommends that the Risk and Audit Committee has at least three independent directors serving as members. We continued to meet this recommendation during 2017.

The Committee is made up of directors who our Board considers to be independent under the UK Code. They provide objectivity and independent scrutiny. Our Board is satisfied 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 Victor Adebowale who is an Independent Non-Executive Director.

Details of attendance by Committee members at meetings held during 2017 are on page 47.

The Chief Finance Officer, Group Secretary, Assistant Secretary, Director of Internal Audit, Chief Risk Officer, Corporate Finance Director, Group Accounting Director and the external auditors attended all Committee meetings. 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 Risk and Audit Committee does

The Committee works for our Board. Its main responsibilities include:

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

Internal controls
- To keep under review the adequacy and effectiveness of our internal financial controls and internal controls system
- To monitor any significant weaknesses in our Co-op's controls and/or disclosure controls and procedures

Internal audit
- To monitor the effectiveness of our Co-op's 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 how management responds to the findings and recommendations of the Director of Internal Audit

External audit
- To make sure that our Co-op has followed proper procedures to choose its external auditor, ensure their independence, approve their fees and check their effectiveness

Risk
- To monitor how effective our Co-op is at managing and controlling risks
- To oversee our risk exposures and proposed improvements to the risk management framework

Sustainability reporting

- To receive, review and recommend to our Board the approval and adoption of the Co-op Way Report
- To put the assurance contract for the Co-op Way Report out to tender when the Committee thinks this is the right thing to do and to make sure the selection process works well
- To approve how and what the assurance provider of the Co-op Way Report will do and how much this will cost

Other

- To monitor the arrangements for colleagues to raise concerns, in confidence, about possible wrongdoing (whistleblowing) and what our Co-op does with the issues raised
- To review each year how our pension schemes are managed
- To ensure our Co-op manages compliance with the Modern Slavery Act 2015 well

How the Committee operates is described in more detail in its terms of reference. These were updated in 2017 to include their new responsibilities to oversee the Co-op Way Report (including the appointment of an assurance provider to audit this) and to monitor how we manage compliance with the Modern Slavery Act 2015. The terms of reference are available on our website: **www.co-operative.coop/investors/rules**.

In 2017, the Committee's main activities included reviewing:

- The integrity of our Co-op's reported financial information, especially the 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
- How we comply with the UK Code and if there are areas where we need to improve
- The approach to key accounting judgements and significant matters
- How we'll be affected by new accounting standards relating to revenue from contracts with customers (IFRS 15) and leases (IFRS 16)
- How well our external auditors, Ernst & Young (EY), were performing after their first year audit
- The development of new and better ways of monitoring and reporting on our approach to sustainability reporting and social impact accounting
- Management of the retender for the assurance provider who independently checks our Co-op Way Report and the appointment of DNV GL to this role
- The modern slavery statement
- How we use and look after data and information, including General Data Protection Regulation (GDPR) and Payment Card Industry Data Security Standard (PCI DSS) Compliance Programmes
- Compliance with the Grocery Supply Code of Practice (GSCOP) including reviewing responses to the Groceries Code Adjudicator (GCA) and the work of our buying teams to improve how we treat our suppliers
- Legislation and regulations regarding pay, including National Living Wage, gender pay and holiday pay
- The findings of audits on how well our Food team were managing the Retail Business Transformation Programme
- Updates on our Co-op's priority risks, together with how we're complying with health and safety standards and the progress of the Risk, Health and Safety Programme
- The risks around separation of our Co-op from The Co-operative Bank ('the Bank') and how these are managed
- The annual review of the pension schemes
- Reports on whistleblowing activity
- Updates to our tax policy

Significant issues relating to the financial statements

When the Committee looked at the 2017 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
Going concern Management continues to monitor whether we will have enough money to continue in business. Our Co-op borrows money from banks and others and we check that we comply with the terms which we have agreed with them, for example, banking covenants. There is judgement involved in assessing whether we are able to continue as a going concern such as ongoing compliance with financial covenants and, in relation to our Insurance subsidiary, CIS General Insurance Ltd (CISGIL), compliance with capital requirements set by the Prudential Regulation Authority.	The Committee reviewed management's assessment of going concern and agreed there was adequate headroom in the terms we've agreed with our lenders during the period under review for the Trading Group (a definition of 'Trading Group' is provided on page 164) and, when combined with the conclusions of the CISGIL going concern review, it was appropriate to continue to adopt the going concern basis for our Co-op.
Goodwill and fixed asset impairment Our balance sheet includes significant goodwill and property, plant and equipment balances. The most significant elements of these balances are in the Food business. When we buy a business, goodwill is the difference between what we pay and the value of its individual assets and liabilities. Each year we need to look at whether these assets have gone down in value and, if they have, whether we need to reduce their value in our balance sheet. Any resulting reduction in value is called impairment. A discount rate is used when calculating the impairment – this is an adjustment to reflect that the value of money changes over time due to inflation or interest rates.	The Committee reviewed the results of management's annual impairment review, and discussed the key judgements and assumptions used in the calculations. The Committee also confirmed that the discount rate used in the calculations had been checked to make sure it was consistent with external rates.
Onerous lease provisions We make provisions where we are likely to have to make a payment in future but we are uncertain of the amount so we make a best estimate. Key areas where significant management judgements have had to be applied include onerous leases. Onerous leases are ones where we still have to make rental payments under the terms of the lease, even if we are no longer using the building.	The Committee reviewed key management judgements regarding material provisions. It checked these judgements with external experts, which supported them. The provisions were assessed for consistency of approach compared with previous years, and against our accounting policies. .
Pensions scheme IAS19 valuation Our Co-op has a number of defined benefit pension schemes which require extensive disclosure. A number of assumptions are made in deciding the value of future pension liabilities, changes in which can materially affect the valuation. We are splitting the assets and liabilities of the Pace pension scheme between our Co-op and the Bank to create two discrete sections of the scheme (sectionalisation). This needs to be accounted for and disclosed in the financial statements. A misstatement was found in the 2016 year end actuarial valuation of the Pace scheme where £39m of pension assets relating to Additional Voluntary Contributions had not been included. A prior year adjustment has been made to correct this as described on page 165. This was not considered to be sufficiently material in the context of the value of assets on the balance sheet to need a third balance sheet to be prepared under IAS 1.	The Committee assessed the key assumptions which are used in the pensions calculations. It also reviewed advice provided by internal and external actuaries, including market benchmarking. A paper was considered which covered pensions accounting and the impact of sectionalisation on the financial statements. The Committee received details of how the misstatement in the 2016 actuarial valuation had happened and gained assurance from further detailed work to make sure that this was an isolated incident. The Committee also considered the materiality of the misstatement in the context of the 2016 balance sheet and agreed with the approach to disclosure in the financial statements.
Supplier income Ensuring that income from suppliers has been included in our financial statements in line with supplier agreements, at an appropriate level and in the relevant period.	The Committee received details of the policy on recognition of supplier income and how this was applied. Work done by Internal Audit on the process and controls over supplier income gave further assurance.
Membership accounting Our balance sheet includes a creditor balance relating to Membership rewards which haven't been used yet. We need to estimate the amount that we think will not be used in the future and reduce the creditor balance by this amount. The calculations are based on how members use their membership cards.	The Committee reviewed the estimate made by management and assumptions used to make the calculation.

Area of focus	What was done
Insurance liabilities CISGIL holds significant insurance liabilities for the estimated cost of settling all claims incurred but unpaid at the balance sheet date, whether reported or not. This is a complex area which needs judgement due to the uncertainty of estimating claims not yet reported, future costs of settling claims, discount rates and whether customers will be awarded a lump sum 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 levels of prudence compared with previous years were also considered.
Revenue recognition There is a risk of error or fraud when recognising revenue, such as management deliberately misstating the allocation of revenue between periods or a risk that revenue is overstated.	The Committee reviewed income recognition policies and treatments for the different sources of income from Food, Funeral plans and Insurance.
Litigation and contingent liabilities Management regularly assesses the status of potential and ongoing litigation and our compliance with the regulatory environments in which we operate. We consider factors such as the likelihood of us having to make a payment and the ability to reliably estimate the potential payment. This helps us to decide if we should either make a provision or whether we should disclose that we have a contingent liability.	The Committee reviewed the status of key ongoing and potential litigation and compliance with regulations, including the recently announced investigation by the Groceries Code Adjudicator. The Committee concluded that the treatment of these items in the financial statements is appropriate.

Review of the Committee's effectiveness

In 2017 our Board commissioned an external evaluation over the effectiveness of your Board and committees. This included the Risk and Audit Committee. The high level outcome of the review showed that while the Committee was operating effectively, it could do better by reducing the number of routine items on meeting agendas and should look at more in-depth reviews into specific areas.

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.

EY are our Co-op's auditors. They were appointed in 2016 following a tender exercise led by the Committee. They also provide the Committee with relevant reports, reviews, information and advice throughout the year. All of these activities are set out in their engagement letter.

Independence, objectivity and fees
Our external auditor must be judged to be independent for the audit to be objective. So we have an External Auditor Independence Policy. We also have 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. This spend is capped at 70% of 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 (but not limited to) the following:

- Bookkeeping or preparing accounting records or financial statements
- Designing and putting in place financial information systems
- Valuation services
- Internal audit services
- Management functions or some human resource services

The Committee reviewed and updated the policy in 2016 when we were deciding who to appoint as our external auditor. At each of its meetings in 2017, the Committee was told about the nature and cost of any non-audit work done by EY for our Co-op and was 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
The Committee reviewed the effectiveness of EY during the year. Feedback was gathered from a number of stakeholders including the Chief Finance Officer. In making its assessment the Committee considered EY's independence and objectivity as well as evaluating its communication with the Committee, the quality of its service and the role of the audit partner. The outcome of the review showed that EY are providing a professional, independent and objective service.

Internal audit

Internal Audit is an independent function authorised by our Board through the Committee. Its main role is to provide professional, objective assurance while providing insight to improve the way our Co-op is managed and controlled.

The Committee reviewed and approved the Internal Audit programme of work. At each meeting, a report from the Director of Internal Audit is received on:
- the work of Internal Audit 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 Internal Audit reports covering key processes, systems and controls and IT projects and programmes. The reports have covered a range of different areas and businesses at our Co-op.

The Committee also approved the Internal Audit Charter.

Internal control

Our Board has overall responsibility to make sure controls are in place to enable our Co-op to work effectively. They assess the effectiveness of these controls using 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 our Board, is responsible for reviewing how effective the internal controls are. The controls are designed to manage rather than remove the risk of our Co-op not being able to achieve its objectives. It can only provide some, not complete, assurance that things won't go wrong.

Each Executive member was asked to review how well the controls were working for their area of responsibility and to self-certify the results of their review. This included looking at the key elements of internal control operated and the key improvement initiatives.

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

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

Control environment
Our control environment is designed to create a culture 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 us deliver our business objectives
- Co-ordinating the way colleagues do things across our Co-op through regular management meetings and other forums
- Setting policies for how we spend money, and making sure that if we need to spend a large amount of money, our Board gives permission

- The Code of Business Conduct, which sets out how colleagues should conduct themselves in line with our Co-op'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.

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

To do this management maintain risk registers that identify the likelihood and impact of risks and what they are doing to manage them. The Risk team supports risk management across our Co-op, and reports on risk to the Committee.

During 2017, the Committee received updates on our priority risks and the Risk, Health and Safety Transformation programme.

Control activities
Our Co-op'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 information on our Co-op's rules, accounting policies, insurance, colleagues and Code of Business Conduct are given to appropriate management.

Information and communication
Our Co-op communicates with colleagues in several ways to make sure they have the information they need to perform their work effectively. 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 Executives and senior management by email, our intranet, conference calls, social media and face-to-face briefings. We also have an external-facing colleague website – **www.coop.co.uk/colleagues**.

Monitoring
We adopt the 'three lines of defence' approach as a way of explaining the relationship between functions and as a guide to how responsibilities for internal control should be divided. The first line is the responsibility of line management who manage and own risk. The second line comes from various functions, including Risk, who monitor and check compliance. Internal Audit provides independent assurance, the third line.

Whistleblowing procedure

In line with best practice and to ensure our Co-op does the right thing in line with co-operative 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 our Co-op. This procedure also allows suppliers to report on any wrongdoing.

In addition to 'Speak Up', reports can be made direct to colleagues. We have a procedure for recording and investigating whistleblowing reports, a summary of which is presented to the Committee.

The whistleblowing policy is included in the Code of Business Conduct, and is available on the colleague intranet and our website. The Committee considers the whistleblowing procedures to be appropriate for the size and scale of our Co-op. Our Co-op also has an Anti-Bribery Policy.

Other activities

How we handle data

The Committee has looked at our Data Governance Strategy. We want our Co-op to be trusted with data and to use it as a valuable asset to deliver benefits to you and your communities. Through 2017 the Committee has received updates on how we handle data and our plans for the future.

The Committee has also received updates from management on information security and cyber security as well as compliance with GDPR and PCI DSS.

Groceries Supply Code of Practice (GSCOP)

The Committee approved the Annual Compliance Report for submission to the Competition and Markets Authority as is required to by the Groceries (Supply Chain Practices) Market Investigation Order 2009. A summary is on page 86. During 2017 our Co-op has had enhanced levels of engagement with our regulator, the Groceries Code Adjudicator. The Committee has, throughout the period, kept under review how our Food business is improving its levels of compliance by hearing from relevant colleagues in our Food business and the Code Compliance Officer.

Sustainability reporting and social impact accounting

The Committee now has responsibility for reviewing our approach to sustainability reporting and social impact accounting. They review and recommend the approval of the sustainability report to our Board. This has been a key change in 2017 to make sure we give the sustainability report the same importance and focus as the annual report and financial statements.

We call the sustainability report the 'Co-op Way Report'. The Committee has looked at developments that build on the content of the 2016 report which won the '2018 edie award for sustainability reporting' and led the re-tender for assurance over the Co-op Way Report and re-appointed DNV GL.

The Committee has also had oversight of, and approved, the modern slavery statement and is responsible for making sure there are processes and procedures in place to enable compliance with the Modern Slavery Act 2015.

Retail Business Transformation

Retail Business Transformation is the multi-year programme set up to simplify and streamline our Retail processes, systems and ways of working. Throughout 2017, the Committee has considered the findings from the work carried out by PwC and Internal Audit to assess whether the project is being well managed.

Health and safety

The Committee considered how our Co-op's complying with health and safety policies and standards.

It also assesses the progress of the Safety, Health and Environmental Programme. In February 2017, it was agreed to run the Risk Management Transformation and Health and Safety programmes under a single governance structure (the 'Risk, Health and Safety Programme'). This combined programme has been responsible for developing risk management processes and monitoring how our health and safety policies and standards are working in practice. Updates on progress have been provided to the Committee throughout 2017.

Report of the Remuneration Committee

Committee Chair's statement

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

I said last year that we had made good progress in 2016 but much work remained to be done to ensure our approach to pay fully reflects our values and principles. I am delighted to tell you that 2017 has seen us begin to really address some key pay matters and my report will hopefully demonstrate this to you.

As I trailed last year, we have changed our executive bonus plans to simplify them and ensure they are a better fit with our business strategy. There have also been a number of other positive changes regarding pay ratios, gender pay reporting and arguably most important of all, customer-facing colleague pay.

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.

Business performance is a crucial factor in executive pay and our businesses performed well in 2017. However, as a Co-op, business performance is only one measure of the value we're creating as the UK's biggest consumer-owned co-op. Allan has given you more details on how we look at shared value, beyond reported profit, on page 7. We are proud that we are a different way of doing business and we reflect this in the way we pay our team.

Background
Pay reform
Executive pay has continued to make the headlines during 2017 with public scrutiny on pay arrangements that are too generous, too difficult to understand and not aligned to driving long-term success or to organisation's strategy and values.

We are expecting a new Corporate Governance Code to be launched later this year which will further improve transparency of executive pay in the UK and we will comply where it makes sense for us to do so.

There has also been increasing focus on what has become the growing gap between the highest and the lowest paid, as some of the UK's biggest companies were seen to be paying too much at the top. The government will also be introducing mandatory reporting of the pay ratio between a firm's chief executive and its average UK worker. Final guidance has not yet been provided but we will be publishing our ratio as required and, in addition, we will continue to report our pay ratio in the same way we did last year and you can find it on page 65.

As a Committee we are committed to making pay for our most senior colleagues less complex and clearer. To support our commitment in 2018 we will be simplifying our pay arrangements, which I refer to later in this report.

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 also take on board Council's views and those of the wider UK co-op movement.

Large public companies only report on the pay for their board directors, which would just be our Chief Executive and Chief Finance Officer. However we choose to give you information on our full Executive.

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

i. Part I – Executive Pay Policy. We have included a summary of our pay policy. We asked our members to vote on our policy in 2016 and 90% voted for it and to support changes to this policy in 2017. We pay our Executive in line with this updated policy. This section also covers how your Committee is applying it in 2018 which includes simplifying those elements of pay which link to performance.

ii. Part II – Annual Report on Remuneration, which covers how we applied the policy in 2017.

We have also included a Pay at a Glance section, on page 67, 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 strongly believe in listening to our members and act on their concerns wherever possible and appropriate to do so.

In 2017 we had a number of meetings with Council members to hear their views and to explain our thinking.

At our 2017 Annual General Meeting (AGM) I gave an update on our approach to pay and answered members' 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 an approach to pay that is clear, 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 9 and 6 and we have shown the clear link between our strategy and 2017 pay in the Pay at a Glance section on page 67.

Decisions and changes

The Committee decided that no annual salary increases were made for our Executive in 2017 and the Committee have decided that there will be no annual salary increases for our Executive in 2018 either.

In February 2017 we announced that Steve Murrells would succeed Richard Pennycook as our Chief Executive. At the same time Pippa Wicks was promoted to Deputy Chief Executive. Neither received a salary increase for those increased responsibilities.

Since his appointment Steve has been building his executive team. He wants our Co-op to be led by a smaller executive team with wider accountability, which will help us to make decisions more quickly and make things simpler. We're pleased to have appointed Jo Whitfield to succeed Steve as Chief Executive, Food; Helen Webb as our new Chief People Officer, Helen Grantham has become our permanent Group Secretary and takes on the role of General Counsel and Matt Atkinson has been appointed as our new Chief Membership Officer.

For the first time, our executive team has more women than men.

Full details of the changes are provided in the Annual Report on Remuneration which can be found on page 73.

Simplify the bonus for our Executive

At last year's AGM you voted in favour of simplifying the bonus arrangements for the Executive by adjusting the balance and design of the annual and long-term bonuses provided the total quantum that can be received did not exceed the amount available under the previous arrangements.

During 2017 your Committee has completed a thorough review of our bonus arrangements. We looked at what others do externally but with particular reference to our unique ownership structure and taking into account:

- a desire to remove complexity and be clearer;
- the practical difficulty of setting fair and robust long-term performance targets; and
- the duplication of measures across our current annual and long-term bonus plans.

Your Committee decided to change and simplify our approach by moving to a single bonus plan from 2018 – the Bonus Plan (BP), which will replace the current Annual Incentive Plan (AIP) and Long Term Incentive Plan (LTIP).

The new BP will operate in a similar way to the current AIP with three key changes:

- The maximum opportunity increases as individuals will no longer participate in the LTIP.
- A deferral period is being introduced – not all of the award will be paid in one go – 50% will be paid two years later (this means we will still keep an element which links to the long term).
- The current AIP profit target will be replaced by a number of measures which we believe are important to our Co-op. This goes beyond just financial performance but will also cover other areas we, and our members, care about like community and colleagues.

When we look at the pay for our Executive we look at total package, not just salary, i.e. salary plus (at 'target') bonus and benefits to ensure they are appropriately aligned to the middle of the relevant market. We have used this principle when setting the target and maximum amount which can be paid under the new BP.

I am pleased to confirm that we will not be exceeding the 200% maximum opportunity which was in place under the old annual and long-term bonus schemes for all our executives except for our Chief Executive. For our Chief Executive we plan a change so his overall package is more appropriately aligned to the market, which I will come to shortly.

LTIP awards which have already been granted will continue. This will apply to those made in 2016 and 2017. If goals are met, payments can still be made in 2018 and 2019 for these awards. No new awards will be made under the LTIP.

Further details of the new BP can be found in the Executive Pay Policy section on page 68.

Bonus Plan maximum opportunity

Our Chief Executive's total package under the new bonus plan is a lot lower than the market rate, and the differential between his total package and the rest of the executive team is not at the right level.

Rather than increase base pay your Committee believes it is better to increase the part of pay which is variable and links to performance. This will mean the maximum amount which he could be paid for this part of his pay will increase from 200% to 250% of base pay. No payment would be made if performance is not good enough, but depending on the level of results achieved a payment of between nil and 250% of salary could be made (half of any payment is deferred for a further two years). As this is a change to the current Executive Pay Policy the Committee will be asking you to vote to support this change at the 2018 AGM.

Pippa Wicks will remain on a maximum opportunity of 200% in recognition of her expanded role. All other members of the Executive will see the maximum amount they can receive under this element of pay reduced. Full details can be found on page 70.

What about our other colleagues?

Your Committee and Board regularly discuss how we 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.

At the 2016 AGM our members voted in favour of the motion encouraging the Board to take further positive steps on colleague pay, having regard to hourly rates recommended as a living wage by the Living Wage Foundation, which reflects their vital contribution to our business. To this end the Board have agreed to invest an additional £4m in customer-facing colleague pay in 2018. This means that we will have increased hourly pay rates for our experienced Customer Team Members by 6.1% in 2018 and increased pay rates by 21.5% in the last three years.

In addition to better pay rates, we offer a good level of benefits to all colleagues including a pension scheme much better than the government minimum. We have also continued to do more to help encourage and improve colleague wellbeing with the introduction of a range of health and financial initiatives.

Of course, we'd like to do more. But food retailing in particular is a highly competitive market. We need to get the balance right between our offer to members and customers, and our offer to colleagues, in order to thrive.

Pay ratio

Later this year the government will require mandatory reporting of the ratio of pay between a firm's chief executive and its average UK worker. Final guidance is yet to be provided, however it is our intention to publish this information from next year.

The new government pay ratio calculation is likely to be based on actual pay received. It therefore can change a lot as bonus payments can vary year on year as they are linked to both business and personal performance.

Last year we shared our pay ratio based on target earnings rather than actual as this approach makes sense to us and we believe it will make it easier for members to compare progress over time. We will continue to provide the ratio on this basis.

At our 2017 AGM you also asked us to look at our pay gap from top to bottom and to report on progress at our 2018 AGM. I will pick this up at the AGM and we have also given some information in our *You said, we did* update which you can see on our website. I have also set out below our ratio for 2017 and 2018.

The ratio between our highest paid executive and lowest paid colleague in April 2018 is 1:48 on base pay only or 1:96 for base pay plus on target bonuses.

The ratio between our highest paid executive and lowest paid colleague in April 2017 was 1:51 on base pay only or 1:101 for base pay plus on target bonuses.

Gender pay reporting

We published our gender pay gap report on 28 February 2018, and our numbers and accompanying report can be found here – www.co-operative.coop/ethics/gender-pay-gap-report.

We know that having more men than women at senior levels is causing much of our pay gap. Right now we're working to understand more about the underlying reasons for our gap which will help to inform and refine the initiatives which are already underway to reduce it.

