

# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF DAIRY CREST GROUP plc

## Opinion on financial statements

### In our opinion:

- The financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 March 2015 and of the Group's profit for the year then ended;
- The Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- The Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, article 4 of the IAS Regulation.

### What we have audited

We have audited the financial statements of Dairy Crest Group plc for the year ended 31 March 2015 which comprise:

Consolidated income statement
Consolidated statement of comprehensive income
Consolidated and Parent Company balance sheets
Consolidated statement of changes in equity
Parent Company statement of changes in equity
Consolidated and Parent Company statement of cash flows
Related notes 1 to 34

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, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

## Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement as set out on page 66, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

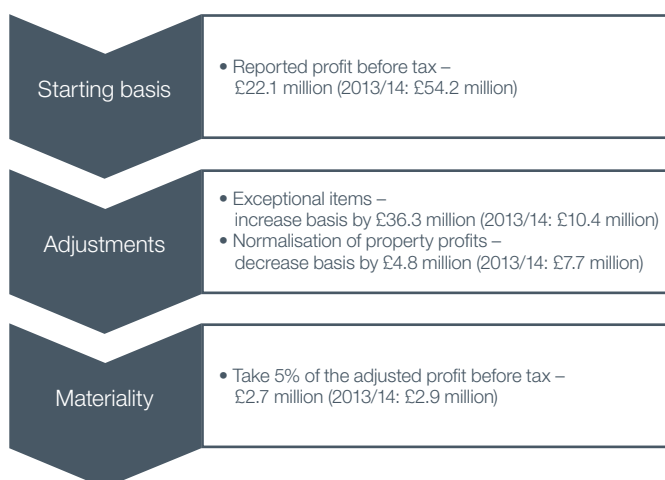
## Our application of materiality

Materiality is a key part of planning and executing our audit strategy. For the purposes of determining whether the financial statements are free from material misstatement, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. As we develop our audit strategy, we determine materiality at the overall financial statement level and at the individual account level. Performance materiality is the application of materiality at the individual account level.

Planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated, and leaves no margin for possible undetected misstatements.

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

We determined materiality for the Group at our planning stage to be £2.7 million (2013/14: £2.9 million) which is approximately 5% of profit before exceptional items and tax, normalised for a long-term rate of return from Dairies depot property disposals included within profit on operations given the returns in 2014/15 are above the long-term trend.



# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF DAIRY CREST GROUP plc CONTINUED

This provided a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

On the basis of our risk assessment, together with our assessment of the Group's overall control environment, our judgment was that overall performance materiality (i.e. our tolerance for misstatement in an individual account or balance) for the Group should be 75% (2013/14: 75%) of materiality, namely £2.0 million (2013/14: £2.2 million). Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in all accounts did not exceed our materiality level.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £135,000 (2013/14: £150,000), 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 the light of other relevant qualitative considerations.

## **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of; whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report 2015 ('AR') to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## **The scope of our audit**

Following our assessment of the risk of material misstatement to the Group financial statements, we performed full scope audit procedures on Dairy Crest Limited, a statutory entity that represents the principal trading business within the Group and which represents 94% of Group revenue and greater than 100% of Group profit before tax, reflecting that the net contribution of the remaining components is a loss. Specific audit procedures were performed on an additional statutory entity. The audit procedures at a specific scope component may not include testing of all significant accounts of the entity but accounts subject to audit procedure contribute to the coverage of significant accounts tested for the Group. For the remaining components not subject to full or specific scope audits, we performed other procedures to test or assess that there were no significant risks of material misstatement in these components in relation to the Group financial statements.

All audit work performed for the purposes of the audit was undertaken by the Group audit team.

## **Our assessment of risks of material misstatement and responses to those risks**

We identified the following risks of material misstatement 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 together with our audit response to those risks:

