

ACCOUNTABILITY

RISK IN ACTION

RISK AND THE ROLE OF INTERNAL AUDIT

Internal Audit & Risk comprises both the Group Risk function and Internal Audit. Group Risk facilitates and manages the risk process that is ultimately owned by the Group Board. Internal Audit, accountable to the Audit Committee, uses a risk-based approach to provide independent assurance over the adequacy and effectiveness of the control environment, including controls related to key risks on the Group Risk Profile. Management actions from all of our audits are tracked to completion and the status of these actions is reported to the Audit Committee to ensure that the risks identified are appropriately addressed. This will, in turn, further mitigate the risks included in our Group Risk Profile.

The following examples illustrate how Internal Audit supports the business through driving improvements to our control environment and adding value in core business areas.

RISK: INTERNATIONAL EXPANSION

In support of the Group's international growth plans, Internal Audit reviewed the process to identify and approve new store locations, with a focus on Asia. The audit confirmed that we have a well defined governance structure in place through the Property Board, from the review of initial

new stores proposals, to the formal post-investment reviews that measure actual performance against initial estimates. The audit highlighted an opportunity to improve the quality and consistency of data supporting these initial estimates prepared by the in-country teams, including greater alignment with the process for UK stores. This would support better decision-making and enable more effective comparison of proposals across countries. The audit also recommended more robust tracking of actions agreed at the post-investment reviews through to their completion, to drive profitability.

RISK: GM CUSTOMER ENGAGEMENT

The continuous improvement of our customers' online experience is an important part of driving customer engagement. Following last year's M&S.com website launch, Internal Audit reviewed the process to maintain product content online, including narrative product descriptions, photographic images, and the navigation paths supporting customer searches. Our review confirmed that robust review mechanisms are in place to minimise the risk of errors or omissions in product information on the website. However, in instances where data is missing or incorrect, delays in resolution can impact

the timeliness with which products are launched online. The audit recommended clearer definition of roles and responsibilities between the GM teams developing and buying the products, and the M&S.com team managing the website content, and a more structured "critical path" for product launches online.

RISK: IT CHANGE

In 2014/15 new agreements were implemented with a number of third-party IT service providers, covering areas such as Infrastructure and Application Support and End User Computing. Effective management of our IT service providers is a key element of managing IT change risk, ensuring, for example, that IT changes are executed in line with M&S IT policies. Internal Audit conducted a review to assess the effectiveness of IT service provider management processes. The audit provided assurance that significant focus had been placed on the successful implementation of the new agreements. At the time of the audit there was further work required to clearly define vendor management roles and responsibilities and to implement monitoring against all contractual service levels, both of which have subsequently been addressed.

RISK INTERDEPENDENCY

We recognise that there is significant interdependency between our key risks.

This diagram, based on our current Group Risk Profile, highlights how changes to one risk could impact on those connected to it, and therefore on the Group Risk Profile as a whole. By understanding the relationship between our key risks, if they were to materialise, we are better placed to ensure that we are managing them appropriately and to understand the entirety of our risk exposure.

The highlighted risks illustrate potential interdependent risk scenarios:

The success of our business is highly influenced by our ability to retain quality individuals ⑩. The loss of key product developers would impact our ability to provide a point of difference against our competitors in terms of quality, value and innovation ③, whilst maintaining expertise in our Food technology team enables us to maintain high standards of food safety and integrity across our products and supply chain in an increasingly challenging environment ②. Our customers tell us

that they trust us to do the right thing. By maintaining these high standards of food safety and integrity, we continue to stand out from our competitors ③.

Strong GM customer engagement ① is influenced by our ability to maximise product availability and provide customers with an efficient and reliable delivery proposition ⑫. The robustness of the online business ⑦ will also impact this supply chain and logistics network, as well as having a direct influence on customer engagement through the provision of a reliable online experience.