Annual and Long Term Incentive Plan outturns in 2017

Payments under the 2017 Annual Incentive Plan (AIP) are based on a combination of business and individual performance. Business performance met most of the targets set.

The 2015-17 Long Term Incentive Plan (LTIP) consisted of four targets, the performance of which is shown below:

Target	Weighting	Performance
Ratio of Net Debt/EBITDA	40%	Near stretch
Membership spend as a percentage of total sales value	25%	Target +
Co-op colleague engagement	25%	Threshold
Brand health	10%	Stretch

The Committee decided that for the 2015-17 LTIP 69.03% of the maximum award should be paid. See page 74 for more information.

Looking ahead

Over the last couple of years your Committee has been reviewing how we reward our Executive to ensure our approach to pay works for our Co-op and its members and is appropriate. We have made significant improvements such as rebalancing our packages to have better balance between fixed and variable pay. We've also simplified our approach to bonuses to make them simpler and improve transparency. We will continue to review our approach to ensure it works but as a Committee we believe our approach to pay for our Executive is in a good place as we move into the next phase of our journey.

At a time when big businesses and national government have lost the confidence of many people in the UK, we believe our Co-op is uniquely placed to rebuild trust and restore confidence in the strength of communities and institutions. We want to raise our ambitions by growing our businesses and their commercial strength so that we can return more to our members, our colleagues and communities and make sure that our Co-op can continue to evolve and grow and look at new markets which can benefit our members. To make our business plans a success we need to be competitive, relevant and innovative. We need to invest in the businesses we have now and we need to open up new opportunities where our Co-op can make a distinctive difference. Our Stronger Co-op, Stronger Communities plan includes all of this, and more.

Governance

Committee

During 2017 I was pleased to welcome Gareth Thomas, our newly appointed Member Nominated Director (MND), to the Committee. Gareth comes from a background at John Lewis Partnership (JLP) and joins his former JLP colleague Margaret Casely-Hayford, alongside Sir Christopher Kelly and Peter Plumb. They have all worked hard this year and made a strong contribution to our work. We also said farewell to Ruth Spellman who had served as an MND for two years and chose not to seek re-election. I'd like to personally thank Ruth for her valued contribution while in post.

My thanks to all the Committee members, and to the members of the Council Remuneration Working Group under Lesley Reznicek's leadership, for the insight and challenge they provided through the year – particularly in making sure our members' voice was always heard.

AGM

Members will be asked to approve the Annual Report on Remuneration at our 2018 AGM and we would welcome your support by voting in favour of it.

We will also be asking for your support to change the maximum bonus we pay to Steve, our Chief Executive. We do not formally need to ask members before we make this change but we think this is the right thing to do and would ask you to vote in favour of the motion.

I recommend the report to you.

Stevie Spring
Chair of the Remuneration Committee

2017 pay at a glance

This section provides an overview of our pay policy in action and payments made to our executives in 2017. Full details of our policy and what we paid in 2017 are set out on page 68 and page 73.

Remuneration policy

Our Co-op is committed to a reward strategy that is clear, 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 2017 pay aligned to our strategy

The following table describes how key elements of our strategy link to the way we reward performance. We are committed to a clear link between our reward structures and how our business performs, while maintaining a strong connection with our colleagues and supporting our Co-op values and purpose.

Co-op KPIs	Net budgeted profit	Debt	Reputation	Colleague
	It's important we make profit to reinvest and support our future strategy and purpose.	Maintaining responsible debt levels is an important part of our financial strategy. We must manage debt well but not at the expense of profit.	It's important that we continue to restore our Co-op's reputation and brand perception.	Colleagues play a significant role in ensuring we continue to deliver to our customers and communities.
Long Term Incentive Plan (LTIP)	✗	✓	✓	✓
Annual Incentive Plan (AIP)	✓	✗	✗	✗

Our new 2018 Bonus Plan will allow us to align pay, performance and strategy better than ever before. Please see page 68 for further details.

2017 pay

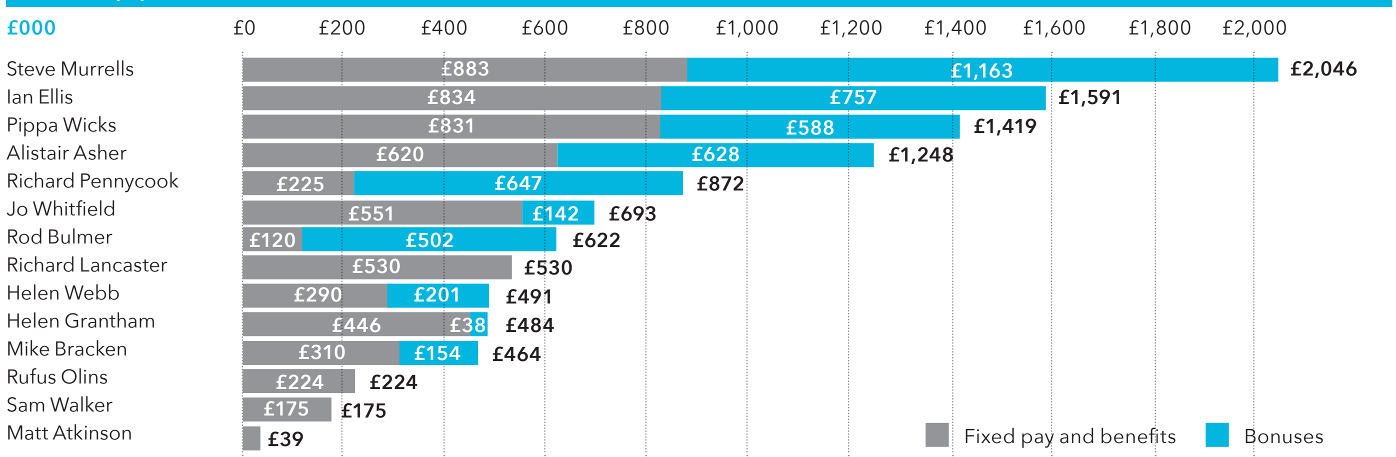
The key elements of pay for our Executive are:

Total Pay	Salary	Benefits	Pension	2017 Bonus (Annual Incentive Plan)	2015-17 Long Term Incentive Plan (LTIP)
Total Pay is made up of different elements. Salary and benefits are fixed. AIP and LTIP are variable and the amount an executive receives depends on the performance achieved.	Our Executive receives a salary for performing their core role	The benefits provided 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.	Opportunity to participate in Co-op's pension plan or receive a cash allowance instead.	Payments are based on a combination of business and individual performance. For 2017 our executives were paid between 22% and 86% of salary.	Awards are cash based, have a three-year performance period, and the amount paid will depend on the level of performance against the measures and targets set at the start of the three-year plan.

2017 total pay

The chart below shows the pay which our executives received in 2017 and full details can be found in the Annual Report on Remuneration which starts on page 73.

2017 total pay



Notes to chart

1. The 2017 financial year ran from 1 January 2017 to 6 January 2018 which is a week longer than the 2016 financial year which ran from 3 January 2016 to 31 December 2016.
2. Pippa Wicks' contract at the beginning of 2017 required her to work four days a week and her salary was adjusted accordingly. Pippa's contract was amended to five days a week with effect from 7 February 2017 and her salary was adjusted accordingly.
3. Helen Webb joined the Executive and was appointed as Chief People Officer on 18 April 2017.
4. Jo Whitfield joined the Executive on an interim basis on 1 March 2017 and was permanently appointed as Chief Executive, Food on 17 July 2017.
5. Helen Grantham was employed as Interim Group Secretary and was subsequently appointed as Group Secretary and General Counsel on 1 July 2017.
6. Matt Atkinson joined our Co-op on 16 October 2017 on a one day a week basis, changing to full time on 8 January 2018.
7. Richard Pennycook, Sam Walker, Rufus Olins, Alistair Asher, Mike Bracken, Rod Bulmer and Richard Lancaster all left the Executive during 2017.

I Executive Pay Policy

Reward philosophy

Our Co-op is committed to an approach to pay that is clear visible and fair which allows us to compete for skills and talent while 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:

- We want to pay our Executive at a level which reflects the job they do, but do not want to overpay. We look at what other similar organisations pay and take this into account.
- We want to reward our Executive for achieving stretching goals as well as for their commitment to our Co-op purpose and values.
- We want a benefits package that reflects our purpose and values.

New Bonus Plan

A new Bonus Plan (BP) has been introduced for 2018 that replaces the Annual Incentive Plan (AIP) and Long Term Incentive Plan (LTIP).

The new BP will operate in a similar way to the current AIP with three key changes:

- The maximum opportunity increases as individuals no longer participate in the LTIP.
- A deferral period is being introduced – not all of the award will be paid in one go – 50% will be paid two years later (this means we will still keep an element which links to the long term).
- The current AIP profit target will be replaced by a number of measures which we believe are important to our Co-op. This goes beyond just financial performance but will also cover other areas we know our members care about, like community and colleagues.

The maximum amount that can be paid under the BP for each Executive member can be found on page 70.

LTIP awards which have already been granted will continue. This will apply to those made in 2016 and 2017. If goals are met payments can still be made in 2018 and 2019 for these awards. No new awards will be made under the LTIP.

Summary of Executive Pay Policy

Our current Executive Pay Policy is summarised below.

Base salary	
Purpose and link to strategy	To set a level of pay for performing the core role that allows us to attract and retain talented leaders.
Summary and operation	We want to pay our Executive at a level that reflects the job they do, but do not want to overpay. We look at what other similar organisations pay and take this into account when setting our Executive's pay.
Maximum Opportunity	There is no maximum salary. Typically, salaries are reviewed annually. When reviewing salaries, the Committee will take account of: • Experience • Personal and business performance • Appropriate comparator business data • Increases being granted to other colleagues throughout the business
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 pay.
Pension	
Purpose and link to strategy	To provide the same percentage 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 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.

Bonus Plan	
Purpose and link to strategy	To motivate and reward achievement of key business performance measures which support the delivery of our purpose and values.
Summary and operation	Our Executive will be eligible for a payment under a BP agreed by the Committee. The performance measures and targets for each annual BP cycle will be set at the start of each year. Payments will be based on a combination of business and individual performance. 50% of any award is subject to a two-year deferral period – not all of the award will be paid in one go – 50% will be paid two years later. Payments made under the BP are subject to malus and clawback provisions.
Maximum Opportunity	The maximum possible bonus opportunity under the AIP and LTIP was 200% of salary and this currently applies under the BP. It is proposed that the maximum possible BP opportunity under this plan is 250% of salary at stretch performance. The maximum amount payable under the BP varies by Executive member and is set at an appropriate level in accordance with our reward philosophy. Target performance bonus remains at 50% of maximum. Also see Notes 1, 2 and 3.

Notes to table
1. The Committee will be asking for our members' support at the 2018 AGM to vary the Pay Policy to increase the maximum opportunity to 250% of salary for the Chief Executive only.
2. The 2017 AGM voted to support a change to our Pay Policy to simplify bonus arrangements for our Executive by adjusting the balance and design of annual and long-term bonus plans provided that combined overall maximums are not exceeded.
3. The performance measures for the 2018 Bonus Plan are shown on page 71.

Following the implementation of the new Bonus Plan we will no longer be operating an AIP or LTIP in 2018. Details of Executive bonus schemes which were applied up to 2017 are summarised below:

Annual Incentive Plan	
Purpose and link to strategy	To motivate and reward achievement of key short-term business performance measures.
Summary and operation	Our Executive were eligible for a payment under an AIP agreed by the Committee. The performance measures and targets for each annual AIP cycle were set at the start of each year. Payments were 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 was 50% of salary at target performance (maximum payout was 100% of salary at stretch performance). Also see Note 1
Long Term Incentive Plan	
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 were 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 are subject to performance measures and targets set at the start of each three-year award cycle. • LTIP awards were made annually although awards could 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 malus and clawback provisions.
Maximum Opportunity	The LTIP opportunity for our Executive is 50% of salary at target performance (maximum payout is 100% of salary at stretch performance). Performance measures and opportunity levels for our Executive are shown below. Also see Notes 1 and 2.

Notes to table
1. The maximum opportunities for the 2017 AIP and 2017-19 LTIP were temporarily set lower than this for Jo Whitfield, Rod Bulmer, Helen Webb and Helen Grantham while the review of our bonus plans was undertaken.
2. The 2016-2018 and 2017-2019 LTIPs will remain in place until the end of their performance periods.

Implementation of the Pay Policy in 2018

Base salary

Annual base salaries for our Executive are set out below:

Executive member	2017[1] £000	2018[1] £000	Comments
Steve Murrells	750	750	Joined Executive 16 July 2012, promoted to Chief Executive 1 March 2017
Pippa Wicks[2]	560	700	Joined Executive 1 April 2016, promoted to Deputy Chief Executive 1 March 2017
Ian Ellis	700	700	Joined Executive 4 September 2015
Jo Whitfield[3]	418	550	Interim appointment to Executive 1 March 2017, promoted to Chief Executive, Food 17 July 2017
Helen Webb[4]	350	350	Joined Executive 18 April 2017
Helen Grantham[5]	293	350	Joined Executive 11 January 2016, promoted to Group Secretary and General Counsel 1 July 2017
Matt Atkinson[6]	110	450	Joined Executive 16 October 2017

Notes to table

1. Salaries are as at 1 January or appointment date to our Executive if later.
2. Pippa Wicks' contract at the beginning of 2017 required her to work four days a week and her salary was adjusted accordingly. Pippa's contract was amended to five days a week with effect from 7 February 2017 and her salary was adjusted accordingly.
3. Jo Whitfield's 2017 salary is inclusive of an interim acting up allowance, Jo was permanently appointed to Chief Executive, Food 17 July 2017 and her new package took effect from that date.
4. Helen Webb joined the Executive and was appointed to the role of Chief People Officer on 18 April 2017. The salary shown for 2017 is her appointment salary.
5. Helen Grantham was employed as Interim Group Secretary and was subsequently appointed as Group Secretary and General Counsel on 1July 2017. Her new package took effect from that date.
6. Matt Atkinson joined our Co-op on 16 October 2017 on a one day a week basis. He changed to full time on 8 January 2018 and his full time salary is shown for 2018.

We benchmark the total pay 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 Committee has determined that no changes to salary will be made in 2018 for 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.

Bonus Plan

This is a new scheme introduced in 2018, and replaces the previous Annual Incentive Plan and Long Term Incentive Plan.

The table below sets out the maximum amount each Executive member can receive under this plan.

Executive member	Maximum BP opportunity as a % of bonusable pay
Steve Murrells[1]	250%
Pippa Wicks	200%
Ian Ellis	180%
Jo Whitfield	150%
Helen Webb	150%
Helen Grantham	150%
Matt Atkinson	150%

Note to table

1. The Committee will be seeking support at the 2018 AGM to vary the approved Pay Policy to increase the maximum opportunity to 250% of salary for the Chief Executive role.

Performance under this plan is measured in reference to a number of measures which we believe are important to our Co-op. This goes beyond just financial performance and also covers other areas we know our members also care about like community, colleagues and personal performance. The 2018 balanced scorecard measures and their weightings are detailed below:

2018 Balanced scorecard measures	Weighting
Financial	
Co-op Operating Profit	50%
Being Co-op	
Member - measures focused on our membership proposition	10%
Community - measures focused on championing co-operation and engagement with community activities	10%
Colleague - measures focused on building and maintaining colleague engagement	10%
Personal performance	
Assessment of how each Executive performs against their job requirements and our Ways of Being Co-op.	20%

Key requirement
Underlying profit before tax is an important performance measure for us to enable us to deliver strategic objectives of our Co-op. If we do not achieve a minimum of 90% of our 2018 profit target then no payment will be made under this plan.

The Committee will look at performance at the end of each year and decide what should be paid under the BP scheme. The Committee can decide nothing is paid or that a payment is made between nil and the maximum opportunity for each executive depending on performance. The Committee has discretion to adjust targets, performance results or payments (up to the maximum or down to zero) for 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 pay 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 pay package that is aligned to an appropriately defined basket of external comparators, while ensuring that it pays no more than is necessary to secure the individual.

The following additional items of pay 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 bonus type awards.** Under exceptional circumstances and at its absolute discretion, the Committee will consider compensating a new executive for variable bonus awards lost from a previous employer. The exact type and amount of compensation will vary depending on the variable bonus 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 better for our Co-op for an individual to remain under a contract of employment 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 bonuses.

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 already hold and whether any BP payment should be made in respect of the period they have been employed. In exercising its discretion the Committee will take account of the reasons for leaving, performance and contractual commitments.

Comparison of pay 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 pay for good performance should be aligned to an appropriately defined basket of external comparators. That policy will apply to all colleagues.

Our Co-op's long-term ambition is for all colleagues to be eligible to participate in a bonus scheme. However, our primary focus is on making sure pay rates for all our customer-facing colleagues remain competitive.

Clawback provisions apply to the new BP and AIP and LTIP plans we have previously used. 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 paid out 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 pay received by our executives while appointed to our Executive during the 2017 financial year.

It is important to note that this financial year ran from 1 January 2017 to 6 January 2018 meaning it was a week longer than 2016. This explains why, for example, the basic salary and benefits shown for Steve Murrells are higher in 2017 than 2016, even though there has been no increase to either pay element.

Table 1a – 2017 pay for our executives in post at 6 January 2018

Name of executive	Date appointed to Executive (Note 1)	Date stepped down from Executive (Note 1)	Period	Basic salary £000	Taxable benefits (Note 3) £000	AIP (Note 4) £000	LTIP (Note 5) £000	Pension benefits (Note 6) £000	Other (Note 7) £000	Total £000
Steve Murrells	16 Jul 2012	-	**2017**	**764**	**43**	**645**	**518**	**76**	-	**2,046**
			2016	750	42	469	500	75	-	1,836
Ian Ellis (Note 7)	4 Sep 2015	-	**2017**	**713**	**16**	**381**	**376**	**71**	**34**	**1,591**
			2016	700	14	368	-	70	45	1,197
Pippa Wicks (Notes 7 and 8)	1 Apr 2016	-	**2017**	**700**	**15**	**588**	**-**	**70**	**46**	**1,419**
			2016	420	9	336	-	42	34	841
Jo Whitfield (Note 11)	1 Mar 2017	-	**2017**	**422**	**11**	**142**	**-**	**42**	**76**	**693**
			2016	-	-	-	-	-	-	-
Helen Webb	18 Apr 2017	-	**2017**	**254**	**11**	**103**	**98**	**25**	**-**	**491**
			2016	-	-	-	-	-	-	-
Helen Grantham (Notes 9 and 10)	11 Jan 2016	-	**2017**	**328**	**12**	**38**	**-**	**33**	**73**	**484**
			2016	288	10	-	-	29	-	327
Matt Atkinson (Note 12)	16 Oct 2017	-	**2017**	**35**	**1**	**-**	**-**	**3**	**-**	**39**
			2016	-	-	-	-	-	-	-

Table 1b – 2017 pay for executives who left our Executive during the 2017 financial year

Name of executive	Date appointed to Executive (Note 1)	Date stepped down from Executive (Note 1)	Period	Basic salary £000	Taxable benefits (Note 3) £000	AIP (Note 4) £000	LTIP (Note 5) £000	Pension benefits (Note 6) £000	Other (Note 7) £000	Total £000
Alistair Asher	1 Jul 2013	31 Dec 2017	**2017**	**550**	**15**	**248**	**380**	**55**	**-**	**1,248**
			2016	550	14	289	367	55	-	1,275
Richard Pennycook	1 Jul 2013	31 Mar 2017	**2017**	**188**	**7**	**-**	**647**	**19**	**11**	**872**
			2016	998	30	600	600	00	45	2,373
Rod Bulmer	9 Jun 2014	1 Mar 2017	**2017**	**105**	**4**	**103**	**399**	**11**	**-**	**622**
			2016	650	14	341	433	65	-	1,503
Richard Lancaster	1 Jan 2017	1 Nov 2017	**2017**	**474**	**10**	**-**	**-**	**46**	**-**	**530**
			2016	-	-	-	-	-	-	-
Mike Bracken	30 Sep 2015	31 Aug 2017	**2017**	**246**	**10**	**-**	**154**	**24**	**30**	**464**
			2016	350	14	184	-	35	45	628
Rufus Olins	17 Oct 2016	1 Jul 2017	**2017**	**175**	**8**	**-**	**-**	**18**	**23**	**224**
			2016	74	3	-	-	7	10	94
Sam Walker	17 Mar 2014	4 Apr 2017	**2017**	**160**	**4**	**-**	**-**	**11**	**-**	**175**
			2016	425	14	-	-	43	-	482

Notes to Table 1a and Table 1b

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. The 2017 financial year ran from 1 January 2017 to 6 January 2018, which is a week longer than the 2016 financial year which ran from 3 January 2016 to 31 December 2016.
3. Taxable benefits include car, fuel, car cash allowance and healthcare (where applicable).
4. AIP payments relate to payments under the Annual Incentive Plan.
5. LTIP payments relate to cash payments made under the 2015-17 Long Term Incentive Plan.
6. Pension includes Co-op Defined Contribution pension plan or cash allowance in lieu of pension provision.
7. Other payments in 2017 financial year, which were agreed at the date of appointment, include:
   - Payments were agreed under the relocation policy to assist executives to stay close to their workplace during the working week. During 2017, Richard Pennycook received £10,990, Ian Ellis received £33,750, Mike Bracken received £30,288, Pippa Wicks received £45,909 and Rufus Olins received £22,500.

8. Pippa Wicks' contract at the beginning of 2017 required her to work four days a week and her salary was adjusted accordingly. Pippa's contract was amended to five days a week with effect from 7 February 2017 and her salary was adjusted accordingly.
9. Helen Grantham was employed as Interim Group Secretary from 11 January 2016 and was subsequently appointed as Group Secretary and General Counsel on 1July 2017. Her new package took effect from that date
10. Helen Grantham was only eligible for AIP from the 1 July 2017 appointment date to her new role, prior to this she had a separate retention arrangement which was linked to being in post at the 2017 AGM and received £73,369 payment in respect of this arrangement.
11. A payment of £75,728 was made to Jo Whitfield as compensation for incentive scheme awards that she forfeited on taking a new position with our Co-op.
12. Matt Atkinson joined our Co-op on 16 October 2017 on a one day a week basis, changing to full time on 8 January 2018.

Will our Executive receive a salary increase in 2018?
The Committee has decided that there will be no salary increases in 2018.

What LTIP scheme interests do our executives hold?
Awards were 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 6 January 2018. Table 2b shows the maximum potential award under each plan for those who were executives at the time of leaving.

