CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

52 weeks ended 2 February 2014

	Note	2014 £m	2013 £m
Turnover	1.2	**17,680**	18,116
Cost of sales		**(16,606)**	(16,910)
Gross profit		**1,074**	1,206
Other operating income		**81**	80
Administrative expenses		**(1,250)**	(337)
Administrative expenses include:			
– Recurring		**(347)**	(337)
– Non-recurring exceptional costs	1.4	**(903)**	–
Operating (loss)/profit	1.6	**(95)**	949
Finance costs	6.2	**(87)**	(75)
Finance income	6.2	**5**	5
Share of profit of joint venture (net of tax)	4.3	**1**	–
(Loss)/profit before taxation		**(176)**	879
Taxation	2.2	**(62)**	(232)
(Loss)/profit for the period attributable to the owners of the Company		**(238)**	647
Other comprehensive income			
Items that will not be reclassified to profit or loss:			
Remeasurements of defined benefit pension schemes	8.2	**11**	(6)
Tax on defined benefit schemes	2.3	**(8)**	(2)
		3	(8)
Items that may be reclassified subsequently to profit or loss:			
Cash flow hedging movement		–	(2)
Tax on cash flow hedging movement	2.3	**(1)**	–
		(1)	(2)
Other comprehensive income for the period, net of tax		**2**	(10)
Total comprehensive income for the period attributable to the owners of the Company		**(236)**	637
Earnings per share (pence)			
– basic	1.5	**(10.23)**	26.65
– diluted	1.5	**(10.23)**	26.57

CONSOLIDATED BALANCE SHEET

2 February 2014

	Note	2014 £m	2013 £m
Assets			
Non-current assets			
Goodwill and intangible assets	3.2	**458**	415
Property, plant and equipment	3.3	**8,625**	8,616
Investment property	3.4	**119**	123
Investment in joint venture	4.3, 4.6	**66**	–
Investments	4.4	**31**	31
		9,299	9,185
Current assets			
Stocks		**852**	781
Debtors	5.2	**316**	291
Derivative financial assets	7.3	**1**	5
Cash and cash equivalents		**261**	265
		1,430	1,342
Liabilities			
Current liabilities			
Creditors	5.3	**(2,272)**	(2,130)
Short term borrowings	6.3	**(553)**	(52)
Derivative financial liabilities	7.3	**(10)**	(3)
Current tax liabilities		**(38)**	(149)
		(2,873)	(2,334)
Non-current liabilities			
Borrowings	6.3	**(2,480)**	(2,380)
Derivative financial liabilities	7.3	**(36)**	(16)
Deferred tax liabilities	2.3	**(430)**	(471)
Net pension liabilities	8.2	**(11)**	(20)
Provisions	5.4	**(207)**	(76)
		(3,164)	(2,963)
Net assets		**4,692**	5,230
Shareholders' equity			
Called-up share capital	6.5	**234**	235
Share premium	6.5	**127**	107
Capital redemption reserve	6.6	**39**	37
Merger reserve	6.6	**2,578**	2,578
Retained earnings and hedging reserve	6.6	**1,714**	2,273
Total equity attributable to the owners of the Company		**4,692**	5,230

The notes on pages 79 to 108 form part of these financial statements.

The financial statements on pages 75 to 108 were approved by the Board of Directors on 12 March 2014 and were signed on its behalf by:

Dalton Philips
Chief Executive

Trevor Strain
Chief Financial Officer

CONSOLIDATED CASH FLOW STATEMENT

52 weeks ended 2 February 2014

	Note	2014 £m	2013 £m
Cash flows from operating activities			
Cash generated from operations	5.5	**1,031**	1,432
Net interest paid		**(89)**	(82)
Taxation paid		**(220)**	(243)
Net cash inflow from operating activities		**722**	1,107
Cash flows from investing activities			
Investment in joint venture		**(66)**	–
Proceeds from sale of property, plant and equipment		**34**	5
Purchase of property, plant and equipment, investment property and software		**(835)**	(846)
Purchase of intangible assets		**(185)**	(134)
Cash outflow from acquisition of businesses, net of cash acquired	4.5	**–**	(36)
Net cash outflow from investing activities		**(1,052)**	(1,011)
Cash flows from financing activities			
Purchase of own shares	6.6	**(53)**	(514)
Purchase of treasury shares	6.5	**–**	(65)
Proceeds from exercise of share options, including issues from treasury shares	6.5	**28**	42
New borrowings		**790**	843
Repayment of borrowings		**(157)**	(81)
Dividends paid to equity shareholders	1.8	**(283)**	(270)
Net cash inflow/(outflow) from financing activities		**325**	(45)
Net (decrease)/increase in cash and cash equivalents		**(5)**	51
Cash and cash equivalents at start of period		**263**	212
Cash and cash equivalents at end of period		**258**	263

RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT IN THE PERIOD

	Note	2014 £m	2013 £m
Net (decrease)/increase in cash and cash equivalents		**(5)**	51
Cash outflow from decrease in debt and lease financing		**157**	81
Cash inflow from increase in borrowings		**(790)**	(843)
Other non-cash movements		**2**	1
Opening net debt		**(2,181)**	(1,471)
Closing net debt	6.4	**(2,817)**	(2,181)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

52 weeks ended 2 February 2014

		Attributable to the owners of the Company						
	Note	Share capital £m	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Hedging reserve £m	Retained earnings £m	Total equity £m
Current period								
At 4 February 2013		**235**	**107**	**37**	**2,578**	**(14)**	**2,287**	**5,230**
(Loss)/profit for the period		**–**	**–**	**–**	**–**	**–**	**(238)**	**(238)**
Other comprehensive income:								
Pension remeasurement	8.2	**–**	**–**	**–**	**–**	**–**	**11**	**11**
Tax in relation to components of other comprehensive income	2.3	**–**	**–**	**–**	**–**	**(1)**	**(8)**	**(9)**
Total comprehensive income for the period		**–**	**–**	**–**	**–**	**(1)**	**(235)**	**(236)**
Shares purchased for cancellation	6.5, 6.6	**(2)**	**–**	**2**	**–**	**–**	**(53)**	**(53)**
Employees share options schemes:								
Issue of shares and utilisation of treasury shares	6.5	**1**	**20**	**–**	**–**	**–**	**7**	**28**
Share-based payments	1.7	**–**	**–**	**–**	**–**	**–**	**6**	**6**
Dividends	1.8	**–**	**–**	**–**	**–**	**–**	**(283)**	**(283)**
Total transactions with owners		**(1)**	**20**	**2**	**–**	**–**	**(323)**	**(302)**
At 2 February 2014		**234**	**127**	**39**	**2,578**	**(15)**	**1,729**	**4,692**

		Attributable to the owners of the Company						
	Note	Share capital £m	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Hedging reserve £m	Retained earnings £m	Total equity £m
Prior period								
At 29 January 2012		253	107	19	2,578	(12)	2,452	5,397
Profit for the period		–	–	–	–	–	647	647
Other comprehensive income:								
Actuarial loss arising in the pension scheme	8.2	–	–	–	–	–	(6)	(6)
Cash flow hedging movement		–	–	–	–	(2)	–	(2)
Tax in relation to components of other comprehensive income	2.3	–	–	–	–	–	(2)	(2)
Total comprehensive income for the period		–	–	–	–	(2)	639	637
Shares purchased for cancellation	6.5, 6.6	(18)	–	18	–	–	(514)	(514)
Employees share options schemes:								
Treasury share purchases and utilisation for share options	6.5	–	–	–	–	–	(24)	(24)
Share-based payments	1.7	–	–	–	–	–	4	4
Dividends	1.8	–	–	–	–	–	(270)	(270)
Total transactions with owners		(18)	–	18	–	–	(804)	(804)
At 3 February 2013		235	107	37	2,578	(14)	2,287	5,230

GENERAL INFORMATION

COMPANY INFORMATION

Wm Morrison Supermarkets PLC is a public limited company incorporated in the United Kingdom under the Companies Act 2006 (Registration number 358949). The Company is domiciled in the United Kingdom and its registered address is Hilmore House, Gain Lane, Bradford, BD3 7DL, United Kingdom.

BASIS OF PREPARATION

The financial statements have been prepared for the 52 weeks ended 2 February 2014 (2013: 53 weeks ended 3 February 2013) in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretation Committee interpretations (IFRIC) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. IFRS and IFRIC are issued by the International Accounting Standards Board (the IASB) and must be adopted into European Union law, referred to as endorsement, before they become mandatory under the IAS Regulation.

The financial statements have been prepared on a going concern basis. The Directors' assessment of going concern has been considered within the Corporate governance report on page 43.

The financial statements are presented in pounds sterling, rounded to the nearest million, except in some instances, where it is deemed relevant to disclose the amounts up to two decimal places. They are drawn up on the historical cost basis of accounting, except as disclosed in the accounting policies set out within these financial statements.

The Group's accounting policies have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

ACCOUNTING REFERENCE DATE

The accounting period of the Group ends on the Sunday falling between 29 January and 4 February each year.

The following amendments to standards are mandatory for the first time for the financial period ended 2 February 2014:

IAS 19 (2011) EMPLOYEE BENEFITS

As a result of IAS 19 (2011), the Group has changed its accounting policy with respect to the basis for determining the income or expense related to the net pension liability. Under IAS 19 (2011), the Group determines the net interest expense (or income) for the period on the net pension liability (or asset) by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net pension liability (or asset) at the beginning of the annual period, taking into account any changes in the net pension liability (or asset) during the period as a result of contributions and benefit payments. Previously, the Group determined interest income on plan assets based on their long-term rate of return.

The effect of this change in the 52 weeks ending 2 February 2014 is to reduce net interest income on the net pension liability by £17m (3 February 2013: £5m) and increase administration costs in operating loss by £3m (3 February 2013: £2m). Actuarial gains in other comprehensive income are reduced by £20m (3 February 2013: actuarial losses increased by £3m). There is no effect on the net pension liability in the balance sheet. The effect on basic earnings per share for the 52 weeks ending 2 February 2014 is a reduction of 0.9 pence (2013: 0.3 pence). The results for the 53 weeks ended 3 February 2013 have not been restated for the change described above because the change is immaterial to the Group's results in that comparative period.

IAS 1 (AMENDMENT) PRESENTATION OF ITEMS OF OTHER COMPREHENSIVE INCOME

As a result of the amendments to IAS 1, the Group has modified the presentation of items of other comprehensive income in order to present separately items that would be reclassified to profit or loss in the future from those that would not be. Comparative information has been represented accordingly.

IFRS 13 FAIR VALUE MEASUREMENT

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair value measurement, when such measurements are required or permitted by other IFRSs. The standard had no impact on the measurement of the Group's assets and liabilities, but has introduced some new disclosures. In accordance with the transitional provisions of IFRS 13, the Group has applied the new fair value measurement guidance prospectively and has not provided any comparative information for new disclosures.

