

Independent auditor's report

to the Members of Channel Four Television Corporation (the 'Corporation') only

Opinions and conclusions arising from our audit

1 Our opinion on the financial statements is unmodified

We have audited the financial statements of the Corporation for the year ended 31 December 2016 set out on pages 134 to 166. In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Corporation's affairs as at 31 December 2016 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the Corporation's financial statements have been properly prepared in accordance with UK Accounting Standards, including FRS 101 *Reduced Disclosure Framework*; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 as if that Act applied to the Corporation.

2 Our assessment of risks of material misstatement

We summarise below the risks of material misstatement (unchanged from 2015) that had the greatest effect on our audit (in decreasing order of significance), our key audit procedures to address those risks and our findings from those procedures in order that the Corporation's Members as a body may better understand the process by which we arrived at our audit opinion. Our findings are the result of procedures undertaken in the context of and solely for the purpose of our statutory audit opinion on the financial statements as a whole and consequently are incidental to that opinion, and we do not express discrete opinions on separate elements of the financial statements.

Programme and film rights £279 million (2015: £254 million)

Risk vs 2015: ▲

Refer to page 127 (Audit Committee Report), page 140 (accounting policy) and page 153 (financial disclosures).

The risk – Programme and film rights are written down to their value to the Group when indicators of a reduction in the value of individual assets are identified, for example when:

- the quality of the programme means it may no longer be broadcast in the originally intended transmission slot; or
- forecast future theatrical revenues no longer support the carrying value of developed film rights.

Following the Corporation's change in strategy with larger individual film investments, there is an increased risk in respect of the valuation of individual assets.

The majority of the costs of programme and film rights are written off on first transmission. There is, however, an increased level of judgement involved in assessing the value to the Group of rights in relation to certain types of programming including feature films, sports rights, acquired series and developed film rights which may be written off over more than one transmission. Judgements made include assessing viewing performance which drives expected future advertising, sponsorship or other related revenue.

Our response – Our audit procedures included:

- with regard to developed film rights exploited through distribution, critically assessing forecast film rights income through independent enquiry of the Film4 commissioning team to understand revenue expectations; reference to third party theatrical release data and sales of distribution rights to date; and historical experience of theatrical and distribution revenues generated from film releases; and
- for other programme and film rights, we focused on those programme and film rights that are the oldest or have the highest carrying amounts, and those near rights expiry. We evaluated the Group's assessment of the expected future transmissions through enquiry of the programme scheduling team who operate independently from finance; inspection of the programme schedule for the three-month period following the year end date, and longer-term sporting event schedules. We also compared a sample of programmes scheduled at the year end to third party TV listings for that period; and
- critically assessing the assumptions underlying the calculation of transmission cost write-off profiles for evidence of change since the

detailed review in the prior year with reference to films that were not fully expensed on first transmission.

Our findings – We found:

- the estimates in respect of future film rights income on developed film rights exploited through distribution to be balanced (2015: balanced);
- the judgements made in relation to the effects of expected future scheduling and in assessing the carrying value of programme and film rights to be balanced (2015: balanced); and
- the assumptions regarding the viewing profile used to calculate the transmission cost write-off profiles to be balanced (2015: balanced).

Revenue recognition £995 million (2015: £979 million) Risk vs 2015: ◀▶
Refer to page 127 (Audit Committee Report), page 139 (accounting policy) and page 142 (financial disclosures).

The risk – In terms of audit risk, the Group's revenue can be divided into two categories:

- TV advertising revenues (£804 million (2015: £812 million)): While the majority of advertising revenue contracts are straightforward, there are a small number of individually significant one-off contracts in respect of barter arrangements, where Channel 4 exchange advertising revenue for programmes or equity investments, and contracts where Channel 4 acts as a sales agent for other broadcasters' advertising. These contracts can contain unique contract terms including complex commission calculations, and judgement is required to determine the appropriate revenue recognition treatment; and
- sponsorship and other revenues (£191 million (2015: £167 million)): This includes many agreements with differing individual terms in respect of the following revenues: sponsorship, digital advertising subscription income from other platforms, box office and DVD sales. The volume and variety of different contracts gives rise to a risk of incorrect revenue recognition between accounting periods, in particular in relation to the allocation of revenues where contracts span the year end.