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

Table 2a – LTIP awards held by our executives in post at 6 January 2018

Name of executive	Award	Notes	Maximum award opportunity at start of the year £000	Maximum 2017-2019 award opportunity granted £000	Awards vested in year £000	Awards lapsed in year £000	Maximum award opportunity at the year end £000
Steve Murrells	2017-2019	1	-	750	-	-	750
	2016-2018	2	750	-	-	-	750
	2015-2017	3	750	-	518	232	-
Pippa Wicks	2017-2019	1,6	-	692	-	-	692
	2016-2018	2,6	646	-	-	-	646
Ian Ellis	2017-2019	1	-	700	-	-	700
	2016-2018	2	700	-	-	-	700
	2015-2017	3	544	-	376	168	-
Helen Grantham	2017-2019	1,5	-	175	-	-	175
Helen Webb	2017-2019	1,7	-	148	-	-	148
	2016-2018	2,7	148	-	-	-	148
	2015-2017	3,7	143	-	98	45	-
Jo Whitfield	2017-2019	1,7	-	155	-	-	155
	2016-2018	2,7	155	-	-	-	155

Notes to Table 2a
1. The 2017-2019 LTIP awards are subject to performance conditions and the measures are:
   - Net debt to EBITDA ratio (50% weighting)
   - Membership spend as a percentage of total sales value (25% weighting)
   - Co-op colleague engagement (25% weighting)
2. The 2016-2018 LTIP awards are subject to performance conditions, and the measures are:
   - Net debt to EBITDA ratio (40% weighting)
   - Membership spend as a percentage of total sales value (25% weighting)
   - Co-op colleague engagement (25% weighting)
   - Brand health (10% weighting)
3. 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)
   - Membership spend as a percentage of total sales value (25% weighting)
   - Co-op colleague engagement (25% weighting)
   - Brand health (10% weighting)
4. A 2017-19 LTIP grant was not made to Matt Atkinson due to starting after the cut-off to join the plan.
5. Helen Grantham held an interim position during 2016 and therefore was not eligible to participate in the 2016-18 LTIP scheme.
6. Adjustment has been made to Pippa Wicks' grant salary due to a change in working hours during the performance period.
7. LTIP grants made while employed in previous roles in our Co-op which were not on our Executive.

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

Name of executive	Award	Notes	Maximum award opportunity at start of the year £000	Maximum 2017-2019 award opportunity granted £000	Awards vested in year £000	Awards lapsed in year £000	Maximum award opportunity at the year end £000
Richard Pennycook	2016-2018	1,2	1,250	-	-	729	521
	2015-2017	1,2	1,250	-	647	603	-
Mike Bracken	2017-2019	3	-	350	-	350	-
	2016-2018	3	350	-	-	350	-
	2015-2017	1,3	263	-	154	109	-
Rod Bulmer	2016-2018	1,4	-	542	-	181	361
	2015-2017	1,4	578	-	399	179	-
Alistair Asher	2017-2019	1,5	-	550	-	-	550
	2016-2018	1,5	550	-	-	-	550
	2015-2017	1,5	550	-	380	170	-

Notes to Table 2b

1. Under the terms of their leaver arrangements the former Executive members in the table who left our Co-op during 2017 retained parts of their LTIP awards that related to the period they were in employment. These remain 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 performance period.
2. The Committee has determined that Richard Pennycook is a qualifying leaver from both 2015-17 and 2016-18 LTIP schemes. His unvested awards are pro-rated 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.
3. Mike Bracken left our Co-op on 31 August 2017. The Committee has determined that Mike is a qualifying leaver from the 2015-17 LTIP. His award has been pro-rated to time served as a member of the Executive during the performance period and remained subject to the original performance measures and the original performance periods. Both the 2016-18 and 2017-19 LTIP awards have lapsed.
4. Rod Bulmer stepped down from the Executive on 1 March 2017 and left our Co-op on 31 December 2017. The Committee has determined that Rod is a qualifying leaver from both 2015-17 and 2016-18 LTIP schemes. His unvested awards are pro-rated to time served during the performance period for each scheme. These remain subject to the original performance measures and the original performance periods. Adjustment has been made to Rod's grant salary due to a change in working hours during the performance period.
5. Alistair Asher stepped down from the Executive on 31 December 2017 and is due to leave our Co-op at the end of May 2018. The Committee has determined that Alistair will be a qualifying leaver from both 2016-18 and 2017-19 LTIP schemes. His unvested awards will be pro-rated upon leaving to time served during the performance period for each scheme. This means he will be eligible for 29/36ths of his 2016-18 LTIP and 17/36ths of his 2017-19 LTIP. These remain subject to the original performance measures and the original performance periods.

What pension benefits are our executives entitled to?

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

Table 3a – Pension entitlements for executives in post at 6 January 2018

Name of executive	Date appointed to Executive	Years of Group Service	Period	Employer Contribtions to Defined Contribution Pension £000	Payment in lieu of pension benefit £000	Total Pensions Benefits £000
Steve Murrells	16 Jul 2012	5	**2017**	**-**	**76**	**76**
			2016	-	75	75
Ian Ellis	4 Sep 2015	2	**2017**	**-**	**71**	**71**
			2016	-	70	70
Pippa Wicks	1 Apr 2016	1	**2017**	**-**	**70**	**70**
			2016	-	42	42
Jo Whitfield	1 Mar 2017	1	**2017**	**6**	**36**	**42**
			2016	-	-	-
Helen Webb	18 Apr 2017	4	**2017**	**-**	**25**	**25**
			2016	-	-	-
Helen Grantham	11 Jan 2016	2	**2017**	**-**	**33**	**33**
			2016	-	29	29
Matt Atkinson	16 Oct 2017	-	**2017**	**-**	**3**	**3**
			2016	-	-	-

Table 3b – Pension entitlements for executives who left or stepped down from the Executive during the 2017 financial year

Name of executive	Date appointed to Executive	Date of stepping down from Executive	Years of Group Service	Period	Employer Contributions to Defined Contribution Pension £000	Payment in lieu of pension benefit £000	Total Pensions Benefits £000
Alistair Asher	1 Jul 2013	31 Dec 2017	4	**2017**	**-**	**55**	**55**
				2016	-	55	55
Richard Pennycook	1 Jul 2013	31 Mar 2017	3	**2017**	**-**	**19**	**19**
				2016	-	100	100
Rod Bulmer	9 Jun 2014	1 Mar 2017	3	**2017**	**-**	**11**	**11**
				2016	14	51	65
Richard Lancaster	1 Jan 2017	1 Nov 2017	1	**2017**	**-**	**46**	**46**
				2016	-	-	-
Mike Bracken	30 Sep 2015	31 Aug 2017	1	**2017**	**-**	**24**	**24**
				2016	-	35	35
Rufus Olins	17 Oct 2016	1 Jul 2017	1	**2017**	**-**	**18**	**18**
				2016	-	7	7
Sam Walker	17 Mar 2014	4 Apr 2017	3	**2017**	**11**	**-**	**11**
				2016	43	-	43

Notes to Table 3a and Table 3b

1. 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.
2. Defined benefit accrual ceased in October 2015 for all colleagues.
3. 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.
4. Rod Bulmer's Defined Benefit pension at 31 December 2016 was £34,624 and at 31 December 2017 was £35,490.
5. Sam Walker's Defined Benefit pension at 31 December 2016 was £3,860 and at 31 December 2017 was £3,957.

What arrangements have been agreed for former executives?
Details of the leaver arrangements for executives who have left our Co-op during 2017 are shown below.

Mike Bracken	Mike's employment terminated on 31 August 2017. His earnings while he was an active member of the Executive up to his leave date are shown in Table 1b. Mike's leaver arrangements included a payment of £175,000 in lieu of his notice period in accordance with his contract, and a payment of £10,769 in lieu of accrued holiday entitlement.
Richard Lancaster	Richard's employment terminated on 1 November 2017. His earnings while he was an active member of the Executive up to his leave date are shown in Table 1b. Richard's leaver arrangements included a payment of £52,885 in lieu of the balance of his notice period in accordance with his contract, and a payment of £14,565 in lieu of accrued holiday entitlement.

Non-executive directors' remuneration
This section of the report includes details of the payments made to the non-executive directors (NEDs) in office during 2017.

What are the fees for the NEDs for 2017?

NED Role	Fees
Chair	• The basic fee for the Chair role is £250,000 per annum. There has been no change in annual fee between 2015 and 2017. 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 Chair has waived his fee of £250,000 per annum. Instead this is paid direct by our Co-op to charity. In 2017, it was paid to the Co-operative Community Investment Foundation. The Chair also has access to a pool car and driver for Co-op business if required. No other benefits will be provided for the Chair or any other NED member of the 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 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 Chair and INEDs were appointed for an initial two-year term subject to election and re-election in accordance with the Rules. A 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 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.

We will be putting a motion to our AGM which would allow directors to serve for longer periods. Additional information can be found in our AGM pack and on our website at www.co-operative.coop/agm.

What did the NEDs earn during the year?

The table below shows the fees paid to our NEDs during the 2017 financial year.

Table 4a – Non-executive members of the Board at 6 January 2018

	Notes	Board £000	Risk and Audit Committee Chair £000	Remuneration Committee Chair £000	Senior Independent Director £000	2017 Total £000	2016 Total £000
Allan Leighton(Chair)	1, 3	**See Note 1**	-	-	-	-	See Note 1
Sir Christopher Kelly	2, 3	**61**	-	-	**15**	**76**	75
Simon Burke	2, 3	**61**	**15**	-	-	**76**	75
Stevie Spring	2, 3	**61**	-	**15**	-	**76**	75
Lord Victor Adebowale CBE	3	**61**	-	-	-	**61**	44
Hazel Blears	3	**61**	-	-	-	**61**	60
Margaret Casley-Hayford	3	**61**	-	-	-	**61**	37
Paul Chandler	3	**61**	-	-	-	**61**	60
Peter Plumb	3	**61**	-	-	-	**61**	60
Gareth Thomas	3, 4	**38**	-	-	-	**38**	-

Notes to Table 4a

1. Since his appointment date, the Chair has waived his fee of £250,000 per annum. Instead this is paid direct by our Co-op to charity. In 2017, it was paid to the Co-operative Community Investment Foundation.
2. The 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. The 2017 financial year ran from 1 January 2017 to 6 January 2018 which is a week longer than the 2016 financial year which ran from 3 January 2016 to 31 December 2016.
4. Gareth Thomas was appointed as a Member Nominated Director on 20 May 2017.
5. No additional fee is paid to the Chair of the Nominations Committee.

Table 4b – Former non-executive members of the Board who left during 2017 financial year

	Notes	Board £000	Risk and Audit Committee Chair £000	Remuneration Committee Chair £000	Senior Independent Director £000	2017 Total £000	2016 Total £000
Ruth Spellman	1, 2	22	-	-	-	22	60

Notes to Table 4b:

1. The 2017 financial year ran from 1 January 2017 to 6 January 2018 which is a week longer than the 2016 financial year which ran from 3 January 2016 to 31 December 2016
2. Ruth Spellman stepped down from the Board on 20 May 2017.

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 Secretary.

Role of the Committee
The Committee is responsible for determining and overseeing the Executive Pay 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 2017 are provided on page 47.

The Chief Executive, the Group Secretary and General Counsel, the Chief People Officer and 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 2017 the Committee retained New Bridge Street (an Aon Hewitt company) as its independent remuneration adviser until September 2017. Following a tender exercise Deloitte were appointed as new independent adviser to the Committee with effect from October 2017. The fees paid to New Bridge Street and Deloitte during this period totalled £87,182 excluding VAT.

Both New Bridge Street and Deloitte are a signatory of the Remuneration Consultants' Code of Conduct which requires their advice to be objective and impartial.

The Committee takes legal advice from our Co-op's internal legal team and also from external legal advisers where appropriate. No external lawyers were used during 2017.

Report of the Nominations Committee

Introduction from the Committee Chair, Allan Leighton

This year marks my third as Co-op Chair and Chair of the Nominations Committee ('the Committee'). I'm pleased to report that there has been a lot of stability and continuity within the Board, with the directors developing into a strong team.

This report looks at the work the Committee has done in 2017, which has largely been focused on the development of the Board Diversity Policy, work on succession planning and the management of an external Board evaluation exercise.

Director changes

The Committee has only had to oversee one new appointment in 2017, being that of Steve Murrells as Chief Executive Officer (CEO) when Richard Pennycook decided to step down.

We were very fortunate to have a colleague of Steve Murrell's standing and experience to take over as CEO. He has brought his own character, outlook and drive to the position since he has led the Executive and we are excited about his vision for the future.

The other director change during the year was Ruth Spellman's decision to stand down as a Member Nominated Director (MND) in May, and election by the members of Gareth Thomas to join the Board as an MND. Paul Chandler was also re-elected for a further term. The MND election process is overseen by the Member Nominated Directors Joint Selection and Approval Committee (MNDJC) and in 2017 there was a contested election with three candidates for two places.

Peter Plumb will be leaving us in May 2018 as he steps down to concentrate on his new role as Chief Executive of JUST EAT plc. Our work as a Committee has already begun to find his successor.

Towards the end of 2017 the Committee has also started to look for an additional Independent Non-Executive Director (INED) with strong digital and technology experience.

During the year, the Committee has dealt with a number of "routine activities", such as checking the eligibility and membership criteria for directors, reviewing and updating terms of reference and approving statements for INEDs due for re-election at the Annual General Meeting.

Diversity and inclusion

We strongly believe that diversity brings improved decision-making and we are delighted that during the year our Board met both gender and ethnic diversity recommendations ahead of target dates. The decision by Ruth Spellman to stand down as an MND and the election by members of Gareth Thomas moved the percentage of women directors on our Board from 33% to 25%. We continue to support and encourage the best candidates towards senior roles – our Executive is made up of four women and three men.

Looking forward

The Committee will continue to focus on the succession plan for the wider Board, making sure it continues to have the necessary skills, mix, values and experience to enable it to do its job well. We'll also look for Peter Plumb's successor and continue our search for an extra INED who can strengthen the Board's digital and technology experience as this area develops at pace.

Allan Leighton
Chair of the Nominations Committee

What the Nominations Committee does

The Committee:

- Leads the selection process for INEDs and Executive Directors. It may also be asked to lead on other non-Board appointments
- Checks and approves that the INEDs and Executive Directors have the right skills, values and background to sit on our Board (including the Membership Criteria and Eligibility Criteria)
- Reviews the effectiveness of the Board and makes sure 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 as a whole
- Makes sure that the right succession plans are in place for key roles
- Submits proposals to the Non-Executive Directors' Fees Committee covering the fees of the Group Chair, INEDs and MNDs.

The MNDJC reviews and approves the qualification and commercial experience requirements of MND candidates and their commitment to our Values and Principles, and, therefore, who should be put forward for election by members.

The Terms of Reference for the Committee were reviewed in July 2017 and are available on our website: **www.co-operative.coop/investors/rules**

Board evaluation

The Chair asked the Senior Independent Director, Sir Christopher Kelly, to help with the external assessment of the Board. He met a number of independent external consultants and Independent Audit Limited was selected.

They interviewed all directors, the Group Secretary, the Members' Council President and a number of colleagues from the executive team. Having looked at all feedback they provided a report to the Committee and the Board, as well as attending a Board meeting to discuss its recommendations.

The overall view was that the Board had many strengths and was doing its role well, but in common with all Boards had opportunities to be even more effective.

Independent Audit's broad conclusions were:

- The Board had a good mix of the right skills and expertise and a diverse group of non-executive directors.
- The MNDs helped make sure the Board was aware of the interests of members.
- The relationship with the Members' Council had strengthened.
- The Board was chaired by a skilled Chair, supported by an able and experienced Senior Independent Director.
- There was a solid core executive team, led by Steve Murrells.
- The Board had focused on many critical areas necessary for the turnaround of our Co-op.
- The Group Secretary provided good professional support to the Board.
- The Board committees generally worked well.

The top five areas (most of which were already being addressed) where the Board could be more effective were:

- Increasing the focus on Board succession planning and giving the Board more information on executive succession planning
- Encouraging management to focus on further development of the HR processes
- Making sure that the Board's role is distinct relative to the responsibilities of the Executive and the Council
- Developing a strong common view on the medium and long-term direction of our Co-op and the balance between commerciality and co-operability
- Continuing to develop the risk management approach and consolidating the improvements that had already taken place in this area

The Board has agreed an action plan for 2018 and beyond which will continue to strengthen Board effectiveness.

Appointment of directors

During the year, the Committee oversaw the process leading to the appointment of Steve Murrells as CEO. His appointment took into account the required balance of skills, experience and diversity of the Board as a whole and also that he met the eligibility and membership requirements to be appointed to our Co-op's Board.

The MNDJC was responsible for the MND election process which led to Gareth Thomas joining the Board as an MND and Paul Chandler being re-elected for another term as an MND.

It is a key priority to ensure that directors appointed to the Board meet the requirements of the Board Composition Charter. This ensures that all directors have the skills and experience needed to understand a business of the scale and complexity of our Co-op and that their skills and experience balance well within the Board as a whole, as well as having a strong commitment to our Values and Principles.

Diversity

The Board is made up of:

- Men: (9) 75%
- Women: (3) 25%
- Black, Asian and Minority Ethnic (BAME): (2) 16.6%

In 2017, the Committee developed, and the Board signed off, the Board Diversity policy, which is aligned to our Diversity and Inclusion policy for colleagues and can be found at **www.co-operative.coop/investors/rules**. The Board as a whole believes strongly in the benefits of diversity in its broadest sense.

We said last year that our aim was to continue to drive the benefits of a diverse Board by at least keeping the current level of women and BAME directors and to make sure that the Board was representative of its membership and reflected society at large.

While the Committee is responsible for the initial appointments of INEDs and Executive Directors, the MNDs are elected directly by our members. Ruth Spellman stepped down as an MND in 2017 and following the member election of Gareth Thomas we have one less woman on the Board compared to last year. Gareth brings his own range of skills and experience and he has quickly become a valuable member of the Board.

Review of INEDs' and Executive Directors' qualification and commercial experience (including Membership Criteria and Eligibility Criteria)

Having reviewed the qualifying and commercial experience for INEDs and Executive Directors throughout the year (including the Membership Criteria and Eligibility Criteria), the Committee can confirm that the INEDs and the Executive Directors have all met the requirements and shown continued commitment to the Values and Principles.

Recommendation to the Non-Executive Directors' Fees Committee

During the year the Committee considered benchmarking data in relation to fees for the Chair, Chairs of committees, Senior Independent Director, INEDs and MNDs and recommended that no change should be made to the level of these fees.

Committee membership and attendance

Details of the Committee members and their attendance at meetings held during 2017 are found on page 47.

Look back at 2017

Last year we reported the Committee's focus for 2017 would be on:

- Implementation of the Board Diversity policy – that was adopted by the Board in May 2017
- Conducting an external Board evaluation and progressing any actions arising from it – this review finished in early autumn and the actions the Board has decided to take forward will be the main focus for the 2018 review
- Completing the Board succession plan – there is an emergency succession plan in place for all the key roles and work will continue on Executive Director and INED succession in 2018. As part of its work in this area, the Committee did a skills audit of the Board. This has led to the Committee starting to look for an extra INED with digital and technology experience. A search firm has been appointed to help the Committee find someone to take on this role.

Focus for 2018

For 2018 the main focus for the Committee will be:

- Continuing work on Board succession planning
- Doing an internal Board evaluation, which will include the action taken in response to the 2017 external review and its impact (as well as covering any areas required by our Rules)
- Continuing with the search for an extra INED with strong digital and technology skills.
- Finding a suitable replacement for Peter Plumb

Directors’ report

The directors present their report, together with the audited financial statements for the period ended 6 January 2018.

Results and distributions

The profit before taxation was £72m (2016: Loss £132m). No interim dividend has been paid for 2017 and the members are not being asked to approve any distribution of profits for the year.

Going concern

The financial statements are prepared on a going concern basis as the directors have a reasonable expectation that we have enough money to continue in business for the foreseeable future. Our Co-op borrows money from banks and others, and we have also checked that we comply with the terms which we have agreed with them, for example, banking covenants and facility levels.

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 168).

Longer term viability

The directors have assessed whether we’ll have enough money to continue in business over the longer term. In making that assessment the directors have considered our current position and the potential impact of our principal risks as set out on page 33.

We believe that a three-year period to 31 December 2020 is an appropriate period over which to provide this longer term viability statement given the dynamic nature of the retail sector. This is in line with the period reviewed by the Board in the strategic planning process.

As part of the strategy process, the directors make a number of assumptions and judgements about business performance. We then flex a number of the main financial assumptions to check that we still comply with the terms of our facilities, even if some of our principal risks happen.

We are due to pay back £450m of bonds in July 2020. In carrying out this review, the directors have assumed that these facilities will be replaced in full. The directors are confident that these facilities can be replaced and are not aware of any reason why this will not be achieved.

Following their review, the directors have therefore concluded that they have a reasonable expectation that we will have enough money to continue in business over the period to 31 December 2020.

Post balance sheet events

There have been no material post balance sheet events.

Corporate governance report

The corporate governance report is on page 43. This includes information on the appointment and retirement of directors, directors' conflicts of interest and directors' indemnities.

Employees and employment of disabled persons

Information on our approach to the employment, development and engagement of colleagues can be found in the Our Colleagues section on page 26.

Community, campaigns and sustainability

Information on our community, campaigns and sustainability can be found on page 29. This section deals with how we manage our social, ethical and environmental impact. More information can also be found in our Co-op Way Report which has been published alongside this report.

Greenhouse gas emissions

Since 2006, our total direct greenhouse gas (GHG) emissions have reduced by 54% as detailed in the table below. Total direct GHG emissions decreased by 16% in 2017. This is due to both using less energy[1], and the UK grid electricity mix being less carbon-intensive in 2017[2].

This year we're publishing our GHG emissions figures in two ways, showing our direct emissions if our electricity was counted at UK grid average (known as location-based reporting), and also if we were to account for our purchase and generation of renewable electricity (known as market-based reporting).

Direct greenhouse gas emissions since 2006

2006 baseline	2014	2015	2016	2017 (location based)	2017 (market based)
1,189,738	732,061	708,765	646,538	**542,480**	**296,714**

Scope 1 and 2 GHG emissions by source – UK grid average electricity

	tCO2e
Scope 1 – Refrigeration	151,081
Scope 1 – Transport	119,306
Scope 1 – Heating / Generation	26,327
Scope 2 – Electricity	245,766
Total	**542,480**

Scope 1 and 2 GHG emissions by source – accounting for renewable electricity

	tCO2e
Scope 1 – Refrigeration	151,081
Scope 1 – Transport	119,306
Scope 1 – Heating / Generation	26,327
Scope 2 – Electricity	-
Total	**296,714**

Carbon intensity

Tonnes CO2-equivalent per £m gross income	**52.8**

[1]We used 9% less energy (total MWh) in 2017 than in 2016, and 50% less than in 2006.
[2]In 2017 the DEFRA emission factor for UK grid electricity was 0.35 kgCO2e per kWh (2016: 0.41), a 15% reduction year on year.

Political donations

Like many other businesses of a comparable size, our Co-op engages with a wide range of political opinion formers and decision makers, designed to protect, promote and enhance our corporate reputation. On issues of relevance to our business, 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, which celebrated its centenary in 2017, and was founded by the co-operative movement back in 1917 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 (2016: £625,600) to The Co-operative Party, which is our financial subscription to the Party for 2017, in line with our members' approval at the Annual General Meeting in 2016. 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.

No political donations are made through the Local Community Fund ('the Fund') and its terms and conditions are explicit that the Fund, managed by the Charities Aid Foundation, cannot be used for party political purposes.

A motion will be put to our members at the 2018 Annual General Meeting regarding future political donations, including subscriptions.

Compliance with Groceries Supply Code of Practice

We want our suppliers to feel that they have effective, collaborative and fair relationships with us. Our Food business's trading relationships with groceries suppliers are regulated by the Groceries Supply Code of Practice ('the Code'). Our Co-op is one of ten designated retailers in the UK that the Code applies to. Christine Tacon, the Groceries Code Adjudicator (GCA), monitors compliance.

One of our obligations under the Code is to submit an annual compliance report approved by the Risk and Audit Committee to the GCA and the Competition and Markets Authority and to summarise this in our annual report. The Risk and Audit Committee approved the compliance report at a meeting on 4 April 2018.