NEW IFRS AND AMENDMENTS TO IAS AND INTERPRETATIONS

There are a number of standards and interpretations issued by the IASB that are effective for financial statements after this reporting period.

The application of these standards and interpretations, which include IFRSs 10–12, is not anticipated to have a material effect on the Group's financial statements.

BASIS OF CONSOLIDATION

Subsidiaries are entities that the Group controls and are included in the Group's consolidated financial statements from the date that control commences to the date that control ceases. Control is achieved where the Company has the power to govern the financial and operating policies of an investee so as to obtain benefits from its activities. The financial statements of subsidiaries used in the consolidation are prepared for the same reporting period as the parent Company and are based on consistent accounting policies. Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions are eliminated on consolidation.

FOREIGN CURRENCIES

Transactions in foreign currencies are recorded at the rates of exchange at the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currency are retranslated at the rates of exchange at the balance sheet date. Gains and losses arising on retranslation are included in the income statement for the period.

CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The judgements that have the most significant effect on the amounts recognised in these financial statements, and sources of estimation uncertainty that have a significant risk of resulting in material adjustment to carrying amounts in the next financial year, are described within the Corporate governance report on page 43. Further detail on each of these matters can be found within notes 1.4, 3.2, 3.3 and 5.4.

NOTES TO THE GROUP FINANCIAL STATEMENTS

52 weeks ended 2 February 2014

1 PERFORMANCE IN THE PERIOD

1.1 ACCOUNTING POLICIES

Turnover recognition

Sale of goods in-store and online, and fuel

Turnover from the sale of goods in-store and online comprises cash from customers and is recorded net of VAT, returns, staff discounts, coupons, vouchers and the free element of multi-save transactions. Sale of fuel is recognised net of VAT and Morrisons Miles award points. Revenue is recognised when transactions are completed in-store, or, in the case of food online, when goods are accepted by the customer on delivery.

Other sales

Other revenue includes income from concessions and commissions based on the terms of the contract and manufacturing sales made direct to third party customers recognised on despatch of goods. Revenue collected on behalf of others is not recognised as turnover, other than the related commission. Sales are recorded net of VAT and intra-group transactions.

Cost of sales

Cost of sales consists of all costs to the point of sale including manufacturing, warehouse and transportation costs. Store depreciation, store overheads and store-based employee costs are also allocated to cost of sales.

Supplier income

Supplier incentives, rebates and discounts are collectively referred to as supplier income in the retail industry. Supplier income is recognised as a deduction from cost of sales on an accruals basis, based on the expected entitlement that has been earned up to the balance sheet date for each relevant supplier contract. The accrued incentives, rebates and discounts receivable at year end are included within prepayments and accrued income. Where amounts received are in the expectation of future business, these are recognised in the income statement in line with that future business.

Other operating income

Other operating income primarily consists of income not directly related to the operating of supermarkets and mainly comprises rental income from investment properties and income generated from recycling of packaging.

1.2 SALES ANALYSIS

This table is provided to reconcile the like-for-like sales described in the Strategic report with the total turnover:

	Like-for-like stores	Other	**2014 Total £m**	2013 Total £m
Sale of goods in-stores	12,990	444	**13,434**	13,674
Fuel	3,878	106	**3,984**	4,241
Total store-based sales	16,868	550	**17,418**	17,915
Other sales	–	262	**262**	201
Total turnover	16,868	812	**17,680**	18,116

Fuel sales are removed from quoted like-for-like figures, given the volatility in the fuel price, in order to provide a more stable measure.

1.3 SEGMENTAL REPORTING

The Group's principal activity is that of retailing, derived solely from the UK. The Group is not reliant on any major customer for 1% or more of revenues.

The Group is required to determine and present its operating segments based on the way in which financial information is organised and reported to the chief operating decision-maker (CODM). The CODM has been identified as the Management Board as it is this Board that makes the key operating decisions of the Group, is responsible for allocating resources and assessing performance.

Key internal reports received by the CODM, primarily the management accounts, focus on the performance of the Group as a whole. The operations of all elements of the business are driven by the retail sales environment and hence have fundamentally the same economic characteristics. All operational decisions made are focused on the performance and growth of the retail outlets and the ability of the business to meet the supply demands of the stores.

The Group has considered the overriding core principles of IFRS 8 as well as its internal reporting framework, management and operating structure. In particular, the Group considered its retail outlets, the fuel resale operation, the manufacturing entities and multi-channel operations. The Directors' conclusion is that the Group has one operating segment, that of retailing.

Reconciliations of reportable segment revenues, profit or loss, assets and liabilities and other material items

Performance is measured by the CODM based on underlying profit before tax as reported in the management accounts. Management believes that this underlying profit measure is the most relevant in evaluating the results of the Group to its peers. This information and the reconciliation to the statutory position can be found in 1.4. In addition, the management accounts present a Group balance sheet containing assets and liabilities. This balance sheet is as shown within the Consolidated balance sheet.

1 PERFORMANCE IN THE PERIOD – CONTINUED

1.4 UNDERLYING EARNINGS

The Directors consider that underlying earnings and underlying earnings per share measures provide useful information for shareholders on underlying trends and performance. Adjustments are made to reported (loss)/profit to (a) remove the impact of pension interest volatility; (b) remove losses or profits arising on property transactions since they do not form part of the Group's principal activities; (c) remove costs of new business development activity; (d) remove non-recurring exceptional costs; and (e) apply a tax rate of 25.3% (2013: 26.5%), being an estimated normalised tax rate.

	2014 £m	2013 £m
(Loss)/profit after tax	**(238)**	647
Add back: tax charge for the period[1]	**62**	232
(Loss)/profit before tax	**(176)**	879
Adjustments for:		
Net pension interest expense (note 8.2)[1]	**1**	4
(Profit)/loss arising on property transactions[1]	**(9)**	1
New business development costs[1]	**66**	17
	58	22
Non-recurring exceptional costs:		
Trading stores[1]	**379**	–
Pipeline[1]	**319**	–
Kiddicare[1]	**163**	–
Other[1]	**42**	–
	903	–
Underlying profit before tax	**785**	901
Taxation[1]	**(199)**	(239)
Underlying profit after tax	**586**	662
Underlying earnings per share (pence)		
– basic (note 1.5.2)	**25.18**	27.26
– diluted (note 1.5.2)	**25.09**	27.17

[1] Adjustments marked 1 equal £824m (2013: £15m) as shown in the reconciliation of earnings disclosed in note 1.5.2.

The new business development costs of £66m include £25m of costs relating to the establishment of our food online business, including legal costs of £7m. In relation to other new business channels, there are £27m of property related costs and £6m of IT and distribution costs.

The charge of £379m, being £330m impairment and £49m onerous leases, has been incurred on certain trading stores in the Group. The impairment charge reflects the Group's view of structural changes in the market, including channel shift and expectations of margin rebuild over time. The assumptions relating to this review are disclosed in note 3.3.

The Group has reviewed its property pipeline using revised investment appraisal criteria and has written down the carrying amount of certain sites, where it no longer intends to build a supermarket, to their recoverable amount resulting in impairment of £90m, a provision of £38m (note 5.4) in respect of onerous property leases and a provision for capital contracts of £191m, which is recognised in other creditors.

The Kiddicare business charge includes £24m of goodwill, £12m of brand, £70m of asset impairments and £57m of onerous lease provisions. Other impairments principally includes £27m write off of the costs incurred in the development of our own organic food online offer which is no longer required as a result of our arrangement with Ocado.

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

1 PERFORMANCE IN THE PERIOD – CONTINUED

1.5 EARNINGS PER SHARE

Basic (loss)/earnings per share (EPS) is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. For diluted EPS, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares. The Company has two (2013: two) classes of instrument that are potentially dilutive: those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the period and contingently issuable shares under the Group's Long term incentive plans (LTIP).

1.5.1 Basic and diluted EPS (unadjusted)

Reconciliations of the earnings and weighted average number of shares used in the calculations are set out below:

	2014			2013		
	Earnings £m	**Weighted average number of shares millions**	**EPS pence**	Earnings £m	Weighted average number of shares millions	EPS pence
Unadjusted EPS						
Basic EPS						
(Loss)/earnings attributable to ordinary shareholders	**(238)**	**2,327.0**	**(10.23)**	647	2,428.0	26.65
Effect of dilutive instruments						
Share options and LTIPs	**–**	**–**	**–**	–	7.0	(0.08)
Diluted EPS	**(238)**	**2,327.0**	**(10.23)**	647	2,435.0	26.57

1.5.2 Underlying EPS

The reconciliation of the earnings used in the calculations of underlying earnings per share is set out below:

	2014			2013		
	Earnings £m	**Weighted average number of shares millions**	**EPS pence**	Earnings £m	Weighted average number of shares millions	EPS pence
Underlying EPS						
Basic EPS						
(Loss)/earnings attributable to ordinary shareholders	**(238)**	**2,327.0**	**(10.23)**	647	2,428.0	26.65
Adjustments to determine underlying profit (note 1.4)	**824**	**–**	**35.41**	15	–	0.61
	586	**2,327.0**	**25.18**	662	2,428.0	27.26
Effect of dilutive instruments						
Share options and LTIPs	**–**	**9.0**	**(0.09)**	–	8.5	(0.09)
Diluted EPS	**586**	**2,336.0**	**25.09**	662	2,436.5	27.17

The weighted average number of shares has decreased compared to the prior period as a result of the Group's equity retirement programme, see note 6.5.

1 PERFORMANCE IN THE PERIOD – CONTINUED

1.6 OPERATING (LOSS)/PROFIT

	2014 £m	2013 £m
The following items have been included in arriving at operating (loss)/profit:		
Employee costs (note 1.7)	**1,972**	1,947
Depreciation and impairment:		
– Property, plant and equipment (note 3.3)	**336**	335
– Investment property (note 3.4)	**5**	4
– Impairment	**457**	–
Amortisation (note 3.2)		
– Intangible assets	**53**	29
– Impairment	**89**	–
Operating lease rentals:		
– minimum lease payments	**83**	69
– sublease receipts	**(7)**	(5)
Value of stock expensed	**13,437**	13,760

During the period KPMG Audit Plc, the Group's auditor, provided the following services:

	2014 £m	2013 £m
Audit services		
Fees payable to the Group's auditor for the audit of the Group and the Company financial statements	**0.4**	0.4
Other services		
Fees payable to the Group's auditor and its associates for other services:		
– the audit of the Group's subsidiaries pursuant to legislation	**0.2**	0.2
– services relating to taxation	**0.1**	0.1
– other services	**0.1**	0.4
	0.8	1.1

Other services includes £0.1m (2013: £0.2m) in relation to independent project assurance.

