Consolidated statement of comprehensive income

52 weeks ended 1 February 2015

	Note	2015 £m	2014 £m
Revenue	1.2	**16,816**	17,680
Cost of sales		**(16,055)**	(16,606)
Gross profit		**761**	1,074
Other operating income		**78**	81
Profit/loss on disposal and exit of properties and sale of businesses	1.4, 4.6	**135**	9
Administrative expenses		**(1,670)**	(1,259)
Operating loss	1.6	**(696)**	(95)
Finance costs	6.2	**(105)**	(87)
Finance income	6.2	**7**	5
Share of profit of joint venture (net of tax)	4.3	**2**	1
Loss before taxation		**(792)**	(176)
Analysed as:			
Underlying profit before tax		**345**	719
Impairment and onerous lease provisions	1.4	**(1,273)**	(903)
Profit/loss on disposal and exit of properties	1.4	**131**	9
Profit arising on disposal of Kiddicare.com Limited	1.4, 4.6	**4**	–
Net pension interest income/(cost)	8.2	**1**	(1)
		(792)	(176)
Taxation	2.2	**31**	(62)
Loss for the period attributable to the owners of the Company		**(761)**	(238)
Other comprehensive (expense)/income			
Items that will not be reclassified to profit or loss:			
Remeasurement of defined benefit pension schemes	8.2	**(31)**	11
Tax on defined benefit pension schemes	2.3	**6**	(8)
		(25)	3
Items that may be reclassified subsequently to profit or loss:			
Cash flow hedging movement		**(9)**	–
Tax on cash flow hedging movement	2.3	**2**	(1)
		(7)	(1)
Other comprehensive (expense)/income for the period, net of tax		**(32)**	2
Total comprehensive expense for the period attributable to the owners of the Company		**(793)**	(236)
Earnings per share (pence)			
– basic	1.5	**(32.63)**	(10.23)
– diluted	1.5	**(32.63)**	(10.23)

Consolidated balance sheet

1 February 2015

	Note	2015 £m	2014 £m
Assets			
Non-current assets			
Goodwill and intangible assets	3.2	**520**	458
Property, plant and equipment	3.3	**7,252**	8,625
Investment property	3.5	**68**	119
Net pension asset	8.2	**4**	–
Investment in joint venture	4.3	**68**	66
Investments	4.4	**31**	31
		7,943	9,299
Current assets			
Stock	5.2	**658**	852
Debtors	5.3	**239**	316
Derivative financial assets	7.3	**6**	1
Cash and cash equivalents	6.4	**241**	261
		1,144	1,430
Non-current assets classified as held-for-sale	3.4	**84**	–
		1,228	1,430
Liabilities			
Current liabilities			
Creditors	5.4	**(2,221)**	(2,272)
Short term borrowings	6.3	**(11)**	(553)
Derivative financial liabilities	7.3	**(18)**	(10)
Current tax liabilities		**(23)**	(38)
		(2,273)	(2,873)
Non-current liabilities			
Borrowings	6.3	**(2,508)**	(2,480)
Derivative financial liabilities	7.3	**(50)**	(36)
Deferred tax liabilities	2.3	**(415)**	(430)
Net pension liabilities	8.2	**(43)**	(11)
Provisions	5.5	**(288)**	(207)
		(3,304)	(3,164)
Net assets		**3,594**	4,692
Shareholders' equity			
Share capital	6.5	**234**	234
Share premium	6.5	**127**	127
Capital redemption reserve	6.6	**39**	39
Merger reserve	6.6	**2,578**	2,578
Retained earnings and hedging reserve	6.6	**616**	1,714
Total equity attributable to the owners of the Company		**3,594**	4,692

The notes on pages 75 to 112 form part of these financial statements.

The financial statements on pages 71 to 112 were approved by the Board of Directors on 11 March 2015 and were signed on its behalf by:

Trevor Strain
Chief Financial Officer

Consolidated cash flow statement

52 weeks ended 1 February 2015

	Note	2015 £m	2014 £m
Cash flows from operating activities			
Cash generated from operations	5.6	**970**	1,031
Interest paid		**(106)**	(91)
Taxation received/(paid)		**10**	(220)
Net cash inflow from operating activities		**874**	720
Cash flows from investing activities			
Interest received		**4**	2
Investment in joint venture		**–**	(66)
Proceeds from the sale of property, plant and equipment and businesses		**450**	34
Purchase of property, plant and equipment and investment property		**(385)**	(835)
Purchase of intangible assets		**(135)**	(185)
Net cash outflow from investing activities		**(66)**	(1,050)
Cash flows from financing activities			
Purchase of own shares for cancellation	6.5	**–**	(53)
Purchase of own shares for trust	6.5	**(8)**	–
Proceeds from exercise of share options, including issues from treasury shares	6.5	**–**	28
New borrowings		**296**	790
Net repayment of revolving credit facility		**(256)**	(100)
Repayment of other borrowings		**(550)**	(57)
Dividends paid to equity shareholders	1.8	**(308)**	(283)
Net cash (outflow)/inflow from financing activities		**(826)**	325
Net decrease in cash and cash equivalents		**(18)**	(5)
Cash and cash equivalents at start of period		**258**	263
Cash and cash equivalents at end of period	6.4	**240**	258

Reconciliation of net cash flow to movement in net debt in the period

	Note	2015 £m	2014 £m
Net decrease in cash and cash equivalents		**(18)**	(5)
Cash outflow from decrease in debt		**806**	157
Cash inflow from increase in borrowings		**(296)**	(790)
Other non-cash movements		**(15)**	2
Opening net debt		**(2,817)**	(2,181)
Closing net debt	6.4	**(2,340)**	(2,817)

Consolidated statement of changes in equity

52 weeks ended 1 February 2015

		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 3 February 2014		**234**	**127**	**39**	**2,578**	**(15)**	**1,729**	**4,692**
Loss for the period		**–**	**–**	**–**	**–**	**–**	**(761)**	**(761)**
Other comprehensive(expense)/income:								
Cash flow hedging movement		**–**	**–**	**–**	**–**	**(9)**	**–**	**(9)**
Pension remeasurement	8.2	**–**	**–**	**–**	**–**	**–**	**(31)**	**(31)**
Tax in relation to components of other comprehensive income	2.3	**–**	**–**	**–**	**–**	**2**	**6**	**8**
Total comprehensive expense for the period		**–**	**–**	**–**	**–**	**(7)**	**(786)**	**(793)**
Purchase of trust shares	6.5	**–**	**–**	**–**	**–**	**–**	**(8)**	**(8)**
Employee share option schemes:								
Share-based payments	1.7	**–**	**–**	**–**	**–**	**–**	**11**	**11**
Dividends	1.8	**–**	**–**	**–**	**–**	**–**	**(308)**	**(308)**
Total transactions with owners		**–**	**–**	**–**	**–**	**–**	**(305)**	**(305)**
At 1 February 2015		**234**	**127**	**39**	**2,578**	**(22)**	**638**	**3,594**

		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 4 February 2013		235	107	37	2,578	(14)	2,287	5,230
Loss for the period		–	–	–	–	–	(238)	(238)
Other comprehensive income/(expense):								
Pension remeasurement	8.2	–	–	–	–	–	11	11
Tax in relation to components of other comprehensive income	2.3	–	–	–	–	(1)	(8)	(9)
Total comprehensive expense for the period		–	–	–	–	(1)	(235)	(236)
Shares purchased for cancellation	6.5	(2)	–	2	–	–	(53)	(53)
Employee share option 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

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 1 February 2015 (2014: 52 weeks ended 2 February 2014) in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Standards Interpretation Committee (IFRS IC) interpretations as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. IFRS and IFRS IC interpretations 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 44.

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 presentational currency of the Group is sterling.

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 1 February 2015:

IFRS 10 Consolidated financial statements

IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 required management to exercise judgement to determine which entities are controlled and therefore are required to be consolidated. The Group has applied IFRS 10 retrospectively in accordance with the transition provisions of IFRS 10. There is no material impact on the Group as a result of applying this standard.

IFRS 11 Joint arrangements

Under IFRS 11, investments in joint arrangements are classified either as joint operations or joint ventures, depending on the contractual rights and obligations each investor has rather than the legal structure of the joint arrangement. Before 2 February 2014, the Group's interest in its jointly controlled entity, MHE JVCo Limited, was accounted for using the equity method. Under IFRS 11, the jointly controlled entity has been assessed to be a joint venture and so the equity method continues to be appropriate.

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, including IFRS 9 Financial instruments and IFRS 15 Revenue from contracts with customers, both of which are effective for annual periods beginning on or after 1 January 2017.

The Group is in the process of assessing the impact that the application of these standards and interpretations will have on the Group's financial statements.

Basis of consolidation

Subsidiaries are all entities over which the Group has control. The Group controls an entity when it has power over an entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date the control ceases. 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.

As described in note 4.6, the Group disposed of its investment in Kiddicare.com Limited on 11 July 2014. This subsidiary has been deconsolidated from that date.

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:

- Commercial income (note 1.1, 1.6, 5.2, 5.3, 5.4);
- Impairment of property, plant and equipment, and intangible assets and onerous property commitments (note 1.4, 3.1, 3.2, 3.3);
- IT systems (note 3.2);
- Stock (note 5.1, 5.2); and
- Taxation (note 2.1, 2.2 , 2.3)

These are also described within the Corporate governance report on page 41 to 43.