On top of regular quarterly meetings with our Code Compliance Officer (CCO) and the annual meeting with the Chair of our Risk and Audit Committee, we've had extensive discussions with the GCA in line with her collaborative approach. Specifically, in April 2017 we invited the GCA to visit our support centre in Manchester. We've engaged positively with the GCA and her office on a range of matters at various times during the year.

As part of our standard compliance activities, we train all members of our buying teams on their obligations under the Code, both when colleagues join our Co-op and annually thereafter. In addition, we train a wide set of colleagues across our supply chain, technical and finance functions. We conduct a programme of spot checks and compliance audits that have informed improvements to our policies, procedures and training.

In 2017, we introduced a new CCO, changed our approach to how we make decisions around delisting suppliers and refreshed our training. In July 2017 our Co-op made fundamental changes to how we handle quantity and cost price discrepancies across all product categories that reduced the compliance risk of making unilateral payments and breaching the Code. In November 2017, we started a full review of how we collaborate with suppliers. This included a significant survey of our suppliers carried out independently by the CCO. We shared what we learnt with the GCA.

By encouraging suppliers to share details of where they believe that we can do better we have identified more issues and potential breaches of the Code than before and are acting on the insight received.

In 2017, 22 suppliers formally raised Code-related complaints with us. This includes three issues raised by suppliers where information was requested by us but nothing further was provided and we have therefore considered this as withdrawn by the supplier. We resolved the concerns through discussion with the buying team and the relevant supplier. 11 issues were still under review at the reporting date.

On 8 March 2018, the GCA launched an investigation into some of our practices relating to delisting and the introduction of benchmarking and depot quality control charges. We acknowledge that we have fallen short and have been discussing the two issues raised with the GCA for some months. We have taken decisive steps in line with our commitment to ensure the fair treatment of all of our suppliers including:

- Strengthening our systems and processes for the future
- Retraining 450 commercial colleagues in the operation of the Code
- Writing to all of our 1,500 direct suppliers to seek information on any delisting decisions that they believe may have been taken without appropriate consultation. A small number of suppliers have raised concerns which we are working through with them.
- Reviewing every case where a supplier was charged for benchmarking and quality control. As a result, suppliers have been refunded a total of approximately £0.5m.

Suppliers are encouraged to contact our CCO (Co-op.Code.Compliance.Officer@coop.co.uk) if they want more information.

Statement of Co-op 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 39 to 41 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.

In this context, 'the Group' means Co-operative Group Limited, and all the companies and societies it owns.

Financial statements

So far as the directors are aware there is no relevant information that has not been disclosed to our 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 our auditor has been made aware of that information.

Auditors

A resolution to re-appoint Ernst & Young LLP as auditors of the Group and to determine their remuneration for the forthcoming year will be proposed at the 2018 Annual General Meeting.

By Order of the Board

Helen Grantham
Group Secretary

5 April 2018

Your Council's annual statement for 2017

The Members' Council is elected by you, our members. We're 100 strong and together we have an important job to support your Co-op. We look after the interests of all members in making sure decision makers keep co-operative Values and Principles front and centre in all they do. The Council is an extra level of assurance for you and we've carried out our roles in 2017 to focus on the things that matter most to you.

We'll report on those matters where we have been effective in 2017 and where we intend to develop our activity in 2018 to add value to your Co-op.

Co-op Compass

The Council has a role in reviewing and reporting to members on the performance of the Board of directors. The Co-op Compass is the framework created by the Council to hold the Board to account for the decisions it makes and has four 'lenses'

- Member Value
- Member Voice
- Ethical and Sustainable Leadership
- Co-operative Leadership

Under each of these themes the Board reports to the Council half yearly on a number of key performance indicators (KPIs) with supporting information. These KPIs are the catalysts for discussion with directors and senior management which go on throughout the year. It's through these debates and interactions that Council members are influential and make sure that the views of ordinary members are taken into account.

Goal: Create sustain and develop Member Value

Member Value Lens

Member Value

It's vital that your Co-op remains commercially strong despite a very competitive and testing economic environment. We congratulate the Board and colleagues on a promising 2017 performance but we look to the directors to maintain focus on the benefits for members and the fulfilment of member needs. This year the Council has challenged the directors on financial results and levels of planned investment. Concern over substantial central costs has been a persistent message and an area where Council has been influential.

We're delighted by the benefits returned to members through the 5% membership reward which is boosting own brand food sales. Our members have also been really positive about the £20 million raised for local causes, building our member links within communities and strengthening understanding of the co-operative model. The success and challenges of the 5 + 1 membership offer is one of the key areas of review. This is a flagship scheme and one which the Council warmly supports.

One of the key ways in which the Council can influence the directors about member value (both financial and social) is through its Member Value and Business Performance Committee. This is a small group of Council members working effectively by reviewing detailed information and questioning our Chief Finance Officer to understand how targets are being met despite challenging trading conditions. Council as a body also scrutinises financial performance quarterly and has challenged the directors within the Council meetings to explain how disposals (such as Gilsland Spa and The Esplanade hotels and Co-op's interest in the NOMA joint venture) have maximised value for members.

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

Member Voice Lens

Member Voice

We expect to see progress made in 2018 to link Council representatives with both members and Member Pioneers.

We were really pleased with the engagement with members and representatives of the local causes you've supported. We're also encouraged by the success of meetings in towns and cities around the country with members and representatives of those community groups. We called these 'Shape Your Community' events and hope to build lots more connections with members locally over the years to come. We loved showcasing your Co-op to a wider audience.

Goal: Demonstrate leadership in ethical and sustainable performance

Ethical and Sustainable Leadership Lens

Ethical and Sustainable Leadership

We want to see Co-op as a leader in sustainability and campaigning, fulfilling our co-operative purpose and doing the right thing for members in all that it does. We've championed ethical policies which will run through your Co-op's businesses.

We delegated Council's responsibility to review and comment on Co-op's sustainability report (now called the Co-op Way Report) to its Ethical and Sustainable Leadership committee. It concluded that this was an excellent improvement on previous years and that co-operative Values and Principles were clearly evidenced throughout the report.

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

Co-operative Leadership Lens

Co-operative Leadership

As champions of the co-operative business model we really want to see your Co-op being more visible as a co-operative leader in Britain and internationally. During the year Dame Pauline Green spoke to Council members to promote the launch of the National Co-operative Development Strategy which was enthusiastically welcomed. We're encouraged by Steve Murrells attendance at the Global Citizen Festival in Hamburg to launch the Global Investment Fund for Water bringing focus to your Co-op's own initiative of One Water in fighting water poverty.

The Council President and Vice President (Business Strategy, Performance & Development) represented your Co-op at the Annual Conference of the International Co-operative Alliance in Kuala Lumpur.

Reviewing the Board – key areas of scrutiny

It's inherent to the work of Council members that there is constructive, but robust challenge of the Board on behalf of members. In 2017 this has continued on the following key areas.

Your Council has a responsibility to report on the performance of the Board. As well as using the Co-op Compass the Council as a whole reviews decisions of the Board and satisfies itself that these meet members' needs and reflect co-operative Values and Principles. The Council holds members' interests at the heart of the work that it does.

Wholesaling and franchising
The Council also has the opportunity to influence Board thinking by putting forward its own collective initiatives. After the sale of stores to McColl's, Council members championed the possibility of wholesaling Co-op own brand products to them. This was actively pursued by your Co-op and while not successful with McColl's, the reflection on this type of trading has been helpful for Council members to understand and support the Nisa transaction and subsequently the Costcutter deal. Council members want to see more Co-op products sold to more Co-op members around the country.

2017 also saw the piloting of Co-op franchises. Here the Council challenged the business model to make sure that any such stores would reflect co-operative Values and Principles. The Council asked the Board to make sure that members would have access to the same membership offer (5% for you and 1% for your community) in franchised stores and the same training for staff as your Co-op colleagues. Council members sought reassurance about the terms and conditions of staff in franchised stores. The Council members were reassured that the strategy of growth meant franchise was in addition to and not instead of organic growth and investment.

Colleagues
We believe our colleagues are doing a brilliant job every day in serving and supporting our members and customers in all our businesses. The rights and conditions of colleagues is championed in the work we do – whether in the discussions on executive reward, the gender pay gap, protecting the pensions of colleagues and former colleagues on the separation from the Co-operative Bank, or seeking reassurance on the position of colleagues on the sale of stores.

The Council challenged the Board on the retreat from the double discount scheme for colleagues and has been delighted to see its reinstatement particularly as this now is linked to Co-op own brand lines.

Supporting and shaping your Co-op ambition
Throughout 2017 Council members have been working with some of our senior managers to comment on and influence thinking about future ambition and we're looking forward to influencing that debate through into 2018 and beyond, in this challenging and dynamic trading environment.

The Co-op Way
Council members influence and speak with directors 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-op 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.

200
Member Pioneers
(up to 1,500 by 2020)

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 of more community based groups to promote our purpose. 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

6

Plenary meetings with the Board

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 2017), Council recognises that this alone is not enough.

Working collaboratively with Board members and with senior managers, Council members are developing positive relationships for the exchange of views and opinions. Many opportunities have been arranged and encouraged both on a formal governance basis because they need to be undertaken but also on a more informal networking basis. These opportunities are very much welcomed by Council members.

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.

The Governance committee of Council looked at the Board Evaluation report, internal governance and Regulations and is creating tools to review and develop effectiveness and influence of the Council, as it works with the Board and Executive for the benefit of members. The Council has also established a Rules Review working group whose work is ongoing.

Wrapping up

The Council is working hard to be effective in carrying out its roles and to promote passionately our collective belief that co-operation is a better way of doing business for society at large. Council members have been fully committed in 2017 through Board and management discussions and also with members in communities.

Looking forward to 2018

We thank the directors, Executive and management for their time and willingness to work together on our joint vision to secure your 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

Our review of Board appointments and elections in 2017

After any non-executive director is appointed or elected, our Co-op has an extra level of checking so members can be sure we've done everything fairly and openly in line with our Values and Principles.

This checking is done by the Scrutiny Committee of the Members' Council and we're pleased to present our report to members for 2017.

How directors are appointed

All our directors need to show their commitment to Co-op difference.

There are two types of directors who don't work day-to-day as Executives for the Co-op.

There are those chosen specifically for their skills and experience, and to add diversity and balance to the Board. In 2017 no new directors were appointed in this way. Our Chair, Allan Leighton, and the Senior Independent Director, Sir Chris Kelly, were re-appointed in 2017 for a second term of two years. These re-appointments were approved at the Annual General Meeting.

Our Co-op also has directors directly elected by members. These individuals need to have the necessary skills and experience of a substantial organisation and awareness of the strategic and operational challenges of a business of the size and complexity of the Co-op. They also need to show very clearly their commitment to bringing the voice of members to the boardroom.

The Scrutiny Committee checks:
- that the selection process for the ballot is fair, open and objective
- the background information gathered on the candidates is satisfactory

Our findings

We carefully reviewed information and interviewed the Chair of the Member Nominated Directors Joint Selection and Approval Committee which has the primary responsibility for the selection process of candidates (involving both members of the Members' Council and directors). As a result, we believe that the selection process in 2017 was fair and that proper background checks were made.

Assurances were received that all directors met our Co-op's trading requirement of 1,000 points. And we've accepted that all elected directors are 'independent' for the purposes of Rules.

We're pleased there was a contested election of member nominated directors and hope that a greater number of suitable candidates will come forward in future and be accepted on to the ballot.

Financial statements

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Financial statements

Consolidated income statement

for the period ended 6 January 2018

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	2017 £m	2016 £m
Revenue	2	**9,470**	9,472
Operating expenses	3	**(9,432)**	(9,363)
Other income	5	**88**	39
Operating profit	1	**126**	148
Finance income	6	**44**	53
Finance costs	7	**(106)**	(162)
Share of profits / (losses) of associates and joint ventures	22	**8**	(171)
Profit / (loss) before tax	1	**72**	(132)
Taxation	8	**(2)**	(2)
Profit / (loss) for the period (all attributable to members of the Society)		**70**	(134)

Non-GAAP measure: underlying profit before tax **

In plain English – what does this show?

The table below adjusts the operating profit figure shown in the consolidated income statement above by stripping out the impact of items that are not generated by our businesses' day-to-day trading. This helps readers of our accounts to better understand how our business is performing. The second table below strips out member rewards to show underlying profit on a comparable basis with 2016.

	Notes	2017 £m	2016 (restated*) £m
Operating profit (as above)		**126**	148
Add back losses / (deduct gains):			
One-off items	1	**23**	21
Property and business disposals	1	**4**	(27)
Change in value of investment properties	21	**(15)**	(16)
Less underlying interest payable	7	**(73)**	(74)
Underlying profit before tax		**65**	52
Underlying profit before tax (as above)		**65**	52
Add back: member rewards	31	**61**	16
Underlying profit before tax and member rewards		**126**	68

*For more details on the restatement, refer to the general accounting policies note on page 165.
**Refer to note 1 for a definition of underlying profit before tax.

Consolidated statement of comprehensive income

for the period ended 6 January 2018

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	2017 £m	2016 (restated*) £m
Profit / (loss) for the period		**70**	(134)
Other comprehensive income:			
Items that will never be reclassified to the income statement:			
Remeasurement gains on employee pension schemes	23	**112**	503
Derecognition of pension surplus attributable to Co-operative Bank	23	**(374)**	-
Related tax on items	8	**44**	(78)
		(218)	425
Items that are or may be reclassified to the income statement:			
Changes in value of available for sale assets		**(7)**	16
Related tax on items	8	**1**	(3)
		(6)	13
Other comprehensive income for the period net of tax		**(224)**	438
Total comprehensive income for the period (all attributable to members of the Society)		**(154)**	304

*For more details on the restatement, refer to the general accounting policies note on page 165.

Consolidated balance sheet

as at 6 January 2018

In plain English – what does this show?

The analysis below provides a snapshot of the financial position of the Group at the end of 2017. It sums up the Co-op's assets and liabilities.

	Notes	2017 £m	2016 (restated*) £m
Non-current assets			
Property, plant and equipment	10	**2,014**	1,943
Goodwill and intangible assets	11	**897**	911
Investment properties	21	**68**	74
Investments in associates and joint ventures	22	**3**	52
Other investments	12	**1,538**	1,414
Reinsurance contracts	24	**44**	47
Derivatives	26	**38**	50
Pension assets	23	**1,746**	1,978
Trade and other receivables	15	**58**	55
Deferred tax assets	13	**228**	221
Reclaim Fund assets	30	**234**	237
Total non-current assets		**6,868**	6,982
Current assets			
Inventories	14	**389**	439
Trade and other receivables	15	**635**	704
Cash and cash equivalents		**403**	283
Assets held for sale	16	**6**	106
Other investments	12	**415**	372
Reinsurance contracts	24	**14**	7
Reclaim Fund assets	30	**439**	332
Total current assets		**2,301**	2,243
Total assets		**9,169**	9,225
Non-current liabilities			
Interest-bearing loans and borrowings	17	**1,138**	1,141
Trade and other payables	18	**1,249**	1,078
Provisions	19	**222**	224
Pension liabilities	23	**193**	251
Deferred tax liabilities	13	**400**	429
Insurance contracts	24	**289**	280
Reclaim Fund liabilities	30	**446**	495
Total non-current liabilities		**3,937**	3,898
Current liabilities			
Overdrafts		**6**	6
Interest-bearing loans and borrowings	17	**34**	21
Income tax payable		**-**	1
Trade and other payables	18	**1,400**	1,506
Provisions	19	**90**	102
Liabilities held for sale	16	**-**	5
Insurance contracts	24	**461**	444
Reclaim Fund liabilities	30	**153**	1
Total current liabilities		**2,144**	2,086
Total liabilities		**6,081**	5,984
Equity			
Members' share capital	20	**73**	72
Retained earnings	20	**2,914**	3,062
Other reserves	20	**101**	107
Total equity		**3,088**	3,241
Total equity and liabilities		**9,169**	9,225

*For more details on the restatement, refer to the general accounting policies note on page 165.

Board's certification

The financial statements on pages 96 to 169 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 2018

Steve Murrells - Chief Executive

Helen Grantham - Group Secretary

Consolidated statement of changes in equity

for the period ended 6 January 2018

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 31 December 2016		72	3,062	107	3,241
Profit for the period		-	70	-	70
Other comprehensive income:					
Remeasurement gains on employee pension schemes	23	-	112	-	112
Derecognition of pension surplus attributable to Co-operative Bank	23	-	(374)	-	(374)
Gains less losses on available for sale assets		-	-	(4)	(4)
Available for sale cumulative gains transferred to the income statement		-	-	(3)	(3)
Revaluation reserve recycled to retained earnings		-	-	-	-
Tax on items taken directly to other comprehensive income	8	-	44	1	45
Total other comprehensive income		-	(218)	(6)	(224)
Contributions by and distributions to members:					
Shares issued less shares withdrawn	20	1	-	-	1
Contributions by and distributions to members:		1	-	-	1
Balance at 6 January 2018		73	2,914	101	3,088

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

	Notes	Members' share capital £m	Retained earnings (restated) £m	Other reserves £m	Total equity (restated) £m
Balance at 2 January 2016		72	2,770	95	2,937
Loss for the period		-	(134)	-	(134)
Other comprehensive income:					
Remeasurement gains on employee pension schemes	23	-	503	-	503
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	-	(78)	(3)	(81)
Total other comprehensive income		-	426	12	438
Contributions by and distributions to members:		-	-	-	-
Balance at 31 December 2016		72	3,062	107	3,241

*For more details on the restatement, refer to the general accounting policies note on page 165.

Consolidated statement of cash flows

for the period ended 6 January 2018

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	2017 £m	2016 £m
Net cash from operating activities	9	**363**	247
Cash flows from investing activities			
Acquisition of property, plant and equipment		**(427)**	(330)
Proceeds from sale of property, plant and equipment		**186**	60
Purchase of intangible assets		**(4)**	(23)
Acquisition of businesses	22	**(10)**	(5)
Proceeds from sale of investments		**55**	5
Disposal of businesses, net of cash disposed		**-**	17
Dividends received from investments	22	**33**	2
Net cash used in investing activities		**(167)**	(274)
Cash flows from financing activities			
Interest paid on borrowings		**(75)**	(72)
Repayment of corporate investor shares	17	**(8)**	-
Repayment of borrowings including derivatives		**(1)**	(22)
Finance leases entered into / (repaid)	17	**8**	(3)
Net cash used in financing activities		**(76)**	(97)
Net increase in cash and cash equivalents		**120**	(124)
Cash and cash equivalents at beginning of period		**277**	401
Cash and cash equivalents at end of period		**397**	277
Analysis of cash and cash equivalents			
Overdrafts (per balance sheet)		**(6)**	(6)
Cash and cash equivalents (per balance sheet)		**403**	283
		397	277

Group Net Debt	Notes	2017 £m	2016 £m
Interest-bearing loans and borrowings:			
- current		**(34)**	(21)
- non-current		**(1,138)**	(1,141)
Total Debt		**(1,172)**	(1,162)
- Group cash		**403**	283
- Overdraft		**(6)**	(6)
Group Net Debt	17	**(775)**	(885)
Add back fair value adjustment	17	**138**	127
Group Net Debt (pre fair value adjustment)	17	**(637)**	(758)

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

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.

	2017				
	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	**7,054**	**182**	**202**	**357**	**(215)**
Funeral and Life Planning	**343**	**66**	**66**	**51**	**(22)**
Insurance	**331**	**11**	**(12)**	**61**	**(61)**
Other businesses	**59**	**(3)**	**(5)**	**1**	**-**
Federal (g)	**1,683**	**-**	**-**	**-**	**-**
Costs from supporting functions	**-**	**(118)**	**(125)**	**33**	**(26)**
Total	**9,470**	**138**	**126**	**503**	**(324)**

	2016 (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	7,064	182	203	286	(210)
Funeral and Life Planning	329	71	101	26	(19)
Insurance	439	11	(18)	64	(61)
Other businesses	67	(4)	3	1	-
Federal (g)	1,573	-	-	-	-
Costs from supporting functions	-	(134)	(141)	40	(22)
Total	9,472	126	148	417	(312)

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 Electricals business and the deferred income recognised on the disposal of the Travel business in 2011 (see also d) below) and these 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 result of the Group's Legal services business has been reported in the segmental analysis within Funeral and Life Planning (previously reported within Other Businesses) to be consistent with a change in the way information is reported to the Group Board. Deferred income recognised on the disposal in 2011 of 70% of the Group's interest in Travel is now shown within property and business disposals whereas previously it was shown within underlying operating profit (within Other businesses). See general accounting policies section on page 165 for details of the restatements.

e) Additions to non-current assets are derived on a cash flow basis. Depreciation and amortisation excludes £nil (2016: £7m) 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 (2016: £61m) and additions of £61m (2016: £64m) on deferred acquisition costs are included within Insurance.

1. Operating segments continued

f) The Group's external revenue and non-current assets arise primarily within the United Kingdom. The Group does not have a major customer who accounts for 10% or more of revenue. There are no material transactions between the main operating segments.

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 (2016: £6m) sales of electrical goods by Co-op Electrical to Food and £1m (2016: £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:

	2017 Food	Funeral and Life Planning	Insurance	Other businesses	Costs from supporting functions	Total
	£m	£m	£m	£m	£m	£m
Underlying segment operating profit	182	66	11	(3)	(118)	138
One-off items	-	-	(23)	-	-	(23)
Property and business disposals	5	-	-	(2)	(7)	(4)
Change in value of investment properties	15	-	-	-	-	15
Operating profit	202	66	(12)	(5)	(125)	126

One-off items include restructuring costs of £23m (2016: £29m) relating to expenditure incurred in relation to the 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.

	2016 (restated*) Food	Funeral and Life Planning	Insurance	Other businesses	Costs from supporting functions	Total
	£m	£m	£m	£m	£m	£m
Underlying segment operating profit	182	71	11	(4)	(134)	126
One-off items	-	-	(29)	-	8	(21)
Property and business disposals	5	30	-	7	(15)	27
Change in value of investment properties	16	-	-	-	-	16
Operating profit	203	101	(18)	3	(141)	148

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

	Notes	2017 £m	2016 (restated*) £m
Underlying segment operating profit		138	126
Underlying interest payable	7	(73)	(74)
Underlying profit before tax		65	52
One-off items		(23)	(21)
(Loss) / profit on property and business disposals - see overleaf	1	(4)	27
Change in value of investment properties	21	15	16
Finance income	6	44	53
Non-cash finance costs	7	(33)	(88)
Share of profit / (losses) of associates and joint ventures	22	8	(171)
Profit / (loss) before tax		72	(132)

*See general accounting policies section on page 165 for details of the restatement.

1. Operating segments continued

(Loss) / Profit from property and business disposals	2017 £m	2017 £m	2016 (restated*) £m	2016 (restated*) £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 NOMA (50% stake in joint venture)				
- proceeds	**35**		-	
- less net book value written off	**(23)**		-	
		12		-
Sale of Bank (remaining 1% shareholding)				
- proceeds	**5**		-	
- less net book value written off	**-**		-	
		5		-
Food store sales to McColls Retail Group				
- proceeds	**121**		-	
- less net book value written off	**(114)**		-	
		7		-
Other Disposals				
- proceeds	**80**		90	
- less net book value written off	**(82)**		(83)	
- provisions recognised on closure	**(19)**		(20)	
		(21)		(13)
Impairment of property, plant and equipment and goodwill		**(7)**		(5)
CFS Management Services Ltd (CFSMS) retirement liability derecognised		**-**		3
Deferred income on Travel disposal		**-**		7
(Loss) / Profit on disposal		**(4)**		27

*See general accounting policies section on page 165 for details of the restatement.