Area of focus	Response	Cross Reference to AR page/note
<p><b>Accounting for promotional accruals, including the impact of revenue recognition</b></p> <p>Revenue of £1,329.8 million is recognised net of rebates and discounts, which comprise promotional expenses in relation to agreed promotional activity and funding with customers. We focused on this area given the significance of revenue to the financial statements and the subjectivity in determining appropriate redemption rates on certain types of promotional activity on which to determine related accruals at the reporting date. In addition, reassessment of redemption rates can lead to changes to existing accruals impacting the income statement.</p> <p>Risks include:</p> <ul style="list-style-type: none"> <li>Promotional expenses are recorded in the wrong financial year</li> <li>The methodology to assess the redemption rates applied in calculating the level of promotional accruals at 31 March 2015 is inappropriate</li> <li>Redemption rates do not reflect ongoing changes in both consumer behaviour and the nature of promotional arrangements.</li> </ul>	<ul style="list-style-type: none"> <li>We undertook transaction testing to verify that revenue has been calculated in accordance with contractual terms and in accordance with the Group's revenue recognition policy and included cut-off testing procedures to verify that revenue has been recognised in the correct accounting period.</li> <li>Where revenue was recorded through journal entries outside of normal business processes, we performed testing on a sample of journals to establish whether a sale had occurred in the financial year to support the revenue recognised.</li> <li>We evaluated the design of controls in relation to the authorisation of promotional activity and the determination of year end promotional accruals.</li> <li>We challenged and evaluated the appropriateness of management's key assumptions in determining redemption rates, including management's re-assessment of redemption rates for the 2014/15 financial year based on observed changes in consumer behaviour in relation to promotional offerings and the Group's experience of payments made against accruals on a three year rolling basis.</li> <li>We have assessed both the timeframe for retaining unclaimed promotional accruals on the Group's balance sheet and the consistency in the application of the Group's policy between reporting periods. Specifically in 2014/15, we evaluated the impact on the Group's policy of the voluntary commitments reached by the Groceries Code Adjudicator with eight large retailers to time limit forensic audits in supplier's trading accounts.</li> <li>In assessing changes in key estimates and the Group's policy, we evaluated both the methodologies and rationale applied in determining changes in approach from prior periods for risk of management override.</li> <li>We tested subsequent invoices and cash paid after the balance sheet date to detect any unrecorded liabilities in promotional accruals and re-evaluated the approach to determining accrual amounts at year end.</li> </ul>	<p>Refer to: Audit Committee Report (pages 40 to 42); and Accounting Policies (pages 77 to 82)</p>
<p><b>Assessing the carrying value of non-current assets</b></p> <p>The Group has non-current assets of £443.6 million (2014: £400.3 million), including £74.3 million (2014: £74.3 million) of goodwill at 31 March 2015. We focused on this area given the number of assumptions required in performing impairment reviews.</p> <p>Risks include:</p> <ul style="list-style-type: none"> <li>Inaccurate models are used to calculate the value in use of cash generating units</li> <li>The assumptions to support goodwill carrying values (e.g. discount rates and growth rates) are inappropriate</li> <li>In the case of the Dairies cash generating unit ("CGU"), where all goodwill was written off in 2011/12, relatively minor changes in key assumptions could lead to the impairment of the intangible assets and property, plant and equipment of that CGU.</li> </ul>	<ul style="list-style-type: none"> <li>In light of the conditional disposal of the Dairies operation, we challenged management on the appropriateness of the updated basis for preparing the value in use impairment calculation under the requirements of IAS 36, 'Impairment of Assets'.</li> <li>We challenged management's methodology and assumptions used in its impairment model for goodwill, intangible and fixed assets across the Group's four CGUs. Specifically: <ul style="list-style-type: none"> <li>We involved EY valuation specialists to assess the appropriateness of the discount rates applied in the impairment models which included comparison to economic and industry forecasts where appropriate.</li> <li>We obtained corroborative evidence where available and involved an EY real estate valuation specialist in assessing the appropriateness of the methodology underlying the forecast property values and cash inflows.</li> <li>We evaluated that the allocation of central costs was based on an appropriate methodology and at an appropriate level of detail by cost type.</li> <li>We applied professional scepticism in independently stress testing key assumptions in relation to the Dairies CGU, assessing the degree to which assumptions would need to move before impairment would be triggered.</li> </ul> </li> <li>We evaluated the adequacy of the disclosures within the Group financial statements.</li> </ul>	<p>Refer to: Audit Committee Report (pages 40 to 42); Accounting Policies (pages 77 to 82); and Notes 10 and 11 (pages 93 to 94)</p>