Notes to the Group financial statements

52 weeks ended 1 February 2015

1 Performance in the period

1.1 Accounting policies

Revenue recognition

Sale of goods in-store and online, and fuel
Revenue from the sale of goods in-store and online comprises cash from customers and excludes VAT. It is net of returns, colleague discounts, coupons, vouchers, Match & More points earned in-store and online and the free element of multi-save transactions. Sale of fuel is recognised net of VAT and Match & More points earned on fuel. 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 revenue, other than the related commission. Sales are recorded net of VAT and intra-group transactions.

Match & More and other initiatives
The fair value of Match & More and other initiatives is determined to be the value to the customer of the points issued, adjusted for factors such as the expected redemption rate. Given Match & More was launched in the year the Group will continue to assess the appropriateness of the rates against actual redemptions going forward.

The fair value is treated as a deduction from revenue at the time the points are issued, and is deferred until the rewards are redeemed by the customer in a future sale.

Cost of sales
Cost of sales consists of all costs of the goods being sold to the point of sale, net of promotional funding and commercial income, and includes property, manufacturing, warehouse and transportation costs. Store depreciation, store overheads and store-based employee costs are also allocated to cost of sales.

Promotional funding
Promotional funding refers to investment in the customer offer by suppliers by way of promotion. The calculation of funding is mechanical and system generated based on a funding level agreed in advance with the supplier. Funding is recognised as units are sold and invoiced in accordance with the specific supplier agreement. Funding is recorded effectively as a direct adjustment to the cost price of the product in the period. Funding is invoiced and collected through the year, shortly after the promotions have ended.

Commercial income
Commercial income is recognised as a deduction from cost of sales, based on the expected entitlement that has been earned up to the balance sheet date for each relevant supplier contract. The Group only recognises commercial income where there is documented evidence of an agreement with an individual supplier.

The types of commercial income recognised by the Group, and the recognition policies are:

Type of commercial income	Description	Recognition
Marketing and advertising funding	Examples include income in respect of in-store marketing and point of sale, as well as funding for advertising	Income is recognised over the period as set out in the specific supplier agreement. Income is invoiced once the performance conditions in the supplier agreement have been achieved.
Volume-based rebates	Income earned by achieving volume or spend targets set by the supplier for specific products over specific periods	Income is recognised through the year based on forecasts for expected sales or purchase volumes, informed by current performance, trends, and the terms of the supplier agreement. Income is invoiced throughout the year in accordance with the specific supplier terms. In order to minimise any risk arising from estimation, supplier confirmations are also obtained to agree the final value to be recognised at year end, prior to it being invoiced.

Uncollected commercial income at the balance sheet date is classified within the financial statements as follows:

- **Creditors:** A large proportion of the Group's trading terms state that income due from suppliers will be netted against amounts owing to that supplier. Any outstanding invoiced commercial income relating to these suppliers at the balance sheet date will be included within trade payables.
- **Debtors:** Where the trading terms described above do not exist, the Group classifies outstanding commercial income within trade debtors. Where commercial income is earned and not invoiced to the supplier at the balance sheet date, this is classified within accrued commercial income.
- **Stock:** The carrying value of stock is adjusted to reflect unearned elements of commercial income as the stock has not yet been sold. This income is subsequently recognised in cost of sales when the product has been sold.

In order to provide users of the accounts with greater understanding in this area additional income statement and balance sheet disclosure is provided in notes 1.6, 5.2, 5.3 and 5.4 to the financial statements.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

1 Performance in the period *continued*

1.1 Accounting policies *continued*

Other operating income
Other operating income primarily consists of income not directly related to in-store and online grocery retailing and mainly comprises rental income from investment properties and income generated from recycling of packaging.

Profit/loss on disposal and exit of properties
Profit/loss from the disposal and exit of properties includes gains and losses on disposal of property assets and other costs incurred by the Group following a decision to dispose, close or no longer purchase properties. Where the Group disposes of a property, this disposal transaction is accounted for upon unconditional exchange of contracts. Gains and losses are determined by comparing sale proceeds with the asset's carrying amount and are presented net of costs associated with disposal.

1.2 Revenue analysis

	Like-for-like sales	Other	**2015 Total £m**	2014 Total £m
Sale of goods in stores and online	12,639	360	**12,999**	13,434
Fuel	3,521	55	**3,576**	3,984
Total store-based and online sales	16,160	415	**16,575**	17,418
Other sales	–	241	**241**	262
Total revenue	16,160	656	**16,816**	17,680

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 note 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.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

1 Performance in the period *continued*

1.4 Underlying profit

The definition of underlying profit has been amended to include new business development costs as they are considered to be ongoing activities and part of the Group's underlying business. The underlying profit reconciliation for the comparative period presented below has been restated to reflect this change. This has resulted in a decrease in post-tax underlying profit from amounts previously reported last year of £49m (pre-tax: £66m).

The amendment of the definition has resulted in the following changes to underlying profit in the comparative period:

	2014	
	Pre-tax £m	Post-tax £m
Restated underlying profit	719	537
New business development costs	66	49
Underlying profit as previously reported	785	586

The Directors consider that the underlying profit and underlying adjusted earnings per share measures referred to in the results provide useful information for shareholders on underlying trends and performance. The adjustments are made to reported loss to (a) remove impairment, onerous lease provisions, or other similar items that do not relate to the Group's principal activities on an ongoing basis; (b) remove profit/loss arising on disposal and exit of properties and sale of businesses; (c) apply a normalised tax rate of 26.1% (2014: 25.3%); and (d) remove the impact of pension interest volatility.

	2015 £m	Restated 2014 £m
Loss after tax	**(761)**	(238)
Add back: tax (credit)/charge for the period[1]	**(31)**	62
Loss before tax	**(792)**	(176)
Adjustments for:		
Impairment and onerous lease provisions[1]	**1,273**	903
Profit/loss arising on disposal and exit of properties[1,2]	**(131)**	(9)
Profit on disposal of Kiddicare.com Limited (note 4.6)[1]	**(4)**	–
Net pension interest (income)/cost (note 8.2)[1]	**(1)**	1
Underlying profit before tax	**345**	719
Normalised tax charge at 26.1% (2014: 25.3%)[1]	**(90)**	(182)
Underlying profit after tax	**255**	537
Underlying earnings per share (pence)		
– basic (note 1.5.2)	**10.93**	23.08
– diluted (note 1.5.2)	**10.89**	22.99

[1] Adjustments marked [1] increase post-tax underlying earnings by £1,016m (2014: increase £775m), as shown in the reconciliation of earnings disclosed in note 1.5.2.
[2] Included within profit/loss arising on disposal and exit of properties is a charge of £19m relating to the closure of ten stores and six convenience stores.

The adjustments above are classified within the Consolidated statement of comprehensive income on the following lines:

- impairment and onerous lease provisions adjustment has been included within administrative expenses;
- profit/loss arising on disposal and exit of properties and profit on disposal of Kiddicare.com Limited are classified within profit/loss arising on disposal and exit of properties and sale of businesses; and
- net pension interest (income)/expense is classified within finance income/costs in the Consolidated statement of comprehensive income.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

1 Performance in the period *continued*

1.4 Underlying earnings *continued*

2014/15 impairment

Impairment and onerous lease provisions in 2014/15 consist of £1,273m in relation to trading stores, of which £1,116m is impairment, £118m is onerous lease provisions, £30m relates to onerous commitments and £9m relates to lease premiums.

2013/14 impairment

Impairment and onerous lease provisions in 2013/14 consisted of £379m in relation to trading stores, £319m in relation to the property pipeline (which consists of undeveloped land), £163m in respect of Kiddicare and £42m of other costs.

The trading stores' costs of £379m consisted of £330m impairment and £49m onerous leases. Pipeline costs of £319m included impairment of £90m and a further £229m in respect of onerous leases and capital contracts. Charges in respect of Kiddicare consisted of £24m of goodwill, £12m brand, £70m impairment and £57m onerous lease provisions. Other impairments of £42m principally included £27m write off of the costs incurred in the development of our own food online offer which was no longer required as a result of our arrangement with Ocado.

1.5 Earnings per share

Basic earnings per share (EPS) is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue 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 (2014: 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:

			2015			2014
	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 attributable to ordinary shareholders	**(761)**	**2,332.5**	**(32.63)**	(238)	2,327.0	(10.23)
Effect of dilutive instruments						
Share options and LTIPs[1]	**–**	**–**	**–**	–	–	–
Diluted EPS	**(761)**	**2,332.5**	**(32.63)**	(238)	2,327.0	(10.23)

[1]The effect of dilutive instruments would improve basic EPS as total earnings is a loss of £761m (2014: loss of £238m). Diluted EPS cannot exceed basic EPS, therefore the diluted EPS disclosed above has been adjusted so that it equals basic EPS.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

1 Performance in the period *continued*

1.5.2 Underlying EPS

Basic EPS is adjusted to more accurately show underlying business performance. The reconciliation of the earnings used in the calculations of underlying earnings per share (restated) is set out below:

	2015			2014		
	Earnings £m	Weighted average number of shares millions	EPS pence	Earnings £m	Weighted average number of shares millions	EPS pence
Underlying EPS (restated)[1]						
Basic EPS						
Loss attributable to ordinary shareholders	**(761)**	**2,332.5**	**(32.63)**	(238)	2,327.0	(10.23)
Adjustments to determine underlying profit (note 1.4) (restated)[1]	**1,016**	**–**	**43.56**	775	–	33.31
	255	**2,332.5**	**10.93**	537	2,327.0	23.08
Effect of dilutive instruments						
Share options and LTIPs	**–**	**9.0**	**(0.04)**	–	9.0	(0.09)
Diluted EPS (restated)[1]	**255**	**2,341.5**	**10.89**	537	2,336.0	22.99

[1] Underlying EPS measures have been restated to reflect the change in definition of underlying earnings as described in note 1.4.