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.

	2017 £m	2016 £m
Sale of goods	**7,164**	7,144
Member reward (5%) earned on sale of goods	**(51)**	(13)
Provision of services	**353**	332
Member reward (5%) earned on provision of services	**(10)**	(3)
Federal sales	**1,683**	1,573
Gross earned premiums	**490**	467
Premiums ceded to reinsurers	**(159)**	(28)
Net revenue (as shown in the consolidated income statement)	**9,470**	9,472
Value Added Tax	**759**	775
Gross sales	**10,229**	10,247

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 Life Planning. 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 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.

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.

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:

	2017 £m	2016 (restated*) £m
Cost of sales		
- Trading activities	**(6,359)**	(6,277)
- Claims incurred, net of claims recovered from reinsurers	**(236)**	(294)
- Fee and commission expense	**(27)**	(27)
Employee benefits expense (see below)	**(1,421)**	(1,388)
Distribution costs	**(349)**	(339)
Net (loss) / gain on property and business disposals (net of impairments)	**(4)**	27
Net gain on other plant and equipment disposals	**-**	2
Change in value of investment properties	**15**	16
Operating lease rentals	**(159)**	(154)
Depreciation	**(256)**	(246)
Amortisation	**(8)**	(5)
Amortisation on deferred acquisition costs in CISGIL	**(61)**	(61)
Subscriptions and donations	**(6)**	(5)
Community Reward (1%) earned	**(13)**	(3)

* See Accounting Policies on page 165 for details of the restatement.

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

	2017 £m	2016 £m
Wages and salaries	**(1,306)**	(1,278)
Social security costs	**(68)**	(65)
Pension costs - defined benefit schemes	**(3)**	(5)
Pension costs - defined contribution schemes	**(44)**	(40)
	(1,421)	(1,388)

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

	2017	2016
Full-time	22,308	25,117
Part-time	43,579	45,282
	65,887	70,399

Remuneration of key management

For details regarding remuneration of the Group Board and the Executive team refer to pages 61 to 79.

Notes to the financial statements continued

3. Operating expenses continued

Auditor remuneration and expenses	2017 £m	2016 £m
Audit of these financial statements	**0.6**	0.6
Amounts receivable by the Society's auditor in respect of:		
- Audit of financial statements of subsidiaries in respect of the Society	**0.5**	0.3
- Other services pursuant to such legislation	**-**	-
Services relating to:		
- Audit related assurance services	**0.1**	0.1
- Other tax advisory services	**-**	-
- All other services	**0.2**	1.4
Total	**1.4**	2.4

No costs in relation to services performed by the auditor were capitalised during the current or prior period. The 2016 figures exclude £0.6m of audit related fees finalised and charged after the accounts were approved.

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	2017 £m	2016 £m
Long-term agreements	**149**	155
Bonus income	**142**	157
Promotional income	**337**	359
Total supplier income	**628**	671
Percentage of Food's Cost of Sales before deducting Supplier Income		
Long-term agreements	**2.1%**	2.2%
Bonus income	**2.1%**	2.3%
Promotional income	**4.8%**	5.2%
	9.0%	9.7%

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

4. Supplier income continued

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 and other 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.

	2017 £m	2016 £m
Investment income	**12**	12
Realised gains arising from financial instruments	**3**	2
Rental income from non-investment property	**11**	11
Rental income from investment property	**2**	1
Fee and commission income	**60**	13
Total other income	**88**	39

Of the fee and commission income above, £43m (2016: £1m) relates to reinsurance commission earned in CISGIL previously in sales.

5. Other income continued

Accounting policies

Investment income
Interest income on CISGIL financial assets designated as available for sale and loans and receivables are recognised within investment income on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees, and discounts and premiums where appropriate. This income is treated as other income rather than as a finance income or cost as it relates to a Financial Services entity.

The EIR basis spreads the interest income over the expected life of the instrument. The EIR is the rate that, at inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating EIR, CISGIL estimates cash flows considering all contractual terms of the instrument (for example prepayment options) but does not consider future credit losses.

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

Realised gains less losses arising from financial instruments
When an available for sale financial asset in CISGIL is sold, or impaired, the accumulated gain or loss accumulated in the available for sale investments reserve is reclassified to profit or loss.

Rental income from investment and non-investment properties
Rental income arising from operating leases on both investment and non-investment properties is accounted for on a straight-line basis over the lease term. For accounting policies relating to investment property, refer to note 21.

Fee and commission income
Fees and commission receivable mainly relates to administration fee income, and brokerage commission received for products not underwritten by CISGIL, both recognised as the service is provided.

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 three 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) and (iii) interest from debtors we may have discounted in the past.

	2017 £m	2016 £m
Net pension finance income	**42**	45
Fair value movement on interest rate swaps (see note 26)	**-**	8
Discount unwind from trade receivables	**2**	-
Net interest on funeral investments and liabilities (see below)	**-**	-
Total finance income	**44**	53

The discount unwind from trade receivables relates to the £50m put option that was recognised in trade receivables in the prior year following the Group serving notice to Thomas Cook of its intention to exit its investment in the Travel JV. The £50m put option (plus interest) was paid by Thomas Cook in December and the Co-op Group no longer holds any receivable balances in respect of Travel.

Included in the above are interest and bonuses of £103m (2016: £23m) earned in the year on funeral plan investments. These have been offset by a £103m (2016: £23m) 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).

	2017 £m	2016 £m
Loans repayable within five years	(27)	(27)
Loans repayable wholly or in part after five years	(46)	(47)
Underlying interest payable	(73)	(74)
Fair value movement on quoted Group debt (see note 17)	(11)	(74)
Fair value movement on interest rate swaps (see note 26)	(12)	-
Discount unwind of provisions (see note 19)	(10)	(14)
Other finance costs	(33)	(88)
Total finance costs	**(106)**	(162)

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.

Total interest expense on financial liabilities that are not at fair value through profit or loss was £15m (2016: £16m).

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. Additional explanatory footnotes are included (on the following page) to help better explain the key items. The Group was re-accredited with the Fair Tax Mark during 2017, and the additional disclosures are in line with best practice guidance.

	Footnote	2017 £m	2016 £m
Current tax charge - current year	(i)	-	-
Current tax - adjustment to group relief payable owed to Co-operative Bank plc	(ii)	3	6
Current tax (charge) / credit - adjustment in respect of prior years	(iii)	(1)	12
Net current tax credit		**2**	18
Deferred tax charge - current year	(iv)	(8)	(24)
Deferred tax credit - adjustments in respect of prior years	(v)	4	4
Net deferred tax charge		**(4)**	(20)
Total tax charge		**(2)**	(2)

8. Taxation

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 19.25% (2016: 20%) as follows:

	Footnote	2017 £m	2016 £m
Profit / (loss) before tax		**72**	(132)
Tax (charge) / credit at 19.25% (2016: 20%)		**(14)**	26
Deferred tax reconciliation:			
Expenses not deductible for tax (including one-off costs)	(vi)	**(4)**	(1)
Depreciation and amortisation on non-qualifying assets	(vii)	**(4)**	(3)
Non-taxable profits / (losses) arising on business disposals	(viii)	**2**	(2)
Impairment of investment - Co-operative Bank plc	(ix)	**-**	(37)
Associated company profits	(x)	**1**	2
Capital gains arising on property disposals	(xi)	**10**	(21)
Adjustment in respect of previous periods	(v)	**4**	4
Restatement of deferred tax to blended rate (2016:17.1%)	(xii)	**1**	12
Subtotal of deferred tax reconciling items		**10**	(46)
Current tax reconciliation:			
Current year tax charge	(i)	**-**	-
Adjustment in respect of previous periods	(iii)	**(1)**	12
Adjustment to group relief payable	(ii)	**3**	6
Current tax reconciling items		**2**	18
Total tax charge		**(2)**	(2)

The net tax charge of £2m on a profit before tax of £72m, gives an effective tax rate of 3%, which is 16.25% lower than the standard rate of 19.25%. The majority of this difference can be explained by two principal items. Firstly, there was a £4m reduction in the amount payable to the Bank in respect of group relief, representing 5% of the difference (see footnote (ii) overleaf). The remaining 11% is in respect of the sale of food stores to McColls Retail Group. Tax legislation dictates that the tax charge on this disposal is triggered in 2016, being the date in which the contract was signed. This differs to the accounting treatment, where the disposal is recognised in 2017, being the period in which the properties were transferred out of the Group.

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

	2017 £m	2016 (restated*) £m
Actuarial gains and losses on employee pension scheme	**44**	(78)
Available for sale assets - Insurance	**1**	(3)
	45	(81)

Of the tax taken directly to the consolidated statement of comprehensive income, £45m credit (2016: £81m charge) relates to deferred taxation credit of £44m (2016: £91m charge) arising on the actuarial movement for the year, net of a credit of £nil (2016: £13m) relating to the restatement of deferred tax rates on the pensions scheme surplus. *For more details on the restatement, refer to the general accounting policies note on page 165. Furthermore, there is a £1m credit representing the movement in deferred taxation on available for sale assets in General Insurance (2016: £3m charge). See note 13 on deferred tax.

8. Taxation continued

The Finance Act 2016 will 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%, 18% 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 **https://www.co-operative.coop/ethics/tax-policy**. The Group have complied with the commitments set out in that policy.

Footnotes to taxation note 8:

i) The Group is not taxpaying in the UK in respect of 2017 due to the fact it has a number of brought forward capital allowances (£187m gross claimed in 2017) and tax losses (£29m gross utilised in 2017) 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 £265k (2016: £253k) is in respect of wholly owned IOM resident subsidiary, Manx Co-operative Society, an entity undertaking convenience retailing in the Isle of Man. This is the Group's only non UK resident entity for tax purposes, which employs 246 out of our total Group headcount figure. All other employees are employed in the UK. The unaudited 2017 revenue of Manx Co-operative Society is £34m, all other Revenue reflected in the consolidated income statement is generated by UK trading activities. The unaudited 2017 profit before tax of Manx Co-operative Society is £2m, all other income in the consolidated income statement is generated by UK trading activities. The net assets of Manx Co-operative Society at December 2016 were £19m, compared to net assets of the consolidated Group of £3,209m. The Manx assets represent the only overseas assets within the Group. A full copy of the most recent accounts is available here **https://www.co-operative.coop/downloads/manx-co-operative-2016-accounts.pdf.** The presence of this IOM resident subsidiary has resulted in this additional tax charge of £265k. If these activities had been carried out in the UK, any taxable profits would have been reduced to nil due to the availability of capital allowances and tax losses. In addition the Group has one company registered in the Cayman Islands, Violet S Propco Limited. This dormant company is 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 holds a creditor balance in relation to group relief claimed from the Bank (see note 18). Group relief is the surrender of tax losses made by one group company to another which made taxable profits. In 2012 and 2013, the Bank had tax losses that it was able to surrender to a number of Group companies which had taxable profits during those two years. This group relief payable is intrinsically linked to and held at prevailing tax rates to 17%. As a result of the change in tax legislation regarding the utilisation of losses, the timing of the total group relief payable has extended into periods when the tax rate will be 17% and a credit is required to be booked in the income statement in respect of this item. In addition a contractual agreement was made to reduce payments due to the Bank by £4m in July 2017 and a credit for reduction in amounts payable has been booked.

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 a liability for a prior period may arise as a result. Provisions for uncertain tax positions booked in previous years of £0.5m have been released in the year as a result of increased certainty gained through correspondence with HMRC during 2017.

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. Notes 13 and 16 explain how each deferred tax balance has moved in the year.

v) In addition to the adjustments arising between prior year estimates and submissions to HMRC, the Group ascertained on the original purchase cost information on deferred tax balances arising on land and buildings. More detail is provided in 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).

8. Taxation continued

viii) In 2017 the Group disposed of its shareholdings in Gisland Spa Ltd, White Mill Windfarm Ltd, Biggleswade Windfarm Ltd, TCCT UK Holdings Ltd and Co-operative Bank Plc. 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) In 2016, the investment held in the Co-operative Bank Plc was impaired, which attracted no tax relief. No such impairment has been made this year.

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. The most significant element of this figure relates to NOMA following the sale of the JV's interest in the CIS Tower Miller Street and disposal of the investment in this partnership.

xii) It is a requirement to measure deferred tax balances at the substantively enacted corporation tax rate at which they are expected to unwind. This figure represents the change in the tax rate identified in 2017 at which these deferred tax balances are expected to unwind.

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.

	2017	2016 (restated*)
	£m	£m
Operating profit	**126**	148
Depreciation and amortisation charges (excluding deferred acquisition costs)	**264**	251
Non-current asset impairments	**9**	5
Profit on disposal of businesses and non-current assets	**(4)**	(32)
Change in value of investment properties	**(15)**	(16)
Retirement benefit obligations	**(45)**	(45)
Decrease in inventories	**50**	6
Increase in receivables	**(137)**	(160)
Increase in payables and provisions	**88**	78
Net cash flow from operating activities before asset and liability movements in Financial Services	**336**	235
Fair value through profit and loss movement	**14**	(27)
Assets available for sale movement	**18**	21
Movement in deferred acquisition costs	**1**	(3)
Reinsurance assets	**(5)**	15
Loan receivables at amortised cost	**9**	(6)
Insurance and other receivables	**(23)**	36
Insurance and participation contract provisions	**24**	(24)
Insurance and other payables	**(11)**	-
Asset and liability movements in Financial Services	**27**	12
Net cash from operating activities	**363**	247

*See general accounting policies section on page 165 for details of the restatement.

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

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 £233m (2016: £109m) and £213m (2016: £109m) 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 6 January 2018	Property £m	Plant and equipment £m	Total £m
Cost or valuation:			
At 31 December 2016	1,479	2,216	3,695
Additions	34	351	385
Reclassified as assets held for sale (see note 16)	(6)	(1)	(7)
Disposals	(55)	(50)	(105)
Fully written-down assets	-	(369)	(369)
At 6 January 2018	1,452	2,147	3,599
Depreciation:			
At 31 December 2016	549	1,203	1,752
Charge for the period	24	232	256
Transfer to intangible assets	-	(2)	(2)
Impairment	2	4	6
Reclassified as assets held for sale (see note 16)	(1)	-	(1)
Disposals	(14)	(43)	(57)
Fully written-down assets	-	(369)	(369)
At 6 January 2018	560	1,025	1,585
Net book value:			
At 6 January 2018	892	1,122	2,014
At 31 December 2016	930	1,013	1,943
Capital work in progress included above	29	66	95

In previous years, fully depreciated assets have been retained on the Group's fixed asset register and included in the table above. To help provide a better understanding of the Group's annual depreciation charge in the current year, these assets have been removed from both cost and accumulated depreciation.

The impairment charge of £6m (2016: £5m) relates to charges against loss-making stores in Food 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 6 January 2018 using internal valuations based upon the expected rental yield of the property.

10. Property, plant and equipment continued

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

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

	2017 £m	2016 £m
Cost	**46**	39
Accumulated depreciation	**(32)**	(34)
Net book value	**14**	5

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

Critical accounting estimates and judgements

Impairment

The carrying amount of property, plant and equipment is reviewed at each balance sheet date and if there is any indication of impairment, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any associated goodwill allocated to cash-generating units, and then to reduce the carrying value of other fixed assets.

The recoverable amount is the greater of the fair value less costs to sell and value in use. The value in use of an asset is estimated by taking the relevant business' 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.

10. Property, plant and equipment continued

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 group loses the right to the future economic benefits associated with the asset. For a property disposal, this usually relates to when the property is unconditionally exchanged.

Leased assets
Leases where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and vehicles acquired under finance leases are stated at an amount equal to the lower of fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and any impairment losses.

Depreciation is provided on the same basis as for owned assets. Minimum finance lease payments are apportioned between the finance charge and the redemption of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Property held under operating leases that would otherwise meet the definition of investment property may be classified as investment property on a property by property basis. Where such leases are treated as investment properties, the assets are held at fair value and the leases are accounted for as finance leases.

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

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 6 January 2018	Goodwill £m	Computer software £m	Assets in course of construction £m	Total £m
Cost:				
At 31 December 2016	1,210	92	11	1,313
Additions	-	-	4	4
Transfers	-	13	(13)	-
Disposals	(6)	-	-	(6)
At 6 January 2018	1,204	105	2	1,311
Accumulated amortisation and impairment:				
At 31 December 2016	372	61	-	433
Charge for the period	-	8	-	8
Transfer from property, plant and equipment	-	2	-	2
Impairment	3	-	-	3
Disposals	(1)	-	-	(1)
At 6 January 2018	374	71	-	445
Net book value:				
At 6 January 2018	830	34	2	866
Deferred acquisition costs (see overleaf)				31
At 6 January 2018				897

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

11. Goodwill and intangible assets continued

Deferred acquisition costs

	2017 £m	2016 £m
At the beginning of the financial year	**31**	28
Deferred acquisition costs	**61**	64
Amortisation	**(61)**	(61)
At the end of the financial year	**31**	31

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

Goodwill

The components of goodwill are as follows:

	2017 £m	2016 £m
Food	**803**	809
Other businesses	**27**	29
	830	838

The components of Food goodwill include £560m (2016: £565m) that is allocated to the group of cash generating units (CGUs) that is Food as a whole; £70m (2016: £74m) allocated to stores acquired with the Alldays group and £173m (2016: £170m) 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 five-year plans approved by the Board. The discount rate is based on the post tax cost of capital of the business of 7.9% (2016: 8.3%). Business-specific growth rates are used to extrapolate cash flows beyond the five-year plan. The cash flows are risk adjusted as appropriate to their respective industry. Certain central corporate costs have been allocated as appropriate to each CGU.

The goodwill that arose on the acquisition of Somerfield is allocated to Food as a whole to reflect the synergies (principally buying benefits) that benefit the whole estate. Accordingly, impairment testing is carried out using the whole estate as the group of CGUs. The key assumption used in the review for potential impairment of this goodwill is cash flows from operation of stores (projecting growth at 1-3% (2016: 1-4%) 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 7.9% (2016: 8.3%). In each of the current and comparative years, sensitivity analysis has been performed on this assumption, testing for a 1% increase in discount rate and a decrease in growth to 1%; within both these sensitivities the cash flows remain well in excess of the current carrying value.

For other Food individual stores / smaller groups such as Alldays, annual cashflows have been inflated for growth by between 1%-3% (2016: 1-4%) per annum (dependent on the size of the acquisition group and in-line with the five-year plan) taken into perpetuity and discounted to present value also using a 7.9% (2016: 8.3%) 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 five-year plan. Cash flows have been projected based on the five-year plan and into perpetuity from year six and discounted back to present value using a discount rate of 7.9% (2016: 8.3%). Sensitivity analysis has been performed with both the growth rate and discount rate adjusted by +/- 1%, and under these sensitivities significant headroom is maintained.

11. Goodwill and intangible assets continued

Accounting policies

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

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

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

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

For transfers of engagements on or after 3 January 2010, considerations transferred have been valued by reference to the fair value of the Group's interest in the acquiree 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 to 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 seven 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
Includes 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.

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.

11. Goodwill and intangible assets continued

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.

Other investments as per the balance sheet:

	2017 £m	2016 £m
Current	**415**	372
Non-current	**1,538**	1,414
Total Other investments	**1,953**	1,786

Other investments held by the Group are as follows:

	2017 £m	2016 £m
Fair value through profit or loss:		
Funeral plan investments (see below)	**1,076**	872
Deposits with credit institutions (Insurance)	**212**	226
Available for sale:		
Listed debt securities (Insurance)	**665**	688
Total Other investments	**1,953**	1,786

Deposits with credit institutions comprises short term fixed rate deposits which are designated as fair value through income and expense upon initial recognition.

Funeral plan investments:

	2017 £m	2016 £m
At start of period	**872**	781
New plan purchases	**246**	135
Plans redeemed or cancelled	**(145)**	(67)
Interest and bonus applied	**103**	23
At end of period	**1,076**	872

The expected maturity profile of the plan liabilities is shown in note 25. The Group holds investments on the balance sheet in respect of Funeral Plan policies which are invested in either individual whole of life policies, trusts or life assurance products. The investments are subject to an annual actuarial valuation. The most recent valuation was performed as at 30 September 2017 and the headroom achieved is shown overleaf.

12. Other investments continued

The "wholesale" actuarial valuation is based upon the Group's estimate of the direct cost for a third party funeral director to perform the promised services and the payment of associated disbursements (crematoria, clergy fees etc) if the Group were not in a position to carry out these funerals. No incremental overheads are included because it's assumed likely the provider could absorb these funerals into existing infrastructures. As the Group fully intends to perform these funerals and undertake the professional funeral services itself the actual cost would in reality be lower and subsequent marginal cost surplus would be higher than the wholesale cost surplus.

The actuarial report is a best estimate and is neither deliberately optimistic nor pessimistic. It is prepared by independent actuaries based on management assumptions such as future funeral and disbursement inflation. The headroom percentage is expressing the surplus as a percentage of total liabilities. A 0.1% increase in the inflation assumptions would reduce the surplus by approximately £12m (2016: £10m).

Funeral Plan Investments Actuarial Valuation	30th September 2017 £m	30th September 2016 £m
Total Assets	**1,013**	887
Liabilities:		
Present value (wholesale basis)	**871**	741
Total Liabilities	**871**	741
Headroom	**142**	146
Headroom as a % of liabilities	**16%**	20%

The surplus has remained broadly constant in actual terms but has slightly decreased relative to the increased liability (given higher plan sales than redemptions). During the period, the Group has increased its estimate of the cost of third party professional fees for performing the Funerals reflecting improved external data availability including the amount competitor plan providers offer to Funeral Directors (by equivalent plan type).

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. 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% (2016: 17.1%).

Net deferred tax comprises:		2017 £m	2016 (restated*) £m
Deferred tax asset		**228**	221
Deferred tax liability		**(400)**	(429)
Net deferred tax liability		**(172)**	(208)
Comprised of:	Footnote:		
Other temporary differences	(i)	**10**	11
Retirement benefit obligations	(ii)	**(264)**	(294)
Capital allowances on fixed assets	(iii)	**207**	200
Unrealised gains on investment properties, rolled-over gains and historic business combinations	(iv)	**(125)**	(126)
Claims equalisation reserve and available for sale assets	(v)	**(6)**	(7)
Tax losses	(vi)	**6**	8
		(172)	(208)

*See general accounting policies section on page 165 for details of the restatement.

13. Deferred taxation continued

		2017	2016 (restated*)
		£m	£m
At beginning of the year		**(208)**	(106)
Income statement charge / (credit):			
Group	(vii)	**(9)**	(20)
Transferred to assets held for sale	(viii)	**-**	5
Disposals		**-**	(6)
Charged to equity:			
Retirement benefit obligations	(ii)	**44**	(78)
Available for sale assets - Insurance		**1**	(3)
At end of period		**(172)**	(208)

*See general accounting policies section on page 165 for details of the restatement.

The Finance Act 2015 reduced 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 17.13% at the balance sheet date, as the majority of the deferred tax provisions will be required and utilised in periods after April 2020.

