Consolidated statement of comprehensive income

52 weeks ended 29 January 2012

	Note	2012 £m	2011 £m
Turnover	2	17,663	16,479
Cost of sales		(16,446)	(15,331)
Gross profit		1,217	1,148
Other operating income		86	80
Administrative expenses		(329)	(323)
Losses arising on property transactions		(1)	(1)
Operating profit	5	973	904
Finance costs	6	(47)	(43)
Finance income	6	21	13
Profit before taxation		947	874
Taxation	7	(257)	(242)
Profit for the period attributable to the owners of the Company		690	632
Other comprehensive (expense)/income:			
Actuarial (loss)/gain arising in the pension scheme	20	(65)	34
Cash flow hedging movement		(23)	3
Tax in relation to components of other comprehensive (expense)/income	7	19	(11)
Other comprehensive (expense)/income for the period, net of tax		(69)	26
Total comprehensive income for the period attributable to the owners of the Company		621	658
Earnings per share (pence)			
– basic	9	26.68	23.93
– diluted	9	26.03	23.43

Consolidated balance sheet

29 January 2012

	Note	2012 £m	2011 £m
Assets			
Non-current assets			
Goodwill and intangible assets	10	303	184
Property, plant and equipment	11	7,943	7,557
Investment property	12	259	229
Net pension asset	20	–	38
Investments	13	31	–
Other financial assets	14	1	3
		8,537	8,011
Current assets			
Stocks		759	638
Debtors	15	320	268
Other financial assets	14	2	4
Cash and cash equivalents		241	228
		1,322	1,138
Liabilities			
Current liabilities			
Creditors	16	(2,025)	(1,914)
Other financial liabilities	17	(115)	–
Current tax liabilities		(163)	(172)
		(2,303)	(2,086)
Non-current liabilities			
Other financial liabilities	17	(1,600)	(1,052)
Deferred tax liabilities	19	(464)	(499)
Net pension liabilities	20	(11)	–
Provisions	21	(84)	(92)
		(2,159)	(1,643)
Net assets		5,397	5,420
Shareholders' equity			
Called-up share capital	22	253	266
Share premium	22	107	107
Capital redemption reserve	23	19	6
Merger reserve	23	2,578	2,578
Retained earnings and hedging reserve	23	2,440	2,463
Total equity attributable to the owners of the Company		5,397	5,420

The accounting policies on pages 65 to 69 and notes on pages 70 to 94 form part of these financial statements.

The financial statements on pages 61 to 94 were approved by the Board of Directors on 7 March 2012 and were signed on its behalf by:

Dalton Philips
Chief Executive

Richard Pennycook
Group Finance Director

Consolidated cash flow statement

52 weeks ended 29 January 2012

	Note	2012 £m	2011 £m
Cash flows from operating activities			
Cash generated from operations	24	1,264	1,141
Interest paid		(55)	(52)
Taxation paid		(281)	(191)
Net cash inflow from operating activities		928	898
Cash flows from investing activities			
Interest received		6	5
Investments		(31)	–
Proceeds from sale of property, plant and equipment		4	8
Purchase of property, plant and equipment and investment property		(724)	(494)
Purchase of intangible assets		(72)	(98)
Cash outflow from acquisition of businesses	27	(74)	(3)
Net cash outflow from investing activities		(891)	(582)
Cash flows from financing activities			
Purchase of own shares	23	(368)	–
Proceeds from issue of ordinary shares		–	16
New borrowings		1,102	25
Repayment of borrowings		(486)	(154)
Dividends paid to equity shareholders	8	(301)	(220)
Net cash outflow from financing activities		(53)	(333)
Net decrease in cash and cash equivalents		(16)	(17)
Cash and cash equivalents at start of period		228	245
Cash and cash equivalents at end of period	25	212	228

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

	Note	2012 £m	2011 £m
Net decrease in cash and cash equivalents		(16)	(17)
Cash outflow from decrease in debt and lease financing		486	154
Cash inflow from increase in borrowings		(1,102)	(25)
Other non-cash movements		(22)	(1)
Debt acquired on acquisition of businesses		–	(4)
Opening net debt		(817)	(924)
Closing net debt	25	(1,471)	(817)