RISK APPETITE

This year, we have placed significant focus on developing our approach to risk appetite in line with the UK Corporate Governance Code. By expressing the types and amount of risk we are willing to take or accept to achieve our plan, we aim to support consistent, risk-informed decision-making across the Group.

Our starting point has been to define draft risk appetite statements for our principal risks, and for key decisions made by the Board. These statements provide parameters within which we typically expect the business to operate, facilitating structured consideration of the risk and reward trade-off in the decisions we make and in how the Group conducts business.

We have covered a wide range of risks from GM ethical sourcing and food safety and integrity, through to investment decisions and business resilience. Given the varied nature and diversity of such risks, there is no 'one size fits all' approach to establishing risk parameters. We believe that taking the time to get this right will yield the greatest benefits to our business and as such we are currently working with management to define a draft set of risk statements which we will refine over time to ensure that they best reflect what the Group stands for.

Providing clear parameters is important; however, it is essential that we also foster an environment where innovation and entrepreneurial activities thrive. At times,

there may be merit in operating outside of these risk parameters but proposed exceptions will need to be escalated to senior management for debate and approval before activities commence, ensuring that appropriate mitigating controls are in place.

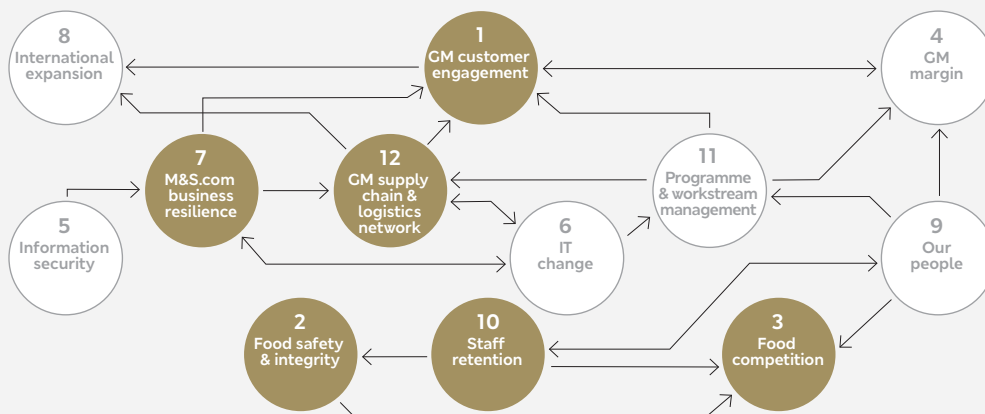
Once finalised, our risk appetite statements will be incorporated into an operating framework, integrated with our existing Group Risk process, and used to monitor business activities and decision-making. We believe we have made good progress this year and risk appetite remains a key priority for the Board in 2015/16.

VIABILITY STATEMENT

Changes to the UK Corporate Governance Code, which came into effect in October 2014, will require companies to state whether they believe they will be able to continue to operate and meet their liabilities, taking into account their current position and principal risks. Companies will need to state over what period they have made their assessment and why they consider that period to be appropriate. The assessed period must be longer than 12 months and relative to business planning processes and how business performance is measured.

On the surface this might appear to be a simple statement to make. However, the Code changes emphasise the need for an interconnected approach to assessing viability. The Board must take into account the Company's business model (and the inputs which support it) and the strategy, ensuring that these are aligned with its risk appetite, supporting risk framework and the controls and activities in place to mitigate risk. The Code requires statements to be made as a 'reasonable expectation' rather than a certainty.

Whilst the Code changes are not applicable to M&S until next year's Annual Report, elements of the Code change are aligned with the principles of integrated reporting. Both require some changes to a number of our ways of working and, as part of our commitment to producing an integrated report next year, we have already made progress. We are committed to ensuring that our response to the Code change is meaningful and adds value both within the business and to our stakeholders. The work we have in progress means that we are in a strong position to meet the requirements in next year's Annual Report.



+ See more in our Risk management section p23-25.