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 £30m net credit has been recognised during 2017. £44m of this net credit has been recognised in OCI, which is offset by a charge of £14m taken to 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 since 2013 due to excess trading losses arising in recent years. However, impairment, disposals and depreciation have continued to be charged against the equivalent accounts value. The Group expects to utilise these allowances against future trading profits. A credit of £6m has arisen during 2017 in respect of differences in prior year estimated provisions and submissions made to HMRC in respect of our 2015 and 2016 accounting periods during 2017.

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 and (c) the disposal of any property that has had an historic capital gain 'rolled into' its base cost (which is an election available by statute designed to encourage corporates to reinvest disposal proceeds from the disposal of trading properties into new trading properties and ventures). During 2017 the Group has collated a significant proportion of the original base costs and March 1982 valuations for properties fair valued on historic mergers. These reviews have created a net £2m 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 had to be held, and is being released evenly over a six year period. 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.

13. Deferred taxation

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. A provision of £8m included in this balance is in respect of uncertain tax positions, 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) This movement is made up of current years movements as explained in footnotes (i) to (vi) above and a prior year adjustment. The net effect of the prior year adjustments in each of the above items is a credit of £4m, comprising of a charge of £2m on the collation of base costs as per footnote (iv) above, offset by a £3m credit on capital allowances and a £3m credit on future capital gains and rollover relief.

viii) In 2016, 298 food stores that were to be sold to McColls Retail Group plc were held within assets held for sale (see note 16). The associated deferred tax liabilities relating to capital allowances were transferred to assets held for sale. During 2017, these stores have been disposed of and a deferred tax credit of £5m has been released to the income statement, which is included within the current year deferred tax charge of £9m.

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.

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:

	2017 £m	2016 £m
Raw materials, consumables and work in progress	4	10
Finished goods and goods for resale	385	429
	389	439

The period end inventory provision is £20m (2016: £16m) and relates largely to the Food business. A net charge of £4m (2016: £1m credit) 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).

	2017 £m	2016 £m
Non-current	**58**	55
Current	**635**	704
	693	759

	2017 £m	2016 £m
Trade receivables	**489**	492
Prepayments and accrued income	**72**	70
Other receivables	**131**	197
	693	759

Trade receivables are stated net of an impairment provision of £10m (2016: £8m). £8m (2016: £2m) has been charged to the income statement during the period offset by a credit of £6m (2016: credit of £3m). Within trade receivables is £90m (2016: £135m) of supplier income that is due to Food from suppliers. As at 5 April 2018, £87m (2016: £130m) of the current year balance had been invoiced and settled.

Included within other receivables is a £nil (2016: £32m) financial asset in respect of dividends still to be received from the Travel associate and £nil (2016: £50m) 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 (2016: £29m) which are overdue but not considered to be impaired, age analysed as follows:

	2017 £m	2016 £m
Amounts overdue:		
Less than 3 months	**17**	21
3 to 6 months	**4**	1
More than 6 months	**8**	7
	29	29

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

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 any assets or liabilities that the Group holds for sale at the year end (these generally relate to properties that we plan to sell soon). When this is the case, our balance sheet shows those assets and liabilities separately as held for sale.

	2017 £m	2016 £m	2017 £m	2016 £m
	Assets held for sale		Liabilities held for sale	
Total	6	106	-	(5)

Assets and liabilities classified as held for sale	2017 £m	2016 £m
Property, plant and equipment	6	48
Intangible assets	-	58
Deferred tax	-	(5)
	6	101

The majority of the assets held for sale in the prior year related to 298 food stores that were sold to McColls Retail Group plc. Assets are recorded at their current carrying value unless this exceeds any expected net proceeds of sale in which case the assets are impaired.

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?

This section of the accounts (notes 17 - 19) outlines the key liabilities that the Group holds at the balance sheet date.

17. Interest-bearing loans and borrowings

In plain English – what does this note show?

The note provides information about the value and contractual terms of the Group's interest-bearing loans. This includes information about their value, interest rate and repayment terms and timings. Details are also given about other borrowings and funding arrangements such as corporate investor shares and finance leases. All items are split between those that are due to be repaid within one year (current) and those which won't fall due until after more than one year.

Non-current liabilities:	2017 £m	2016 £m
£450m 6 7⁄8% Eurobond Notes due 2020*	**502**	511
£350m 7 1⁄2% Eurobond Notes due 2026*	**436**	416
£21m 8 7⁄8% First Mortgage Debenture Stock 2018*	**-**	21
£109m 11% final repayment subordinated notes due 2025	**109**	109
£16m Instalment repayment notes (final payment 2025)	**15**	16
Non-current portion of finance lease liabilities	**8**	-
Trading Group interest-bearing loans and borrowings	**1,070**	1,073
£70m 12% Financial Services Callable Dated Deferrable Tier Two Notes due 2025	**68**	68
Total Group interest-bearing loans and borrowings	**1,138**	1,141

Current liabilities:	2017 £m	2016 £m
£21m 8 7⁄8% First Mortgage Debenture Stock 2018*	**21**	-
Instalment repayment notes (final payment 2025)	**1**	1
Corporate investor shares	**8**	16
Current portion of finance lease liabilities	**2**	2
Other unsecured loans	**2**	2
	34	21

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

For more information about the Group's exposure to interest rate and foreign currency risk, and a breakdown of IFRS 13 level hierarchies in relation to these borrowings, see note 26.

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. The Group's Eurobonds and first mortgage debenture stock borrowings are designated as financial liabilities at fair value through the income statement. The year-on-year fair value movement on these liabilities is shown under non-cash movements in the tables overleaf. The total cumulative fair value movement on these liabilities is also shown at the botom of each table.

17. Interest-bearing loans and borrowings continued

	For period ended 6 January 2018 Start of period £m	Non-cash movements £m	Cash flow £m	Movement in corporate investor shares £m	End of period £m
Interest-bearing loans and borrowings:					
- current	(21)	(21)	-	8	(34)
- non-current	(1,141)	10	(7)	-	(1,138)
Total Debt	(1,162)	(11)	(7)	8	(1,172)
Group cash:					
- Group cash (per balance sheet)	283	-	120	-	403
- Overdraft (per balance sheet)	(6)	-	-	-	(6)
Group Net Debt	(885)	(11)	113	8	(775)
Comprised of:					
Trading Group debt	(1,095)	(11)	(6)	8	(1,104)
Trading Group cash	208	-	106	-	314
Trading Group Net Debt	(887)	(11)	100	8	(790)
CISGIL debt and overdrafts	(73)	-	(1)	-	(74)
Co-operative Banking Group Ltd (CBG Ltd) cash and overdrafts	75	-	14	-	89
Group Net Debt	(885)	(11)	113	8	(775)
Less fair value adjustment	127	11	-	-	138
Group Net Debt before fair value adjustment	(758)	-	113	8	(637)

	For period ended 31 December 2016 Start of period £m	Non-cash movements £m	Cash flow £m	Movement in corporate investor shares £m	End of period £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)
CBG Ltd cash and overdrafts	74	-	1	-	75
Group Net Debt	(692)	(74)	(120)	1	(885)
Less fair value adjustment	53	74			127
Group Net Debt before fair value adjustment	(639)	-	(120)	1	(758)

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 £502m) and the 7.5% (inclusive of 1.25% coupon step up) Eurobond Issue 2026 has an original value of £350m (carrying amount of £436m). 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 at par value.

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 6 January 2018 the amounts outstanding are final repayments notes of £109m and the instalment repayment notes of £16m.

The unsecured bank loans consist of a £355m Revolving Credit Facility which expires in February 2021. The facility is undrawn as at 6 January 2018.

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:

	2017 £m	2016 £m
Less than one year	2	2
Greater than one year but less than five years	4	-
Greater than five years	4	-
	10	2

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 rate 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.

	2017 £m	2016 £m
Current	1,400	1,506
Non-current	1,249	1,078
	2,649	2,584

	2017 £m	2016 £m
Trade payables	743	819
Value Added Tax, PAYE and social security	28	23
Accruals and deferred income	193	229
Member payments payable	13	25
Funeral plans	1,139	915
Deferred consideration	-	13
Other payables	529	553
Other reinsurance liabilities	4	7
	2,649	2,584

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 £130m (2016: £137m) in respect of historic group relief. See note 8 for further details.

Other payables includes £21m (2016: £14m) of member rewards earned that have either not been redeemed by members (5%) or have not yet been paid out to local causes (1%). During the year £6m (2016: £nil) of member reward earned (5%) has been written back to the income statement in-line with a prudent assessment of the rate of non-redemption.

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.

	2017 £m	2016 £m
Non-current	222	224
Current	90	102
	312	326

19. Provisions continued

	Uninsured claims £m	Onerous leases £m	Restructuring & integration £m	Regulatory / other £m	2017 Total £m	2016 Total £m
At beginning of the period	64	194	44	24	326	439
Credit to income statement	(7)	(6)	-	(11)	(24)	(117)
Charge to income statement	24	25	-	2	51	57
Transfer from payables	-	-	-	10	10	-
Discounting	-	10	-	-	10	14
Payments	(22)	(22)	(15)	(2)	(61)	(67)
At end of the period	59	201	29	23	312	326

Critical accounting estimates and judgements

Uninsured claims (excluding CISGIL)
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. 46% (2016: 39%) of the provision relates to five onerous properties that are mainly former offices or distribution centres. The remaining percentage is mainly former trading stores all with varying terms and lengths. 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. Payments under lease commitments, net of amounts receivable under sub-lettings, will be approximately £72m (2016: £75m) payable over the next five years. Prior year includes a £77m credit in relation 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 £nil (2016: £14m) 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.

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 - 31) contains additional notes to the accounts.

20. Members' 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.

	2017 £m	2016 (restated*) £m
Individual shares of £1 and 10p each	64	63
Corporate shares of £5 each	9	9
Share Capital	**73**	72
Other Reserves	101	107
Retained Earnings	2,914	3,062
Total Retained Earnings and Other Reserves	**3,015**	3,169
Total Capital Resources	**3,088**	3,241

* For more details on the restatement, refer to the general accounting policies note on page 165.

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 Independent Society Members (corporate shares) are not withdrawable and are transferable only between Independent Society 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 Independent Society Members is in proportion to trade with the Society with Independent Society Members totalling 21.9% (2016: 21.9%) of the vote at the Annual General Meeting. Each individual member has one vote with individual members totalling 78.1% (2016: 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 £100,000 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 £0.6m in the period being the net of new member contributions of £1.0m and withdrawals of £0.4m. There are 15.0m (2016: 13.9m) individual member records on the share register.

Other reserves

	Reclaim Fund £m	Revaluation Reserve £m	Available for Sale Investments £m	Total £m
Balance at 31 December 2016	74	10	23	107
Gains less losses on available for sale assets	-	-	(4)	(4)
Available for sale assets cumulative gains transferred to the income statement	-	-	(3)	(3)
Revaluation reserve recycled to retained earnings	-	-	-	-
Tax on items taken directly to other comprehensive income	-	-	1	1
Balance at 6 January 2018	**74**	**10**	**17**	**101**

20. Members' Share capital and Reserves continued

	Reclaim Fund	Revaluation Reserve	Available for Sale Investments	Total
	£m	£m	£m	£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 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. Owing 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 and community payments. Following the launch of the new 5% and 1% membership proposition in 2016, the Group has made payments to members and communities of £86m in 2017 (2016: £31m). See note 31 for more details. It has also invested in future growth through capital expenditure additions of £431m (2016: £353m) and still kept within its net debt limits. Total member funds decreased during the period by £153m (2016: increased £272m).

Financial Services mainly comprises 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 as showing additions, disposals and transfers in and out of Investment properties.

	2017 £m	2016 £m
Valuation at beginning of period	74	87
Additions	-	2
Disposals	(21)	(31)
Revaluation gain recognised in income statement	15	16
Valuation at end of period	68	74

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. 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.

A breakdown of the investments held and income received is disclosed below:

	2017		2016	
	Income / (losses) £m	Investments £m	Income / (losses) £m	Investments £m
The Co-operative Bank plc	-	-	(185)	-
TCCT Holdings UK Limited (Travel) - share of income / (losses)	-	-	12	-
NOMA	8	-	1	39
Other investments (including windfarms)	-	3	1	13
Total	8	3	(171)	52

22. Investments in associates and joint ventures continued

The movements in investments in associates, joint ventures and other investments are as follows:

	2017 £m	2016 £m
At beginning of period	**52**	285
Additions	**10**	5
Share of profits / (losses)	**8**	(171)
Dividends received	**(33)**	(2)
Disposals	**(34)**	(65)
At end of period	**3**	52

The Co-operative Bank plc (the Bank)
On 1 September 2017, The Co-operative Bank plc ('the Bank') announced that it had successfully recapitalised, raising approximately £700m of additional core tier 1 capital and positioning the Bank to meet regulatory capital requirements in full in the medium term. The Group's shareholding therefore reduced from 20% to 1% from 1 September 2017. As a result, some formal arrangements including the right of the Group to nominate a Director to the Bank Board ended and meant the Group no longer accounts for the Bank as an associate as it has lost significant influence. The remaining 1% shareholding was subsequently sold for £5m in September 2017.

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 was received on 3 April 2017. This amount was recognised by the Group in 2015 and the balance as at 31 December 2016 was held within trade and other receivables.

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 meant that Thomas Cook Retail Ltd had 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 was no longer able to demonstrate significant influence over the entity. Therefore, the book value of the investment in Travel transferred to trade and other receivables and was treated as a disposal in the prior year in the above table. The £50m put option (plus interest) was paid by Thomas Cook in December 2017 and the Co-op Group no longer holds any receivable balances in respect of Travel.

NOMA
During 2017, the Group invested an additional £10m (2016: £5m) into the NOMA joint venture and also received dividends of £33m (2016: £1m) relating to the sale of the JV's interest in the CIS Tower Miller Street in June 2017. On 22 December the Group completed the sale of its 50% stake in NOMA to Hermes Real Estate. Over the full term of the joint venture since its incorporation in 2014, the Group received total cash proceeds and dividends of £123m in return for total investment of £77m in property (£58m) and cash (£19m).

Windfarms
The Group sold its investment in Biggleswade and Whitemill windfarms on 20 December 2017 for £12m. The only remaining investment is the 20% interest in Coldham windfarm.

Other Joint Ventures or Associates
The principal place of business for all of the Group's remaining investments in associates and joint ventures is the United Kingdom. There were no contingent liabilities or capital commitments in respect of the Group's other joint ventures or associates as at 6 January 2018 (31 December 2016: £nil).

22. Investments in associates and joint ventures continued

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 five funded DB pension schemes all of which are closed to future accrual. The assets of these schemes 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 80% of the Group's pension assets. The DB section of Pace ('Pace Complete') closed to future service accrual on 28 October 2015.

Pace is a multi employer scheme in which the Bank is a participating employer. Following discussion during 2017 it is anticipated that during 2018 the scheme will be split such that the liabilities and corresponding assets attributable to the Bank will be moved to a new section. Discussion during 2017 has also facilitated the identification of the Group's share of assets and liabilities and the Group's financial statements at the 2017 year end now reflect only its own share of the scheme. 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 through the DC section of Pace. 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 2% colleague and 3% 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 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.

23. Pensions continued

Balance sheet position for DB plans

The table below summarises the net surplus in the balance sheet by scheme:

	Net 2017 £m	Net 2016 (restated) £m
Schemes in surplus		
The Co-operative Group Pension Scheme (Pace)	**1,603**	1,822
Somerfield Pension Scheme	**143**	156
Total schemes in surplus	**1,746**	1,978
Schemes in deficit		
United Norwest Co-operatives Employees' Pension Fund	**(133)**	(173)
Yorkshire Co-operatives Limited Employees' Superannuation Scheme	**(11)**	(21)
The Plymouth and South West Co-operative Society Limited Employees' Superannuation Fund	**(43)**	(51)
Other unfunded obligations	**(6)**	(6)
Total schemes in deficit	**(193)**	(251)
Total schemes	**1,553**	1,727

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 carried out a review of the provisions for the recovery of surplus in its pension schemes. This review concluded that all of the DB schemes can recoup surplus via a right to refund and this is reflected in the balance sheet position.

Restatement

The net surplus of the Pace scheme in 2016 has been restated from £1,783m to £1,822m with a corresponding increase in other comprehensive income to recognise £39m of insured pensions assets relating to AVCs that had not been included in the 2016 actuarial valuation.

Pace - nature of scheme

As Pace represents around 80% 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 2016, in accordance with the scheme specific funding requirements of the Pensions Act 2004. The results of the valuation showed that Pace Complete had a surplus of £251m. The Group agreed on completion of the actuarial valuation in November 2017 that contributions to Pace would cease with effect from 1 December 2017.

Pace - Multi-employer provisions

The Bank, an associate of the Group during the year 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, and therefore account for pension contributions in respect of the scheme on a DC basis.

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. In the past there has been no contractual agreement or stated policy for charging the net DB obligation, or surplus, to participating employers. Furthermore there has been no contractually agreed share of pension liabilities between the Group and the Bank. As such, the net DB pension asset has historically been recognised fully by the Group, being the Principal Employer and the most significant participant in the scheme.

23. Pensions continued

During 2017, the Group, The Co-operative Bank ('the Bank') and the Pace Scheme Trustees agreed heads of terms to sectionalise the Bank's element of the Pace scheme. Pace had previously been accounted for, on a defined benefit basis, entirely by the Group because sufficient information was not available to identify the Bank's share of the assets and liabilities. In particular there was uncertainty as to the treatment of assets and liabilities relating to deferred and pensioner members of the CIS Employees' Pension Scheme which were transferred into Pace on its establishment in 2006. Following discussions during 2017, it has been agreed that as part of the sectionalisation exercise the Bank will be allocated a pro rata share of these assets and liabilities.

Therefore there is now sufficient information to account for the scheme proportionally on a multi-employer basis. The proportion of the scheme attributable to the Group will vary over time in line with changes in market conditions, but is expected to be around 79%. The Group continues to account on a defined benefit basis for its share of Pace's assets and liabilities. The ability to determine an appropriate share of the scheme between the participating entities has resulted in a de-recognition of £374m of the Pace surplus with a corresponding charge through other comprehensive income.

Sectionalisation should conclude by the end of the third quarter of 2018. This will also remove the Bank's 'last man standing' obligation to the rest of the Pace scheme. An obligation on the Group to support the pension liabilities of the Bank section could arise in limited circumstances if the Bank were to not meet its own section pension liabilities.

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 also a 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 IAS19. The Group may therefore be required to pay contributions to eliminate a funding shortfall even when a surplus is reported in the IAS19 disclosure.

Any 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.

Despite contributions to Pace ceasing (see above), the expected deficit recovery contributions to all pension schemes over the 2018 financial year is £48m. Ongoing discussions are taking place regarding the Northern schemes (United Norwest and Yorkshire). 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.

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 2017
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 2017

Discussions are currently underway in relation to the 2017 funding valuations.

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.

23. Pensions continued

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 90% of the liability is currently protected from movements in yields on Government bonds. 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 90% of the liability is currently protected from movements in inflation.
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

	2017	2016
Discount rate	**2.62%**	2.74%
RPI Inflation rate	**3.44%**	3.45%
Pension increases in payment (RPI capped at 5% p.a.)	**3.25%**	3.26%
Future salary increases	**3.69%**	3.70%

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.

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 2016 projections and a long term future improvement rate of 1.25% p.a. (2016: CMI 2015 1.25% 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.

	2017	2016
Male currently aged 65 years	**22.0**	22.1
Female currently aged 65 years	**23.6**	23.8
Male currently aged 45 years	**23.4**	23.8
Female currently aged 45 years	**25.1**	25.7

23. Pensions continued

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 also increase. 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.

	2017	2016
Change in liability from a 0.1% increase in discount rate	(180)	(229)
Change in liability from a 0.1% increase in RPI inflation	134	171
Change in liability from a 0.25% increase in long-term rate of longevity improvements	109	212

Changes in the present value of the defined benefit obligation (DBO)

	2017 £m	2016 £m
Opening defined benefit obligation (restated)	11,152	9,669
De-recognition of Britannia Pension Scheme (unfunded)	-	(3)
Interest expense on DBO	275	355
Remeasurements :		
a. Effect of changes in demographic assumptions	(106)	(550)
b. Effect of changes in financial assumptions	223	2,432
c. Effect of experience adjustments	(26)	(285)
Benefit payments from plan	(667)	(466)
Derecognition of scheme liabilities attributable to Co-operative Bank	(1,866)	-
Closing defined benefit obligation	8,985	11,152

Changes in the fair value of the plan assets

	2017 £m	2016 (restated) £m
Opening fair value of plan assets	12,879	10,799
Interest income	317	400
Return on plan assets (excluding interest income)	203	2,100
Administrative expenses paid from plan assets	(3)	(5)
Employer contributions	49	51
Benefit payments from plan	(667)	(466)
Derecognition of plan assets attributable to Co-operative Bank	(2,240)	-
Closing fair value of plan assets	10,538	12,879

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.

	2017 Quoted £m	2017 Unquoted £m	2017 Total £m	2016 Quoted £m	2016 (restated) Unquoted £m	2016 Total £m
Equity instruments	242	-	242	563	-	563
Liability driven investments	5,709	-	5,709	7,548	-	7,548
Real estate	223	-	223	261	5	266
Investment grade credit	2,810	-	2,810	1,751	-	1,751
Diversified growth funds	127	-	127	214	-	214
Illiquid / other credit	-	731	731	-	44	44
Alternative investments	-	316	316	-	552	552
Cash and cash equivalents	380	-	380	1,941	-	1,941
	9,491	1,047	10,538	12,278	601	12,879

23. Pensions continued

	2017 £m	2016 (restated) £m
Amounts recognised in the balance sheet		
Present value of funded obligations	**(8,979)**	(11,146)
Present value of unfunded liabilities	**(6)**	(6)
Fair value of plan assets	**10,538**	12,879
Net retirement benefit asset	**1,553**	1,727

	2017 £m	2016 (restated) £m
Amounts recognised in the income statement and other comprehensive income		
Interest expense on defined benefit obligations	**(275)**	(355)
Interest income on plan assets	**317**	400
Administrative expenses and taxes	**(3)**	(5)
Total recognised in the income statement	**39**	40
Remeasurement gains on employee pension schemes	**112**	503
Derecognition of pension surplus attributable to Co-operative Bank	**(374)**	-
Total	**(223)**	543

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 an 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 surplus 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 and asset returns excluding interest income) 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. 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.

The gain or loss on the sectionalisation of the Pace pension scheme is treated within other comprehensive income because it arises from a change in estimate of the Bank's estimated share rather than a settlement.

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.

	2017		2016	
	Gross insurance liability £m	Reinsurance asset £m	Gross insurance liability £m	Reinsurance asset £m
At the beginning of the year	**724**	**(54)**	746	(69)
Claims paid during the year	**(371)**	**52**	(347)	9
Increase / (decrease) arising from current year claims	**384**	**(98)**	370	(6)
Increase / (decrease) arising from prior year claims	**6**	**(7)**	(59)	12
Quota share	**-**	**49**	-	-
Increase / (decrease) in unearned premiums	**7**	**-**	15	-
Increase / (decrease) in unexpired risk provision	**-**	**-**	(1)	-
	750	**(58)**	724	(54)
Comprising:				
- Claims reported	**413**	**(87)**	349	(29)
- Claims incurred but not reported	**84**	**(20)**	128	(25)
- Claims settlement expenses	**12**	**-**	11	-
- Provision for unearned premiums	**241**	**-**	236	-
- Quota share	**-**	**49**	-	-
	750	**(58)**	724	(54)
Non-current (*restated)	**289**	**(44)**	280	(47)
Current (*restated)	**461**	**(14)**	444	(7)
	750	**(58)**	724	(54)

*For more details on the restatement, refer to the general accounting policies note on page 165.

