

directors' report

to the members

We are pleased to present the Annual Report of the Heart of England Co-operative Society Limited for the 52 Weeks ended 20th January 2007.

general

In spite of the slow down in the economy and the down turn in consumer spending, particularly in the retail sector, we are delighted to report an eleventh successive year of trading profit, which this year was £3.5m.

This equates to 5.0% of net sales, one of the highest trading profit ratios to be achieved in the co-operative movement and it re-affirms our position as one of the top performing retail co-operative societies.

membership

Our membership continues to grow consistently since the introduction of our unique and meaningful Members' Privilege scheme in 2000.

Total Society membership now stands at 179,657 showing an increase of 10,758 new members or 6.4%, with 346 members having left during the year.

The Society continues to actively promote new membership and encourages existing members to re-register. This drive has resulted in the total number of members who have registered for our increasingly popular Members' Privilege scheme rising to 58,170 an increase of 24.5%.

Our Members' Privilege scheme cost a total of £1.3m compared with £1.1m in the previous year, an increase in excess of 18%, demonstrating the genuine and tangible benefits of membership of a successful co-operative business.

financial review

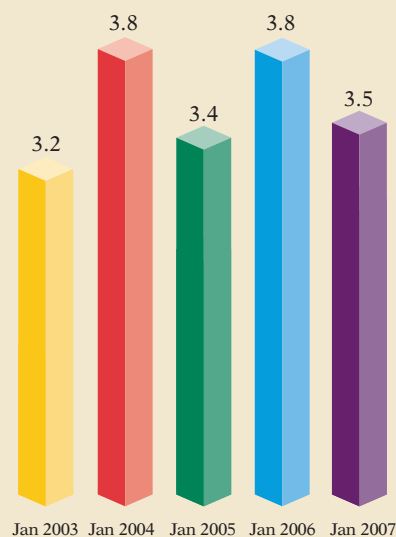
2006 was not expected to be an easy year for the retail sector – and it turned out to be extremely challenging with more 'profit warnings' issued by a number of trading organisations. Despite the challenges, the Society achieved acceptable results in all of its trading divisions, leading to a trading profit of £3.5m. In the current climate the level of trading profit is very satisfactory.

The continued achievement of a trading profit level of 5.0% of net sales represents the attainment of an ambitious objective, which will not only rate highly within the co-operative movement, but will stand comparison with many successful retailers.

Group turnover for the year reached £77.6m, an increase of £2.7m or 3.6% over the previous year on a like-for-like basis, which demonstrates a very satisfactory growth in market share.

The policies put in place in recent years are clearly being successfully implemented and are helping to create an increasingly strong regional co-operative business.

eleventh successive year of trading profit £m



We are delighted to have continued to operate with no borrowings, indeed we are very well placed to continue with our ambitious re-development programme without having to rely on external funding. The Society continues to invest substantial sums in its renewal programme, with a further £1.3m having been utilised on new projects during 2006. This brings our total capital expenditure to more than £9m over the past six years. A number of further projects have already been approved by the Directors, which will involve significant capital expenditure in the coming years.

Our overall reserves have increased by £7.2m, improving the Society's net asset value once again.

The Society's net worth has now reached a new record level of £31m. This shows an increase of 46% over the past five years. This demonstrates the very strong financial position of our Society, which enables us to view the future with optimism despite the difficult trading challenges we face.



Members' calendar, point of sale material and exclusive Member's Privilege card.

supplier payments policy

It is the Society's policy to agree and clearly communicate the supplier payment terms we operate as part of the commercial arrangements negotiated with suppliers and then pay according to those terms based upon the timely receipt of accurate invoices.

Trade creditor days of the Group for the year ended 20th January 2007 were 35 days (2006:33 days). This represents the ratio, expressed in days, between the amounts invoiced to the Society by its suppliers in the year and the amounts due at the year end, to trade creditors within one year.



Stoney Stanton - interior.



Harbury Lateshop - refurbished last year.



Refurbished Stoney Stanton Lateshop.

trading review

food division

There can be no doubt that food retailing continues to be one of the most fiercely contested trading areas, particularly in the convenience sector, which the multiples continue to target for their growth. Our well-established strategy of concentrating on convenience store retailing continues to pay dividends. In the face of this fierce and challenging market place, it is a real credit to our management team and staff who have worked extremely hard. The Division produced an excellent increase in net sales, on a like-for-like basis, which were 6.1% higher than the previous year. Our outstanding sales figures helped us achieve a healthy year of trading profit.

The Society has an active renewal programme for its food stores and during the year our food store at Stoney Stanton was completely refurbished. Customer response has been excellent and significant sales increases have been achieved. A number of our food stores, including the ones we refurbished last year, have also performed extremely well and have recorded double-digit increases in sales.

Improvements have also been made to many of our food stores during the year, including such items as car parking and service yard facilities,



new fixtures, new service counter, new floors, new heating systems, CCTV and alarm upgrades.

We have continued to review and improve our product ranges paying particular attention to our fresh and frozen food and we have also continued to support and extend our Fairtrade products; with around 133 products now in our range.

Your Directors have also authorised a significant sum of capital expenditure for the refurbishment and the extension of our Balsall Common Foodcentre and the work will commence in the spring. We also anticipate further store refurbishments during 2007.

At the financial year end, we had to close our loss making food store in Foleshill. This store had faced stiff competition for a number of years, compounded by the opening of a Tesco extra superstore last year. However, all our staff have been relocated in our other stores with no redundancies.

directors' report

non-food division

We were pleased to confirm the appointment of Bryan Wheatley as the new General Manager of the Non-Food and Travel Division following the retirement of Sue Foster in October. Bryan had worked as Sue's deputy for five years and we wish him well in this challenging role.