1.6 Operating loss

	2015 £m	2014 £m
The following items have been included in arriving at operating loss:		
Employee costs (note 1.7)	**1,970**	1,972
Depreciation and impairment:		
– Property, plant and equipment (note 3.3)	**315**	336
– Investment property (note 3.5)	**2**	5
– Impairment of property, plant and equipment (note 3.3)	**1,113**	457
Amortisation and impairment (note 3.2)		
– Intangible assets	**70**	53
– Impairment of goodwill and intangible assets	**3**	89
Operating lease rentals:		
– Land and buildings	**87**	71
– Other	**16**	12
– Sublease receipts	**(6)**	(7)
Value of stock expensed	**12,875**	13,437

1 Performance in the period *continued*

1.6 Operating loss *continued*

Value of stock expensed

In order to provide context on commercial income earned in the period, each is shown below as a percentage of the value of stock expensed (VSE) before commercial income is deducted.

	2015		2014	
	£m	% of VSE	£m	% of VSE
Commercial income:				
Marketing and advertising funding	**291**	**2.2**	280	2.0
Volume-based rebates	**134**	**1.0**	116	0.9
Total commercial income	**425**	**3.2**	396	2.9

[1] See additional disclosure in notes 5.2, 5.3 and 5.4.

Auditor remuneration

During the period PricewaterhouseCoopers LLP (2014: KPMG Audit Plc), the Group's auditor, provided the following services:

	2015 £m	2014 £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
– other services	**0.3**	0.1
	0.9	0.8

The Board has a policy on the engagement of the external auditor to supply non-audit services, which is available in the Corporate governance compliance statement set out in the investor relations section of the Group's website at www.morrisons-corporate.com.

1.7 Employees and Directors

	2015 £m	2014 £m
Employee benefit expense for the Group during the period		
Wages and salaries	**1,755**	1,787
Social security costs	**118**	121
Share-based payments	**11**	6
Other pension costs	**86**	58
	1,970	1,972

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

1 Performance in the period *continued*

1.7 Employees and Directors *continued*

	2015 No.	2014 No.
Average monthly number of people, including Directors		
Stores	**104,047**	111,199
Manufacturing	**7,497**	7,320
Distribution	**5,731**	5,996
Centre	**2,503**	2,888
	119,778	127,403

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 53). There are no Executive Directors (2014: none) who have retirement benefits accruing under any of the Group's defined benefit pension schemes.

Senior management remuneration

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.

	2015 £m	2014 £m
Senior managers		
Wages and salaries	**37**	27
Social security costs	**5**	4
Share-based payments	**2**	3
Other pension costs	**2**	1
	46	35

1.8 Dividends

Amounts recognised as distributed to equity holders in the period:

	2015 £m	2014 £m
Interim dividend for the period ended 1 February 2015 of 4.03p (2014: 3.84p)	**94**	90
Final dividend for the period ended 2 February 2014 of 9.16p (2013: 8.31p)	**214**	193
	308	283

The Directors propose a final dividend in respect of the financial period ending 1 February 2015 of 9.62p per share which will absorb an estimated £225m of shareholders' funds. Subject to approval at the AGM, it will be paid on 10 June 2015 to shareholders who are on the register on 8 May 2015.

The dividends paid and proposed during the year are from cumulative realised distributable reserves of Wm Morrison Supermarkets PLC.

2 Taxation

The focus of the Group's approach to tax affairs is to ensure compliance with the relevant laws of the territories in which the Group operates. Almost all of the Group's stores and sales are in the UK, therefore the majority of taxes are paid in the UK.

The Group takes a compliance-focused approach to its tax affairs, and has a transparent relationship with the UK and overseas tax authorities and interacts with HMRC on a regular basis. The Group's tax policy provides a governance framework with all related risks and stakeholder interests taken into consideration. The tax policy is approved by the Board, with updates on tax compliance and governance matters being provided to the Audit Committee.

The Group operates a small number of branches and subsidiary companies outside of the UK based in the following overseas jurisdictions:

- The Netherlands: The Group has manufacturing operations in the Netherlands as part of its produce supply chain. Local corporation taxes of £1.9m were paid during 2015 (2014: £2.2m);
- Hong Kong: Offices in Hong Kong were established in 2011 and source many of the Group's non-food products. Local corporation taxes of £0.4m were paid during 2015 (2014: £0.3m);
- Isle of Man, Jersey and Guernsey: The Group's insurance company is based in the Isle of Man for regulatory reasons, and property assets with a net book value of £44m are held in Jersey and Guernsey as a result of historic acquisitions. All profits in each of these jurisdictions are subject to UK tax.

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 or loss 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 are 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 the probable outcome of tax compliance issues. All accruals are included in current liabilities.

2.2 Taxation

2.2.1 Analysis of (credit)/charge in the period

	2015 £m	2014 £m
Current tax		
– UK corporation tax	**71**	153
– overseas tax	**4**	5
– adjustments in respect of prior periods	**(99)**	(46)
	(24)	112
Deferred tax		
– origination and reversal of timing differences	**1**	(12)
– adjustments in respect of prior periods	**(8)**	30
– impact of change in tax rate	**–**	(68)
	(7)	(50)
Tax (credit)/charge for the period	**(31)**	62

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

2 Taxation *continued*

2.2 Taxation *continued*

2.2.2 Tax on items charged in other comprehensive expense and equity

	2015 £m	2014 £m
Remeasurements arising in the pension scheme (of which rate change is £nil (2014: £6m))	**(6)**	8
Cash flow hedges	**(2)**	1
Total tax on items included in other comprehensive income and equity	**(8)**	9
Analysis of items charged to other comprehensive income and equity:		
Deferred tax (note 2.3)	**(8)**	9

2.2.3 Tax reconciliation

The reconciliation below shows how the tax credit of £31m has arisen on loss before tax of £792m.

The tax for the period is higher (2014: higher) than the standard rate of corporation tax in the UK of 21.3% (2014: 23.2%). The differences are explained below:

	2015 £m	2014 £m
Loss before taxation	**(792)**	(176)
Loss before taxation at 21.3% (2014: 23.2%)	**(169)**	(41)
Effects of:		
Expenses not deductible for tax purposes	**3**	4
Disallowed depreciation on UK properties	**28**	35
Deferred tax on Safeway acquisition assets	**(22)**	(5)
Profit on property transactions	**(4)**	1
Impairment and onerous lease provisions not deductible for tax	**240**	154
Effect of change in tax rate	**–**	(68)
Other	**–**	(3)
Adjustments in respect of prior periods	**(107)**	(15)
Tax (credit) / charge for the period	**(31)**	62

Factors affecting current and future tax charges

The Group's tax charge has reduced from the prior year. The reduction in the current tax charge reflects the lower underlying profit, whilst elements of the asset impairments announced by the Group are also deductible for tax purposes. The Group also benefited from adjustments in respect of prior periods for which the liability has now been settled with HMRC. The Group's deferred tax liabilities have also reduced year on year, primarily as a result of impairments reducing the carrying value of property assets for which the Group provides for deferred tax.

Legislation to reduce the rate of corporation tax to 20% was included in the Finance Act 2013. The 20% rate will apply from April 2015. Deferred tax is already provided at 20%. There has not been any indication of any further changes in the rate of corporation tax from 20%.

2.3 Deferred tax

	2015 £m	2014 £m
Deferred tax liability	**(462)**	(472)
Deferred tax asset	**47**	42
Net deferred tax liability	**(415)**	(430)

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.

2 Taxation *continued*

2.3 Deferred tax *continued*

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

	Property, plant and equipment £m	Pensions £m	Other short term temporary differences £m	Total £m
Current period				
At 3 February 2014	(456)	2	24	**(430)**
Credited/(charged) to loss for the period	28	–	(21)	**7**
Credited to other comprehensive income and equity	–	6	2	**8**
At 1 February 2015	(428)	8	5	**(415)**
Prior 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)

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 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. During the year the Group disposed of £15m of fully written down brands relating to Kiddicare.

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 such as borrowing costs and employment costs of those people directly working on the construction and installation of property, plant and equipment.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

3 Operating assets *continued*

3.1 Accounting policies *continued*

Depreciation rates

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.

Non-current assets classified as held-for-sale

Non-current assets are classified as held-for-sale if their carrying amount is to be recovered principally through a sale transaction, rather than continuing use within the Group, and the sale is considered highly probable. The sale is expected to complete within one year from the date of classification and the assets are available for sale in their current condition. Non-current assets held-for-sale are stated at the lower of carrying amount and fair value less costs to dispose and are not depreciated.

Lessor accounting – operating leases

Assets acquired and made available to third parties under operating leases are recorded as property, plant and equipment or 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.