1.7 EMPLOYEES AND DIRECTORS

	2014 £m	2013 £m
Employee benefit expense for the Group during the period		
Wages and salaries	**1,787**	1,780
Social security costs	**121**	118
Share-based payments (section 9)	**6**	4
Pension costs	**58**	45
	1,972	1,947

	2014 No.	2013 No.
Average monthly number of people, including Directors		
Stores	**111,199**	112,965
Manufacturing	**7,320**	6,598
Distribution	**5,996**	6,248
Centre	**2,888**	2,894
	127,403	128,705

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

1 PERFORMANCE IN THE PERIOD – CONTINUED

1.7 EMPLOYEES AND DIRECTORS – CONTINUED

Directors' remuneration

A detailed analysis of Directors' remuneration, including salaries, bonuses and long term incentives, and the highest paid Director, is provided in the Single total figure of remuneration table, in the audited section of the Directors' remuneration report, which forms part of these financial statements (page 63).

There are no Executive Directors (2013: one – Morrisons CARE scheme) who have retirement benefits accruing under any of the Group's defined benefit pension schemes.

The table below shows the remuneration of senior managers. It excludes members already included in the Directors' remuneration report. Senior managers are considered to be key management personnel in accordance with the requirements of IAS 24 'Related party disclosures', and senior manager in the context of gender disclosures required by the Companies Act 2006.

	2014 £m	2013 £m
Senior managers		
Wages and salaries	**27**	20
Social security	**4**	3
Share-based payments	**3**	–
Pension costs	**1**	1
	35	24

1.8 DIVIDENDS

Amounts recognised as distributed to equity holders in the period:

	2014 £m	2013 £m
Interim dividend for the period ended 2 February 2014 of 3.84p (2013: 3.49p)	**90**	84
Final dividend for the period ended 3 February 2013 of 8.31p (2012: 7.53p)	**193**	186
	283	270

The Directors propose a final dividend in respect of the financial period ending 2 February 2014 of 9.16p per share which will absorb an estimated £214m of shareholders' funds. Subject to approval at the AGM, it will be paid on 11 June 2014 to shareholders who are on the register on 9 May 2014.

2 TAXATION

2.1 ACCOUNTING POLICIES

Current tax

The current income tax charge is calculated on the basis of the tax laws in effect during the period and any adjustments to tax payable in respect of previous periods. Taxable profit differs from the reported profit for the period as it is adjusted both for items that will never be taxable or deductible, and temporary differences. Current tax is charged to profit for the period, except when it relates to items charged or credited directly in other comprehensive income or equity in which case the current tax is reflected in other comprehensive income or equity as appropriate.

Deferred tax

Deferred tax is recognised using the balance sheet method. Provision is made for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. No deferred tax is recognised for temporary differences that arise on the initial recognition of goodwill or the initial recognition of assets and liabilities that is not a business combination and that affects neither accounting nor taxable profits.

Deferred tax is calculated based on tax law that is enacted or substantively enacted at the reporting date and provided at rates expected to apply when the temporary differences reverse. Deferred tax is charged or credited to profit for the period except when it relates to items charged or credited directly to other comprehensive income or equity, in which case the deferred tax is reflected in other comprehensive income or equity as appropriate.

Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the asset can be utilised. Deferred tax assets recognised are reviewed at each reporting date as judgement is required to estimate the availability of future taxable income. Deferred tax assets and liabilities are offset where amounts will be settled on a net basis as there is a legally enforceable right to offset.

Accruals for tax contingencies require management to make judgements and estimates of ultimate exposures in relation to tax compliance issues. All accruals are included in current liabilities.

2.2 TAXATION

2.2.1 Analysis of charge in the period

	2014 £m	2013 £m
Corporation tax		
– current period	**158**	261
– adjustments in respect of prior periods	**(46)**	(32)
	112	229
Deferred tax		
– origination and reversal of timing differences	**(12)**	(3)
– adjustments in respect of prior periods	**30**	47
– impact of change in tax rate	**(68)**	(41)
	(50)	3
Tax charge for the period	**62**	232

2.2.2 Tax on items charged in other comprehensive expense and equity

	2014 £m	2013 £m
Remeasurements arising in the pension scheme (of which rate change is £6m)	**8**	2
Cash flow hedges	**1**	–
Total tax on items included in other comprehensive income	**9**	2
Share-based payments	**–**	2
Total tax on items included in other comprehensive income and equity	**9**	4
Analysis of items charged to other comprehensive income and equity:		
Deferred tax (note 2.3)	**9**	4

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

2 TAXATION – CONTINUED

2.2 TAXATION – CONTINUED

2.2.3 Tax reconciliation

The tax for the period is higher (2013: higher) than the standard rate of corporation tax in the UK of 23.2% (2013: 24.3%). The differences are explained below:

	2014 £m	2013 £m
(Loss)/profit before tax	**(176)**	879
(Loss)/profit before tax at 23.2% (2013: 24.3%)	**(41)**	214
Effects of:		
Expenses not deductible for tax purposes	**5**	10
Non-qualifying depreciation	**35**	39
Deferred tax on Safeway acquisition assets	**(5)**	(10)
Non-recurring exceptional costs not deductible for tax	**154**	–
Effect of change in tax rate	**(68)**	(41)
Other	**(3)**	5
Prior period adjustments	**(15)**	15
Tax charge for the period	**62**	232

Factors affecting current and future tax charges

Legislation to reduce the rate of corporation tax from 23% to 20% was included in the Finance Act 2013. As it had been substantively enacted at the balance sheet date, the deferred tax balances at 2 February 2014 have been measured at this rate. The impact of this change in tax rate results in a credit of £68m to the Income statement, and a debit of £6m to Other comprehensive income. There have been no indications of any further changes in the rate of corporation tax from 20%.

2.3 DEFERRED TAX

	2014 £m	2013 £m
Deferred tax liability	**(472)**	(519)
Deferred tax asset	**42**	48
Net deferred tax liability	**(430)**	(471)

IAS 12 'Income taxes' permits the offsetting of balances within the same tax jurisdiction. All of the deferred tax assets are available for offset against deferred tax liabilities.

The movements in deferred tax (liabilities)/assets during the period are shown below:

	Property, plant and equipment £m	Pensions £m	Share-based payments £m	Other short term temporary differences £m	Total £m
Current period					
At 4 February 2013	(519)	5	–	43	**(471)**
Credited/(charged) to loss for the period	63	5	–	(18)	**50**
Charged to other comprehensive income and equity	–	(8)	–	(1)	**(9)**
At 2 February 2014	(456)	2	–	24	**(430)**
Prior period					
At 29 January 2012	(509)	2	6	37	**(464)**
(Charged)/credited to profit for the period	(10)	5	(4)	6	**(3)**
Charged to other comprehensive income and equity	–	(2)	(2)	–	**(4)**
At 3 February 2013	(519)	5	–	43	**(471)**

Included within the total (charged)/credited to (loss)/profit for the period is an amount credited of £68m (2013: £41m), and within the total charged to other comprehensive income a charge of £6m (2013: £4m), in respect of the change in the tax rate at which deferred tax balances are expected to reverse.

3 OPERATING ASSETS

3.1 ACCOUNTING POLICIES

Intangible assets

Goodwill
Goodwill arising on a business combination is not amortised but is reviewed for impairment on an annual basis or more frequently if there are indicators that it may be impaired. Goodwill is allocated to cash generating units that will benefit from the synergies of the business combination for the purpose of impairment testing.

Brands
Brands acquired through a business combination are initially recognised at their fair value at the acquisition date and amortised to profit or loss on a straight line basis over their estimated useful economic life.

Software development costs
Costs that are directly attributable to the creation of identifiable software, which meet the development asset recognition criteria as laid out in IAS 38 'Intangible assets' are recognised as intangible assets.

Direct costs include consultancy costs, the employment costs of internal software developers and borrowing costs. All other software development and maintenance costs are recognised as an expense as incurred. Software development assets are held at historic cost less accumulated amortisation and impairment, and are amortised over their estimated useful lives (3 to 10 years) on a straight line basis.

Licences
Separately acquired pharmaceutical licences and software licences are recognised at historic cost less accumulated amortisation and impairment. Those acquired in a business combination are recognised at fair value at the acquisition date. Pharmaceutical licences and software licences are amortised over their useful lives (3 to 10 years) on a straight line basis.

Property, plant and equipment
Property, plant and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Costs include directly attributable costs. Annual reviews are made of estimated useful lives and material residual values.

Depreciation rates used to write off cost less residual value on a straight line basis are:

Freehold land	0%
Freehold buildings	2.5%
Leasehold land	Over the lease period
Leasehold buildings	Over the shorter of lease period and 2.5%
Plant, equipment, fixtures and vehicles	10% to 33%
Assets under construction	0%

Depreciation expense is primarily charged in cost of sales with an immaterial amount in administration expenses.

Investment property
Property held to earn rental income is classified as investment property and is held at cost less accumulated depreciation and impairment. The depreciation policy is consistent with that described for property above.

Lessor accounting – operating leases
Assets acquired and made available to third parties under operating leases are recorded as property, plant and equipment and investment property and are depreciated on a straight line basis to their estimated residual values over their estimated useful lives. Operating lease income is credited on a straight line basis to the date of the next rent review.

Impairment of non-financial assets
Intangible assets with indefinite lives, such as goodwill, and those in construction that are not yet being amortised, are tested for impairment annually. Other non-financial assets are tested if events or changes in circumstances indicate that the carrying amount may not be recoverable.

Testing is performed at the level of a cash generating unit (CGU) in order to compare the CGU's recoverable amount against its carrying value. An impaired CGU is written down to its recoverable amount, which is the higher of value in use or its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses are reversed if there is evidence of an increase in the recoverable amount of a previously impaired asset, but only to the extent that the recoverable amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognised. Impairment losses relating to goodwill are not reversed.

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

3 OPERATING ASSETS – CONTINUED

3.2 INTANGIBLE ASSETS

	Goodwill £m	Brands £m	Software development costs £m	Licences £m	**Total £m**
Current period					
Cost					
At 4 February 2013	34	15	406	26	**481**
Additions	–	–	164	14	**178**
Interest capitalised	–	–	7	–	**7**
At 2 February 2014	34	15	577	40	**666**
Accumulated amortisation and impairment					
At 4 February 2013	–	2	49	15	**66**
Charge for the period	–	1	46	6	**53**
Impairment	24	12	52	1	**89**
At 2 February 2014	24	15	147	22	**208**
Net book amount at 2 February 2014	10	–	430	18	**458**

Goodwill

The goodwill brought forward arose on the acquisition of kiddicare.com Limited ('Kiddicare') (£24m), Flower World Limited (£3m) and Farmers Boy (Deeside) Limited £7m.

Cash generating units

The Group considers that each of its Morrisons stores is a CGU, which together form a grocery group of CGUs supported by corporate assets such as head office and vertically integrated suppliers. The Kiddicare business forms a single, separate CGU.

Impairment testing of goodwill

Remaining goodwill of £10m, after the write down of £24m described to the right, is allocated to the grocery group of CGUs. This group of CGUs has been tested for impairment via a value in use calculation, within which the key assumptions are the growth rates and the discount rate, as well as those performance assumptions made in determining budgeted cash flows over the next five years, which are based on the latest Board approved cash flow projections. The growth rate applied to the period after five years is 2% (2013: 2%). The discount rate applied is 6.5%.