Competitive pressure in non-food retailing has never been more severe than in 2006. Our performance has undoubtedly been affected by the growth in internet retailing and the pressure from national retailers increasing their share in this market, as well as the slowdown in retailing due to increases in interest rates during the year.



Ladies fashions - Rooms of Coventry.

Our net sales recorded a decrease of 2.6% on a like-for-like basis. Nevertheless, against the trend of many of our large competitors and despite the introduction of warehouse charges during the year of £123k by the Co-operative Group (CWS), the Non-Food Division achieved a satisfactory trading result.

Sales in this Division have, once again, been supported by a range of exclusive members' events and discounts, which have proved extremely popular. Our last event in early December was tremendously successful and resulted in the Non-Food Division's highest ever recorded week's sales in excess of £1.3m.

The withdrawal by the Co-operative Group (CWS) from non-food retailing put further pressure on independent

societies to decide on what avenues to pursue in terms of their buying arrangements. In May, we decided to join the Associated Independent Stores (AIS) Buying Group, which is one of the largest independent buying groups with an annual turnover in the region of £1.6 billion. AIS procure the majority of our products with the exception of all electrical products. We have already started to see improved terms and margins achieved through AIS. The decision of where to source our electrical products from was a considerably difficult one. A number of different options were considered before we decided to deal direct with all the major electrical suppliers.

A comfort cooling system was installed in our 'Rooms of Coventry' store, which will bring about a much more comfortable environment for our customers and our employees. We also introduced three ladies fashion concessions; Planet, Precise Petit and Windsmoor, all operated by Jacques Vert Group.

In Rugby, the major town centre re-development work will commence shortly and it is anticipated that the new shopping centre will be completed by early 2009.

In Hinckley we are still making further enquires and are awaiting

further details regarding the town centre re-development master scheme.

travel division

Our managed travel business, trading under the 'Travelcare' banner, recorded a modest increase in net sales. However, the growing trend of reductions in commission paid by tour operators and the growth in internet bookings has impacted the level of profits achieved.

funeral division

Although the overall market continues to be in decline, we were able to increase our Funeral Division's net sales by 2.1%, and maintain our market share.

We continue to take steps to raise our standards to the highest possible level, whilst maintaining a competitive pricing policy for our client families.

The solid foundations laid during the preceding six years produced a satisfactory result for the Division.

In March a dedication service was held at the newly re-furbished premises of Gilliver's funeral home in Barlestone, where local people were delighted to see the results of the significant investment that the Society had made in this long established family business.



Gilliver's - Dedication.

During the year we carried out a survey of the Division by writing to our client families. We were able to gauge their views on all aspects of the service provided by our funeral homes. It is very pleasing that over 97% of the respondents thought the overall service provided by our funeral homes was excellent.

Once again, Christmas 2006 saw the memorial Christmas tree initiative repeated in all our funeral homes which was well received by client families.

post office division

The Society operates five Post offices within our Food and Non-Food stores. In the current year the Post offices achieved an increase in turnover of 1.4%.

investing in our people our employees

In recent years we have placed great emphasis on training and development of our employees at all levels throughout the Society, utilising the framework of the Investor in People standard to help support our endeavours. We are committed to realising the potential of every member of staff within our Society.

Following the successful Investor in People re-assessment of our Non-Food Division and the Head Office Administration, under the new standard, we were extremely delighted to note that the independent assessor presented an excellent report on the further progress made.

In spite of volatility encountered in the stock market, resulting in the reduced value of our Society's pension funds, we have continued to maintain a defined benefit final salary pension scheme, for the benefit of our employees. It is our intention to make further substantial special



Society Employee of the Year, Jacqui Pinnock with her award.

contributions into the scheme in the new financial year.

appreciation

We would like to take this opportunity to thank all our staff for their personal efforts in contributing to the Society's trading profit in what has been a very difficult year.

the OSCAS awards

The 'Outstanding Service to Customers and Staff' (OSCAS) Awards Ceremony took place at the Ricoh Arena, home of Coventry City Football Club, in September with around 250 people in attendance; the event was a huge success with the award for the Society Employee of the Year going to Jacqui Pinnock from our Market Bosworth Lateshop.

retired colleagues/long service awards

In late November, many of our retired colleagues were able to join us at the Benn Hall in Rugby as our guests for their annual Society luncheon.

During the event, a number of long service awards were given out to employees in recognition of their service with the Society ranging from twenty-five to forty years. We are



2006 Oscas winners.

always pleased to celebrate our longer-serving colleagues' loyalty to the Society.

We would also like to offer our best wishes for a long, healthy and happy retirement to all our retired former colleagues.

obituaries

Sadly, we must record the deaths, over the past year, of a number of people associated with the Society. To the families involved, we would like to extend our deepest sympathy in their sad loss. Those who knew them will remember them with affection and gratitude.

directors' report

corporate governance

As custodians of the Society, the Directors are committed and intend to continue to work towards meeting the highest possible standards of corporate governance.

The Co-operatives UK Limited issued the Code of Best Practice in July 1995 followed by subsequent amendments and updates. In May 2005 the Co-operative Congress approved the adoption of the updated and revised version of the Corporate Governance Code of Best Practice for Consumer Co-operative Societies, issued by Co-operatives UK. This succeeded the earlier version of the Code following extensive consultation with member societies. The new Code presents societies with a significant task in reviewing current practices and to decide whether change is necessary to comply or to provide valid explanations for non-compliance. Accordingly the Society provides explanation in regards to those areas of the Code where it is non-compliant in the Statement of the Directors on Corporate Governance.

corporate social responsibility

The Heart of England Co-operative Society's origins are based upon the fundamental principles of co-operation and the Society continues to operate with these principles in mind. The Society genuinely strives to put co-operative values into practice in every aspect of its business. Wherever



practicable, this co-operation extends to other co-operative organisations, as it is our belief that the most successful co-operative businesses are focused on meeting genuine local community requirements, whilst working together with other co-operative organisations for mutual benefit.