Our response – Our audit procedures included:

- testing the controls over the standard advertising revenue arrangements;
- reviewing the terms of barter, sales agent and equity investment contracts, and agreeing the accounting treatment in terms of:
 - i. applying the relevant accounting standards to the contract terms and comparing with the actual treatment adopted;
 - ii. obtaining evidence of performance of contractual obligations including the delivery of airtime;
 - iii. considering the valuation basis applied for the programmes received in barter deals with reference to third party production costs which are seen to reflect fair value;
 - iv. considering the valuation basis applied for the equity investments received in barter deals with reference to discounted cash flow projections and funding round investments;
- testing the revenue recognition approach on a sample of higher value items of sponsorship and other revenue with reference to our own analysis of the application of relevant accounting standards to non-standard contract terms and transmission schedules in respect of sponsorship campaigns, to assess whether revenue has been recognised in the appropriate accounting period; and
- considering the adequacy of the Group's accounting policy disclosures in their description of the method applied to recognising revenue for these arrangements.

Our findings – We found:

- our testing did not identify weaknesses in the controls that would have required us to expand the extent of our planned detailed testing (2015: no weaknesses identified);
- the judgements regarding measurement of airtime delivery to reflect the fulfilment of performance obligations on barter and sales agent contracts to be balanced (2015: balanced);
- for barter and sales agent contracts the judgements applied in determining the fair value of programme rights received, used for the recognition of revenue, to be balanced (2015: balanced);
- the judgements applied in arriving at the revenue recognition

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- treatments to be balanced (2015: balanced); and
- the Group's accounting policy disclosures to be proportionate (2015: proportionate).

3 Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £7.0 million (2015: £7.0 million), determined with reference to a benchmark of Group revenue (of which it represents 0.7% (2015: 0.7%)). We consider revenue, rather than profit, to be the appropriate benchmark as the Corporation's aim is to achieve a long-term break-even position.

We reported to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.3 million (2015: £0.3 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

The Group's operations are all accounted for at the Group's office in London. The Group audit team performed the audit of the Group as if it was a single aggregated set of financial information. The audit was performed using the materiality level set out above and covered 100% of total Group revenue, Group profit before tax, and total Group assets.

4 Our opinion on other matters prescribed under the terms of our engagement is unmodified

In addition to our audit of the financial statements, the directors have engaged us to audit the information in the Members' Remuneration Report that is described as having been audited, which the directors have decided to prepare as if the company were required to comply with the requirements of Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008 No. 410) made under the Companies Act 2006.

In our opinion, the part of the Members' Remuneration Report which we were engaged to audit has been properly prepared in accordance with Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 made under the Companies Act 2006, as if those requirements were to apply to the corporation.

5 We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the Members' viability statement on page 114, concerning the principal risks, their management, and, based on that, the Members' assessment and expectations of the Group's continuing in operation over the three years to 2019; or
- the disclosures in the Group accounting policies concerning the use of the going concern basis of accounting.

6 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Members' statement that they consider that the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for stakeholders to assess the Group's position and performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

Under the terms of our engagement we are required to report to you if, in our opinion:

- proper accounting records have not been kept by the Corporation, or returns adequate for our audit have not been received from branches not visited by us; or
- the Corporation's individual financial statements and the part of the Members' Remuneration Report which we were engaged to audit are not in agreement with the accounting records and returns; or
- certain disclosures of Members' remuneration are not made; or
- we have not received all the information and explanations we require for our audit.

In addition to our audit of the financial statements, the Members have engaged us to review the Corporate Governance Statement as if the Corporation were required to comply with the Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority in relation to those matters.

Under the terms of our engagement we are required to review:

- the Members' statements, set out on pages 114 and 115, in relation to going concern and longer-term viability; and
- the part of the Corporate Governance Statement on pages 119 to 121 relating to the Corporation's compliance with the 11 provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Respective responsibilities of Members and auditor

As explained more fully in the Members' Responsibilities Statement set out on page 116, the Members are responsible for the preparation of financial statements which are intended by them to 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 UK Ethical Standards for Auditors.

Scope of an audit of financial statements performed in accordance with ISAs (UK and Ireland)

A description of the scope of an audit of financial statements is provided on our website at www.kpmg.com/uk/auditscopeother2014. This report is made subject to important explanations regarding our responsibilities, as published on that website, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

The purpose of our audit work and to whom we owe responsibilities

This report is made solely to the Corporation's Members as a body, in accordance with the Broadcasting Act 1990 and the terms of our engagement, and, in respect of the separate opinion in relation to the Members' Remuneration Report, reporting on corporate governance, and, in order that the Corporation's Members as a body may better understand the process by which we arrived at our audit opinion, the inclusion of findings in respect of the identified risks of material misstatement, on terms that have been agreed. Our audit work has been undertaken so that we might state to the Members those matters that we have agreed to state to them in our 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 Corporation and the Members, as a body, for our audit work, for this report, or for the opinions we have formed.

KAREN WIGHTMAN
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
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24 April 2017