Software development costs

The cumulative interest capitalised included within software development costs is £27m (2013: £20m). The cost of internal labour capitalised is not material for separate disclosure. During the period, Morrisons has invested £30m in the technology required to operate an online grocery business, which is included in software development costs (see note 4.6).

Impairment of software development costs, goodwill and brand

As explained in note 1.4, the impairment includes £27m write off of the investment in the development of Morrisons own organic food online offer. Also included is £12m of the Kiddicare brand, £24m of goodwill, which arose on acquisition of Kiddicare, and £24m of software development assets, principally relating to Kiddicare. A discount rate of 6.5% and a nil growth rate after five years have been applied in the value in use calculation underpinning this impairment loss.

3 OPERATING ASSETS – CONTINUED

3.2 INTANGIBLE ASSETS – CONTINUED

	Goodwill £m	Brands £m	Software development costs £m	Licences £m	Total £m
Prior period					
Cost					
At 29 January 2012	34	15	269	22	340
Additions	–	–	130	4	134
Interest capitalised	–	–	7	–	7
At 3 February 2013	34	15	406	26	481
Accumulated amortisation and impairment					
At 29 January 2012	–	1	25	11	37
Charge for the period	–	1	24	4	29
At 3 February 2013	–	2	49	15	66
Net book amount at 3 February 2013	34	13	357	11	415

3.3 PROPERTY, PLANT AND EQUIPMENT

	Land and buildings			
	Freehold £m	Leasehold £m	Plant, equipment, fixtures & vehicles £m	**Total £m**
Current period				
Cost				
At 4 February 2013	8,205	1,009	2,340	**11,554**
Additions at cost	365	103	339	**807**
Interest capitalised	10	–	–	**10**
Transfer to investment properties	(13)	–	–	**(13)**
Disposals	(2)	–	(6)	**(8)**
At 2 February 2014	8,565	1,112	2,673	**12,350**
Accumulated depreciation and impairment				
At 4 February 2013	1,070	180	1,688	**2,938**
Charge for the period	109	35	192	**336**
Impairment	296	140	21	**457**
Transfer to investment properties	2	–	–	**2**
Disposals	(2)	–	(6)	**(8)**
At 2 February 2014	1,475	355	1,895	**3,725**
Net book amount at 2 February 2014	7,090	757	778	**8,625**

Included above are assets under construction of £236m (2013: £395m). Also included are leasehold land and buildings held under finance lease with a cost of £308m (2013: £308m) and accumulated depreciation of £19m (2013: £16m). In freehold land and buildings is property of £81m relating to the arrangement with Ocado (see note 4.6).

The cost of financing property developments prior to their opening date has been included in the cost of the project. The cumulative amount of interest capitalised in the total cost above amounts to £269m (2013: £259m).

As discussed in note 1.4, the impairment relates to costs incurred on stores we no longer intend to open, trading stores and assets of the Kiddicare business.

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

3 OPERATING ASSETS – CONTINUED

3.3 PROPERTY, PLANT AND EQUIPMENT – CONTINUED

Impairment

An impairment test was conducted on under-performing stores and each store's recoverable amount determined as the higher of value in use and fair value less costs to sell on a case-by-case basis. The former is determined by projecting individual store cash flows over the store's useful life, with a growth rate applied after five years that is consistent with the IGD's forecast of long term growth rates in the retail industry. A discount rate of 6.5% (2013: 6.8%) was used. Fair value less costs to sell is based on valuations prepared by independent valuers using a vacant possession basis.

An impairment loss of £457m has been recognised during the year on the assets described in note 1.4. Recoverable amount is based on value in use in the majority of cases. The events and circumstances that led to this loss are discussed in note 1.4.

	Land and buildings			
	Freehold £m	Leasehold £m	Plant, equipment, fixtures & vehicles £m	Total £m
Prior period				
Cost				
At 29 January 2012	7,565	930	2,073	10,568
Acquired in a business combination (note 4.5)	14	–	6	20
Additions at cost	492	79	283	854
Interest capitalised	8	–	–	8
Transfer from investment properties	136	–	–	136
Disposals	(10)	–	(22)	(32)
At 3 February 2013	8,205	1,009	2,340	11,554
Accumulated depreciation and impairment				
At 29 January 2012	977	153	1,495	2,625
Charge for the period	95	27	213	335
Transfer from investment properties	4	–	–	4
Disposals	(6)	–	(20)	(26)
At 3 February 2013	1,070	180	1,688	2,938
Net book amount at 3 February 2013	7,135	829	652	8,616

3 OPERATING ASSETS – CONTINUED

3.4 INVESTMENT PROPERTY

	2014 £m	2013 £m
Cost		
At start of period	**189**	325
Additions	**3**	–
Transfer from/(to) property, plant and equipment	**13**	(136)
Disposals	**(22)**	–
At end of period	**183**	189
Accumulated depreciation and impairment		
At start of period	**66**	66
Charge for the period	**5**	4
Transfer from/(to) property, plant and equipment	**(2)**	(4)
Disposals	**(5)**	–
At end of period	**64**	66
Net book amount at end of period	**119**	123

Included in other operating income is £26m (2013: £23m) of rental income generated from investment properties. The fair value of investment properties at the end of the period was £230m (2013: £255m). The Directors do not believe that there has been a material change in yield since the last period. Investment properties are valued by independent surveyors on a vacant possession basis using observable inputs (fair value hierarchy Level 2). Investment properties transferred (to)/from property, plant and equipment have arisen following a review of asset categories, and remain within the same asset class for depreciation purposes.

3.5 OPERATING LEASES – LESSOR

The Group has non-cancellable agreements with tenants with varying terms, escalation clauses and renewal rights. The future minimum lease income is as follows:

	2014 £m	2013 £m
Within one year	**27**	26
More than one year and less than five years	**88**	89
After five years	**127**	114
	242	229

3.6 CAPITAL COMMITMENTS

	2014 £m	2013 £m
Contracts placed for future capital expenditure not provided in the financial statements (property, plant and equipment)	**179**	77

4 INTERESTS IN OTHER ENTITIES

4.1 ACCOUNTING POLICIES

Joint ventures

Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for the strategic financial and operating decisions. Investments in jointly controlled entities are accounted for under the equity method and are initially recognised at cost.

The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of the equity accounted investees, after adjustment to align the accounting policies with those of the Group, from the date that joint control commences until the date that joint control ceases.

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

4 INTERESTS IN OTHER ENTITIES – CONTINUED

Investments

Investments comprise investments in equity instruments held for long term investment. They are measured at fair value through other comprehensive income, where the fair value can be measured reliably. Where the fair value of the instruments cannot be measured reliably, for example, when there is variability in the range of estimates, the investments are recognised at cost less accumulated impairment losses.

Business combinations

The acquisition method is used to account for business combinations. Consideration is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group, including the fair value of any contingent consideration arrangement. Acquisition related costs are expensed as incurred. Identifiable assets acquired, and liabilities and contingent liabilities assumed, are measured initially at their fair values at the acquisition date. On an acquisition by acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

Goodwill is the excess of consideration transferred, plus any non-controlling interest and the fair value of any previous equity interest in the acquiree, over the fair value of the Group's share of the identifiable net assets acquired. In the event that this excess is negative the difference is recognised directly in profit for the period.

4.2 PRINCIPAL SUBSIDIARIES

Subsidiaries of Wm Morrison Supermarkets PLC	Principal activity	Equity holding %
Farmers Boy Limited	Manufacturer and distributor of fresh food products	100
Neerock Limited	Fresh meat processor	100
Wm Morrison Produce Limited	Produce packer	100
Safeway Limited	Holding company	100
Optimisation Developments Limited	Property development	100
Kiddicare Limited	Baby product retailer	100
Subsidiaries of other Group companies		
Safeway Stores Limited	Grocery retailer	100

The Group has taken advantage of the exemption under Section 410(2) of Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affect the financial statements. All of the above companies are registered in England and Wales and the principal area of trading for all the above companies is the United Kingdom. All equity holdings are in ordinary shares.

In addition to the above, the Company has a number of other subsidiary companies, particulars of which will be annexed to the next annual return.

4.3 JOINT VENTURES

Morrisons and Ocado are sole investors in a company (MHE JV Co), which owns the plant and equipment at the Dordon Customer Fulfilment Centre (CFC) (see note 4.6). Each party owns 50% of the equity of MHE JV Co and decisions regarding MHE JV Co require the unanimous consent of both parties. The Directors have considered the impact of IFRS 11 Joint arrangements, which will be applicable from the Group's year ending January 2015, and determined that the Group continues to jointly control MHE JV Co on application of that standard.

MHE JV Co	2014 £m	2013 £m
Current assets	**17**	–
Non-current assets	**118**	–
Current liabilities	**17**	–
Income	**2**	–

The Company is also part of a joint venture, with The Great Steward of Scotland Dumfries House Trust, in respect of The Morrisons Farm at Dumfries House Limited, whose principal activity is to farm 859 acres of agricultural land located on the Dumfries House Estate near Cumnock in Ayrshire, Scotland. The Farm's results are immaterial to the Group.

4.4 INVESTMENTS

	2014 £m	2013 £m
Equity investments	**31**	31

The equity investments held for long term investment represents a 12% stake in Fresh Direct Inc, an internet grocer serving the New York and Philadelphia markets. The investment was made on 9 March 2011.

4 INTERESTS IN OTHER ENTITIES – CONTINUED

4.5 BUSINESS COMBINATIONS

52 weeks ended 2 February 2014
On 24 July 2013 Wm Morrison Produce Limited acquired 51% of the equity of Global Ripeners Limited, a company within Global Pacific group, for £4m cash consideration. This acquisition further expands the Group's manufacturing capability in a key product, bananas. Global Pacific has retained 49% of the issued share capital. As part of the transaction a put and call option has been put in place between the Group and Global Pacific. As a result of the nature of these options, Global Ripeners Limited has been treated as a 100% subsidiary from acquisition, with the stake of Global Pacific being treated as debt. The fair value of the Group's commitment in relation to the 49% shareholding at the date of acquisition is £4m. No goodwill arose on this acquisition and plant and machinery of £4m has been recognised in the Group. Global Ripeners Limited had £4m of cash on acquisition.
On 31 July 2013, Global Ripeners Limited changed its name to Wm Morrison Bananas Limited.

53 weeks ended 3 February 2013
On 27 March 2012, the Group acquired a site at Winsford from Vion Food Group Limited, a meat packaging business based in Cheshire. Total cash consideration for the purchase was £21m; of this £20m is attributable to the property, plant and equipment acquired and £1m to other net assets. There was no goodwill arising.