Those principles of co-operation are fundamental to the Society's objectives of demonstrating how it differs from other retailers, and having completed seven years operating as the Heart of England Co-operative Society, along with a heritage of more than 170 years of continuous co-operative trading, we take great pride in being able to demonstrate that difference.

In order to more clearly measure and monitor our performance in achieving this aim, the Society has adopted a series of Key Social and Co-operative Indicators building on the Code of Business Conduct. As these develop over the coming years they will enable us to measure progress on a range of social and co-operative issues, by monitoring trends and identifying opportunities for continuous improvement. In that way, the co-operative principles and values will remain at the forefront of all that we do.

employees

accident rates

The health and safety of our employees is of the utmost importance and we are committed to ensuring that we control the risks of health and safety through training and awareness. As such the Society provides a continuous programme of health and safety training for its employees and provides regular updates to staff through written briefings and training sessions.

In the year ended 20th January 2007 the Society has recorded a total of 12

reportable accidents and 184 minor accidents.

staff profile

The Society operates an equal opportunities policy.

In the year ended 20th January 2007 the Society recorded staff profiles as follows:-

male and female/full and part-time

	number	%
Male full-time	165	17
Female full-time	186	19
Male part-time	147	15
Female part-time	479	49

ethnicity profile

	number	%
African - Caribbean	1	0
African - Other	4	0
Asian - British	24	2
Asian - Other	16	2
British	906	93
European	11	1
Other	15	2

age profile

	number	%
Under 16	3	0
Between 16 and 18	118	12
Between 19 and 25	173	18
Between 26 and 35	109	11
Between 36 and 45	156	16
Between 46 and 55	273	28
Between 56 and 65	145	15

During the year, the Society adopted a policy whereby all employees retire upon reaching their 65th birthday.

participation of employees in training and education

The Heart of England Co-operative Society holds the Investor in People award for all of its trading divisions and administrative functions. Our employees are important stakeholders in our organisation, and the Society continually strives to find ways to enhance the opportunities they have

to contribute fully and further to our success. We maintain a structured and responsive training programme across all of our divisions, and for all of our employees formal training records are maintained of the training opportunities given and gained.

In the year ended 20th January 2007 the Society provided 9,384 hours of training to our employees, which equates to an average of 14.13 hours per full-time equivalent employee.

members

members economic involvement

One of the key benefits of membership of the Heart of England Co-operative Society is to share in the success that it generates through our Members' Privilege scheme, that enables members to take advantage of our exclusive members' events and discounts throughout all of our trading divisions. This engagement of our members at an economic level is vital to the maintenance and development of a strong membership base, and the continued growth of our trading results.

In the year ended 20th January 2007 it was not feasible to identify a meaningful percentage of trade that distinguished between members and non-members.

member democratic participation

Our Society is a democratic organisation controlled by its members. No election of Directors took place during the year ended 20th January 2007 due to insufficient nominations received. An election was held for the Nuneaton and Hinckley member relations committee, however, and the total number of votes cast was 81.



customers

customer satisfaction

Customer satisfaction is fundamental to the success of our business. We regularly seek feedback from our customers to try and gauge levels of satisfaction, through the media of surveys, feedback questionnaires and random sampling. We actively encourage our customers to feedback their comments direct to the Chief Executive, both positive and negative, in order that we can continue to develop and improve in the area of customer service. In the Funeral Division we regularly send out customer feedback questionnaires to our clients, and in the Food and Non-Food Divisions we provide point of sale comment cards for customers to fill in there and then or to take away with them. We monitor all responses. The nature of the customer feedback we seek in the Food and Non-Food Divisions does not provide a percentage satisfaction rating. However, within our Funeral Division it is very pleasing that over 97% of the respondents thought the overall service provided by our funeral homes was excellent.

the environment

emissions and waste

The issue of emissions and waste has become a key issue both locally and

nationally in recent years. The Heart of England Co-operative Society is committed to playing its part in finding ways to lessen the impact of these areas on the natural environment we live in and to seek ways of achieving greater sustainability across a number of measures.

In the year ended 20th January 2007 the Society generated 6,283 tonnes of CO₂, which is equivalent to 9.46 tonnes per full-time equivalent employee, or alternatively 80.97 tonnes per £1m of turnover.

In the year ended 20th January 2007 the Society generated 3,083 tonnes of waste of which 33.8% was recycled. The Society is always exploring new ways to generate less waste and to increase the level of recycling we achieve.

procurement and investment

The Heart of England Co-operative Society is committed to the fundamental co-operative values of equality and equity and puts these into action, by supporting the principles of ethical trading across the full range of its activities. As a regional consumer co-operative society whose main economic interaction is with a variety of UK businesses, the Heart of England Co-operative Society does not directly face the full range of ethical issues associated with procurement and investment decisions. However, our Society is fully committed to pro-actively seeking and working with businesses that have clear policies for sourcing products equitably and ethically.

The Heart of England Co-operative Society is a member of the Co-operative Retail Trading Group (CRTG), which in turn is a member of the Ethical Trading Initiative (ETI) and is working to ETI and International Labour Organisation

directors' report

(ILO) principles and standards. The Society also sources products from and maintains links with, wherever practicable, a number of other UK co-operative businesses and organisations that are committed to the application of the same co-operative values.

We currently maintain links of various types with the following co-operative organisations:-

- Co-operative Bank
- Co-operative Employers Association (CEA)
- Co-operative Group (CWS) Limited
- Co-operative Insurance Society (CIS)
- Co-operative Retail Trading Group (CRTG)
- Co-operative Travel Trading Group (CTTG)
- Co-operatives UK
- Midlands Co-operative Society
- Shoefayre
- Travelcare

At a local level the Society is committed to promoting the sale of fairtrade products across its trading area.