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;
- Deriving average costs per claim to apply to claim numbers; and
- Projecting historic claims paid and incurred data (payment plus estimates) – statistical actuarial techniques including chain ladder, Bornhuetter Ferguson and Cape Cod.

Detailed claims data, including individual case estimates, is used to derive patterns in average claims costs and timings between occurrence and estimate/payment of claims. The most common method used is the chain ladder method. This technique involves the analysis of historical claims development trends and the selection of estimated development factors based on this historical pattern. The selected development factors are then applied to cumulative claims data for each accident year which is not yet fully developed to produce an estimated ultimate claims cost for each accident quarter. 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 exposure within the electric industry.

Discounted reserves in respect of periodic payment settlements are £24m (2016: £22m) and historic liability claims from the electric industry discounted reserve amounts to £3m (2016: £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 2017 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 2017 CISGIL held an URP of £nil (2016: £nil).

As outlined within the risk management section, there is significant uncertainty in the assessment of liabilities, and provisions are set to be adequate to cover the anticipated eventual cost, a management margin is added to the 'actuarial best estimate' so that no adverse run-off deviations are envisaged. Sensitivity analysis is performed to assist the selection of key parameters and, hence, the provisions adopted. Provisions are subject to detailed review regarding the appropriateness of key assumptions and the quantum of the provisions established.

The overall objective of CISGIL's reserving policy is to produce reliable and accurate reserves. Assumptions underlying the reserving calculations are agreed by the Quarterly Reserving Committee (QRC). Methodologies are peer reviewed throughout the calculation process. Provisions are approved and signed off by the QRC, and any margin above the actuarial best estimate reserve is set by the Chief Financial Officer.

Periodic reports are produced by the actuarial team and presented to the Periodic Reserving Committee in order to advise management of the performance of the business. More detailed reports are produced on a quarterly basis providing information on the performance of the business against plan. These reports are presented to 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	2017 Effect on gross provision £m	2017 % Effect	2016 Effect on gross provision £m	2016 % Effect
Motor					
Average cost of claims for last three years – bodily injury and legal	10%	35	9.0%	31	8.4%
Mean term to settlement – bodily injury and legal	+1/2 year	8	2.2%	8	2.1%
Rate of future inflation – bodily injury and legal	1%	11	2.9%	11	2.9%
Ogden discount rate – bodily injury	-3/4%	13	3.3%	(2)	(0.6%)
Other classes					
Mean term to settlement (liability)	+1/2 year	-	1.9%	-	1.9%
Mean term to settlement (non-liability)	+1/2 year	1	1.6%	1	1.6%
Rate of future inflation (liability)	+1%	1	4.6%	1	7.3%
Rate of future inflation (non-liability)	+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) Premiums

Gross written premiums comprise premiums receivable on those 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 adjustments in the accounting period relating to premium receivable in respect of business written in prior periods

Gross written premiums:
- are stated gross of commission and exclude any taxes or levies based on premiums;
- include an estimate for cancellations for those renewal contracts which incepted prior to the year-end but which may be cancelled after the statement of financial position date; and
- include an estimate of pipeline premium.

Gross written premium (whether paid in advance or by instalments) is earned evenly over the period of the contract.

ii) 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.

iii) 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.

iv) 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').

24. Insurance contracts liabilities and reinsurance assets continued

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.

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.

v) 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).

vi) 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.

vii) 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 33 to 36. Owing 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 2017 £m	Carrying amount 2016 £m
Trade and other receivables (excluding prepayments and accrued income)	414	505
Interest rate swaps	38	50
Funeral bond investments	1,076	872
Cash deposits	314	208

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 6 January 2018 was 58% (at 31 December 2016: 59%). 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 31 December 2016: 5.63% to 6.25%). At 6 January 2018, the Trading Group had interest rate swaps with a notional contract amount of £390m (at 31 December 2016: £390m).

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 6 January 2018 was a net asset of £38m (2016: net asset £50m) comprising assets of £38m (2016: £50m) and liabilities of £nil (2016: £nil). 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 6 January 2018, the Trading Group had forward currency transactions in Euros with a notional contract amount of £nil (2016: £14m).

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 6 January 2018, the Trading Group had available borrowing facilities totalling £1,301m (2016: £1,302m), which comprised uncommitted facilities of £nil (2016: £nil) and committed facilities of £1,301m (2016: £1,302m). These are detailed below:

Bank facilities as at 6 January 2018

	2017		2016	
	Expiry	**£m**	Expiry	£m
Uncommitted facilities	**August 2016**	**-**	August 2016	-
Syndicate Revolving Credit Facility	**Feb 2021**	**355**	Feb 2021	355
		355		355
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**	**16**	December 2025	17
Eurobond issue - 2026	**July 2026**	**350**	July 2026	350
		1,301		1,302

The Group's £355m Syndicated Revolving Credit Facility expires in February 2021.

25. Financial risk management continued

The following are the maturities of financial liabilities as at 6 January 2018:

	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	**(502)**	**(450)**	**-**	**-**	**-**	**(450)**	**-**
Sterling Eurobond 2026	**(436)**	**(350)**	**-**	**-**	**-**	**-**	**(350)**
Final repayment subordinated notes - 2025	**(109)**	**(109)**	**-**	**-**	**-**	**-**	**(109)**
Instalment repayment subordinated notes - 2025	**(16)**	**(16)**	**-**	**(1)**	**(1)**	**(5)**	**(9)**
Finance lease liabilities	**(10)**	**(10)**	**(1)**	**(1)**	**(2)**	**(2)**	**(4)**
Funeral plans	**(1,139)**	**(1,139)**	**(50)**	**(56)**	**(112)**	**(378)**	**(543)**
Trade and other payables	**(1,285)**	**(1,285)**	**(1,167)**	**(38)**	**(23)**	**(15)**	**(42)**

The Group did not hold any derivative financial instruments (interest rate swaps used for hedging) at the balance sheet date in the current or prior years.

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)	(41)	(46)	(91)	(308)	(429)
Trade and other payables	(1,492)	(1,492)	(1,360)	(58)	(16)	(18)	(40)

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 6 January 2018 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 (2016: GBP £47m) higher and GBP £51m (2016: GBP £56m) 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 6 January 2018 and 31 December 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 6 January 2018 the total amount of guarantees / bonds outstanding is £48m (2016: £45m).

Insurance risk - CISGIL
Insurance risk comprises the risk of loss resulting from:
• Future claims events other than catastrophes (Premium Risk).
• Adverse change in the value of insurance liabilities (Reserve Risk).
• Natural or man-made catastrophe events (Catastrophe Risk).
• The assumptions underlying expenses are not borne out in practice (Expense Risk).

The main classes of business written are UK private Motor and Home business, either written directly or through brokers. In addition, CISGIL used to write some commercial insurance business, which is 100% reinsured and this book is now in run off. CISGIL continues to manage commercial Motor business which is also in run off, and a small book of pet insurance. 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. Periodic Payment Orders (PPOs) are being used to settle injury claims in the UK, with compensation being 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 length of life expectancy and the payments increase with care worker future inflation. 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.

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.

In 2017, 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.

25. Financial risk management continued

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.

The quota share reinsurance arrangement operates on a funds withheld basis, which means that only the reinsurer margin is transferred to the reinsurer.

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 (2016: £60m) with a trading counterparty that provides administrative services including the collection of premiums. Credit Insurance was purchased during 2017 to mitigate against this exposure to within risk appetite.

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 2017	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)	-	-	212	-	-	212
Available for sale assets:						
Listed debt (fixed rate)	109	292	143	-	-	544
Listed debt (variable rate)	28	25	63	5	-	121
Reinsurance assets	-	30	25	-	3	58
Insurance receivables and other assets	2	3	4	-	165	174
Cash and cash equivalents	-	-	15	-	-	15
	139	350	462	5	168	1,124
Assets not subject to credit risk						74
						1,198

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
Cash and cash equivalents	-	-	-	-	-	-
	120	386	463	5	153	1,127
Assets not subject to credit risk						71
						1,198

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 £148m (2016: £177m) is held against short term deposits which have been placed into a reverse repo transaction of £145m as at 31 December 2017 (2016: £175m). On 29 December 2017, an additional £3m was placed on deposit, 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 statement of financial position.

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 loss as £114m (2016: £104m), giving a minimum requirement for £23m (2016: £21m) of liquid assets against actual liquid assets of £739m (2016: £773m). These values are gross of all reinsurance.

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.

2017	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	508	592	208	109	63	38	23	151
Financial liabilities at amortised cost:								
Subordinated debt	68	132	8	8	8	8	8	92
Other reinsurance liabilities	4	4	4	-	-	-	-	-
Insurance and other payables	57	57	57	-	-	-	-	-
Cash and cash equivalents	6	6	6	-	-	-	-	-
	643	791	283	117	71	46	31	243
Other liabilities								6
Total recognised liabilities								649

25. Financial risk management continued

2016	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	488	562	197	102	58	37	23	144
Financial liabilities at amortised cost:								
Subordinated debt	68	141	8	8	8	8	8	99
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

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:

	2017			2016		
	Contractual/ notional amount £m	**Fair value assets £m**	**Fair value liabilities £m**	Contractual/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Interest rate swaps	**390**	**38**	**-**	390	50	-
Total recognised derivative assets	**390**	**38**	**-**	390	50	-

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.

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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.

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 2017 £m	Fair value 2017 £m	Carrying value 2016 £m	Fair value 2016 £m
Interest-bearing loans and borrowings	203	215	194	203

The table below analyses financial instruments by measurement basis as detailed by IAS 39 (Financial Instruments: Recognition and Measurement).

2017	Designated at fair value £m	Loans and receivables £m	Available for sale £m	Other amortised cost £m	Total £m
Assets					
Other investments	1,288	-	665	-	1,953
Derivative financial instruments	38	-	-	-	38
Trade and other receivables	-	606	-	-	606
Cash and cash equivalents	-	-	-	403	403
Total financial assets	1,326	606	665	403	3,000
Liabilities					
Interest-bearing loans and borrowings	959	-	-	203	1,162
Trade and other payables	-	-	-	2,456	2,456
Funeral plans	1,139	-	-	-	1,139
Overdrafts	-	-	-	6	6
Total financial liabilities	2,098	-	-	2,665	4,763

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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					
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

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.

Valuation of financial instruments

2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Financial assets at fair value through income or expense				
- Funeral plan investments	**-**	**-**	**1,076**	**1,076**
- Derivative financial instruments	**-**	**38**	**-**	**38**
- Insurance investments	**-**	**212**	**-**	**212**
Available for sale assets	**-**	**665**	**-**	**665**
Total financial assets at fair value	**-**	**915**	**1,076**	**1,991**
Liabilities				
Financial liabilities at fair value through income or expense				
- Fixed-rate sterling eurobond	**-**	**938**	**-**	**938**
- First mortgage debenture	**-**	**21**	**-**	**21**
- Funeral plan liabilities	**-**	**-**	**1,139**	**1,139**
Total financial liabilities at fair value	**-**	**959**	**1,139**	**2,098**

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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				
- 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

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:

	2017 £m	2016 £m
Carrying amount	**665**	688
Fair value	**665**	688
Amortised cost	**647**	664

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:

	2017	2016
Derivatives	**0.70% - 1.51%**	0.40% - 1.22%
Loans and borrowings	**3.96% - 5.01%**	3.65% - 9.41%

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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 are originated.

ii) Derecognition of financial assets and financial liabilities
Financial assets are derecognised when they are qualifying transfers and:

- the rights to receive cash flows from the assets have ceased; or
- 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.

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.

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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.

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).

26. Financial instruments, derivatives and fair values of financial assets and liabilities continued

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.

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's 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 £nil (2016: £4m). The prior year figure 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 6 January 2018, the future minimum lease payments under non-cancellable operating leases were:

	2017		2016	
	Land and buildings	Other	Land & buildings	Other
	£m	£m	£m	£m
Within one year	177	7	171	7
In two to five years	659	9	606	9
In over five years	1,335	-	1,318	-
	2,171	16	2,095	16

The total of future minimum sublease payments expected to be received under non-cancellable subleases less than 50 years is £208m (2016: £198m).

Co-op Insurance entered into a long term "software as a service" contractual agreement in 2016. This contract has now been terminated. The estimated value of the remaining commitment is £nil (2016: £148m), these amounts have not been provided for in the financial statements.

Commitments relating to associates and joint ventures are disclosed in note 22.

c) Contingent liabilities:

On 8 March 2018, an investigation was launched into the Group's treatment of Grocery suppliers, more information on which can be found on page 87. The adjudicator has a range of measures that can be taken as part of an investigation and these are set out in the "Statutory guidance on how the Groceries Code Adjudicator will carry out investigation and enforcement functions" document on the GCA website at **https://www.gov.uk/government/publications/statutory-guidance.**

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, associates or joint ventures of the Group). The note outlines the nature of the relationship of any related parties and the extent of material transactions and balances with them.

	Relationship	2017 £m	2016 £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 Group's associates and joint ventures are set out in note 22.
ii) The Group is a member of Co-operatives UK Limited.

The Group's Independent Society members include consumer co-operative societies which, in aggregate, own the majority of the corporate shares with rights attaching as described in note 20. Sales to Independent Society members, on normal trading terms, were £1,683m (2016: £1,573m) and the amount due from Independent Society members in respect of such sales was £122m at 6 January 2018 (31 December 2016: £124m). No distributions have been made to Independent Society 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 number of key management personnel had transacted with our Funeral division. These transactions totalled £25,000 (2016: £5,000). Other than the compensation set out in the Remuneration Report, there were no other transactions greater than £1,000 with the Group's entities (2016: £nil). Total compensation paid to key management personnel is shown below.

Key management personnel compensation	2017 £m	2016 £m
Short-term employee benefits	**8.5**	9.0
Post-employment benefits	**0.5**	0.5
Other long-term benefits	**2.6**	1.9
Termination benefits	**0.0**	0.4
Total	**11.6**	11.8

Of the above, £nil (2016: £0.3m) 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.

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. All transactions were at arms length. NOMA sold its leasehold interest in the CIS Tower, Miller Street to Castlebrook Investments in June 2017 and subsequently paid the Group a dividend of £33m representing its 50% share of the net proceeds. On 22 December the Group completed the sale of its stake in NOMA to Hermes Real Estate.

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 163 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. See also General accounting policies section (page 164) for further details on accounting dates.
iii) All transactions between entities are in the usual course of business and are at arms length.

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. 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.

	2017 £m	2016 £m
Non-current		
Investment securities	**234**	237
Current		
Cash	**394**	297
Investment securities	**45**	35
	439	332
Reclaim fund assets	**673**	569
Non-current		
Provision for reclaims of dormant account balances	**374**	342
Provision for future distributions to Big Lottery Fund	**72**	153
	446	495
Current		
Trade and other payables	**153**	1
Reclaim Fund liabilities	**599**	496

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.

£153m has been approved for distribution to Big Lottery Fund and is available for immediate distribution. It is therefore included within trade and other payables rather than provisions. No amount had been approved for distribution as of the balance sheet date in 2016.

Although the dormant account balances are repayable on demand, the provision is expected to be utilised over a very long time period. Therefore the amount has been included within non-current liabilities.

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.

31. Membership and community reward

In plain English – what does this note show?

This note shows the number of active members that the Group has at the end of the period as well as the benefits earned by those members for themselves and their communities during the period. Active members are defined as those members that have traded with one or more of the Group's businesses within the last 12 months.

	2017 (unaudited) m	2016 (unaudited) m
Members		
Active Members	**4.6**	4.0

	2017 £m	2016 £m
Membership and community rewards (within income statement)		
Member reward (5%) earned	**61**	16
Community reward (1%) earned	**13**	3
Carrier bag levy donated to charities	**9**	10
Other donations	**3**	2
Total reward	**86**	31

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, and the trading locations of all stores and branches can be located on our website **https://finder.coop.co.uk/food**.

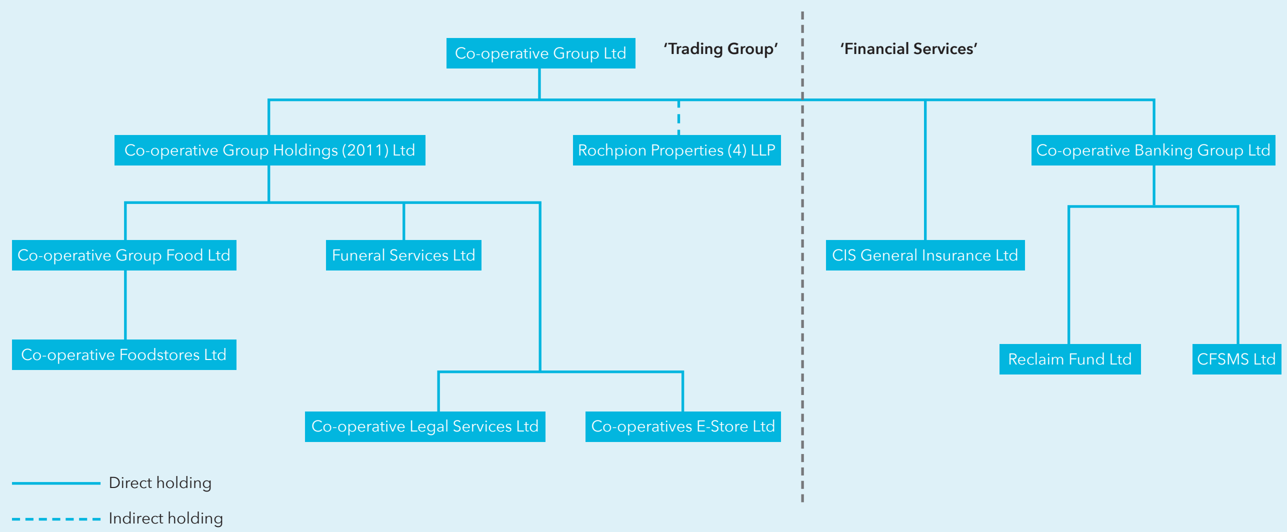
Basis of preparation
The Group accounts have been prepared in accordance with the Co-operative and Communities Benefit Act 2014 and applicable International Financial Reporting Standards as endorsed by the EU (IFRS) for the 53 week period ended 6 January 2018. As permitted by statute, a separate set 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). This distinction is made as the Trading Group, CISGIL and the rest of Financial Services are separately funded.

Accounting dates
The Group and the Trading Group subsidiaries prepare their accounts for the first Saturday of January unless 31 December is a Saturday. These financial statements are therefore prepared for the 53 weeks ended 6 January 2018. Comparative information is presented for the 52 weeks ended 31 December 2016. Since the financial periods are virtually co-terminous with the calendar years, the current period figures are headed 2017 and the comparative figures are headed 2016. The comparative amounts are not entirely comparable with the results of 2017, which are based on a longer period.

The Financial Services subsidiaries of the Group have prepared accounts for the period ended 31 December 2017. This differs from the parent of the Group and other Trading Group subsidiaries. For the period ending 6 January 2018, there are no significant transactions or events which need to be adjusted for to reflect the difference in reporting dates.

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 operating profit. In calculating this non-GAAP measure, property and business disposals (including individual store impairments), the change in value of investment properties, one-off costs 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)
- Non-current asset impairment (Notes 10 & 11)
- Pensions (Note 23)
- Provisions (Note 19)
- General Insurance claims and reserves (Notes 12 & 24)

General accounting policies continued

The Group has applied all endorsed IFRSs that are effective on a European basis for the Group's financial statements for the period ended 6 January 2018 and the comparative period.

Restatements
The comparative figures presented within these financial statements for the financial year ended 31 December 2016 are consistent with the 2016 annual report with the exception of the restatements noted below:

- pension assets on the balance sheet have been restated in the prior year by an increase of £39m. Retained earnings have been restated by an increase of £32m (net of £7m deferred tax) to reflect this adjustment. 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 £3.2bn and a net pension surplus of £1.7bn in the prior year to warrant a third balance sheet as required under IAS 1.

- insurance contracts in the balance sheet have been restated to reclassify £197m of insurance contract liabilities from non-current to current liabilities. This restatement is not considered material enough in the context of total current liabilities of £2.1bn and non-current liabilities of £3.9bn to warrant a third balance sheet under IAS 1.

- the result of the Group's Legal services business is now reported within Funeral and Life Planning (in the segmental analysis) whereas previously it was reported within Other Businesses. This is to be consistent with a change in the way information is reported to the Group Board.

- deferred income recognised on the disposal in 2011 of 70% of the Group's interest in Travel is now shown within profits / (losses) from property and business disposals in the segmental analysis (note 1 of the accounts) whereas previously it was shown within underlying operating profit (within Other businesses). As a result of this change underlying segment operating profit has decreased by £7m (FY 2016) and profit on property and business disposals has increased correspondingly. The change helps to facilitate a more meaningful comparison of underlying operating profit.

New and amended standards adopted by the Group
The Group has applied the following standards and amendments for the first time for their annual reporting period commencing 1 January 2017:

- IAS 12 (amendments) – regarding the recognition of deferred tax assets for unrealised losses;

- IAS 7 (amendments) – to the disclosure initiative; and

- IFRS 12 (amendments) – annual improvements to IFRS Standards 2014-2016 Cycle.

The adoption of these amendments did not have a material impact upon the Group's accounts.

Standards, amendments and interpretations issued but not yet effective
Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2017 reporting periods and 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 40 (amendments) – to clarify transfers of property to, or from, investment property; *

- IFRS 1 and IAS 28 (amendments) – annual improvements to IFRSs 2014 – 2016 Cycle - various standards; *

- IFRIC 22 – Foreign currency transactions and advance consideration and *

- IFRIC 23 – Uncertainty over Income tax treatments. **

** Effective 1 January 2018. ** Effective 1 January 2019.*

General accounting policies continued

The adoption of the following standards will or may have a material impact on the Group's accounts when adopted and the Group's assessment of the impact of these new standards and interpretations is set out below.