Finance leases

Assets funded through finance leases are capitalised as property, plant and equipment and depreciated over their useful economic life or lease term, whichever is shorter. The amount capitalised is 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. The obligations to pay future rentals are included within liabilities. 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.

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 dispose. 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.

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

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. Any reversal of impairment losses would be excluded from underlying earnings.

3 Operating assets *continued*

3.2 Goodwill and intangible assets

Current period	Goodwill £m	Brands £m	Software development costs £m	Licences £m	**Total £m**
Cost					
At 3 February 2014	34	15	577	40	**666**
Additions	–	–	121	5	**126**
Interest capitalised	–	–	9	–	**9**
Disposals	(24)	(15)	(30)	–	**(69)**
Fully written down assets	–	–	(44)	(12)	**(56)**
At 1 February 2015	**10**	**–**	**633**	**33**	**676**
Accumulated amortisation and impairment					
At 3 February 2014	24	15	147	22	**208**
Charge for the period	–	–	63	7	**70**
Impairment	–	–	2	1	**3**
Disposals	(24)	(15)	(30)	–	**(69)**
Fully written down assets	–	–	(44)	(12)	**(56)**
At 1 February 2015	**–**	**–**	**138**	**18**	**156**
Net book amount at 1 February 2015	**10**	**–**	**495**	**15**	**520**

Included within software development costs are assets under construction of £153m (2014: £175m).

In previous years, fully depreciated assets have been retained in the Group's fixed asset register and included in the table above. In order to provide greater understanding of the Group's annual depreciation charge in the current year, these assets have been removed from both cost and accumulated depreciation.

Goodwill
The goodwill arose on the acquisition of Flower World Limited (£3m) and Farmers Boy (Deeside) Limited (£7m).

Impairment testing of goodwill
Goodwill of £10m is allocated to the grocery group of CGUs. This group of CGUs has been tested for impairment via the value in use calculation described in note 3.3. The growth rate applied to the period after five years is 2% (2014: 2%).

Software development costs
The cumulative interest capitalised included within software development costs is £36m (2014: £27m). The cost of internal labour capitalised is not material for separate disclosure.

Prior period	Goodwill £m	Brands £m	Software development costs £m	Licences £m	Total £m
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

Included within the above is £51m of assets that were fully depreciated. These assets have been removed within the current year disclosure.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

3 Operating assets *continued*

3.2 Goodwill and intangible assets *continued*

Prior year impairment of software development costs, goodwill and brand

As explained in note 1.4, the 2013/14 impairment included £27m write off of the investment in the development of Morrisons own food online offer. Also included is £24m of goodwill which arose on acquisition of Kiddicare, £24m of software development assets, principally relating to Kiddicare, and £12m relating to the Kiddicare brand. A discount rate of 6.5% and a nil growth rate after five years were applied in the value in use calculation underpinning this impairment loss. These assets have subsequently been disposed of in the current year following the sale of Kiddicare.com Limited (note 4.6).

3.3 Property, plant and equipment

Current period	Freehold land £m	Freehold buildings £m	Leasehold land and buildings £m	Plant, equipment, fixtures & vehicles £m	Total £m
Cost					
At 3 February 2014	4,046	4,519	1,112	2,673	**12,350**
Additions at cost	53	107	22	206	**388**
Interest capitalised	–	2	–	–	**2**
Transfers to investment properties	–	(4)	–	–	**(4)**
Transfers to assets held-for-sale	(104)	(237)	(44)	(28)	**(413)**
Disposals	(6)	(18)	(7)	(17)	**(48)**
Fully written down assets	–	(39)	(28)	(1,533)	**(1,600)**
At 1 February 2015	3,989	4,330	1,055	1,301	**10,675**
Accumulated depreciation and impairment					
At 3 February 2014	211	1,264	355	1,895	**3,725**
Charge for the period	–	116	27	172	**315**
Impairment	449	302	214	148	**1,113**
Transfers to investment properties	–	(3)	–	–	**(3)**
Transfers to assets held-for-sale	–	(50)	(14)	(26)	**(90)**
Disposals	–	(14)	(6)	(17)	**(37)**
Fully written down assets	–	(39)	(28)	(1,533)	**(1,600)**
At 1 February 2015	660	1,576	548	639	**3,423**
Net book amount at 1 February 2015	3,329	2,754	507	662	**7,252**
Assets under construction included above	5	8	1	13	**27**

The Group has performed its annual assessment of its depreciation policies and asset lives and deemed them to be appropriate. No changes have been made to asset lives during the year.

In previous years, fully depreciated assets have been retained in the Group's fixed asset register and included in the table above. In order to provide greater understanding of the Group's annual depreciation charge in the current year, these assets have been removed from both cost and accumulated depreciation.

Included within the above are leasehold land and buildings held under finance lease with a cost of £319m (2014: £308m) and accumulated depreciation of £22m (2014: £19m).

The cost of financing property developments prior to their opening date has been included in the cost of the asset. The cumulative amount of interest capitalised in the total cost above amounts to £271m (2014: £269m).

3 Operating assets *continued*

3.3 Property, plant and equipment *continued*

Impairment

The Group considers that each store is a separate cash generating unit (CGU) and therefore considers every store for an indication of impairment annually. The Group calculates each store's recoverable amount and compares this amount to its book value. The recoverable amount is determined as the higher of 'value in use' and 'fair value less costs of disposal'. If the recoverable amount is less than the book value, an impairment charge is recognised based on the following methodology:

'Value in use' is calculated by projecting individual store pre-tax cash flows over the remaining useful life of the store, based on forecasting assumptions. The methodology used for calculating future cash flows is to:

- use the actual cash flows for each store in the current year;
- allocate a proportion of the Group's central costs to each store on an appropriate basis;
- project each store's cash flows over the next five years by applying forecast sales and cost growth assumptions;
- project cash flows beyond year five for the remaining useful life of each store by applying a long term growth rate; and
- discount the cash flows using a pre-tax rate of 9.0% (2014: 6.5%). The discount rate takes into account the Group's weighted average cost of capital.

'Fair value less costs of disposal' is estimated by the Directors based on their knowledge of individual stores and the markets they serve and likely demand from grocers or other retailers. The Directors also obtain valuations by store prepared by independent valuers and consider these in carrying out their estimate of fair value less cost of disposal for the purposes of testing for impairment. In determining their valuation, the independent valuers assume an expected rent and yield for each store based on the quality of the asset, local catchment and the store being occupied by a supermarket tenant with a similar covenant to Morrisons.

In order to reflect recent changes in market conditions, in particular the very significant decrease in demand from major grocery retailers for supermarket space, the Directors consider it appropriate for the purpose of testing for impairment to revise downwards the rent and yield assumptions in the independent valuation to reflect the following factors on a store by store basis:

- Whether a major grocery operator might buy the store, taking into consideration whether they are already located near the store, and whether the store size is appropriate for their business model, and then if not;
- Assessing whether a smaller store operator might buy the store, in which case the value has been updated to reflect the Directors' assessment of the yield which would be achievable if such an operator acquired the store, and then if not;
- Assessing whether a non-food operator might buy the store, in which case the value has been updated to reflect the Directors' assessment of the yield which would be achievable if such an operator acquired the store.

Having applied the above methodology and assumptions, the Group has recognised an impairment charge of £1,116m (tangible assets: £1,113m and intangible assets: £3m) during the year (2014: £459m).

An increase of 1% in the discount rate would result in an additional impairment charge of £70m.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

3 Operating assets *continued*

3.3 Property, plant and equipment *continued*

Prior period	Freehold land £m	Freehold building £m	Leasehold land and building £m	Plant, equipment, fixtures & vehicles £m	Total £m
Cost					
At 4 February 2013	3,994	4,211	1,009	2,340	11,554
Additions at cost	57	308	103	339	807
Interest capitalised	–	10	–	–	10
Transfer to investment properties	(5)	(8)	–	–	(13)
Disposals	–	(2)	–	(6)	(8)
At 2 February 2014	4,046	4,519	1,112	2,673	12,350
Accumulated depreciation and impairment					
At 4 February 2013	98	972	180	1,688	2,938
Charge for the period	–	109	35	192	336
Impairment	113	183	140	21	457
Transfer to investment properties	–	2	–	–	2
Disposals	–	(2)	–	(6)	(8)
At 2 February 2014	211	1,264	355	1,895	3,725
Net book amount at 2 February 2014	3,835	3,255	757	778	8,625
Assets under construction included above	112	43	2	79	236

Included within the above is £1,161m (of which £1,097m relates to plant and equipment) of assets that were fully depreciated. These assets have been removed within the current year disclosure.

As described in note 1.4, the impairment from the prior year related to costs incurred on stores the Group no longer intended to open, trading stores and assets of the Kiddicare business.

3.4 Non-current assets classified as held-for-sale

	2015 £m	2014 £m
At start of period	**–**	–
Transfers from property, plant and equipment at net book value	**323**	–
Transfers from investment property at net book value	**51**	–
Additions	**3**	–
Disposals	**(293)**	–
At end of period	**84**	–

Assets transferred from property, plant and equipment had a cost of £413m and accumulated depreciation of £90m. Assets transferred from investment property had a cost of £77m and accumulated depreciation of £26m.