The Society's main banking activity is conducted through the Co-operative Bank, and any long-term investments are held in or by other UK co-operative businesses. The Society is committed to promoting the

concept of the mutual business model to a wider acceptance.

investment in community and co-operative initiatives

The Society is very proud of its status as the only retail organisation in the world that donates all of the profits from its tobacco sales to local charitable causes. As such this has topped the £386,000 level since its inception and a further £50,000 has been committed in the year ended 20th January 2007 making a total commitment of £436,000.

The annual commitment represents 2.8% of our pre-tax profits.

In addition, the Society actively encourages its employees to take part in community activities and has continued the initiative aimed at matching pound for pound, up to a maximum of £250 per person, any charitable fund raising activity engaged in by our employees in the trading area of the Society.

Members' events such as coach trips, concerts, education days and information exchanges with other co-operative societies have been organised during the year, and the Society maintains links with the Wheatsheaf Players, the Co-operative Orchestra and the Co-operative Choir in the local area.

the heart of england co-operative difference

The Society believes that this information demonstrates how it consolidates the principles of co-operation into its everyday activity, both locally and nationally, and how it further shows in a tangible way what is meant by the Heart of England Co-operative difference. Given that other types of organisations exist primarily to maximise their profits in order to create wealth for shareholders, with little genuine concern for the local community from which these profits originate, the Heart of England Co-operative Society believes its approach provides tangible evidence of an alternative and successful model of business practice.

The profits we make produce direct benefit for our primary stakeholders, i.e. our customers, our members, our employees and our local communities.

for our customers

We intend to continue to plough back a major proportion of our profits into improving our shops and other facilities, whilst also seeking new suitable trading opportunities, to expand our business throughout the heart of England.



for our members

The Society has enhanced our unique Members' Privilege scheme each year since its inception in 2000, with 2006 providing the biggest and best range of members' privileges we have ever offered.

This scheme gives each member the opportunity to make exclusive savings across a range of products and services, which can be worth hundreds of pounds per year.

The Society believes it is the best way of giving the members their 'instant dividend' and enabling them to share in the Society's trading success.

The Society still wishes to encourage even more of our existing members to re-register with us for the Members' Privilege scheme, so that they can take full advantage of all the available privileges of membership.

for our employees

Another successful trading year has meant that for the eleventh successive year our unique staff bonus scheme has been implemented. This is in keeping with our aim of making the Heart of England Co-operative Society, an excellent place to work, by providing employees with security of employment, competitive remuneration packages, and good career opportunities.

Our commitment to maintaining a defined benefit final salary pension scheme for our employees, in spite of the significant difficulties involved, once again sets us apart from many of our competitors, who have taken the easy way out by closing such schemes to new employees and reducing the benefits to existing employees.

for our local communities

Our commitment to giving our profits from selling tobacco to local good

causes has resulted in more than £386,000 being made available for this purpose within the first seven years since the introduction of our unique tobacco initiative in 2000.

Our locally elected Education/ Member Relations Committees have already been able to provide much appreciated assistance to more than 1,500 local good causes since the inception of the scheme.

Our local communities have also benefited from several millions of pounds worth of local investment in recent years as we continue to plough the greatest part of our profits back into creating new and modern stores and services for local people – following the principles of co-operation set out many generations ago.

Local communities also benefit from the retention of local secure employment and by 20th January 2007 our total employee numbers were 977.

to the future

Increasing sales levels, whilst carefully controlling costs, remains the best way to achieve a consistent growth in profits, and in the long-term maintain our Society's outstanding level of success.

We intend to continue with our strategy of renewing and expanding our businesses and the considerable cash reserves we have built up will enable us to continue to do this without the need for any external financial assistance in the short-term.

However, our development programme is likely to move at a pace with contracts having now been exchanged on the Rugby town centre development, whilst in the medium-term the proposals for the Hinckley town centre re-development will gather momentum. A number of

other potential refurbishment opportunities are also reaching the funding stage, giving us the prospect of achieving further increases in market share in the years ahead.

We envisage the retail market place becoming even more competitive, particularly in the food and non-food sectors, as the market becomes saturated with the sheer number of retailers jostling for market share.

Despite these pressures, we intend to maintain our unique position in the heart of England by building on our reputation as one of the UK's leading retail co-operatives by continuing to:-

- **Develop additional profitable trading activities.**
- **Maintain community friendly initiatives and policies.**
- **Pursue and enhance the range of member privileges.**
- **Become an employer of choice.**

In spite of the uncertain economic outlook ahead, we remain optimistic about our Society's future prospects as one of the leading independent regional co-operative societies.



M.J. Sherwood – President



A. Kurji – Chief Executive



M. Woolhouse – Secretary
27th March 2007

statement of the directors on corporate governance

statement of the directors on corporate governance

As an Industrial and Provident Society, the Heart of England Co-operative Society Limited is not required to adhere to the provisions of the Combined Code, the UK Code on Corporate Governance, which applies to listed companies. However, Co-operatives UK, the apex body for co-operative enterprises in the UK, with the support of Congress, has issued a Code for consumer co-operatives to which it requires voluntary compliance. This Code is based on the principles contained in the Combined Code but is tailored to the particular governance characteristics found in consumer co-operative societies. You can view the Code at www.goodgovernance.coop.

The following statement, authorised by the Directors, outlines how the Society has complied with the principles of the Code and explains in its final statement any provisions the Society does not comply with and the reasons for non-compliance. The statement relates to the period 22nd January 2006 to 20th January 2007.

the members

Co-operatives are member owned democratic organisations and the Board has sought to encourage members to play their part in the governance of the business and improve membership participation. The Society continues to actively promote new membership and encourages existing members to re-register. As a result the Society defines an active member as a member who has recently joined or re-registered for the Members' Privilege scheme. The membership register was recently updated.

members meetings

The Society operates with a single tier board structure. The Society actively promotes the Annual General Meetings via posters in all branches, through the Annual Report, the Society's website, the Members' Privilege calendar and through newspaper advertisements. The Society provides refreshments to encourage members to attend the meetings.