In March 2012, the Group acquired from Cranswick plc the outstanding 49% shareholding in Farmers Boy (Deeside) Limited which it did not already own, for cash consideration of £15m. This business had previously been accounted for as a subsidiary due to the existence of option arrangements between the Group and Cranswick plc.

4.6 INVESTMENT IN FOOD ONLINE

On 25 July 2013, Morrisons entered into an agreement with Ocado to provide operational and distribution services in relation to Morrisons online grocery offering.

As part of the agreement, Morrisons acquired a Customer Fulfilment Centre (CFC) in Dordon, which is leased back to Ocado under an operating lease. This acquisition has been effected via the purchase of 100% of the equity of Last Mile Developments Limited (LMD), which is controlled by, and becomes a subsidiary of, the Group. The Directors have considered the application of IFRS 3 Business Combinations to this acquisition and concluded that it is not in the scope of this standard. LMD is a single-asset leasing vehicle with no strategic processes and so does not meet the definition of a business. Consequently, the cash consideration paid of £81m has been allocated to Property in the Consolidated balance sheet and Cash flow statement.

The Directors have considered the impact of IFRS 10 Consolidated financial statements, which will be applicable for the Group's year ending January 2015, and determined that the Group continues to control LMD on application of that standard. On 14 August 2013, LMD changed its name to Firsdell Limited.

In addition, Morrisons entered into a joint venture agreement with Ocado (see note 4.3) and invested £30m in the technology required to operate an online grocery business, which is recognised in the Group's software intangibles (see note 3.2).

5 WORKING CAPITAL AND PROVISIONS

5.1 ACCOUNTING POLICIES

Stocks
Stocks represent goods for resale and are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale. Cost is calculated on a weighted average basis and comprises purchase price, import duties and other non-recoverable taxes less rebates. Provision is made for obsolete and slow moving items.

Financial assets and liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Trade and other debtors
Trade and other debtors are initially recognised at fair value, which is generally equal to face value, and subsequently held at amortised cost. Provision is made when there is objective evidence that the Group will not be able to recover balances in full, with the charge being included as an administrative expense.

Cash and cash equivalents
Cash and cash equivalents for cash flow purposes includes cash-in-hand, cash-at-bank and bank overdrafts. In the balance sheet, bank overdrafts that do not have right of offset are presented within current liabilities.

Cash held by the Group's captive insurer, Farock Insurance Company Limited, is not available for use by the rest of the Group as it is restricted for use against the specific liability of the captive. As the funds are available on demand, they meet the definition of cash in IAS 7 'Cashflow statements'.

Trade and other creditors
Trade and other creditors are initially recognised at fair value, which is generally equal to face value, and subsequently held at amortised cost.

Net debt
Net debt is cash and cash equivalents, long term cash on deposit, bank and other current loans, finance lease debt, bonds, private placement loan notes and derivative financial instruments (stated at current fair value).

Provisions
Provisions are created where the Group has a present obligation as a result of a past event, where it is probable that it will result in an outflow of economic benefits to settle the obligation, and where it can be reliably measured. For onerous leases, this is when the rent payable exceeds rent receivable; for petrol filling station decommissioning costs when the filling station is first constructed and for dilapidations on leased buildings, when the lease is entered into. For onerous contracts, this is when the net cash outflows exceed the anticipated future benefits. The amounts provided are based on the Group's best estimate of the likely committed outflow. Where material, these estimated outflows are discounted to net present value.

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

5 WORKING CAPITAL AND PROVISIONS – CONTINUED

5.2 DEBTORS

	2014 £m	2013 £m
Trade debtors	**188**	173
Less: provision for impairment of trade debtors	**(8)**	(5)
	180	168
Other debtors	**20**	37
Prepayments and accrued income	**116**	86
	316	291

The ageing analysis of trade debtors is as follows:

	2014 £m	2013 £m
Neither past due nor impaired	**176**	158
Past due but not impaired:		
Not more than three months	**1**	9
Greater than three months	**3**	1
Impaired debt	**8**	5
	188	173

As at 2 February 2014 and 3 February 2013, trade debtors that were neither past due nor impaired related to a number of debtors for whom there is no recent history of default. The other classes of debtors do not contain impaired assets.

5.3 CREDITORS – CURRENT

	2014 £m	2013 £m
Trade creditors	**1,436**	1,501
Other taxes and social security payable	**58**	31
Other creditors	**315**	112
Accruals and deferred income	**463**	486
	2,272	2,130

5.4 PROVISIONS

	Property provisions £m
At 4 February 2013	**76**
Charged to profit for the period	**145**
Utilised/released during the period	**(17)**
Unwinding of discount	**3**
At 2 February 2014	**207**

The majority of the property provisions comprise the onerous lease provision (£176m), other provisions relate to a petrol filling station decommissioning reserve for the cost of decommissioning petrol tanks and provisions for dilapidations on leased buildings, for the cost of restoring the asset to its original condition. Onerous leases relate to sublet and vacant properties, with commitments ranging from one to 59 years. The provision is revised regularly in response to market conditions. During the year, £144m has been charged to onerous lease provisions in respect of the impairment detailed in note 1.4.

5 WORKING CAPITAL AND PROVISIONS – CONTINUED

5.5 CASH FLOW FROM OPERATING ACTIVITIES

	2014 £m	2013 £m
(Loss)/profit for the period	**(238)**	647
Adjustments for:		
Taxation	**62**	232
Depreciation, amortisation and impairment	**940**	368
(Profit)/loss on disposal of property, plant and equipment	**(9)**	1
Net finance cost	**82**	70
Other non-cash charges	**3**	1
Excess of contributions over pension service cost	**2**	–
Increase in stocks	**(71)**	(22)
(Increase)/decrease in debtors	**(25)**	29
Increase in creditors	**154**	114
Increase/(decrease) in provisions	**131**	(8)
Cash generated from operations	**1,031**	1,432

6 CAPITAL AND BORROWINGS

6.1 ACCOUNTING POLICIES

Borrowings
Interest-bearing loans and overdrafts are initially recorded at fair value, net of attributable transaction costs. Subsequent to initial recognition, any difference between the redemption value and the initial carrying amount is recognised in profit for the period over the period of the borrowings on an effective interest rate basis.

Borrowing costs
All borrowing costs are recognised in the Group's profit for the period on an effective interest rate basis except for interest costs that are directly attributable to the construction of buildings and other qualifying assets, which are capitalised and included within the initial cost of the asset. Capitalisation commences when both expenditure on the asset and borrowing costs are being incurred, and necessary activities to prepare the asset for use are in progress. In the case of new stores, this is generally once planning permission has been obtained. Capitalisation ceases when the asset is ready for use. Interest is capitalised at the effective rate incurred on borrowings before taxation of 5% (2013: 5%).

Leases
Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases; all other leases are classified as finance leases. Property leases are analysed into separate components for land and buildings and tested to establish whether the components are operating leases or finance leases. Rental payments on operating leases in which the Group is lessee are taken to profit for the period on a straight line basis over the life of the lease.

Finance leases
The lower of the fair value and the present value, calculated using the interest rate implicit in the lease, of the future minimum lease payments is included within property, plant and equipment and financial liabilities as an obligation to pay future rentals. Depreciation is provided at the same rates as for owned assets, or over the lease period, if shorter. Rental payments are apportioned between the finance charge and the outstanding obligation so as to produce a constant rate of finance charge on the remaining balance.

Share capital
Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Where any Group company purchases the Company's equity share capital, the consideration paid, including directly attributable incremental costs, is deducted from retained earnings until the shares are cancelled. On cancellation, the nominal value of the shares is deducted from share capital and the amount is transferred to the capital redemption reserve.

Own shares held
The Group has an employee trust for the granting of Group shares to executives and members of the employee share plans. Shares in the Group held by the employee share trust are presented in the balance sheet as a deduction from retained earnings. The shares are deducted for the purpose of calculating the Group's earnings per share.

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

6 CAPITAL AND BORROWINGS – CONTINUED

6.2 FINANCE COSTS AND INCOME

	2014 £m	2013 £m
Interest payable on short term loans and bank overdrafts	**(12)**	(11)
Interest payable on bonds	**(86)**	(69)
Interest capitalised	**17**	15
Total interest payable	**(81)**	(65)
Provisions: unwinding of discount	**(3)**	(4)
Other finance costs	**(2)**	(2)
Net pension interest expense (section 8)	**(1)**	(4)
Finance costs	**(87)**	(75)
Bank interest received	**3**	3
Amortisation of bonds	**2**	2
Finance income	**5**	5
Net finance cost	**(82)**	(70)

6.3 BORROWINGS

The Group had the following current and non-current borrowings and other financial liabilities:

	2014 £m	2013 £m
Current		
Bank overdraft	**3**	2
Short term borrowings	**400**	50
£150m Sterling bonds 6.50% August 2014	**150**	–
	553	52

	2014 £m	2013 £m
Non-current		
£150m Sterling bonds 6.50% August 2014	**–**	152
£200m Sterling bonds 6.00% January 2017	**201**	201
£200m Sterling bonds 6.12% December 2018	**203**	203
£400m Sterling bonds 4.625% December 2023	**397**	397
£400m Sterling bonds 3.50% July 2026	**390**	393
$250m US private placement loan notes (USPP) 4.4% November 2026	**149**	156
€700m Euro bond 2.25% June 2020	**568**	–
Total non-current bonds and loan notes	**1,908**	1,502
Floating credit facility – 1.3% (2013: 1.4%)	**572**	671
Term loan – 0.9%	**–**	200
Finance lease obligations	**–**	7
	2,480	2,380

6 CAPITAL AND BORROWINGS – CONTINUED

6.3 BORROWINGS – CONTINUED

Borrowing facilities

Borrowings are denominated in sterling, US dollars and Euros, and bear fixed interest rates, with the exception of the floating credit facility and the term loan which bear floating interest rates. All borrowings are unsecured. On 19 June 2013, the Group issued a €700m Euro bond at a fixed interest rate of 2.25% expiring June 2020. This is part of the Group's £3bn Euro Medium Term Note programme.

In the event of default of covenants on the bank facility, the principal amounts and any interest accrued are repayable on demand.

At the balance sheet date, the Group has £775m (2013: £675m) of undrawn, floating, committed borrowing facilities available in respect of which all conditions present had been met. These facilities expire in between three and five years' time.

Maturity of borrowings

The table below summarises the maturity profile of the Group's borrowings based on contractual, undiscounted payments, which include interest payments. As a result, amounts shown below do not agree to the amounts disclosed on the balance sheet for borrowings. Creditors (note 5.3) are excluded from this analysis.

Where borrowings are subject to a floating rate, an estimate for interest has been made.