3 Operating assets *continued*

3.5 Investment property

	2015 £m	2014 £m
Cost		
At start of period	**183**	189
Additions	**1**	3
Transfers from property, plant and equipment	**4**	13
Transfers to assets held-for-sale	**(77)**	–
Disposals	**(3)**	(22)
At end of period	**108**	183
Accumulated depreciation and impairment		
At start of period	**64**	66
Charge for the period	**2**	5
Transfers from/(to) property, plant and equipment	**3**	(2)
Transfers to assets held-for-sale	**(26)**	–
Disposals	**(3)**	(5)
At end of period	**40**	64
Net book amount at end of period	**68**	119

Included in other operating income is £21m (2014: £26m) of rental income generated from investment properties. At the end of the period the fair value of investment properties, including those held in assets held for sale, was £200m (2014: £230m). Investment properties are valued by independent surveyors on a vacant possession basis using observable inputs (fair value hierarchy Level 2).

3.6 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:

	2015 £m	2014 £m
Within one year	**26**	30
More than one year and less than five years	**85**	99
After five years	**114**	140
	225	269

3.7 Capital commitments

	2015 £m	2014 £m
Contracts placed for future capital expenditure not provided in the financial statements (property, plant and equipment and intangible assets)	**149**	179

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

4 Interests in other entities

4.1 Accounting policies

Joint ventures

The Group applies IFRS 11 to all joint arrangements. Under IFRS 11 investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor. The Group has assessed the nature of its joint arrangements and determined them to be joint ventures. Joint ventures 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, from the date that joint control commences until the date that joint control ceases.

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 identifiable net assets acquired. In the event that this excess is negative the difference is recognised directly in profit for the period.

Disposal of subsidiaries

When the Group ceases to have control over a subsidiary, any retained interest in the entity is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

4.2 Principal subsidiaries

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 companies below are registered in England and Wales and the principal area of trading is the United Kingdom. All equity holdings are in ordinary shares.

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
Subsidiaries of other Group companies		
Safeway Stores Limited	Grocery retailer	100

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 Interests in other entities *continued*

4.2 Principal subsidiaries *continued*

This includes the following overseas subsidiaries:

Overseas subsidiaries of the Group	Country of registration	Principal activity	Equity holding %
Bos Bros Fruit and Vegetables BV	Netherlands	Manufacturer and distributor of fresh food products	100%
Safeway Stores (Gibraltar) Pension Trustees Limited	Gibraltar	Dormant	100%
RP (No. 37) Limited	Jersey	Property development	100%
Stalwart Investments Limited	Jersey	Property holding company	100%
Freehold Investments Limited	Jersey	Property holding company	100%
Lease Securities Limited	Jersey	Property holding company	100%
Maypole Limited	Guernsey	Holding company	100%
Wm Morrison (HK) Limited	Hong Kong	Acquirer of non food products	100%
Farock Insurance Limited	Isle of Man	Insurance captive	100%

4.3 Joint ventures

The Group and Ocado Group plc are sole investors in a company (MHE JV Co), which owns the plant and equipment at the Dordon Customer Fulfilment Centre (CFC) (see note 4.5). 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, applicable this financial year, and determined that the Group continues to jointly control MHE JV Co.

MHE JV Co	2015 £m	2014 £m
Current assets	**24**	17
Non-current assets	**117**	118
Current liabilities	**(5)**	(17)
Net assets	**136**	118
Profit	**4**	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

	2015 £m	2014 £m
Equity investments at cost	**31**	31

The equity investments held for long term investment represents the Group's 10% stake in Fresh Direct Inc, a US internet grocer. The investment was made on 9 March 2011, and at that point, the Group made available to Fresh Direct a $15m 8% unsecured seven year loan facility. The facility is undrawn at the balance sheet date.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

4 Interests in other entities *continued*

4.5 Business combinations

In the 52 weeks ended 1 February 2015 there have been no 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.

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 in the prior year.

The Directors have considered the impact of IFRS 10 Consolidated financial statements, applicable this financial year, 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).

4.6 Disposals relating to the Kiddicare business

A charge of £163m (comprising the write off of goodwill £24m, brand £12m, asset impairment £70m and onerous lease provisions £57m) was made last year in respect of the Kiddicare business. On 11 July 2014, the Group disposed of Kiddicare.com Limited to Endless LLP receiving consideration of £2m for the sale of the shares. This resulted in a profit on disposal of £4m. This profit is one-off in nature and so has been excluded from reported underlying earnings. As at the year end, seven of the ten leases relating to Kiddicare had been assigned and two leases had been exchanged but not yet completed.

One of these two leases was subsequently assigned in February 2015.

5 Working capital and provisions

5.1 Accounting policies

Stock

Stock represents goods for resale and is 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, reduced by promotional funding and commercial income and a provision for estimated losses relating to shrinkage and markdowns. Losses relating to shrinkage in stores are based on historical losses verified by physical stock counts conducted by an independent third party. Provision is made for obsolete and slow moving items.

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 in administrative expenses.

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 'Cash flow statements'.

Trade and other creditors

Trade and other creditors are initially recognised at fair value, which is generally equal to face value of the invoices received, and subsequently held at amortised cost. Trade creditors are presented net of commercial income due when the Group's trading terms state that income from suppliers will be netted against amounts owing to that supplier.

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 petrol filling station decommissioning costs this is when the filling station is first constructed and for dilapidations on leased buildings, when the lease is entered into. Provisions for onerous leases are recognised when the Group believes that the unavoidable costs of meeting the lease obligations exceed the economic benefits expected to be received under the lease. The amounts provided are based on the Group's best estimate of the least net cost of exit. Where material, these estimated outflows are discounted to net present value using a pre-tax rate that reflects current market assumptions. The unwinding of this discount is recognised as a financing cost in the income statement.

5 Working capital and provisions *continued*

5.2 Stock

	2015 £m	2014 £m
Finished goods	**658**	852

Included in finished goods is a deduction for unearned elements of commercial income as the stock has not been sold.

5.3 Debtors

	2015 £m	2014 £m
Trade debtors:		
– Commercial income trade debtors	**10**	21
– Accrued commercial income	**37**	20
– Other trade debtors	**136**	147
Less: provision for impairment of trade debtors	**(5)**	(8)
	178	180
Prepayments and accrued income	**51**	116
Other debtors	**10**	20
	239	316

The ageing analysis of trade debtors is as follows:

	2015 £m	2014 £m
Neither past due nor impaired	**178**	176
Past due but not impaired:		
Not more than three months	**–**	1
Greater than three months	**–**	3
Impaired debt	**5**	8
	183	188

As at 1 February 2015 and 2 February 2014, 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.

As of 5 March 2015, £7m of the £10m commercial income trade debtor balance had been settled and £21m of the £37m accrued commercial income balance had been invoiced and settled.

5.4 Creditors – current

	2015 £m	2014 £m
Trade creditors	**1,493**	1,568
Less: commercial income due, offset against amounts owed	**(96)**	(132)
	1,397	1,436
Other taxes and social security payable	**96**	58
Other creditors	**241**	315
Accruals and deferred income	**487**	463
	2,221	2,272

As of 5 March 2015, £83m of the £96m commercial income due above had been offset against payments made.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

5 Working capital and provisions *continued*

5.5 Provisions

	Onerous lease provision £m	Other property provisions £m	Total £m
At 3 February 2014	**176**	**31**	**207**
Charged to profit for the period	**118**	**–**	**118**
Utilised/released during the period	**(42)**	**(2)**	**(44)**
Unwinding of discount	**6**	**1**	**7**
At 1 February 2015	**258**	**30**	**288**

Part of onerous leases relate to sublet and vacant properties, with commitments ranging from one to 58 years. The provision is revised regularly in response to market conditions. During the year, £118m has been charged to onerous lease provisions in respect of the impairment detailed in note 1.4. The utilisation of onerous lease provisions this year mostly relates to the assignment of Kiddicare leases.

The majority of other property provisions relate to a petrol filling station decommissioning reserve for the cost of decommissioning petrol tanks and provision for dilapidations on leased buildings, for the cost of restoring the asset to its original condition.

5.6 Cash generated from operations

	2015 £m	2014 £m
Loss for the period	**(761)**	(238)
Net finance costs	**98**	82
Taxation (credit)/charge	**(31)**	62
Share of profit of joint venture	**(2)**	(1)
Operating loss	**(696)**	(95)
Adjustments for:		
Depreciation and amortisation	**387**	393
Impairment	**1,116**	547
Profit arising on disposal and exit of properties and sale of businesses	**(135)**	(9)
Adjustment for non-cash element of pension charges	**(5)**	2
Other non-cash charges	**14**	4
Decrease/(increase) in stocks[1]	**180**	(71)
Decrease/(increase) in debtors[1]	**77**	(25)
(Decrease)/increase in creditors[1]	**(76)**	154
Increase in provisions[1]	**108**	131
Cash generated from operations	**970**	1,031

Total working capital (the sum of items marked [1] above) is £289m in the year. This includes £157m as a result of the current year impairment and onerous leases charge (see note 1.4) and is net of £74m of onerous capital payments in the year. When adjusted to exclude these items, the working capital inflow is £206m.

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% (2014: 5%). Capitalised interest is included within interest paid in cash flow from operating activities.

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.