During the year the Society held a Board of Directors Open Evening, designed to encourage more active member participation in the democratic processes of the Society and to promote the idea of existing members coming forward to stand for election as Directors. The results of the evening were encouraging. In addition, the Society is looking to target mailing to those members who are eligible to become Directors of the Society to encourage them to consider participation in this way.

At the Annual General Meetings, those Directors who were eligible for re-election on this occasion were re-elected unopposed.

the board's role

It is the responsibility of the Board of Directors to determine the vision and the strategy of the Society.

The Board of Directors currently consists of thirteen members, directly elected by the membership, who appoint the President and Vice President annually from within their number.

The Board of Directors is charged with ensuring that the business of the Society is conducted in accordance with the co-operative principles, as set out by the International Co-operative Alliance and with the

interests of the Society and its members uppermost at all times.

The Board of Directors also has the responsibility for supervising the work of the Chief Executive and the Management Executive. The Secretary is appointed by the Chief Executive and is part of the Management Executive.

The Board of Directors meet every four weeks. They also meet twice a year as the Audit Committee, and would also meet as a Search Committee and Remuneration Committee as required.

The matters reserved to the Board of Directors are in accordance with Appendix 5 of the Code except for the appointment and removal of the Secretary. All items of capital expenditure over £5,000 in value must be approved by the Board of Directors.

It is the responsibility of the Management Executive to meet the strategic objectives of the Society. Day-to-day management of the Society's activities rests with the Chief Executive and the Management Executive.

election, renewal of the board and succession planning

The Society has amended the age rule for new Directors in line with the Combined Code. The Board is comprised of employees, retired employees and members, with a broad range of skills and experience and it does not have power under the existing rules to co-opt professional non-executive directors. At present a Search Committee has not been established but will be constituted as and when required. The terms of reference for the Search Committee would be available from the Secretary at that time, on request.



board balance and independence

Directors	Occupation
Michael Sherwood	- retired employee
Hanne Hoeck	- accountant
Brian Boyd	- employee
Paul Elverson	- manager
Michael Green	- retired employee
Nadine Harris	- business development manager
Maurice Holden	- retired employee
Alan Lewell	- retired employee
Clive Miles	- employee
Chris Newman	- employee
Bill Seddon	- retired employee
Jacqueline Smith	- retired
Pat Sunner	- retired employee

No Director or member of the Management Executive holds any other significant directorships.

president and vice president of the society

The President and Vice President of the Society are elected annually by all the Directors, and the term of office is for a period of twelve months. Whilst the rules of the Society do not preclude an employee or recently retired superannuated employee from being the President or Vice President, the Directors believe that it is best practice not to elect the President from the employee Directors.

information and professional development

The Directors receive regular information at each board meeting and its accuracy, quality and timing are reviewed on a regular basis.

All new Directors are offered the opportunity to spend time with the President and the Chief Executive before attending the Board for the first time, to outline to them the procedures, rules, standing orders and conduct required of individual Directors. In addition, all Directors are offered the opportunity to undertake further formal training to develop their skills and experience.

The Code prescribes that a minimum of three Directors or a third of the Board, whichever is the greater, be sufficient for independent professional advice to be accessed at the Society's expense. The Board of Directors are currently able to seek independent professional advice, at the Society's expense, subject to the request being supported by Directors making up not less than one third of the full Board.

board skills and performance evaluation

The Board of Directors believe that the experience gained through their working career with the Society, and the common sense approach used when making Board decisions is adequate and therefore they do not wish to undergo further training. In addition no performance evaluation of the Board or its individual Directors is undertaken.

remuneration report

The Society is committed to the highest standards of good corporate governance. To that end it uses as a guideline for its disclosure in relation to remuneration, the disclosure requirements set out in the



statement of the directors on corporate governance

Co-operatives UK Corporate Governance Code of Best Practice, as endorsed by the Co-operative Congress in May 2005.

The Society's Board is entirely non-executive, the Directors being elected from its membership. The day-to-day management of the Society falls to the Management Executive. For completeness this report provides details of both Directors' and the Management Executive's remuneration.

The remuneration report is presented by the Board and contains the following information:-

- A description of the role of the Remuneration Committee.
- A summary of the Society's remuneration policy.
- Details of the terms of the service contracts and the remuneration of each Management Executive member for the year ended 20th January 2007.
- Details of the current terms of office and the remuneration of each Director for the year ended 20th January 2007.

role of the remuneration committee

The Remuneration Committee is made up of the full Board of Directors. The Committee is responsible for all aspects of remuneration and contractual terms and conditions of the Management Executive team. The Committee sets the remuneration policy and strategy for these individuals.

remuneration policy

The current policy is to pay remuneration determined and agreed by the Directors. The Committee considers that a successful remuneration policy needs to be

sufficiently flexible to take account of changes in the Society's business environment and in remuneration practice.

elements of remuneration

Management Executive remuneration consists of salary, pension and other benefits.

salary

Management Executive salaries are reviewed annually with any increases normally payable with effect from 1st July each year. Salaries paid to the Management Executive in the financial year ended 20th January 2007 are set out in Note 3 in the notes to the accounts. The Board of Directors is of the opinion that there is no value to be gained by disclosing the individual Management Executive remuneration packages.

other benefits

Other benefits provided to the Management Executive include the provision of a Society car.

service contracts

No member of the Management Executive has a notice period of greater than 12 months.

pension

The Management Executive is eligible to join the Society's Pension scheme on the same basis, and all members of the Management Executive were members of the scheme at 20th January 2007. These schemes are funded, Inland Revenue approved, defined benefit final salary occupational pension schemes. Members of the Fund contribute between 6.5% and 8.5%, dependant on age, of their pensionable salary up to the Inland Revenue maximum. Basic salary is the only element of remuneration that is pensionable.