	2014 £m	2013 £m
Less than one year	**647**	133
One to two years	**88**	433
Two to three years	**858**	71
Three to four years	**69**	946
Four to five years	**268**	252
More than five years	**1,805**	1,264

Fair values

The fair value of the sterling and euro denominated bonds is measured using closing market prices (level 1). The fair value of the USPP is estimated by comparing the interest rate to market rates available to Morrisons at the balance sheet date (level 2). These compare to carrying values as follows:

	2014		2013	
	Amortised cost £m	**Fair value £m**	Amortised cost £m	Fair value £m
Total bonds: non-current and current	**1,909**	**1,959**	1,346	1,455
Total loan notes: non-current	**149**	**171**	156	169
	2,058	**2,130**	1,502	1,624

The fair value of other items within current and non-current borrowing equals their carrying amount, as the impact of discounting is not material.

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6 CAPITAL AND BORROWINGS – CONTINUED

6.4 ANALYSIS OF NET DEBT

	Note	2014 £m	2013 £m
Cash and cash equivalents per balance sheet		**261**	265
Bank overdrafts	6.3	**(3)**	(2)
Cash and cash equivalents per cash flow		**258**	263
Foreign exchange forward contracts		**1**	4
Energy price contracts		**–**	1
Other financial assets	7.3	**1**	5
Short term borrowings and current bonds	6.3	**(550)**	(50)
Forward foreign exchange contracts	7.3	**(4)**	–
Energy price contracts	7.3	**(6)**	(3)
Current financial liabilities		**(560)**	(53)
Bonds	6.3	**(1,759)**	(1,346)
Private placement loan notes	6.3	**(149)**	(156)
Floating credit facility	6.3	**(572)**	(671)
Other unsecured loans	6.3	**–**	(200)
Cross-currency contracts and interest rate swaps	7.3	**(34)**	(12)
Energy price contracts	7.3	**(2)**	(4)
Finance lease obligations	6.3	**–**	(7)
Non-current financial liabilities		**(2,516)**	(2,396)
Net debt		**(2,817)**	(2,181)

Cash and cash equivalents include restricted balances of £37m (2013: £39m) held by Farock Insurance Company Limited.

6.5 CALLED-UP SHARE CAPITAL

	Number of shares millions	Share capital £m	Share premium £m	Total £m
Current period				
At 4 February 2013	2,346	235	107	**342**
Shares cancelled net of options exercised	(11)	(1)	20	**19**
At 2 February 2014	2,335	234	127	**361**
Prior period				
At 29 January 2012	2,532	253	107	**360**
Shares cancelled	(186)	(18)	–	**(18)**
At 3 February 2013	2,346	235	107	**342**

The total authorised number of ordinary shares is 4,000 million shares (2013: 4,000 million shares) with a par value of 10p per share (2013: 10p per share). All issued shares are fully paid. There were 8,811,865 shares issued pursuant to the exercise of options (2013: 60,783) with a nominal value of £0.9m (2013: £0.01m) and an aggregate consideration of £21m (2013: £0.1m). Shares cancelled of 20,338,000 (2013: 185,805,022) relate to the equity retirement programme, which completed in March 2013. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at the meetings of the Company.

Trust shares

Included in retained earnings is a deduction of £4.5m (2013: £5m) in respect of own shares held at the balance sheet date. This represents the cost of 1,938,608 (2013: 2,284,993) of the Company's ordinary shares (nominal value of £0.2m (2013: £0.3m)). These shares are held by a trust using funds provided by the Group and were acquired to meet obligations under the Group's share option schemes. The market value of the shares at 2 February 2014 was £5m (2013: £6m). The trust has waived its rights to dividends. These shares are not treasury shares as defined by the London Stock Exchange.

6 CAPITAL AND BORROWINGS – CONTINUED

6.5 CALLED-UP SHARE CAPITAL – CONTINUED

Treasury shares

In addition the Company acquired nil of its own shares (2013: 23,803,406 nominal value of £2m) to hold as treasury shares to meet obligations under the Group's share option schemes. The total amount paid to acquire the shares, net of tax, was £65m (in 2013) and has been deducted from retained earnings. During the period, the Company utilised 2,770,220 treasury shares to satisfy options exercised by employees during the period. Proceeds received on exercise of these shares amounted to £7m and has been credited to retained earnings. At 2 February 2014, there were no remaining treasury shares.

6.6 RESERVES

	2014 £m	2013 £m
Capital redemption reserve	**39**	37
Merger reserve	**2,578**	2,578
Hedging reserve	**(15)**	(14)
Retained earnings	**1,729**	2,287
Total	**4,331**	4,888

Capital redemption reserve

The capital redemption reserve at the start of the period related to 57,788,600 of the Company's own shares which it purchased on the open market for cancellation between 31 March 2008 and 21 November 2008 at a cost of £146m, 125,699,939 which it purchased between 10 March 2011 and 27 January 2012 at a cost of £368m and 185,805,022 purchased between 30 January 2012 and 1 February 2013 at a cost of £514m.

The movement in the period of £2m relates to 20,338,000 of the Company's own shares which it purchased on the open market for cancellation between 14 February 2013 and 8 March 2013. The total amount paid to acquire the shares, net of tax, was £53m and has been deducted from retained earnings within shareholders' equity. The shares purchased represent 1% of the ordinary share capital at 2 February 2014.

Merger reserve

The merger reserve represents the reserve in the Company's balance sheet arising on the acquisition in 2004 of Safeway Limited. In the opinion of the Directors, this reserve is not distributable and accordingly it will be carried forward as a capital reserve.

Hedging reserve

This represents the gains and losses arising on derivatives used for cash flow hedging.

6.7 CAPITAL MANAGEMENT

The Group defines the capital that it manages as the Group's total equity and net debt balances, with an adjustment to reflect rental commitments.

The Group's objectives are to safeguard its ability to continue as a going concern providing returns to shareholders via optimising debt and equity balances, maintaining a strong investment grade credit rating and having adequate liquidity headroom. The Group manages its capital structure by issuing new debt or shares. During the current financial year, the proportion of debt relative to equity has increased, driven by increased debt issuance and the conclusion of the three year equity retirement programme. Additional funding of £589m has been obtained through the Group's bond programme, as well as a further £200m term loan from one of the Group's syndicate banks; the overall impact of this additional funding has been an increase in the average maturity period of the Group's debt. A key objective of the Group's capital management is to maintain compliance with the covenants set out in the revolving credit facility. The Group's covenants require maintenance of a gearing ratio of less than 3.5 and interest cover of at least three times. Throughout the year, the Group has comfortably complied with these covenants.

6.8 OPERATING LEASES – LESSEE

The Group has outstanding commitments for future minimum lease payments under non-cancellable operating leases. The leases have varying terms, escalation clauses and renewal rights, and fall due as follows:

	2014		2013	
	Property £m	**Vehicles, plant and equipment £m**	Property £m	Vehicles, plant and equipment £m
Within one year	**77**	**11**	58	11
More than one year and less than five years	**292**	**25**	218	27
After five years	**934**	**–**	691	–
	1,303	**36**	967	38

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7 FINANCIAL RISK AND HEDGING

7.1 ACCOUNTING POLICIES

Derivative financial instruments and hedge accounting

Derivatives are measured at fair value through profit or loss except when the derivative qualifies for cash flow hedge accounting. At inception of a hedge, the Group documents the relationship between the hedging instrument and hedged item, its risk management objective and strategy for undertaking the hedge. The Group assesses, both at inception and annually, whether the hedging instrument is highly effective in offsetting changes in fair values or cash flows of the hedged item, both retrospectively and prospectively.

Cash flow hedges

A cash flow hedge mitigates the Group's exposure to variability in cash flows attributable either to a recognised asset or liability or a highly probable forecasted transaction. The Group has cross-currency swaps and energy price contracts designated as cash flow hedges.

The effective part of any movement in the fair value of the derivative is recognised in other comprehensive income and presented in the hedging reserve within equity. Ineffectiveness is immediately recognised in profit for the period, energy price contracts within cost of sales and cross-currency swaps within finance income/costs. Cumulative gains or losses on derivatives held in the hedging reserve are reclassified into profit for the period when the transaction occurs.

Fair value hedge

A fair value hedge mitigates the Group's exposure to changes in fair value of a recognised asset or liability or a firm commitment.

The change in fair value of the hedged asset or liability that is attributable to the hedged risk is recognised in profit for the period.

7.2 FINANCIAL RISK MANAGEMENT

The Group's treasury operations are controlled centrally by the Treasury Committee in accordance with clearly defined policies and procedures that have been authorised by the Board. There is an amount of delegated authority to the Treasury Committee, but all activities are summarised in half yearly treasury reports that are presented to the Audit Committee.

The Group enters into derivative transactions as described below, with the objective of managing risks arising from the Group's operations and its sources of finance. The policies and processes for managing these risks are stated below. It remains the Group's policy not to engage in speculative trading of financial instruments.

As part of normal banking arrangements, the Group utilises letters of credit in order to facilitate contracts with third parties.

Foreign currency risk

The Group makes the majority of its purchases in sterling, however it makes some trade purchases in other currencies, primarily the euro and US dollar. The Group's objective is to reduce short term profit volatility from exchange rate fluctuations. It is Group policy that up to 90% of forecasted foreign currency purchases within the next six months be hedged via forward foreign exchange contracts and options, and up to 70% in the following six months. At the balance sheet date, the Group had hedged 84% of its forecasted purchases within the next six months (2013: 74%).

Cross-currency swaps are used to mitigate the Group's currency exposure arising from payments of interest and principal in relation to US dollar private placement loan notes and the Euro bond. The sensitivity to a reasonably possible change (+/– 10%) in the US dollar and euro exchange rates has been determined as being immaterial.

Liquidity risk

The Group policy is to maintain a balance of funding with a range of maturities and a sufficient level of undrawn committed borrowing facilities to meet any unforeseen obligations and opportunities. Short term cash balances, together with undrawn committed facilities, enable the Group to manage its liquidity risk. The Group finances its operations with a combination of bank credit facilities, bonds and the USPP.

The Treasury Committee monitors rolling forecasts of the Group's liquidity reserve on a quarterly basis, which comprises committed and uncommitted borrowing facilities on the basis of expected cash flow.

The Group's long term policy is to protect itself against adverse movements in interest rates by maintaining at least 60% of its total borrowings at fixed interest rates. As at the balance sheet date 62% (2013: 62%) of the Group's borrowings are at fixed rate.

Whilst still applying the policy described above, in order to balance cash flow and fair value risk in respect of borrowings, from time to time the Group enters into fixed-to-floating interest rate swaps.

Credit risk

As a retailer, the majority of the Group's revenue is received in cash at the point of sale and so credit risk is not considered significant to the Group. Some credit risk does arise from cash and cash equivalents, deposits with banking groups and exposures from other sources of income such as supplier income and tenants of investment properties. The Group manages this via appropriate credit verification procedures and, in respect of financial institutions, limits on deposits with any one counterparty.

The maximum exposure is the carrying amount of cash and debtors disclosed in the balance sheet. There are no significant concentrations of credit risk within the Group.

Commodity price risk

The Group manages the risks associated with the purchase of electricity, gas and diesel consumed by its activities (excluding fuel purchased for resale to customers) by entering into bank swap contracts to fix prices for expected consumption.