Title	IFRS 15 Revenue from Contracts with Customers
Nature of the change	IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue can be recognised. The new standard replaces existing revenue recognition guidance including IAS 18 (Revenue), IAS 11 (Construction Contracts) and IFRIC 13 (Customer Loyalty programmes). The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer. The standard permits either a full retrospective or a modified retrospective approach for the adoption. The standard sets out criteria for deciding when and whether revenue can be recognised and of particular relevance to Co-op, whether a "performance obligation" has been delivered. IFRS 15 defines performance obligations as a "promise to provide a *distinct good or service* or a series of distinct goods or services".
Impact	Management has assessed the effects of applying the new standard on the Group's financial statements and has identified the following areas that will be affected: **Funerals:** Funeralcare sells funeral plans that allow an individual to arrange and pre-pay their funeral. Under the current IAS 18 standard, Funeralcare recognises an amount of revenue at the time a funeral plan is sold that is equivalent to the costs incurred in selling the plan. The balance of income is then recognised when the funeral is conducted. This approach will change with effect from 7 January 2018 under IFRS 15 which states that revenue should be recognised in respect of separable "performance obligations" delivered to the customer. Upon analysis of the standard, it has been concluded that the only separable performance obligation is the funeral itself and therefore revenue can only be recognised at the date the plan is redeemed and the funeral is performed. The new standard also requires that certain costs associated with delivering a funeral plan to the customer are deferred until the funeral is delivered. This cost deferment only applies to incremental or fulfilment costs i.e. costs directly relating to the plan sale that would otherwise not have been incurred. These costs will be charged to the income statement when the funeral plans are redeemed at the same time as revenue is recognised. After restatement, the impact of the new standard on the year ending 6 January 2018 is a reduction in revenue of c. £22m and a reduction in profit before tax of c. £21m.This is because the number of new plans being sold is much higher than the amount of plans being redeemed. As the redemptions on these plans grows relative to plan sales in the future, the impact on profit will reverse. Trading cash flows are unaffected by this change. The prior year adjustment will mean that at 6 January 2018 the deferred funeral plan income liability will increase by c. £107m as if no income had ever been recognised at the point of funeral plan sales. This income will now be recognised when the funeral is performed. Similarly, the deferred funeral plan cost asset will increase by c. £17m to reflect incremental costs incurred on existing plans deferred until redemption or cancellation of the plan. In aggregate, there will be an estimated reduction in retained earnings of c. £90m. **Retail:** There is no material profit impact for Retail since the vast majority of sales relate to upfront consideration for the immediate transfer of goods and as such the delivery of the performance obligation is very clear. IFRS 15 will require the Group to show some income that is currently netted within costs as a reduction in revenue. This primarily relates to rebates paid to FRTS members that are currently recognised as a cost of sale but which under IFRS 15 will be treated as a reduction in revenue (estimated £200m reduction in revenue within Federal sales).

General accounting policies continued

Title	IFRS 15 Revenue from Contracts with Customers
	Other businesses: Insurance is subject to its own accounting changes when IFRS 17 is effective in 2021 and the vast majority of its business is out of scope for IFRS 15 and so will be unaffected by the new standard. There will be a change to personal injury revenue recognition in Legal Services where the new standard will see an earlier recognition of revenue than currently but this will not be material to the Group. **Member rewards and dividends:** Member rewards (the 5%) is currently treated as a reduction in revenue in line with IFRIC 13 (Customer Loyalty Programmes) and this treatment will not be affected by the introduction of the new standard.
Date of adoption by the Group	Mandatory for financial years commencing on or after 1 January 2018. The Group intends to adopt the standard using the fully retrospective approach which means that the comparative figures will be restated to reflect the cumulative impact of the adoption.

Title	IFRS 16 Leases
Nature of the change	IFRS 16 was issued in January 2016. It will result in almost all leases being recognised on the balance sheet, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exceptions are short-term and low-value leases.
Impact	Management has undertaken an initial assessment of the expected impact of applying the new standard on the Group's financial statements. Further detailed assessment work is required to determine the actual impact upon the Group's accounts and that impact will also be dependent upon future economic conditions, including calculating incremental borrowing rates, the make-up of the Group's lease portfolio at that date, the Group's assessment as to whether it will exercise any lease renewal or break options and the extent to which the Group chooses to use practical expedients and recognition exemptions at the time of adoption. However it is clear at this stage that the most material impact of the new standard will be that approximately 3,000 property leases asset and liabilities will need to be brought on balance sheet and the Group's initial assessment of the impact of this is noted below: Property leases: *(indicative numbers rounded to nearest £100m, based on using the modified retrospective transition option with practical expedients)* **Balance Sheet:** — **£m** Right of use asset — 900 Lease liability — (1,300) **Change in reserves** — **(400)** The impact on profit before tax is estimated as a £40m net reduction in 2019. **Non-property leases:** The Group has started assessing what other contractual commitments could contain leases in scope for IFRS 16. These could include vehicles, equipment, IT systems and anything else where the Group is paying to use and benefit from an underlying asset as part of a contractual arrangement. Based on the current business set up, most equipment is bought by the Group rather than rented and therefore the impact in this area is expected to be minimal.
Date of adoption by the Group	Mandatory for financial years commencing on or after 1 January 2019. The Group currently intends to adopt the standard using transition option 2a which means measuring the right of use assets as if IFRS 16 had always been applied, but discounting at an incremental borrowing rate at the date of transition. This approach will be confirmed during 2018.

General accounting policies continued

Title	IFRS 9 Financial Instruments
Nature of the change	IFRS 9 addresses the classification, measurement and de-recognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets.
Impact	Most of the changes to IFRS 9 are not relevant to the Group. However, there are a couple of changes that may impact the Group in future periods: **Fair value election:** The Group currently fair values its Eurobond debt and under IFRS 9 there is an option to reset the accounting treatment such that these liabilities could be carried at amortised cost. This would remove the requirement to fair value the debt each year. Management are considering if this would be an appropriate election to make as the requirement to mark to market (fair value) the Group's swaps would remain. **Bad debts:** IFRS 9 also requires an entity to move to an "expected credit losses model" for bad debt. It will change the way we account for bad debt but is not expected to be material.
Date of adoption by the Group	Mandatory for financial years commencing on or after 1 January 2019.

Title	IFRS 17 Insurance Contracts
Nature of the change	IFRS 17 requires insurance liabilities to be measured at a current fulfilment value and provides a more uniform measurement and presentation approach for all insurance contracts. These requirements are designed to achieve the goal of a consistent, principle-based accounting for insurance contracts. IFRS 17 supersedes IFRS 4 Insurance Contracts.
Impact	The standard will be effective for annual periods beginning on or after 1 January 2021 and management are currently assessing the impact of the new standard upon the Group's Insurance business.
Date of adoption by the Group	Applicable to annual reporting periods beginning on or after 1 January 2021. Not yet endorsed for use in the EU.

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 14). 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.

General accounting policies continued

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.

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.

Independent auditor's report to the members of Co-operative Group Limited

Opinion

In our opinion:

- Co-operative Group Limited's financial statements (the "financial statements") give a true and fair view of the state of the Group's affairs as at 6 January 2018 and of the Group's profit for the 53-week period then ended;

- The Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;

- The Group financial statements comply with the Co-operative and Community Benefit Societies Act 2014.

We have audited the financial statements of Co-operative Group Limited which comprise:

Group
Consolidated income statement for the 53-week period ended 6 January 2018
Consolidated statement of comprehensive income for the 53-week period ended 6 January 2018
Consolidated balance sheet as at 6 January 2018
Consolidated statement of changes in equity for the 53-week period ended 6 January 2018
Consolidated statement of cash flows for the 53-week period ended 6 January 2018
Related notes 1 to 31 to the financial statements, including the summary of general accounting policies

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.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

This report is made solely to the Society, in accordance with Section 87 of the Co-operative and Community Benefit Societies Act 2014. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs(UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 33 to 36 that describe the principal risks and explain how they are being managed or mitigated;

- the directors' confirmation set out on page 84 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 directors' statement set out on page 168 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 set out on page 84 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 disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Revenue recognition – cut-off (Group) • Supplier income (Food) • Impairment of Property, Plant and Equipment and Goodwill (Food, Estates, Funeralcare) • Valuation and completeness of Insurance Contract Liabilities (Insurance)
Audit scope	• We performed an audit of the complete financial information of Food, Funeralcare and Insurance components and audit procedures on specific balances for a further five components, Estates, Corporate, Co-operative Banking Group, the Reclaim Fund and CFSMS. Further to this, we performed alternative procedures on the Electrical and Legal components. • The components where we performed full or specific audit procedures accounted for 100% of Profit before tax, 99% of Revenue and 100% of Total assets.
Materiality	• Overall group materiality of £40m which represents 0.5% of Adjusted Revenue.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Risk and Audit Committee
Revenue recognition – cut off (2017: £9,470m; 2016: £9,472m) 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 material Group revenue streams. Our testing has focused upon the following judgemental areas where there is an opportunity to materially overstate revenue: **Funeralcare: At Need Revenue** • Revenue is recognised when the funeral service is delivered. There is a risk that revenue is overstated through management recording manual top-side journals into revenue which are not supported by underlying invoices in order to manipulate results. **Insurance: Earned Premiums** • Revenue recognised is related to the premium earnings pattern. There is the risk that revenue is recognised incorrectly either through erroneous gross premium or inappropriate earnings patterns being applied to the premium recognised resulting in overstated revenue recognition. There is a risk that revenue is overstated through management recording manual top-side journals into revenue rather than through core underwriting systems in order to manipulate results. **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. Management may record fictitious revenue transactions or manipulate the recorded revenue results from stores through adjustment to the "non-polled" store data at yearend. **Refer to the Audit Committee Report (page 57); Accounting Policies (page 104); and note 2 of the Consolidated Financial Statements (page 104)**	**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 including review of revenue recorded compared to expectation/ periodic averages and reconciliation to journals posted • We performed detailed cut-off testing of revenue transactions during the period either side of the Balance Sheet date with reference to delivery documentation and we also tested 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 or IFRS 4: Insurance contracts • 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 were appropriately recorded in the general ledger. **Funeralcare: At Need Revenue** • We tested manual revenue journals to address the risk of fraud in revenue recognition based on our audit strategy. We have evaluated all manual journals posted to revenue during the year and performed substantive testing as appropriate **Insurance: Earned Premiums** • We obtained an understanding of the process by which premium is recognised for the various distribution channels and the data flows from inception through to the financial statements • We performed detailed substantive testing on a sample basis to validate the gross written premium data, checking key data points such as financial amount, inception date, class of business as such policy terms are key for financial reporting • We obtained and tested the reconciliations of gross written premium data from underwriting system to general ledger and corroborated reconciling items • We tested the pipeline premium model • We performed an independent recalculation of the Unearned Premium Reserve balance thus seeking to validate the earned premium for the year ended 31 December 2017 • We obtained management's paper on the premiums earned in the six days between statutory (31 December 2017) and group period end (6 January 2018); and corroborated the principal assumptions based on actual performance • We performed detailed substantive testing of manual journals on a sample basis to determine the commercial purpose via review of support for the journals in question. **Food** • We tested journals submitted on the week following the reporting date and aggregated these to a store level • We tested in detail the manual journal relating to "non-polled" stores to ensure no duplication of stores within the population or unusual amounts of revenue recognised • 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 We performed full and specific scope audit procedures over this risk area, which covered 99% of the risk amount. We also performed specified procedures over the Electrical component, which covered 1% of the risk amount.	Revenue has been recognised appropriately in the 53-week period ended 6 January 2018

Supplier Income (2017: £628m, 2016: £671m) 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 2017 was £628m (2016: £671m). 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 overstate the balance of supplier income recognised. There is also a risk that supplier income earned jointly with other independent societies through the Member buying group is not allocated and accounted for appropriately. **Refer to the Accounting Policies (page 107); and note 4 of the Consolidated Financial Statements (page 106)**	• 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 process for recording the three different arrangement types. We were able to take a controls reliance approach in respect of Long Term Agreements • We performed analytical review procedures to understand unusual movements in income statement and balance sheet accounts period on period, including ageing analysis. We 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. 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. 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. • We have also verified management's allocation of supplier income earned jointly with other independent societies through the Member buying group has been applied appropriately. We performed full and specific scope audit procedures over this risk area in the Food component, which covered 100% of the risk amount.	Supplier arrangement amounts are appropriately recognised in the Income Statement and Balance Sheet and the disclosures included are appropriate.

Impairment of Property Plant and Equipment and Goodwill (2017: Goodwill: £830m, PPE: £2,014m, 2016 Goodwill: £838m, PPE: £1,943m)
 	
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 goodwill balances annually for impairment. PPE is required to be assessed when indicators of impairment are identified, with a particular focus on loss making stores when considering PPE impairment. We recognise the risk around goodwill impairment extends to all stores, as they could be profitable but not sufficiently profitable to exceed the total goodwill value. At the year-end Management recognised an impairment of £3m
 	
We have identified a significant risk in relation to the impairment of PPE and goodwill due to the sensitivity of the impairment assessment and models 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 56); Accounting Policies (pages 116 and 119); and notes 10 and 11 of the Consolidated Financial Statements (pages 114 and 117)
	• 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 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.
	• We benchmarked the discount rate calculation applied, using our internal valuation experts to assist in our testing 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 confirmed that the disclosure in the financial statements is in line with the requirements of IAS 36: Impairment of assets
	• We have gained an understanding of the process management undertake when establishing, reviewing, challenging and approving the budget and have walked through the design and implementation of controls
	• We evaluated and challenged the composition of the cash flow projections, and the process by which they were drawn up. We checked management's ability to accurately forecast by comparing historical forecasts to actual results, and challenges significant or unexpected variances
	
	We performed full and specific scope audit procedures over this risk area across food, estates and funerals, which covered 98% of the risk amount.
		We have concluded that the impairment charge has been appropriately calculated and the carrying value of PPE and Goodwill is supported by the impairment models.

Valuation and completeness of Insurance contract liabilities (2017: £750m, 2016: £724m) The Group's balance sheet includes significant insurance liabilities in relation to the Insurance division. The gross liability recognised on the Balance Sheet as at 6 January 2018 was £750m (2016: £724m) The setting of insurance contract liabilities is inherently uncertain and has a material impact on the reported results. The subjectivity in setting the Best Estimate on both a gross and net basis and the recognition of a margin makes the liabilities susceptible to the risk of management over-ride. In addition to the subjectivity in the projections themselves, management carries a margin intended to bring the reserves to within the Board risk appetite of a 70-80% confidence level. The adopted reserve is highly judgemental as the margin is held to recognise liabilities and uncertainties that have not manifest through the available data. **Refer to the Audit Committee Report (page 57); Accounting Policies (page 143); and note 24 of the Consolidated Financial Statements (page 141)**	Supported by our actuarial specialists, and using management's own data, we independently projected, on both a gross and net basis, the best estimate and a range of reasonable estimates. We investigated significant differences between our projections and management's best estimate at each reserving class. In addition we challenged the level of margin held compared to market practice, prior periods and in the context of the areas of uncertainty for which the margin is held. We also tested, on a sample basis, that the reinsurance recoveries were recorded in line with the underlying contract terms.	We concluded that the data used for the purposes of the actuarial projections was consistent with the underlying policy records. Taken as a whole we consider the judgments applied in setting the best estimate reserves to be reasonable. We consider the booked reserves (i.e. the best estimate plus margin) to lie within a range of reasonable estimates on both a gross of reinsurance and a net of reinsurance basis. Management's adopted reserve including the reserving margin, both gross and net, sits within our view of a reasonable range.

An overview of the scope of our audit

We completed our first statutory audit last year for the 52 week period ended 31 December 2016. Based on our findings from that audit, our accumulated knowledge, and based on subsequent discussions with the Risk and Audit Committee, we are satisfied that inventory valuation, the completeness and valuation of provisions and the valuation of pension scheme assets and liabilities no longer represent key audit matters and we have revised our risk assessment accordingly.

We also have removed the carrying value of the investment in the Co-operative Bank as a key audit matter compared to the prior year, following disposal of the entire investment during 2017.

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 and Insurance components, which represent the principal business units within the Group based on their size and risk profile. For the Corporate, Estates, Reclaim Fund, Co-operative Banking Group and CSFMS, 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. Further to this, we performed other alternative procedures on the Electrical and Legal components.

The reporting components where we performed audit procedures accounted for 100% (2016: 100%) of the Group's Revenue and 100% (2016: 100%) of the Group's Total assets. We note that one of the components in scope is a central cost centre which significantly distorts the profit before tax measure and as such, gross profit has been considered to represent a more meaningful profit measure to demonstrate coverage.

For the current year, the full scope components contributed 99% (2016: 99%) of the Group's Revenue and 55% (2016: 59%) of the Group's Total assets. The specific scope component contributed 0% (2016: 0%) of the Group's Revenue and 45% (2016: 41%) 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.

Of the remaining two components that together represent 1% of the Group's Revenue, none are individually greater than 1% of the Group's Revenue. For these components, we performed other procedures, including detailed analytical review to respond to any potential risks of material misstatement to the Group financial statements.

Changes from the prior year

We completed our first statutory audit last year for the 52 week period ended 31 December 2016. Based on the findings of that audit, and accumulated knowledge, and subsequent discussions with the Risk and Audit Committee, we revised our scoping to reduce the Reclaim Fund (included within Corporate) from Full scope to Specific scope.

We note CLS and Electrical have reduced from Specific scope to Review scope given the relative significance of their revenues and assets in this financial period.

The Co-operative Bank is no longer deemed a significant component given the Group has disposed of its investment during 2017.

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 auditors under our instruction. Of the three full scope components, audit procedures were performed by component teams, except for certain central balances audited directly by the primary audit team. Of the five specific scope components, the audit of three components was performed by the primary audit team. For the two specific scope components, where the work was performed by component auditors, we determined the appropriate level of involvement 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.

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 determined materiality for the Group to be £40m (2016: £40m), which is 0.5% (2016: 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.

Starting basis	• Starting point - £9,470m total Revenue
Adjustments	• Remove £1,683m of income generated by Federal joint buying group • Add back £151m of disbursement income presented net within operating expenses
Materiality	• Totals £7,938m • Materiality of £40m (0.5% of adjusted Revenue)

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% (2016: 50%) of our planning materiality, namely £20m (2016: £20m). We have set performance materiality at this percentage due to the number of audit adjustments identified in the prior year.

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 (2016: £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 (2016: £2m), which is set at 5% (2016: 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.

Other information

The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Matters on which we are required to report by exception

Under the Co-operative and Community Benefit Societies Act 2014 we are required to report to you, if in our opinion:
- the Society has not kept proper books of account; or
- the Society has not maintained a satisfactory system of control over its transactions; or
- the financial statements are not in agreement with the Society's books of account; or
- we have not received all the information and explanations we require for our audit.

The directors have instructed us to review their Corporate Governance Statement on page 45 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 nothing to report in this regard.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 87, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Alistair Denton (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Manchester

5 April 2018

Notes:

1. The maintenance and integrity of the Co-operative Group Limited web site 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. Owing 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.

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've performed a service, but haven't billed the customer, we'll 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's 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 hasn't 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've spent money already building them, but they aren't ready yet so we're 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 low risk investments. It doesn't sound like they're available for sale, but that's 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's 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've 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've paid in the year plus any change in our estimate of future claims we may have to pay.

Jargon buster continued

Claims paid	This is the amount of insurance claims we've paid out in the year.
Claims reported	This is the amount on our balance sheet where we know what the claim is and how much is going to be paid out.
Commitments	This is an amount where we've committed to a certain spend (e.g. building projects), but we haven't put the amount on the **balance sheet** as we're 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's only possible, rather than probable, that we'll have to pay the amount, then we won't 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 is expected to last for less than a year.
Current tax	This is the amount we expect to pay in tax for the year based on the profits we make.
Debenture	This is a loan that we've 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'll be paying to a seller for businesses we've bought or an amount we'll be getting from 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 they are for tax purposes. The tax on the difference in value is called deferred tax and can be an **asset** or **liability** depending on whether the value is greater in the **balance sheet** or for tax purposes.

Jargon buster continued

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 high-quality 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 the **asset** evenly over years in the **income statement**.
Derivatives	These are financial products where the 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 the amount that we're **discounting** is going to be worth more as we get nearer to paying or receiving it. We have to put that increase in value (the discount unwind) 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 cash we pay or receive in the future is going to be worth less than it is 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.
Free 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.

Jargon buster continued

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.
Fuel	Refers to fuel sales generated from our petrol forecourts.
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 more than what its **assets** less **liabilities** are worth. This additional amount we pay 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've 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're trying to sell. The cost of this is shown on our **balance sheet**.

Jargon buster continued

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'll 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's a listed debt security.
Member payments	This is an amount we've paid our members in the year and approved at the AGM such as dividends.
Member rewards	These are the benefits that members have earned for themselves and their communities during the year as part of the 5% membership offer.
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 is expected to last for more than 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 make a **provision** for the amount of the rental payments we will have to pay in future and hold this 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 its sales and profit is disclosed in note 1.

Jargon buster continued

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**.
Payables	A **liability**.
PAYE	Pay As You Earn. A tax which is paid on wages.
Pension interest	This is the interest that we're 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 in today's money.
Provision for unearned premiums	When we sell an insurance policy, some of the premium we receive may not relate to the current financial year if the insurance cover goes beyond the end of the year. We have to put any amounts which relate to later years on the **balance sheet** as a **liability**.
Provisions	This is a **liability**, but one in which we're unsure what the final amount 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 so that we can manage the level of risk we face in case a major 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**.
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 word for a loan.

Jargon buster continued

Reserves	This is a collective word for **equity**, but excludes **share capital**.
Restated	Sometimes we change the numbers that we showed in last year's accounts. This might be because we have changed where or how we record certain things or it could be that we have corrected an error. There are strict rules around what can be changed and when we do we explain why in the accounting policies.
Retained earnings	This is all the profits we've 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 planned **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 can't 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 our agreements with suppliers mean they will give us money back based on the amount of their products we buy and sell.
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	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	2017 (i)	2016*	2015	2014	2013
Revenue					
Food	7,054	7,064	6,958	7,041	7,193
Funerals & Life Planning*	343	329	317	295	310
Insurance	331	439	343	371	476
Federal	1,683	1,573	1,504	1,503	1,479
Other	59	67	79	81	66
Total revenue	**9,470**	**9,472**	**9,201**	**9,291**	**9,524**
Underlying profit before tax					
Food	182	182	186	181	186
Funerals & Life Planning*	66	71	69	52	44
Insurance	11	11	(13)	(1)	36
Other	(121)	(138)	(78)	(54)	(106)
Underlying segment operating profit	138	126	164	178	160
Underlying interest	(73)	(74)	(83)	(113)	(100)
Underlying profit before tax	**65**	**52**	**81**	**65**	**60**
EBITDA (ii)					
Underlying segment operating profit (above)	138	126	164	178	160
Depreciation	256	246	256	257	259
Amortisation	8	5	7	9	-
Underlying segment EBITDA (ii)	**402**	**377**	**427**	**444**	**419**
Other performance items					
Dividend	-	-	-	-	(55)
5% Member reward	(61)	(16)	-	-	-
1% Community reward	(13)	(3)	-	-	-
Profit / (loss) after tax	70	(134)	15	216	(2,301)
Trading Group ROCE (ii)	6.2%	6.5%	9.5%	9.7%	6.6%
Balance sheet items					
Total assets	9,169	9,225	8,729	8,485	8,623
Group net debt	(775)	(885)	(692)	(808)	(1,400)
Total equity	3,088	3,241	2,937	2,865	2,037
Net debt : EBITDA ratio	1.93	2.35	1.62	1.80	3.27
Total pension assets	10,538	12,879	10,799	10,921	9,665
Total pension liabilities	(8,985)	(11,152)	(9,669)	(9,932)	(9,465)
Total net surplus	1,553	1,727	1,130	989	200
Business-specific measures					
Total Food like-for-like sales increase	3.4%	3.5%	1.6%	0.4%	-0.2%
Number of Food stores	2,532	2,774	2,803	2,796	2,779
Total Food sales area ('000 sq ft) (iii)	8,307	8,797	9,185	9,606	9,916
Number of at need Funerals sold	99,925	97,607	97,147	92,058	98,241
Number of pre need Funerals sold	68,969	58,999	34,904	27,771	29,288
Number of Funeral homes	1,079	1,026	986	961	926
Number of insurance policies in force ('000s)	1,355	1,416	1,426	1,294	1,463

(i) 53 week year

(ii) See Jargon buster on page 184 for definition

(iii) Quoted excluding Fuel gross area

*See page 165 for details of the restatements.

Co-operative Group Limited
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Registered number: 525R

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