The pension arrangements were amended with effect from the 6th April 2004. For those members who joined the scheme prior to 6th April 2004, the pension arrangements broadly provide a pension based on increments of 60th's for each year of pensionable service. For those members who joined the scheme after 6th April 2004, the pension arrangements broadly provide a pension based on increments of 80th's for each year of pensionable service. Pensions are also payable to dependants on death and a lump sum is payable if death occurs in service.

directors

The Directors do not have service contracts. The years of their election are shown in Table 1 together with the expiry of their current term of office. Each Director is subject to re-election every three years.

Directors' fees are approved by the Society's members. The current fee levels were recommended to the membership and approved by them in May 2006.

The fee levels were determined in line with the December RPI. The total fees received by each Director is set out in Table 1.

audit committee

There are clear and consistent procedures in place for monitoring the system of internal financial controls.

The Internal Auditor and Accountant/Assistant Secretary meet regularly within their remit and review the effectiveness of the Society's system of internal financial controls. The Accountant/Assistant Secretary receives reports from the Society internal audit function and management where appropriate.

Table 1 - Directors' remuneration

	Elected	Term Expires	2006 remuneration
Michael Sherwood	1983	2008	£1,870
Hanne Hoeck	1996	2009	£1,269
Brian Boyd	2002	2008	£1,269
Paul Elverson	1997	2009	£1,269
Michael Green	1980	2008	£1,269
Nadine Harris	2005	2008	£1,269
Maurice Holden	1999	2008	£1,269
Alan Lewell*	1998	2007	£1,269
Clive Miles	1996	2009	£1,269
Chris Newman	1998	2007	£1,269
Bill Seddon	1988	2008	£1,269
Jacqueline Smith	2003	2007	£1,269
Pat Sunner*	1991	2007	£1,269

*Recently retired employees.

A documented whistle-blowing procedure is in place to enable staff to raise concerns in confidence, in matters of financial reporting, financial control or any other issues. These procedures are made available to staff at their time of commencing employment.

The full Board of Directors meet twice a year as the Audit Committee. This Committee is responsible for reviewing the effectiveness of the Society's systems of internal control.

The Committee meets to:-

- Consider reports from the Management Executive, internal audit and external audit on the systems of internal control and any material control weaknesses.
- Discuss with the Internal Auditor the actions taken on problem areas identified in these reports or by the Board.
- Review the effectiveness of the risk management process and ensure significant risk issues are referred to the Board for consideration so that appropriate steps can be taken to minimise such risks to the Society.

- Consider the effectiveness of the operation of the internal audit function.
- Consider the appointment of external auditors and in conjunction with management agree the nature and scope of the external audit review.
- Review the external audit management letter and the management response to the report.
- Recommend reviews of other areas of the business where a more intense audit procedure is necessary.

The Audit Committee also has a duty to discuss problems and reservations arising from the Society's audit and any matter the Auditor may wish to discuss, if necessary, in the absence of the Chief Executive.

Accordingly the Board of Directors confirms that the effectiveness of the system of internal controls for the year ended 20th January 2007 has been reviewed in line with the criteria set out in the Corporate Governance Code of Best Practice.

co-operative and social responsibility

The Society takes seriously its commitment to the principles of co-operation and social responsibility. It has therefore fully adopted the 10 Key Social and Co-operative Indicators outlined by the Co-operatives UK. The policies and progress the Society has made in relation to the 10 Key Social and Co-operative Performance Indicators are detailed on pages 12 to 14 of the Directors' report.

statement of compliance

As custodians of the Society, the Directors are committed and intend to continue to work towards meeting the highest possible standards of corporate governance.

The Society provides explanation in regards to those areas of the Code where it is non-compliant, as follows:-

The Code prescribes that the Board of Directors adopt a code of conduct for Directors, and sign an acceptance of that code of conduct. The Board of Directors believe that the signing of the code of conduct by individual Directors is currently not necessary and accordingly have left the letter on the table. However, in the absence of a signed letter, the Board of Directors amended Clause 17 of the Society's standing orders to reflect the need for ongoing confidentiality as well as confidentiality upon the cessation of their term of office.

The Code prescribes that the Directors should give consideration to holding an Interim General Meeting. The Directors considered the requirement to hold members' interim meetings. However, the Directors are currently of the opinion that such a meeting is not necessary and would not serve a useful purpose for the Society.

statement of the directors on corporate governance

The Code prescribes that the Society should ensure that financial information is made available to members twenty-one days prior to the Annual General Meetings. The Society's rules state that the members will receive financial information fourteen days prior to the Annual General Meetings. The Society will aim to increase this time period to twenty-one days by reviewing the year-end processes and timetable accordingly.

The Code prescribes that the term of office of the Chair should be no longer than three years, and that the Chair should serve for a maximum of six years before standing down. The Chair would not normally be eligible for the office again. Further, the Code states that a mechanism should be in place to remove a poorly performing Chair and that the Chair should not be a current employee or recently retired superannuated employee. The President of the Society is elected annually by all the Directors, and the term of office is for a period of twelve months. The Board of Directors believe that this annual election of the President, coupled with the rules allowing for the removal of any Director under given circumstances, means that there is no further need for a mechanism to remove a poorly performing incumbent. The Board of Directors believe that the individual elected annually should be judged on merit, and should not be restricted to a pre-set maximum term. Whilst the rules of the Society do not preclude an employee or recently retired superannuated employee from being the President or Vice President, the Board of Directors believe that it is best practice not to elect the President from the employee Directors.