The Treasury Committee reviews the Group's market price exposure to these commodities on a quarterly basis and determines a strategy for utilising derivative financial products in order to mitigate the volatility of energy prices. A +/– 10 % change in the fair value of the commodity price at the balance sheet date affects the hedging reserve by £10m (2013: £24m). The Group has adopted a capital at risk model for hedging its fuel and power consumption. Under the model, the Group limits the maximum price that it will pay to 12.5% above the market price of the product.

7 FINANCIAL RISK AND HEDGING – CONTINUED

7.3 DERIVATIVE FINANCIAL ASSETS

	2014 £m	2013 £m
Current assets		
Energy price contracts	–	1
Foreign exchange forward contracts	1	4
	1	5

All derivatives are categorised as Level 2 instruments. Level 2 fair values for simple, over-the-counter derivatives are determined by reference to prices available from the markets on which the instruments are traded.

Derivative financial liabilities	2014 £m	2013 £m
Current		
Forward foreign exchange contracts	4	–
Energy price contracts	6	3
	10	3
Non-current		
Cross-currency contracts and interest rate swaps	34	12
Energy price contracts	2	4
	36	16

	2014 £m			2013 £m		
Maturity analysis of derivative liabilities	< 1 year £m	1 – 5 years £m	5 + years £m	< 1 year £m	1 – 5 years £m	5 + years £m
Derivatives settled on a gross basis						
Cross-currency swaps – cash flow hedges						
– Outflow	(25)	(99)	(830)	(8)	(31)	(226)
– Inflow	20	78	793	7	28	223
Interest rate swaps						
– Outflow	(3)	(11)	(22)	–	–	–
– Inflow	7	28	56	–	–	–
Forward contracts – cash flow hedges						
– Outflow	(232)	–	–	(73)	–	–
– Inflow	212	–	–	77	–	–
Derivatives settled on a net basis						
Energy price contracts – cash flow hedges						
– Outflow	(10)	–	–	(4)	(3)	–

7.4 HEDGING ACTIVITIES

Cash flow hedges

At 2 February 2014 and 3 February 2013, the Group held US dollar cross-currency swaps designated as cash flow hedges. Prior to this, the cross-currency swaps were designated as fair value hedges against the commitment to issue the USPP.

At 2 February 2014, the Group also held euro cross-currency swaps designated as cash flow hedges. The notional principal amount of the outstanding cross-currency swaps at 2 February 2014 was $250m (2013: $250m) and €700m (2013: €nil).

The energy price contracts and foreign currency derivatives shown in note 7.3 are also designated as cash flow hedges. The cash flows hedged will occur within 12 months of the balance sheet date.

Fair value hedges

Losses recognised on fixed-to-floating interest rate swaps designated in fair value hedges are £4m (2013: £nil).

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8 PENSIONS

8.1 ACCOUNTING POLICIES

A defined contribution scheme is a pension scheme under which the Group pays fixed contributions into a separate entity and provides no guarantee as to the quantum of retirement benefits that those contributions will ultimately purchase. A defined benefit scheme is one that is not a defined contribution scheme.

Defined benefit schemes

Pension scheme assets are valued at market rates. Pension scheme obligations are an estimate of the amount required to pay the benefits that employees have earned in exchange for current and past service, assessed and discounted to present value using the assumptions shown in note 8.4.1. The net pension liability or asset recognised in the Group's balance sheet is the net of the schemes' assets and obligations, which are calculated separately for each scheme. The Group has a right to recognise a net pension asset, should one arise, in respect of each of the schemes.

Current service cost is treated as an operating cost in the Income statement and Statement of cash flows and is part of underlying earnings. Net interest expense is calculated by applying the discount rate on liabilities to the net pension liability or asset (adjusted for cashflows over the accounting period) and is recognised in finance costs and excluded from underlying earnings.

Expenses incurred in respect of the management of scheme assets are included in other comprehensive income as a reduction in the return on scheme assets. Other scheme expenses are recognised in profit or loss as an operating expense.

Remeasurements comprise actuarial gains and losses on the obligations and the return on scheme assets (excluding interest). They are recognised immediately in other comprehensive income.

Amounts shown within section 8 are before any adjustments for deferred taxation.

As explained on page 79, due to the immaterial effect of IAS 19 revised on the comparative period, the amounts shown in respect of 2012/13 are not restated. Where they differ from amounts disclosed in the prior year, comparable amounts for 2012/13 have been given for information only.

Defined contribution schemes

Contributions by the Group are charged to profit or loss for the period as they arise.

8.2 DEFINED BENEFIT SCHEMES: SUMMARY AND DESCRIPTION

Balance sheet:	2014 £m	2013 £m
Fair value of scheme assets	**3,094**	2,839
Present value of obligations	**(3,105)**	(2,859)
Net pension liability	**(11)**	(20)
– Comprising schemes in assessed surplus	**7**	–
– Comprising schemes in assessed deficit	**(18)**	(20)

Consolidated statement of comprehensive income	2014 £m	2013 £m	2013–IAS 19 Revised £m
Current service cost – recognised in cost of sales	**24**	25	25
Current service cost – recognised in administrative expenses	**8**	7	7
Administrative costs paid by Schemes – recognised in administrative expenses	**3**	–	2
Net interest on net pension liability – finance costs	**1**	4	(1)
Total expense charged to Income statement	**36**	36	33
Statement of other comprehensive income:			
Remeasurements in other comprehensive income (credit)/charge	**(11)**	6	9

The Group operates three defined benefit retirement schemes (together 'the Schemes') providing benefits based on a benefit formula that depends on factors including the employee's age and number of years of service. The Morrison and Safeway Schemes provide pension benefits based on either the employee's compensation package or career average revalued earnings (CARE) (the 'CARE Schemes'). The CARE Schemes are generally not open to new members. The Retirement saver plan ('RSP') is a cash balance scheme, which provides a lump sum benefit based upon a defined proportion of an employee's annual earnings, which is revalued each year in line with inflation.

The Schemes are registered schemes under the provisions of Schedule 36 of the Finance Act 2004 and the assets are held in legally separate, trustee-administered funds. The Board of each Scheme is required by law to act in the best interest of the Scheme participants and is responsible for setting the investment, funding and governance policies of the fund. A representative of the Group attends Trustee Investment Committee meetings in order to provide the Group's view on investment strategy, but the ultimate power lies with the Trustees. The Deed and Rules of the Morrison Scheme gives the Trustees the power to set contributions. In the Safeway Scheme and the RSP this power is given to the Group, subject to regulatory override.

The latest full actuarial valuations are being carried out as at 1 April 2013 for the Safeway Scheme and 5 April 2013 for the Morrison Scheme and the RSP. The preliminary results of these valuations have been used and updated for IAS 19 'Employee benefits' purposes for the period by a qualified independent actuary. The Schemes expose the Group to inflation risk, interest rate risk and market investment risk. In addition, the CARE Schemes expose the Group to longevity risk.

8 PENSIONS – CONTINUED

8.3 SCHEME ASSETS

Assets of the Schemes generate returns and ultimately cash that is used to satisfy the Schemes' obligations. They are not necessarily intended to be realised in the short term. The Trustees of each Scheme invest in different categories of asset and in different allocations amongst those assets, according to the investment principles of that Scheme.

Currently, the investment strategy of the CARE Schemes is to maintain a balance of approximately 40% equities and 60% bond-like investments. RSP investments are currently based primarily in equities. There are no direct investments in the parent Company's own shares or property occupied by any member of the Group.

Fair value of Scheme assets:

	2014 £m	2013 £m
Equities (quoted)	**1,328**	1,213
Corporate bonds (quoted)	**891**	793
Government bonds (quoted)	**6**	–
Liability driven investments (unquoted)	**863**	831
Cash (quoted)	**6**	2
Total	**3,094**	2,839

Liability driven investments (LDI)

The policy in the CARE Schemes is to limit investment risk and to manage the liabilities in order to reduce fluctuations in the Schemes' funding levels. To help achieve this, "liability driven investments" are used with the aim of matching the liability profile and future cash flows through the use of derivatives such as swaps and other investment instruments. There are no annuities or longevity swaps.

The movement in the fair value of the Schemes' assets over the period was as follows:

	2014 £m	2013 £m	2013–IAS 19 Revised £m
Fair value of scheme assets at start of period	**2,839**	2,589	2,589
Expected return on scheme assets	**–**	120	–
Actuarial gain recognised in OCI	**–**	145	–
Recognition of RSP scheme assets	**39**	–	n/a
Interest income	**137**	–	125
Return on scheme assets excluding interest	**96**	–	142
Employer contributions	**34**	33	33
Employee contributions	**10**	10	10
Benefits paid	**(58)**	(58)	(58)
Administrative expenses	**(3)**	–	(2)
Fair value of scheme assets at end of period	**3,094**	2,839	2,839

The Group has previously entered into a pension funding partnership structure under which it has contributed interests in a Scottish Limited Partnership ('SLP') valued at £90 million (as at 31 January 2013) to the CARE schemes. The CARE Schemes' interests in the SLP reduce the respective deficits on a funding basis, although the agreements do not affect the position directly on an IAS 19 accounting basis because the investments held by the CARE Schemes do not qualify as assets for IAS 19 purposes.

As partners in the SLP, the CARE Schemes are entitled to receive a share of the profits of the SLP twice a year for 20 years. The profits shared with the Schemes are reflected in the Group financial statements as pension contributions. The SLP made a cash contribution of £3.3 million during the year ending 2 February 2014, and will make annual contributions of £6.6 million for a further 19 years.

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8 PENSIONS – CONTINUED

8.4 PRESENT VALUE OF OBLIGATIONS

The movement in the defined benefit obligation over the period was as follows:

	2014 £m	2013 £m
Defined benefit obligation at start of period	**(2,859)**	(2,600)
Recognition of RSP defined benefit obligation	**(37)**	–
Current service cost	**(32)**	(32)
Interest expense	**(138)**	(124)
Actuarial loss – financial assumptions	**(118)**	(151)
Actuarial gain – experience	**31**	–
Employee contributions	**(10)**	(10)
Benefits paid	**58**	58
Defined benefit obligation at end of period	**(3,105)**	(2,859)

The durations of the defined benefit obligations at the end of the 2014 reporting period are: RSP 20 years; Morrison CARE 25 years; Safeway CARE 24 years. The weighted average duration of all three schemes is 24 years.