Consolidated statement of changes in equity

52 weeks ended 29 January 2012

		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 30 January 2011		266	107	6	2,578	5	2,458	5,420
Profit for the period		–	–	–	–	–	690	690
Other comprehensive income:								
Actuarial loss arising in the pension scheme	20	–	–	–	–	–	(65)	(65)
Cash flow hedging movement		–	–	–	–	(23)	–	(23)
Tax in relation to components of other comprehensive income	7	–	–	–	–	6	13	19
Total comprehensive income for the period		–	–	–	–	(17)	638	621
Shares purchased for cancellation	22	(13)	–	13	–	–	(368)	(368)
Employees share options schemes:								
Share-based payments	26	–	–	–	–	–	25	25
Dividends	8	–	–	–	–	–	(301)	(301)
Total transactions with owners		(13)	–	13	–	–	(644)	(644)
At 29 January 2012		253	107	19	2,578	(12)	2,452	5,397

The hedging reserve represents the gains and losses arising on derivatives used for cash flow hedging, principally from the Group's cross-currency swaps, energy price contracts and forward exchange contracts.

		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 31 January 2010		265	92	6	2,578	3	2,005	4,949
Profit for the period		–	–	–	–	–	632	632
Other comprehensive income:								
Actuarial gain arising in the pension scheme	20	–	–	–	–	–	34	34
Cash flow hedging movement		–	–	–	–	3	–	3
Tax in relation to components of other comprehensive income	7	–	–	–	–	(1)	(10)	(11)
Total comprehensive income for the period		–	–	–	–	2	656	658
Employees share options schemes:								
Share-based payments	26	–	–	–	–	–	17	17
Share options exercised	22	1	15	–	–	–	–	16
Dividends	8	–	–	–	–	–	(220)	(220)
Total transactions with owners		1	15	–	–	–	(203)	(187)
At 30 January 2011		266	107	6	2,578	5	2,458	5,420

Group accounting policies

General 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 29 January 2012 (2011: 30 January 2011) in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretation Committee interpretations (IFRIC) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. IFRS and IFRIC are issued by the International Accounting Standards Board (the IASB) and must be adopted into European Union law, referred to as endorsement, before they become mandatory under the IAS Regulation. Shown below are recent standards and interpretations that have been issued by the IASB, indicating their status of endorsement.

The financial statements have been prepared on a going concern basis. The Directors' assessment of going concern has been considered within the general information section of the Directors' report.

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 below.

The Group's accounting policies are set out below and have, unless otherwise stated, been applied consistently to all periods presented in these consolidated financial statements.

There are no IFRS or IFRIC interpretations that are effective for the first time for the financial year beginning on or after 31 January 2011 that would have a material impact on the Group. The Group has adopted all amendments published in 'Improvements to IFRSs 2010'. The adoption of these amendments has not had any significant impact on the amounts reported 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.

New IFRS and amendments to IAS and interpretations
There are a number of standards and interpretations issued by the IASB that are effective for financial statements after this reporting period. The following have not been early adopted by the Group:

International Financial Reporting Standards		Effective for accounting periods starting on or after
IFRS 7*	Amendment to Financial instruments: Disclosures on derecognition	1 July 2011
IAS 12	Amendment to Income taxes on deferred tax	1 January 2012
IAS 1	Amendment to Financial statement presentation	1 July 2012
IAS 19	Amendment to Employee benefits	1 January 2013
IFRS 9	Financial instruments	1 January 2015
IFRS 10	Consolidated financial statements	1 January 2013
IFRS 11	Joint arrangements	1 January 2013
IFRS 12	Disclosures of interests in other entities	1 January 2013
IFRS 13	Fair value measurement	1 January 2013
IAS 27	Separate financial statements (revised)	1 January 2013
IAS 28	Associates and joint ventures (revised)	1 January 2013

* Endorsed by the European Union.

IAS 19 'Employee benefits' was amended in June 2011. The impact on the Group will be immediately to recognise all past service costs, and to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit asset/ liability.

The application of these standards and interpretations is not anticipated to have a material effect on the Group's financial statements.

Basis of consolidation
The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries (together the 'Group'), being those undertakings that it controls. Control is achieved where the Company has the power to govern the financial and operating policy of an investee entity so as to obtain benefits from its activities. The financial statements of subsidiaries used in the preparation of the consolidated financial statements are prepared for the same reporting period as the Parent Company and are based on consistent accounting policies. The results of subsidiaries acquired or disposed of during the period are included in the consolidated financial statements from the effective date of acquisition up to the effective date of disposal, as appropriate.

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Significant accounting policies
The Directors consider the following to be significant accounting policies in the context of the Group's operations:

Group accounting policies
(continued)

Segmental reporting
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 who make the key operating decisions of the Group, are responsible for allocating resources and assess performance of the operating segments.