The Code prescribes that there should be a Chief Executive succession plan

in place, and that this should be reviewed annually. The Board does not maintain a standing Search Committee; as such a Committee would comprise the full Board. A Search Committee is formed of the full Board of Directors when the existing Chief Executive announces their resignation or retirement.

The Code prescribes that a minimum of three Directors or a third of the Board, whichever is the greater, be sufficient for independent professional advice to be accessed at the Society's expense. The Board of Directors are currently able to seek independent professional advice, at the Society's expense, subject to the request being supported by Directors making up not less than one third of the full Board.

The Code prescribes that the Directors should undertake a periodic skills audit in order to identify appropriate training needs. The Board should also undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors. Further, the Chair should be subject to an annual appraisal in their absence. The Board of Directors believe that they are fully accountable to the membership and that the ultimate test of its performance and that of individual Directors is at election time. The membership has the opportunity at the Annual General Meetings to fully question the Board of Directors and in total can express their satisfaction or otherwise by casting their ballot.

The Code prescribes that no Director who is also a current employee of the Society should serve on the Remuneration Committee. The agenda of the Remuneration Committee is an integral part of the

main Board agenda. As a result the full Board of Directors will be present when these matters are discussed, including employee Directors. However, where an issue arises that directly impacts upon an employee Director they are precluded from voting. No member of the Management Executive is a Director.

The Code prescribes that neither the Chair, nor a current employee or superannuated recently retired employee, should serve on the Audit Committee. The full Board of Directors, including the President and current and superannuated ex-employees, meets as the Audit Committee twice a year without the Chief Executive present. The Internal Auditor, who is also a Director, attends the meeting as the Internal Auditor and is questioned as such in the absence of the Chief Executive. The Board, having considered the aspect of the Audit Committee function, believes that there are major benefits for all the Directors to be actively involved in the audit process.



internal control

The Board is ultimately responsible for the Society's system of internal control and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable and not absolute assurance against material misstatement or loss.

The Co-operatives U.K. revised (May 2005) Corporate Governance Code of Best Practice maintains a requirement that the Directors review the effectiveness of the Society's system of internal controls. This extends the existing requirement in respect of internal financial controls to cover all controls including financial, operational, compliance and risk management.

The Internal Auditor has continued to review and report upon internal financial controls.

Key elements of the Society's system of internal financial controls are as follows:-

risk identification

Society Managers are responsible for the identification and evaluation of key risks applicable to their areas of business. These risks are assessed on a continual basis and may be associated with a variety of internal or external sources including control breakdowns, disruption in information systems, competition, natural catastrophe and regulatory requirements.

control environment

The Society is committed to the highest standards of business conduct and seeks to maintain these standards across all of its operations, which provide practical guidance for all staff. Also in place are supporting Society policies and employee procedures for the reporting and resolution of suspected fraudulent activities.

The Society has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve Society objectives. Lines of responsibility and delegations of authority are documented.

information and communication

Society divisions participate in periodic strategic reviews, which include consideration of long-term financial projections and the evaluation of business alternatives. Operating units prepare annual budgets and performance against budget is actively monitored at the Board and divisional level supported by regular forecasts. Forecasts and results are consolidated and presented to the Board on a regular basis.

Through the above mechanisms, Society performance is continually monitored, risks identified in a timely manner, their financial implications assessed, control procedures re-evaluated and corrective actions agreed and implemented.

control procedures

The Society and its operating units have implemented control procedures designed to ensure complete and accurate accounting for financial



transactions and to limit the potential exposure to loss of assets or fraud. Measures taken include physical controls, segregation of duties, reviews by management and internal audit and external audit to the extent necessary to arrive at their audit opinions.

A process of controls, self-assessment and hierarchical reporting is currently being established, which provides for a documented and auditable trail of accountability. These procedures will be relevant across Society operations and provide for successive assurances to be given at increasingly higher levels of management and, finally, to the Board. These documents will be reviewed by the Internal Auditor, where appropriate, for completeness and accuracy. Planned corrective actions will be independently monitored for timely completion.

statement of the directors' responsibilities and independent auditors' report

statement of directors' responsibilities

The Directors are required by Industrial and Provident Society Law to prepare financial statements, which give a true and fair view of the state of affairs of the Group at the end of each financial year and of the income and expenditure of the Group for the year to that date. The financial statements must be prepared in compliance with the required format and disclosures of the Industrial and Provident Societies Acts.

The Directors confirm that:-

Suitable accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, have been used in the preparation of the Group's financial statements; and applicable accounting standards have been followed.

The Directors are responsible for keeping proper accounting records, which disclose with reasonable accuracy, at any time the financial position of the Group.

The Directors 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 any other irregularities.

In so far as the Directors are aware:-

- There is no relevant audit information of which the Group's auditors are unaware; and
- The Directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

going concern

After making all appropriate enquiries the Directors have a reasonable expectation that the Group has adequate resources 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 accounts.

Board certification:-

The accounts and notes on pages 24 to 41 are hereby signed on behalf of the Board of Directors pursuant to Section 3 (5) (c) of the Friendly and Industrial Provident Societies Act 1968.



M.J. Sherwood - President



H.S. Hoeck - Vice President



M. Woolhouse - Secretary
27th March 2007



report of the independent auditors to the members of heart of england co-operative society limited

We have audited the Group financial statements (the 'financial statements') of the Heart of England Co-operative Society Limited for the period ended 20th January 2007, which comprise the principal accounting policies, the Group revenue account, the Group balance sheet, the Group cash flow statement, the Group statement of total recognised gains and losses, the reconciliation of movements in members' funds and notes 1 to 22. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Society's members, as a body, in accordance with the Industrial and Provident Societies Acts 1965 to 2002. 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 auditors' 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.

respective responsibilities of the directors and independent auditors

The Directors' responsibilities for preparing the annual report and the financial statements in accordance with United Kingdom law and accounting standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, International Standards on Auditing (UK and Ireland) and the Co-operatives UK Limited's Code of Best Practice (The Code).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Industrial and Provident Societies Acts 1965 to 2002, and the Industrial Societies (Group Accounts) Regulations 1969. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Society has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Society is not disclosed.