Sale and leaseback of properties

The accounting treatment of the sale and leaseback depends upon the substance of the transaction (by applying the lease classification principles described above). For sale and operating leasebacks, the assets are sold at fair value, and accordingly the profit or loss from the sale is recognised immediately in the Statement of comprehensive income. A number of new property operating leases have been entered into in the year ended 1 February 2015 (see property commitments note 6.8). When forming the conclusion of operating lease classification, consideration was given to the key lease classification indicators of IAS 17. The leases are typically for a 25 year period. The Directors have reviewed the remaining useful lives for these particular properties and concluded they are significantly longer than the period of the lease. As disclosed on page 88 a review of the useful economic lives of each of the property, plant and equipment categories has been performed in the year with no changes made. Other key indicators considered in reaching an operating lease classification were the present value of the minimum lease payments and the ownership clauses in the contracts upon expiry of the lease.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

6 Capital and borrowings *continued*

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 employee trusts for the granting of Group shares to executives and members of the employee share plans. Shares in the Group held by the employee share trusts 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.

Net debt

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

6.2 Finance costs and income

	2015 £m	2014 £m
Interest payable on short term loans and bank overdrafts	(10)	(12)
Interest payable on bonds	(96)	(86)
Interest capitalised	11	17
Total interest payable	(95)	(81)
Provisions: unwinding of discount	(7)	(3)
Other finance costs	(3)	(2)
Net pension interest cost (section 8)	–	(1)
Finance costs	(105)	(87)
Bank interest received	5	3
Amortisation of bonds	1	2
Net pension interest income (section 8)	1	–
Finance income	7	5
Net finance cost	(98)	(82)

6.3 Borrowings

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

	2015 £m	2014 £m
Current		
Bank overdraft	1	3
Short term borrowings	10	400
£150m Sterling bonds 6.50% August 2015	–	150
	11	553

6 Capital and borrowings *continued*

6.3 Borrowings *continued*

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

	2015 £m	2014 £m
Non-current		
£200m Sterling bonds 6.00% January 2017	**201**	201
£200m Sterling bonds 6.12% December 2018	**202**	203
£400m Sterling bonds 4.625% December 2023	**397**	397
£400m Sterling bonds 3.50% July 2026	**421**	390
£300m Sterling bonds 4.75% July 2029	**291**	–
$250m US private placement loan notes (USPP) 4.4% November 2026	**164**	149
€700m Euro bond 2.25% June 2020	**518**	568
Total non-current bonds and loan notes	**2,194**	1,908
Revolving credit facility	**314**	572
	2,508	2,480

Borrowing facilities

Borrowings are denominated in sterling, US dollars and euros, and bear fixed interest rates, with the exception of the revolving credit facility which bears floating interest rates. All borrowings are unsecured. In July 2014, the Group issued a £300m sterling bond at a fixed interest rate of 4.75% expiring in July 2029. This is part of the Group's £3bn Euro Medium Term Note programme. In September 2014 the Group entered into a new five year syndicated committed revolving credit facility of £1.35bn, replacing the £1.2bn facility that was due to mature in March 2016. The revolving credit facility incurs commitment fees at market rates and drawdowns bear interest at a spread above LIBOR.

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 £1,180m (2014: £775m) of undrawn, floating, committed borrowing facilities available in respect of which all conditions present had been met.

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 5.4) are excluded from this analysis.

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

	2015 £m	2014 £m
Less than one year	**100**	647
One to two years	**290**	88
Two to three years	**78**	858
Three to four years	**277**	69
Four to five years	**386**	268
More than five years	**2,145**	1,805

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

6 Capital and borrowings *continued*

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 the Group at the balance sheet date (level 2). The fair values of borrowings included in level 2 are based on the net present value of the anticipated future cash flows associated with these instruments using rates currently available for debts on similar terms, credit risk and remaining maturities.

These compare to carrying values as follows:

	2015		2014	
	Amortised cost £m	**Fair value £m**	Amortised cost £m	Fair value £m
Total bonds: non-current and current	**2,030**	**2,115**	1,909	1,959
Total loan notes: non-current	**164**	**175**	149	171
	2,194	**2,290**	2,058	2,130

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

6.4 Analysis of net debt

	Note	2015 £m	2014 £m
Cash and cash equivalents per balance sheet		**241**	261
Bank overdrafts	6.3	**(1)**	(3)
Cash and cash equivalents per cash flow		**240**	258
Foreign exchange forward contracts		**6**	1
Other financial assets	7.3	**6**	1
Short term borrowings and current bonds	6.3	**(10)**	(550)
Forward foreign exchange contracts	7.3	**(6)**	(4)
Energy price contracts	7.3	**(12)**	(6)
Current financial liabilities		**(28)**	(560)
Bonds	6.3	**(2,030)**	(1,759)
Private placement loan notes	6.3	**(164)**	(149)
Revolving credit facility	6.3	**(314)**	(572)
Cross-currency contracts and interest rate swaps	7.3	**(45)**	(34)
Energy price contracts	7.3	**(5)**	(2)
Non-current financial liabilities		**(2,558)**	(2,516)
Net debt		**(2,340)**	(2,817)

Cash and cash equivalents include restricted balances of £21m (2014: £37m) which is held by Farock Insurance Company Limited.

6 Capital and borrowings *continued*

6.5 Called-up share capital

	Number of shares millions	Share capital £m	Share premium £m	Total £m
Current period				
At 3 February 2014 and 1 February 2015	2,335	234	127	**361**
Prior 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

The total authorised number of ordinary shares is 4,000 million shares (2014: 4,000 million shares) with a par value of 10p per share (2014: 10p per share). All issued shares are fully paid. There were 41,962 shares issued pursuant to the exercise of options (2014: 8,811,865) for an aggregate consideration of £0.1m (2014: £21m). During the 52 weeks to 2 February 2014, the Group acquired 20,338,000 of its own shares for cancellation as part of the equity retirement programme for consideration of £53m. The equity retirement programme completed in March 2013 and the Group did not acquire any of its own shares for cancellation in the 52 weeks ended 1 February 2015.

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 £6m (2014: £5m) in respect of own shares held at the balance sheet date. This represents the cost of 2,907,374 (2014: 1,938,608) of the Group's ordinary shares (nominal value of £0.3m (2014: £0.2m)). These shares are held in a trust and were acquired by the business to meet obligations under the Group's employee share plans using funds provided by the Group. The market value of the shares at 1 February 2015 was £5m (2014: £5m). The trust has waived its right to dividends. These shares are not treasury shares as defined by the London Stock Exchange.

During the period the Group acquired 4,000,000 of its own shares to hold in trust for consideration of £8m, and utilised 3,031,234 trust shares to satisfy awards under the Group's employee share plans.

Treasury shares
During the 52 weeks ended 1 February 2015 the Group received nil proceeds (2014: £7m) in respect of treasury shares utilised to satisfy share options exercised by employees during the period. At 1 February 2015, no treasury shares remain (2014: nil).

Issue of new shares
The Group issued 41,962 (2 February 2014: 8,811,865) new shares to satisfy options exercised by employees during the period. Proceeds received on exercise of these shares amounted to £0.1m (2014: £21m).

6.6 Reserves

	2015 £m	2014 £m
Capital redemption reserve	**39**	39
Merger reserve	**2,578**	2,578
Hedging reserve	**(22)**	(15)
Retained earnings	**638**	1,729
Total	**3,233**	4,331

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

6 Capital and borrowings *continued*

6.6 Reserves *continued*

Capital redemption reserve
The capital redemption reserve at the start of the period related to 389,631,561 of the Company's own shares which it purchased on the open market for cancellation between 31 March 2008 and 8 March 2013 at a total cost of £1,081m.

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, as well as its lease commitments.

The Group's capital management objectives are to safeguard its ability to continue as a going concern providing returns to shareholders via optimising debt and equity balances, maintaining an 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, net debt has reduced by £477m, reflecting strong operating cash flow, reduced capital expenditure and £448m of property disposals. Additional funding of £300m has been obtained through the Group's bond programme, whilst the Group's syndicated revolving credit facility has been renewed and extended to £1.35bn. The overall impact of this additional funding has been an increase in the average maturity period of the Group's debt. Throughout the year, the Group has comfortably complied with the gearing and fixed charge cover covenants attaching to its revolving credit facility, and the USPP.

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:

	2015		2014	
	Property £m	Vehicles, plant and equipment £m	Property £m	Vehicles, plant and equipment £m
Within one year	**108**	**15**	77	11
More than one year and less than five years	**411**	**28**	292	25
After five years	**1,520**	**–**	934	–
	2,039	**43**	1,303	36

The movement in the property lease commitments within one year is summarised below:

Property operating lease commitment within one year	£m
At 3 February 2014	**77**
Impact of disposal programme	**15**
Leases on new stores	**14**
Other	**2**
At 1 February 2015	**108**

7 Financial risk and hedging

7.1 Accounting policies

Derivative financial instruments and hedge accounting

Derivatives are transacted to mitigate financial risks that arise as a result of the Group's operating activities and funding arrangements. At the inception of a hedge, the Group documents the relationship between the hedging instrument and the hedged item, the risk management objective and strategy for undertaking the hedge.

The Group assesses whether the hedging instrument is highly effective in offsetting changes in fair values or cash flows of the hedged item at inception and it also assesses whether the hedge has been and will continue to be effective on an ongoing basis.

All derivatives are initially recognised at fair value and are also measured at fair value at each reporting date. Derivatives with positive fair values are recognised as assets and those with negative fair values as liabilities. They are also categorised as current or non-current according to the maturity of each derivative. All gains or losses arising due to changes in the fair value of derivatives are recognised in profit or loss except when the derivative qualifies for cash flow hedge accounting.