The Directors consider, based on its internal reporting framework, management and operating structure, that it has one operating segment, that of retailing. The level of disclosure of segmental and other information is driven by such assessment. Further details of the considerations made and the resulting disclosures are provided in note 3 to these financial statements.

Revenue recognition
Revenue comprises the fair value of consideration received or receivable for the sale of goods in the ordinary course of the Group's activities. It is recognised when significant risks and rewards of ownership have been transferred to the buyer, there is reasonable certainty of recovery of the consideration and the amount of revenue, associated costs and possible return of goods can be estimated reliably.

a) Sale of goods in-store and fuel
Sale of goods in-store is recorded net of value added tax, returns, staff discounts, coupons, vouchers and the free element of multi-save transactions. Sale of fuel is recognised net of value added tax and Morrisons Miles award points. Revenue is recognised when transactions are completed in-store.

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

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

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

Other operating income
Other operating income primarily consists of income not directly related to the operating of supermarkets and mainly comprises rental income from investment properties and income generated from recycling of packaging. Rental income arising from operating leases on investment properties is accounted for on a straight-line basis to the date of the next rent review. Details of rental income from investment property are provided in note 12.

Property transactions
Property includes the balance sheet headings of Property, plant and equipment and Investment property. The results of transactions relating to disposal of property are reported in profit for the period under 'Profit/loss arising on property transactions'. Depreciation and any impairment charges or reversals are recognised in cost of sales or administrative expenses, as appropriate.

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 of interest ceases when the asset is ready for use.

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

Deferred tax is recognised using the balance sheet method. Provision is made for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. No deferred tax is recognised for temporary differences that arise on the initial recognition of goodwill or the initial recognition of assets and liabilities that is not a business combination and that affects neither accounting nor taxable profits. Deferred tax is calculated based on tax law that is enacted or substantively enacted at the reporting date and provided at rates expected to apply when the temporary differences reverse. Deferred tax is charged or credited to profit for the period except when it relates to items charged or credited directly to other comprehensive income, in which case the deferred tax is reflected in other comprehensive income.

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

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

Intangible assets
a) Business combinations and goodwill
The acquisition method of accounting is used to account for business combinations by the Group. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination 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.

The excess of consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired, in the case of a bargain purchase, the difference is recognised directly in profit for the period.

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 goodwill may be impaired. Any impairment is recognised immediately in profit or loss.

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

c) 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. Borrowing costs are capitalised until such time as the software is substantially ready for its intended use.

All other software development and maintenance costs are recognised as an expense as incurred.

Software development costs recognised as assets are held at historic cost less accumulated amortisation and impairment, and are amortised over their estimated useful lives (3-10 years) on a straight line basis.

d) 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 (3-10 years) on a straight line basis.

Property, plant and equipment

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

b) 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	10-33%
Assets under construction	0%

Investment property

Property held to earn rental income is classified as Investment property. Investment property is recorded at cost less accumulated depreciation and any recognised impairment loss. The depreciation policy is consistent with that described for property, plant and equipment.

Investments

Investments comprise of investments in equity instruments. All equity instruments are held for long term investment and 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 investment will be recognised at cost less accumulated impairment losses, in accordance with IAS 39 'Financial instruments: recognition and measurement'. Any impairment is recognised immediately in profit or loss.

Impairment of non-financial assets

Property, plant and equipment, Investment property and Intangible assets are annually reviewed for indications of impairment, or when events or changes in circumstances indicate that the carrying amount may not be recoverable. This is performed for each cash generating unit, which in the case of a supermarket is an individual retail outlet. If there are indications of possible impairment then a test is performed on the asset affected to assess its recoverable amount against carrying value. An impaired asset is written down to its recoverable amount which is the higher of value in use or its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If there is indication of an increase in fair value of an asset that had been previously impaired, then this is recognised by reversing the impairment, 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 for the asset. Impairment losses previously recognised relating to goodwill cannot be reversed.

Stocks

Stocks are measured at the lower of cost and net realisable value. Provision is made for obsolete and slow moving items. Cost is calculated on a weighted average basis and comprises purchase price, import duties and other non-recoverable taxes less rebates. Stocks represent goods for resale.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale.

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.

Lessor accounting – operating leases

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

Group accounting policies
(continued)

Lessee accounting – operating leases
Rental payments are taken to profit for the period on a straight line basis over the life of the lease. Property leases are analysed into separate components for land and buildings and tested to establish whether the components are operating leases or finance leases.