We review whether the Directors' Statement on Corporate Governance reflects the Society's compliance with paragraphs F1.1, F1.2 and F1.3 of the Code and we report if it does not. We are not required to form an opinion of the effectiveness of the Society's corporate governance procedures or its internal controls.

We read other information contained in the annual report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report and the Statement of the Directors on Corporate Governance. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.



Our responsibilities do not extend to any other information.

basis of opinion

We conducted our audit in accordance with international standards on auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity

or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

opinion

In our opinion:-

- The financial statements give a true and fair view in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's affairs as at 20th January 2007 and of the Group's surplus for the period then ended; and
- The financial statements have been properly prepared in accordance with the Industrial and Provident Societies Acts 1965 to 2002, and the Industrial Societies (Group Accounts) Regulations 1969; and
- The information given in the Directors' Report is consistent with the financial statements for the year ended 20th January 2007.

Grant Thornton UK LLP

Registered Auditors
Chartered Accountants
Birmingham.
27th March 2007

Note: The maintenance and integrity of the Heart of England Co-operative Society Limited 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.

Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

statement of accounting policies

basis of accounting

The accounts are prepared under the historical cost accounting convention, modified by the revaluation of investment properties and in accordance with applicable accounting standards.

basis of consolidation

The Group accounts consolidate the accounts of the Society and its subsidiary, Chartridge Properties Limited, a company incorporated in England and Wales. Chartridge Properties Limited is now dormant.

accounting date

The current period is for the 52 weeks ended 20th January 2007 compared with a period of 52 weeks ended 21st January 2006.

gross value of sales

Includes cash sales, goods sold on credit, television/video rental income, property rental income and commission on travel activities inclusive of Value Added Tax where applicable.

Revenue is recognised at the point of sale.

goodwill

Positive purchased goodwill arising on acquisition is capitalised, classified as an asset on the balance sheet and amortised over its useful economic life up to a maximum of twenty years. This length of time is presumed to be the maximum useful life of purchased goodwill because it is difficult to make projections beyond this period. Goodwill is reviewed for impairment at the end of the first full financial year following each acquisition and subsequently as and when necessary if circumstances emerge that indicate that the carrying value may not be recoverable.

amortisation

Amortisation is calculated to write off the cost of an asset, less its estimated residual value, over the useful economic life of that asset as follows:-

Goodwill - 20 years

tangible fixed assets and depreciation

Fixed assets other than land, are depreciated by equal instalments over their estimated working lives:-

Buildings - freehold	- 50 years
Buildings - leasehold	- period of lease
Fixtures, Fittings and Plant	- 5/10 years
Transport	- 5 years
T.V. and Video Sets on Rental	- 4 years

Land and buildings were valued as at 20th January 2007 at open market value for existing use and the valuation showed a considerable surplus over book value, which has not been incorporated into the accounts.

In the opinion of the Directors, the total realisable values of the land and buildings are considerably higher than book values and the total residual values of buildings will be at least equal to their book values.

investment properties

Investment properties are included at a professional valuation in accordance with Statement of Standard Accounting Practice No. 19.

No depreciation is provided in respect of freehold investment properties. The Directors consider that this accounting policy results in the financial statements giving a true and fair view. Depreciation is only one of many factors reflected in this annual valuation and the amount which might otherwise have been shown

cannot be separately identified or quantified.

assets acquired under leases

Rentals due under operating leases are charged to revenue in the year that the expenditure is incurred.

investment income

Interest receivable is accounted for on an accruals basis. Dividends are accounted for on the receipts basis.

repairs

Repair expenditure is charged against surplus in the year that the cost is incurred.

funeral plans

State Street Trustees Limited act as Independent Custodian Trustees for the scheme, for all funeral plans prior to 5th February 2004. All new plans are held by the Co-operative Insurance Society. Such receipts are shown within debtors and creditors. Liabilities under the funeral plans are based on total commitments at the balance sheet date.

taxation

Current taxation: Corporation tax is provided at the applicable rate on the taxable profits and chargeable gains of the year.

Deferred taxation: Deferred tax is recognised on all timing differences where the transactions or events that give the Group an obligation to pay more tax in the future, or a right to pay less tax in the future, have occurred by the balance sheet date. Deferred tax on defined benefit final salary pension scheme deficits is adjusted against these deficits. Deferred tax assets are recognised when it is more likely than not that they will be recovered. Deferred tax is measured using rates of tax that have been enacted or substantively enacted by the balance sheet date.

Warwick - Lord Leycester Hospital. Dates from the late 14th Century and is dominated by the Chapel of St. James, built over the West Gate into Warwick by Thomas Beauchamp - the 12th Earl of Warwick. Today it serves as a home for retired ex-servicemen and their wives.



stocks

Stocks are valued at the lower of cost and net realisable value.

pensions

The Group operates two defined benefit final salary pension schemes covering a large number of employees, which require contributions to be made to separately administered funds.

The net liabilities of the pension schemes are included in the balance sheet, current service costs and net financial returns are included in the revenue account and actuarial gains

and losses are recognised in the statement of total recognised gains and losses.

financial instruments

Financial assets, financial liabilities and equity instruments are classified according to the substance and the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the entity after deducting all of its liabilities. Where the contractual terms of share capital do not have any terms meeting the definition of a financial liability then this is classed as an

equity instrument. Dividends and distributions relating to equity instruments are charged direct to equities.

Payments made to and on behalf of members that are not related to equity instruments but are of a discretionary nature and remain subject to member approval are charged direct to the revenue account.

In prior years, share interest was charged through the revenue account and an adjustment has been made to reflect the change in policy.