Cash flow hedges

The Group designates derivatives into a cash flow hedge where they have been transacted to hedge a highly probable forecast transaction or a particular risk associated with an asset or liability. The effective portion of the change in the fair value of the derivatives, that are designated into cash flow hedge relationships, are recognised in other comprehensive income. Cumulative gains or losses on derivatives are reclassified from other comprehensive income into profit or loss in the period when the transaction occurs. Any ineffective portion of the gain or loss on the derivative is immediately recognised in profit or loss.

Fair value hedge

The Group designates derivatives into a fair value hedge relationship when they hedge the Group's exposure to changes in the 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 loss or the period as well as the gain or loss from changes in the fair value of the derivative.

7.2 Financial risk management

The Group has a centralised treasury function which manages funding, liquidity and other financial risk in accordance with the Board approved treasury policy. The objective of the policy and controls that are established are to mitigate the risk of an adverse impact on the performance of the Group as a result of its exposure to financial risks arising from the Group's operations and its sources of finance. It is the Group's policy not to engage in speculative trading of financial instruments.

The Board retains ultimate responsibility for treasury activity and is involved in key decision making. A Treasury Committee is established to provide governance and oversight to treasury activity within delegated authority limits and formally reports to the Audit Committee.

Foreign currency risk

The majority of purchases made by the Group are denominated in sterling, however some trade purchases are made 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 a minimum of 80% of committed and highly probable exposures within the next six months are hedged and at least 40% of exposures in the following six months. At the balance sheet date, the Group had hedged 84% of its exposure within the next six months (2014: 84%).

Cross-currency interest rate swaps are used to mitigate the Group's currency exposure arising from payments of interest and principal in relation to foreign currency funding, including the US dollar private placement (USPP) loan notes and the euro denominated bond.

At the reporting date, the sensitivity to a reasonable possible change (+/–10%) in the US dollar and euro exchange rates would equate to a £7m post tax profit or loss exposure in relation to the euro and £5m in relation to the US dollar, for the unhedged forecast foreign currency exposures over the next 12 months. The impact on other comprehensive income would be £20m.

Liquidity risk

The Group policy is to maintain a balance of funding borrowings across a range of maturities and a sufficient level of committed headroom to meet obligations. The Group finances its operations using a diversified range of funding providers including banks, bondholders, and USPP noteholders.

A central cash forecast is maintained by the treasury function who monitor the availability of liquidity to meet business requirements and any unexpected variances. The treasury function seek to centralise all surplus cash balances to minimise the level of gross debt. Short term cash balances, together with undrawn committed facilities, enable the Group to manage its day to day liquidity risk. Any short term surplus is invested in accordance with the approved investment policy.

The Treasury Committee compares the committed liquidity available to the Group against the forecast requirements and policy headroom.

Interest rate risk

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 79% (2014: 62%) of the Group's borrowings are at fixed rate.

Whilst still applying the policy described above, from time-to-time the Group enters into fixed-to-floating interest rate swaps to achieve the appropriate proportion of fixed versus floating rate borrowings.

Credit risk

As a retailer, the majority of the Group's revenue is received in cash at the point of sale and therefore 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 commercial income and tenants of investment properties.

The Group has established appropriate credit verification procedures in respect of financial institutions. Limits on the total exposure to any counterparty or Group of connected counterparties are established within treasury policy taking into account credit ratings. Compliance with limits is regularly monitored.

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 hedging contracts to fix prices for expected consumption.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

7 Financial risk and hedging *continued*

7.2 Financial risk management *continued*

The Group has adopted a capital at risk model for hedging its fuel and power consumption. The Treasury Committee reviews the Group's exposure to commodity prices and ensures it remains within policy limits. A change of +/– 10 % in the market value of the commodity price at the balance sheet date would affect other comprehensive income by £9m (2014: £10m).

7.3 Derivative financial assets and liabilities

Derivative financial assets	2015 £m	2014 £m
Current		
Foreign exchange contracts	**6**	1
	6	1

All derivatives are categorised as level 2 instruments. Level 2 fair values for simple, over-the-counter derivatives are calculated by using benchmark, observable market interest rates to discount future cash flows.

Derivative financial liabilities	2015 £m	2014 £m
Current		
Foreign exchange contracts	**6**	4
Energy price contracts	**12**	6
	18	10
Non-current		
Cross-currency swaps and interest rate swaps	**45**	34
Energy price contracts	**5**	2
	50	36

			2015 £m			2014 £m
Maturity analysis of derivatives	< 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)**	**(80)**	**(823)**	(25)	(99)	(830)
– Inflow	**19**	**77**	**756**	20	78	793
Interest rate swaps – fair value hedges						
– Outflow	**(3)**	**(11)**	**(18)**	(3)	(11)	(22)
– Inflow	**7**	**28**	**46**	7	28	56
Forward contracts – cash flow hedges						
– Outflow	**(215)**	**–**	**–**	(232)	–	–
– Inflow	**210**	**–**	**–**	212	–	–
Derivatives settled on a net basis						
Energy price contracts – cash flow hedges						
– Outflow	**(12)**	**(4)**	**–**	(10)	–	–

The amounts disclosed in the table above are the contractual undiscounted derivative cash flows and therefore differ to those in the balance sheet.

7.4 Hedging activities

Cash flow hedges

At 1 February 2015 and 2 February 2014, 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 1 February 2015, the Group also held euro cross-currency swaps designated as cash flow hedges. The notional principal amount of the outstanding cross-currency swaps at 1 February 2015 was $250m (2014: $250m) and €700m (2014: €700m).

7 Financial risk and hedging *continued*

7.4 Hedging activities *continued*

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
Profits recognised on fixed-to-floating interest rate swaps designated in fair value hedges are £31m (2014: loss of £4m). The change in fair value of the underlying hedged item was a loss of £31m (2014: gain of £4m).

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 Consolidated 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 the net pension asset in the Retirement saver plan (RSP).

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

8.2 Defined benefit schemes: summary and description

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 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 position of each scheme at 1 February 2015 is as follows:

Net position (liability)/asset:	2015 £m	2014 £m
CARE schemes	**(43)**	(13)
RSP	**4**	2
Combined net position	**(39)**	(11)

At the year end, schemes in surplus have been disclosed within assets on the balance sheet and schemes in deficit have been disclosed within liabilities. In the prior year, a net position was disclosed within liabilities since the surplus was considered immaterial.

The disclosures below show the details of the schemes combined:

Balance sheet:	2015 CARE £m	2015 RSP £m	2014 CARE £m	2014 RSP £m
Fair value of scheme assets	**4,047**	**87**	3,055	39
Present value of obligations	**(4,090)**	**(83)**	(3,068)	(37)
Net pension (liability)/asset	**(43)**	**4**	(13)	2

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

8 Pensions *continued*

8.2 Defined benefit schemes: summary and description *continued*

Consolidated statement of comprehensive income	2015 CARE £m	2015 RSP £m	2014 CARE £m	2014 RSP £m
Current service cost – recognised in cost of sales	**39**	**33**	24	–
Current service cost – recognised in administrative expenses	**4**	**4**	8	–
Administrative costs paid by Schemes – recognised in administrative expenses	**3**	**1**	3	–
Curtailment gain	**(1)**	**–**	–	–
Net interest on net pension asset / liability – finance (income)/costs	**–**	**(1)**	1	–
Total expense charged to statement of comprehensive income	**45**	**37**	36	–
Statement of other comprehensive income:				
Remeasurements in other comprehensive income charge/(credit)	**31**	**–**	(11)	–

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 have been carried out as at 1 April 2013 for the Safeway Scheme and 5 April 2013 for the Morrison Scheme and the RSP. The results of these valuations for the CARE Schemes have been used and updated for IAS 19 'Employee benefits' purposes for the period to 1 February 2015 by a qualified independent actuary. For the RSP, an actuarial valuation for the purposes of IAS 19, based on member data as at 1 February 2015, has been completed by an 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.

8.3 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:

	2015 CARE £m	2015 RSP £m	2014 CARE £m	2014 RSP £m
Equities (quoted)	**1,401**	**84**	1,289	39
Corporate bonds (quoted)	**1,109**	**–**	891	–
Government bonds (quoted)	**–**	**–**	6	–
Liability driven investments (unquoted)	**1,534**	**–**	863	–
Cash (quoted)	**3**	**3**	6	–
Total	**4,047**	**87**	3,055	39

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. This is achieved through the use of 'liability driven investments' (LDI), whose main goal is to have sufficient assets to meet all current and future liabilities as they fall due. LDI involves the use of derivatives such as swaps and other investment instruments. There are no annuities or longevity swaps.

8 Pensions *continued*

8.3 Scheme assets *continued*

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

	2015 CARE £m	2015 RSP £m	2014 CARE £m	2014 RSP £m
Fair value of scheme assets at start of period	**3,055**	**39**	2,839	–
Recognition of RSP scheme assets	**–**	**–**	–	39
Interest income	**137**	**3**	137	–
Return on scheme assets excluding interest	**879**	**9**	96	–
Employer contributions	**46**	**39**	34	–
Employee contributions	**1**	**2**	10	–
Benefits paid	**(68)**	**(4)**	(58)	–
Administrative expenses	**(3)**	**(1)**	(3)	–
Fair value of scheme assets at end of period	**4,047**	**87**	3,055	39

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 £90m (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 £6.6m during the year ending 1 February 2015, and will make annual contributions of £6.6m for a further 18 years.