<p><b>(New in 2015) Accounting for the conditional disposal of the Dairies operations</b></p> <p>We focused on this area given the conditional sale of the dairies operations to Muller Wiseman (UK and Ireland) and the Group's judgment that the Dairies operations do not meet the criteria to be classified as 'held for sale' in accordance with IFRS 5, 'Non-current assets held for sale and discontinued operations', as at 31 March 2015.</p> <p>The classification of the Dairies operation as 'held for sale', would require that the operations and their results on the income statement be accounted for as discontinued and the assets and liabilities of this disposal group reported as single amounts on separate line items within the consolidated balance sheet. In addition, the impairment review of the Dairies CGU would be based on a Fair Value less Cost to Sell ("FVLCS") basis, rather than recoverable amount (higher of FVLCS and Value in Use basis) and basic earnings per share would exclude the dairies results on the basis that they are discontinued.</p>	<p>In assessing the Group's judgement that the conditional sale of the Dairies operations does not meet the highly probable requirement to be accounted for as 'held for sale' under IFRS 5:</p> <ul style="list-style-type: none"> <li>We evaluated documentation including correspondence with the Competition and Markets Authority ('CMA'), Board minutes and other key internal documentation, and challenged management's judgment on the accounting treatment for the Dairies operations for consistency with the content of these documents.</li> <li>We have met with the Executive Board members individually, and with the Audit Committee to discuss the status of the proposed transaction, the key factors that support their judgment that the proposed transaction does not meet the requirements under IFRS 5 for the Dairies operations to be accounted for as 'held for sale'.</li> <li>We have met with management's external legal advisers, who have engaged a specialist competition lawyer to advise on the transaction. We challenged the external adviser on their assessment of the probability of regulatory clearance with or without remedy, and obtained their assessment of the progress of the CMA review process at the balance sheet date.</li> <li>We have challenged management on the nature and extent of disclosure, including the disclosure of this accounting treatment as a significant judgment in the Accounting policies section of the financial statements. In addition, we have assessed the narrative reporting within the Annual Report and Accounts for consistency with the accounting treatment adopted.</li> </ul>	<p>Refer to: Strategic Report (pages 4 to 31); Audit Committee Report (pages 40 to 42); and Accounting Policies (pages 77 to 82)</p>
<p><b>Classification of items as exceptional</b></p> <p>Dairy Crest Group considers the separate reporting of exceptional items helps to give a better understanding of the underlying operational performance of the Group where items are material and one-off in nature.</p> <p>We have focused on this area as £36.3 million of net costs are classified as exceptional in the current year (2013/14 £10.4 million).</p> <p>Risks include:</p> <ul style="list-style-type: none"> <li>Inappropriate classification of costs as exceptional items</li> <li>Inconsistent treatment of exceptional items from year to year</li> <li>Inappropriate quantification of exceptional items.</li> </ul>	<ul style="list-style-type: none"> <li>We have challenged whether items are recorded in line with the Group's policy for exceptional items and that the policy has been applied consistently with prior years.</li> <li>We have tested a sample of costs classified as exceptional to assess whether the cost has been recorded in the appropriate period.</li> <li>In particular, we challenged the appropriateness of the methodology and rationale supporting the calculation of duplicate running costs in relation to the consolidation of the Group's spreads operations on to one site and the initiation costs in relation to the demineralised whey powder and GOS projects.</li> <li>We have assessed the level of transparency of the disclosures in relation to exceptional items.</li> </ul>	<p>Refer to: Audit Committee Report (pages 40 to 42); Accounting Policies (pages 77 to 82); and Note 4 (pages 87 to 88)</p>

# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF DAIRY CREST GROUP plc CONTINUED

The above risks are the same as in the prior year, unless stated otherwise. In 2014, we also included 'Determination of reportable segments in accordance with IFRS 8, Operating Segments' as a risk given the Group restructuring that had been undertaken in the year. This was fully embedded by 31 March 2014 so has not required the same level of consideration in 2014/15.

## **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion:

- The part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- The information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## **Matters on which we are required to report by exception**

We have nothing to report in respect of the following:

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- Materially inconsistent with the information in the audited financial statements; or
- Apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- Is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- Adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- The Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- Certain disclosures of directors' remuneration specified by law are not made; or
- We have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- The directors' statement, set out on page 63, in relation to going concern; and
- The part of the Corporate Governance Statement relating to the company's compliance with the ten provisions of the UK Corporate Governance Code specified for our review.

**Alison Duncan** (Senior Statutory Auditor)

For and on behalf of Ernst & Young LLP,  
Statutory Auditor  
London

20 May 2015

Notes

1. The maintenance and integrity of the Dairy Crest Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.