8.4.1 Significant actuarial assumptions

The following are the principal actuarial assumptions at the reporting date (expressed as weighted averages):

Financial assumptions	2014	2013
Discount rate applied to scheme liabilities (% p.a.)	**4.50%**	4.85%
Inflation assumption (RPI) (% p.a.)	**3.50%**	3.70%

Life expectancies	2014	2013
Longevity in years from age 65 for current pensioners		
Male	**22.3**	22.1
Female	**23.2**	23.1
Longevity in years from age 65 for current members aged 45		
Male	**24.7**	24.5
Female	**25.6**	25.4

Assumptions regarding future mortality experience are set based on actuarial advice and in accordance with published statistics. The mortality tables used at both year ends 2013 and 2014 are the S1PMA/S1PFA-Heavy tables (males/females) based on year of birth. Amongst the UK population, there is a continuing trend for a generation to live longer than the preceding generation, and this has been reflected in the longevity assumption by adopting 80%/60% (males/females) of the "long cohort" longevity projections and also incorporating a minimum annual rate of improvement in longevity of 1.25% p.a.

Related actuarial assumptions (expressed as weighted averages)

	2014	2013
Rate of increases in salaries (% p.a.)	**3.50%**	3.70%
Rate of increase of pensions in payment: RPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	**2.30%/3.50%**	2.30%/3.70%
Pre-retirement revaluation in CARE Schemes for active members (% p.a.)	**3.50%**	3.70%
Pre-retirement revaluation in RSP for active members (% p.a.)	**2.10%**	n/a
Rate of increase of pensions in deferment: CPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	**2.50%/2.70%**	n/a/2.90%
CPI inflation (% p.a.)	**2.70%**	2.90%

8 PENSIONS – CONTINUED

8.4 PRESENT VALUE OF OBLIGATIONS – CONTINUED

8.4.2 Sensitivity analysis on significant actuarial assumptions

The following table summarises the impact on the defined benefit obligation at the end of the reporting period if each of the significant actuarial assumptions listed above were changed, in isolation, assuming no other changes in market conditions at the accounting date. In practice any movement in assumptions could be accompanied by a partially offsetting change in asset values, and the corresponding overall impact on the net asset/(liability) is therefore likely to be lower than the amounts below in a number of scenarios. Extrapolation of the sensitivities shown may not be appropriate.

		2014 £m	2013 £m
Discount rate applied to Scheme obligations	+/- 0.1% pa	**-/+ 74**	-/+ 72
Inflation assumption (RPI and associated assumptions)	+/- 0.1% pa	**+/- 65**	+/- 63
Longevity	+/- one year	**+/- 94**	+/- 87

8.5 FUNDING

The CARE Schemes and the RSP are funded schemes to which both employees and the Group contribute. The Morrison Scheme is entirely funded by the parent company and the Safeway Scheme is funded by Safeway Limited and its subsidiaries. The Group's subsidiaries participate in the RSP. There is no contractual agreement or stated policy for charging the net defined benefit cost between the parent company and its subsidiaries. The contribution of each participating subsidiary to the RSP is calculated in proportion to the number of employees that are members of the RSP.

The current best estimate of Group contributions to be paid for the accounting period commencing 3 February 2014 is £52m (2013: £33m). However, the triennial valuations currently being undertaken are not yet finalised; when they are, the amount of future contributions payable may differ from this estimate.

8.6 DEFINED CONTRIBUTION PENSION SCHEME

The Group operated a stakeholder pension scheme, to which the Group made matching contributions of a maximum of 5% of eligible earnings. This was closed to new members and employer's contributions with effect from September 2012 following the introduction of the RSP.

Pension costs for the defined contribution scheme are as follows:

	2014 £m	2013 £m
Stakeholder pension scheme	**–**	5

9 SHARE-BASED PAYMENTS

9.1 ACCOUNTING POLICY

Share-based payments

The Group issues equity settled share-based payments to certain employees in exchange for services rendered by them. The fair value of the share-based award is calculated at the date of grant and is expensed on a straight line basis over the vesting period with a corresponding increase in equity. This is based on the Group's estimate of share options that will eventually vest. This takes into account movement of non-market conditions, being service conditions and financial performance, if relevant.

The fair value of share options is measured by use of a binomial stochastic model. The expected life used in the model has been adjusted, based on management's best estimate, for effects of non-transferability, exercise restrictions and behavioural considerations.

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52 weeks ended 2 February 2014

9 SHARE-BASED PAYMENTS – CONTINUED

9.2 SHARE SAVE SCHEMES

The Sharesave scheme began in May 2000 and all employees (including Executive Directors) are eligible once the necessary service requirements have been met. The scheme allows participants to save up to a maximum of £250 each month for a fixed period of three years. Options are offered at a discount of 20% to the mid-market closing price on the day prior to the offer and are exercisable for a period of six months commencing after the end of the fixed period of the contract. The exercise of options under this scheme is subject only to service conditions. The scheme that launched in May 2011 and subsequently are under the new scheme rules, approved by the shareholders in June 2010.

The fair value of options granted and the inputs used to determine it are as follows:

Grant date	13 May 2013	14 May 2012	17 May 2011	18 May 2010
Share price at grant date	£2.92	£2.79	£3.01	£2.70
Fair value of options granted	£8.13m	£9.12m	£11.5m	£9.7m
Exercise price	£2.25	£2.36	£2.28	£2.37
Dividend yield	4.17%	3.69%	3.2%	3.04%
Annual risk free interest rate	0.45%	0.53%	1.65%	1.63%
Expected volatility*	16.8%	19.4%	24.2%	26.5%

*The volatility measured at the standard deviation of expected share price returns is based on statistical analysis on weekly share prices over the past 3.37 years prior to the date of grant.

The requirement that the employee has to save in order to purchase shares under the Sharesave plan is a non-vesting condition. This feature has been incorporated into the fair value at grant date by applying a discount to the valuation obtained from the binomial stochastic option pricing model. The discount is determined by estimating the probability that the employee will stop saving based on expected future trends in the share price and employee behaviour.

	2014		2013	
	Weighted average exercise price in £ per share	**Options thousands**	Weighted average exercise price in £ per share	Options thousands
Movement in outstanding options				
Outstanding at start of period	**2.34**	**43,660**	2.17	48,402
Granted	**2.25**	**18,901**	2.36	23,135
Exercised	**2.37**	**(11,578)**	1.98	(21,094)
Forfeited	**2.32**	**(7,990)**	2.30	(6,783)
Outstanding at end of period	**2.30**	**42,993**	2.34	43,660
Exercisable at end of period	**2.37**	**36**	1.98	37

	2014		2013	
	Weighted average share price at date of exercise £	**Number of shares thousands**	Weighted average share price at date of exercise £	Number of shares thousands
Share options exercised in the financial period	**2.73**	**11,578**	2.77	21,094

	2014	2013
Share options outstanding at the end of the period		
Range of exercise prices	**£2.25 to £2.37**	£1.98 to £2.37
Weighted average remaining contractual life	**2.0 years**	2.0 years

9 SHARE-BASED PAYMENTS – CONTINUED

9.3 LONG TERM INCENTIVE PLANS

In May 2007, a discretionary LTIP for the benefit of certain employees was introduced. The awards have no exercise price, have performance conditions attached and accrue the value of dividends over the vesting period. During the period, certain holders of the LTIPs were offered replacement awards (restricted share award) in return for giving up their rights under the LTIPs.

Awards normally vest three years after the original grant date, provided the relevant performance criteria have been met.

The fair value of awards granted and the inputs used to determined it are as follows:

Grant date	**17 Oct 2013**	**22 Apr 2013**	15 Oct 2012	13 Apr 2012	1 Oct 2011	18 Apr 2011	14 Oct 2010
Share price at grant date	**£2.79**	**£2.80**	£2.68	£2.93	£3.02	£2.85	£2.96
Assumed leavers	**0%**	**0%**	5%	5%	5%	5%	8%
Performance criteria	**50%**	**50%**	65%	65%	77%	77%	80%
Fair value of share awards granted	**£0.9m**	**£8.4m**	£28.1m	£1.5m	£1.4m	£23.3m	£1.7m

	2014 Share awards thousands	2013 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	**24,630**	22,706
Granted	**7,267**	10,185
Exercised	**–**	(6,114)
Forfeited	**(21,453)**	(2,147)
Outstanding at end of period	**10,444**	24,630
Exercisable at end of period	**–**	–

The weighted average remaining contractual life of the share awards is 2.0 years (2013: 1.4 years).

9.4 ONE OFF SHARE AWARDS

As part of the package for certain senior management, restricted share awards may be granted. These are primarily designed to replace the value of share scheme awards forfeited from the previous employer. Vesting of these awards is subject only to service conditions.

The fair value of awards granted and the inputs used to determined it are as follows:

Grant date	**2014**	2013
Share price at grant date	**–**	£2.71
Assumed leavers	**–**	0%
Exercise price	**–**	£nil
Fair value of share awards granted	**–**	£1.9m

There are no share awards outstanding at the end of the period (2013: 566,250). The movement during the period is entirely the result of options being exercised. The weighted average remaining contractual life of the share awards is nil years (2013: 0.3 years).

9.5 RESTRICTED SHARE AWARD

Following the non vesting of the 2011 and 2012 LTIP, a decision was made to replace the LTIP for those colleagues below Management Board with restricted share awards. This scheme is not subject to financial performance measures. The awards vest subject to a requirement to remain in employment for a certain period; half the awards vest after one year and the remaining half after two years.

NOTES TO THE GROUP FINANCIAL STATEMENTS CONTINUED

52 weeks ended 2 February 2014

9 SHARE-BASED PAYMENTS – CONTINUED

9.5 RESTRICTED SHARE AWARD – CONTINUED

The fair value of awards granted and the inputs used to determined it are as follows:

Grant date	22 April 2013[1]	22 April 2013[2]	17 October 2013
Share price at grant date	**£2.80**	**£2.80**	**£2.79**
Assumed leavers	**8%**	**8%**	**8%**
Fair value of share awards granted	**£7.1m**	**£7.1m**	**£0.6m**

1 Vests April 2014
2 Vests April 2015

	2014 Share awards thousands	2013 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	**–**	–
Granted	**4,925,648**	–
Outstanding at end of period	**4,925,648**	–

9.6 DEFERRED SHARE BONUS PLAN

Certain members of senior management are eligible for the deferred share bonus plan which allows 33% to 50% of any bonus payable to be deferred in shares for three years from the date the deferred shares award is made. Dividend equivalents accrue over the vesting period, to be paid when the shares vest. Vesting of these share awards is subject only to service conditions.

The fair value of awards granted and the inputs used to determined it:

Grant date	**2013/14 scheme**	2012/13 scheme
Share price at grant date	**–**	£3.03
Assumed leavers	**–**	0%
Exercise price	**–**	£nil
Fair value of share awards granted	**–**	£2.9m

	2014 Share awards thousands	2013 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	**1,423,512**	658,501
Granted	**–**	968,148
Exercised	**(486,971)**	(203,137)
Outstanding at end of period	**936,541**	1,423,512

The weighted average remaining contractual life of the share awards is 0.8 years (2013: 1.8 years).

10 OTHER

10.1 RELATED PARTY TRANSACTIONS

The Group's related party transactions in the period include the remuneration of the senior managers (note 1.7), and the Directors' emoluments and pension entitlements, share awards and share options in the audited section of the Remuneration report, which forms part of these financial statements.