8.4 Present value of obligations

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

	2015 CARE £m	2015 RSP £m	2014 CARE £m	2014 RSP £m
Defined benefit obligation at start of period	**(3,068)**	**(37)**	(2,859)	–
Recognition of RSP defined benefit obligation	**–**	**–**	–	(37)
Current service cost	**(43)**	**(37)**	(32)	–
Interest expense	**(137)**	**(2)**	(138)	–
Actuarial loss – demographic assumptions	**(21)**	**–**	–	–
Actuarial loss – financial assumptions	**(889)**	**(16)**	(118)	–
Actuarial gain – experience	**–**	**7**	31	–
Curtailment gain	**1**	**–**	–	–
Employee contributions	**(1)**	**(2)**	(10)	–
Benefits paid	**68**	**4**	58	–
Defined benefit obligation at end of period	**(4,090)**	**(83)**	(3,068)	(37)

The durations of the defined benefit obligations at the end of the 2015 reporting period are: RSP 20 years; Morrisons CARE 27 years; Safeway CARE 26 years. The weighted average duration of all three schemes is 26 years.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

8 Pensions *continued*

8.4 Present value of obligations *continued*

8.4.1 Significant actuarial assumptions

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

Financial assumptions	2015 CARE	2015 RSP	2014 CARE	2014 RSP
Discount rate applied to scheme liabilities (% p.a.)	**3.10%**	**3.10%**	4.50%	4.40%
Inflation assumption (RPI) (% p.a.)	**3.10%**	**3.10%**	3.50%	3.50%

Life expectancies	2015 CARE	2015 RSP	2014 CARE	2014 RSP
Longevity in years from age 65 for current pensioners				
Male	**22.6**	**n/a**	22.3	n/a
Female	**24.0**	**n/a**	23.2	n/a
Longevity in years from age 65 for current members aged 45				
Male	**24.8**	**n/a**	24.7	n/a
Female	**26.4**	**n/a**	25.6	n/a

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 2014 and 2015 are the S1PMA/S1PFA-Heavy tables (males/females) based on year of birth. Following analysis completed as part of the 2013 actuarial valuations a scaling factor of 110% was applied to the mortality tables used in the Morrison Scheme as at 1 February 2015. 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 as at 2 February 2014 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. For the 2015 year end, and in line with the 2013 actuarial valuations this projection was updated to use the CMI 2012 rates with an annual rate of improvement of 1.5% pa.

Related actuarial assumptions (expressed as weighted averages)

	2015 CARE	2015 RSP	2014 CARE	2014 RSP
Rate of increases in salaries (% p.a.)	**3.10%**	**2.30%**	3.50%	3.50%
Rate of increase of pensions in payment: RPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	**2.10%/3.10%**	**–**	2.30%/3.50%	–
Pre-retirement revaluation for active members (% p.a.)	**3.10%**	**1.80%**	3.50%	2.10%
Rate of increase of pensions in deferment: CPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	**–/2.30%**	**2.30%/–**	–/2.70%	2.50%/–
CPI inflation (% p.a.)	**2.30%**	**2.30%**	2.70%	2.70%

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.

		2015 CARE £m	2015 RSP £m	2014 CARE £m	2014 RSP £m
Discount rate applied to Scheme obligations	+/– 0.1% pa	**–/+ 99**	**–/+ 2**	–/+ 73	–/+ 1
Inflation assumption (RPI and associated assumptions)	+/– 0.1% pa	**+/– 89**	**+/– 1**	+/– 64	+/– 1
Longevity	+/– one year	**+ 159**	**–**	+/– 94	–

8 Pensions *continued*

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 2 February 2015 is £92m. This estimate includes amounts payable from the SLP and salary sacrificed contributions from employees.

8.6 Proposed closure of CARE schemes to future accrual

During January 2015, the Group reached an agreement in principle with the Trustees of the CARE Schemes to close them to future accrual, subject to the outcome of consultation with current scheme members. The Group's proposal is that scheme members' accrued benefits will be frozen (subject to inflationary revaluation), and that future benefits will no longer accrue in these schemes. Following this agreement the Group has entered into a consultation with scheme members on 23 February 2015. The Group expects that the consultation process will conclude during May 2015. Subject to the outcome of the consultation, any changes would become effective in early July 2015. The financial effect of closing these schemes to future accrual would be to reduce the Group's exposure to future volatility, and increases in pension liabilities and costs.

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.

The charge in the period for share-based payments was £11m (2014: £6m).

9.2 Share save schemes

The Share save 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 schemes 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	20 May 2014	13 May 2013	14 May 2012	17 May 2011
Share price at grant date	£2.10	£2.92	£2.79	£3.01
Fair value of options granted	£11.6m	£8.1m	£9.1m	£11.5m
Exercise price	£1.64	£2.25	£2.36	£2.28
Dividend yield	6.21%	4.17%	3.69%	3.2%
Annual risk free interest rate	1.00%	0.45%	0.53%	1.65%
Expected volatility*	18.3%	16.8%	19.4%	24.2%

* 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.

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

9 Share-based payments *continued*

9.2 Share save schemes *continued*

The requirement that the employee has to save in order to purchase shares under the Share save 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.

	2015		2014	
	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	**2.30**	**42,993**	2.34	43,660
Granted	**1.64**	**41,208**	2.25	18,901
Exercised	**2.28**	**(42)**	2.37	(11,578)
Forfeited	**2.16**	**(33,374)**	2.32	(7,990)
Outstanding at end of period	**1.85**	**50,785**	2.30	42,993
Exercisable at end of period	**2.28**	**56**	2.37	36

	2015		2014	
	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	**2.14**	**42**	2.73	11,578

	2015	2014
Share options outstanding at the end of the period		
Range of exercise prices	**£1.64 to £2.36**	£2.25 to £2.37
Weighted average remaining contractual life	**2.5 years**	2.0 years

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 and accrue the value of dividends over the vesting period.

LTIP grants issued before 2013 are subject to the performance conditions, as stated below. Since 2013, the performance conditions apply to Management Board members only. Senior employees eligible for LTIPs have to satisfy a service condition only. Given the size of the Management Board, the fair value of the LTIP grants assumes no leavers. The leavers assumptions below relate to the senior employees only.

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	**16 Oct 2014**	**20 Jun 2014**	**22 Apr 2014**	17 Oct 2013	22 Apr 2013	15 Oct 2012	13 Apr 2012	1 Oct 2011
Share price at grant date	**£1.57**	**£1.91**	**£2.02**	£2.79	£2.80	£2.75	£2.91	£3.02
Assumed leavers (Senior employees only)	**7%**	**–**	**7%**	8%	8%	5%	5%	5%
Performance criteria (Management Board only)	**–**	**–**	**55%**	50%	50%	65%	65%	77%
Fair value of share awards	**£0.9m**	**£3.0m**	**£16.7m**	£1.5m	£18.8m	£1.5m	£28.1m	£1.4m

9 Share-based payments *continued*

9.3 Long term incentive plans *continued*

	2015 Share awards thousands	2014 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	**10,444**	24,630
Granted	**10,484**	7,267
Forfeited	**(2,135)**	(21,453)
Outstanding at end of period	**18,793**	10,444
Exercisable at end of period	**–**	–

The weighted average remaining contractual life of the share awards is 2.6 years (2014: 2.0 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	2015	2014
Share price at grant date	**£2.12**	–
Assumed leavers	**–**	–
Fair value of share awards granted	**£0.4m**	–

There are 165,358 share awards outstanding at the end of the period (2014: nil). The movement during the period is entirely the result of options being granted. The weighted average remaining contractual life of the share awards is 1.1 years (2014: nil 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.

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] Vested in April 2014.
[2] Vests April 2015.

	2015 Share awards thousands	2014 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	**4,926**	–
Granted	**–**	4,926
Exercised	**(2,453)**	–
Lapsed	**(133)**	–
Outstanding at end of period	**2,340**	4,926

Notes to the Group financial statements *continued*

52 weeks ended 1 February 2015

9 Share-based payments *continued*

9.6 Deferred share bonus plan

Certain members of senior management participate in the deferred share bonus plan under which 33% to 50% of any bonus payable is deferred in shares for three years from the date the deferred share 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 determine it:

Grant date	2014/15 scheme	2013/14 scheme
Share price at grant date	**£2.10**	–
Assumed leavers	**0%**	–
Exercise price	**£nil**	–
Fair value of share awards granted	**£0.6m**	–

	2015 Share awards thousands	2014 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	**937**	1,424
Granted	**286**	–
Exercised	**(408)**	(487)
Outstanding at end of period	**815**	937

The weighted average remaining contractual life of the share awards is 0.8 years (2014: 0.8 years).

10 Other

10.1 Related party transactions

As identified on page 60 of the Directors' report, the Directors were advised during the year that certain distributions made in the years ended 3 February 2013 and 2 February 2014 were not in accordance with the Companies Act 2006. The resolution referred to in this section of the Directors' Report also meets the criteria of a related party transaction under IAS 24. The matter has been resolved through the filing of a circular with the UK Listings Authority on 10 February 2015 and a general meeting of the Company's shareholders on 6 March 2015.

The Group's other 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.