Critical Accounting Judgments and Key Sources of Estimation Uncertainty

In the application of the Group’s accounting policies, which are described on pages 107 to 113, the Directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the change takes place if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

CRITICAL JUDGMENTS IN APPLYING THE GROUP’S ACCOUNTING POLICIES

The following are critical judgments, apart from those involving estimations (which are dealt with separately below), that the Directors have made in the process of applying the Group’s accounting policies and that have the most significant effect on the amounts recognised in the Group Accounts.

REBATES PAYABLE AND RECEIVABLE
Supplier rebate income is significant to the Group’s result, with a substantial proportion of purchases covered by rebate agreements. Supplier rebate income affects the recorded value of cost of sales, trade payables and inventories. Customer rebates affect the recorded value of revenue and trade receivables. The amounts payable and receivable under rebate agreements are often subject to negotiation after the balance sheet date. A number of agreements are non-coterminous with the Group’s financial year, requiring judgment over the level of future purchases and sales. At the balance sheet date the Directors make judgments on the amount of rebate that will become both payable by and due to the Group under these agreements based upon prices, volumes and product mix.

PROVISIONS AGAINST RECEIVABLES
Using information available at the balance sheet date, the Directors make judgments based on experience regarding the level of provision required to account for potentially uncollectible receivables.

POST-EMPLOYMENT BENEFITS
The Group operates six defined benefit pension schemes. All post-employment benefits associated with these schemes have been accounted for in accordance with IAS 19 “Employee Benefits”. As detailed within the Statement of Significant Accounting Policies on page 109, in accordance with IAS 19, all actuarial gains and losses have been recognised immediately through the Consolidated Statement of Comprehensive Income.

For all defined benefit pension schemes, pension valuations have been performed using specialist advice obtained from independent qualified actuaries. In performing these valuations, significant actuarial assumptions and judgments have been made to determine the defined benefit obligation, in particular with regard to discount rate, inflation and mortality.

KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that may have a significant risk of causing a material adjustment to the carrying values of assets and liabilities within the next financial year, are discussed below.

IMPAIRMENT OF NON-CURRENT ASSETS
Determining whether goodwill is impaired requires an estimation of the value in use of the CGUs to which goodwill has been allocated. The key estimates made in the value in use calculation are those regarding discount rates, sales and operating profit growth rates. The Directors estimate discount rates using pre-tax rates that reflect current market assessments of the time value of money for the Group. For those businesses not based in the UK or Western Europe, the cash flows are further risk-adjusted to reflect the risks specific to that individual CGU.

For the majority of the CGUs, the Group performs goodwill impairment reviews by forecasting cash flows based upon the following year’s budget and a projection of cash flows based upon industry growth expectations (0%-3%) over a further period of four years. Where detailed five year forecasts for a CGU have been prepared and approved by the Board, which can include higher growth rates or varied results reflecting specific economic factors, these are used in preparing cash flow forecasts for impairment review purposes. After this period, the sales growth rates applied to the cash flow forecasts are no more than 1% and operating profit growth no more than 3% in perpetuity. The discount rates applied to all CGUs represent pre-tax rates and range between 7.9% and 10.8%.

Assumptions regarding sales and operating profit growth are considered to be the key area of estimation in the impairment review process, and appropriate sensitivities have been performed and disclosed in Note 11.

Impairments are allocated initially against the value of any goodwill and intangible assets held within a CGU, with any remaining impairment applied to property, plant and equipment on a pro-rata basis. The carrying amount of relevant non-current assets at 31 December 2015 is £668.4m (2014: £596.0m). Impairment reviews performed during the year indicated that the carrying value of all of the Group’s non-current assets at 31 December 2015 is considered supportable.

TAXATION
Accruals for corporation tax contingencies require the Directors to estimate the level of corporation tax that will be payable based upon the interpretation of applicable tax legislation on a country-by-country basis and an assessment of the likely outcome of any open tax computations. All such accruals are included within current liabilities.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Therefore, estimates are made to establish whether deferred tax balances should be recognised, in particular in respect of non-trading losses.