Lessee accounting – finance leases
The present value, calculated using the interest rate implicit in the lease, of the future minimum lease payments is included within Property, plant and equipment and financial liabilities as an obligation to pay future rentals. Depreciation is provided at the same rates as for owned assets, or over the lease period, if shorter.

Rental payments are apportioned between the finance charge and the outstanding obligation so as to produce a constant rate of finance charge on the remaining balance.

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.

Provisions are made in respect of individual properties where there are obligations for onerous contracts, dilapidations and certain decommissioning obligations for petrol filling stations. The amounts provided are based on the Group's best estimate of the likely committed outflow to the Group. Where material, these estimated outflows are discounted to net present value.

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 except when they are deferred in other comprehensive income as qualifying cash flow hedges.

Retirement benefits
The Group operates defined benefit and defined contribution schemes. A defined contribution scheme is a pension scheme under which the Group pays fixed contributions into a separate entity. A defined benefit scheme is one that is not a defined contribution scheme. Pension benefits under defined benefit schemes are defined on retirement based on age at date of retirement, years of service and a formula using either the employee's compensation package or career average revalued earnings.

The Group operates two defined benefit retirement schemes which are funded by contributions from the Group and members. The defined benefit schemes are not open to new members. Pension scheme assets, which are held in separate trustee administered funds, are valued at market rates. Pension scheme obligations are measured on a discounted present value basis using assumptions as shown in note 20. The operating and financing costs of the scheme are recognised separately in profit for the period when they arise. Death-in-service costs are recognised on a straight line basis over their vesting period. Actuarial gains and losses are recognised immediately in other comprehensive income.

The Group has a right to recognise an asset, should one arise, in respect of the Group's net obligations to the pension schemes. Therefore either an asset or a liability is recognised in the balance sheet, calculated separately for each scheme.

Payments by the Group to the defined contribution scheme are charged to profit for the period as they arise.

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.

Fair value 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.

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

a) Financial assets
i) Trade and other debtors
Trade and other debtors are initially recognised at fair value. Provision is made when there is objective evidence that the Group will not be able to recover balances in full, with the charge being recognised in 'Administrative expenses' in profit for the period. Balances are written off when the probability of recovery is assessed as being remote.

ii) Cash and cash equivalents
Cash and cash equivalents for cash flow purposes includes cash-in-hand, cash-at-bank and bank overdrafts together with short term, highly-liquid investments that are readily convertible into known amounts of cash, with an insignificant risk of a change in value, within three months from the date of acquisition. 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 is not available for use by the rest of the Group as it is restricted for use against the specific liability of the captive. As the funds are available on demand, they meet the definition of cash in IAS 7 'Cashflow statements'.

b) Financial liabilities
i) Trade and other creditors
Trade and other creditors are stated at fair value.

ii) 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.

c) Derivative financial instruments and hedge accounting
Derivative financial instruments are initially measured at fair value and are remeasured at fair value through profit or loss, except where the derivative qualifies for hedge accounting.

i) Cash flow hedges
Derivative financial instruments are classified as cash flow hedges when they hedge the Group's exposure to variability in cash flows that are either attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecasted transaction.

The Group has cross-currency swaps designated as cash flow hedges. These derivative financial instruments are used to match or minimise risk from potential movements in foreign exchange rates inherent in the cash flows of the US private placement loan notes.

To minimise the risk from potential movements in energy prices, the Group has energy price contracts which are designated as cash flow hedges.

To minimise the risk from potential movements in foreign exchange rates, the Group uses forward exchange contracts with financial institutions which are designated as cash flow hedges.

Derivatives are reviewed annually for effectiveness. Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or highly probable forecast transaction, the effective part of any gain or loss on the movement in fair value of the derivative financial instrument is recognised in other comprehensive income and presented in the hedging reserve in equity.

The gain or loss on any ineffective part of the hedge is immediately recognised in profit for the period within 'Cost of sales' in relation to the energy price contracts and within 'Finance income/costs' in relation to the cross-currency swaps. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or liability, the associated cumulative gains or losses that were recognised directly in equity are reclassified into profit for the period when the transaction occurs.

ii) Fair value hedges

Derivative financial instruments are classified as fair value hedges when they hedge the Group's exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment. The hedging instrument is stated at fair value and any changes in fair value are immediately recognised in other comprehensive income.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss reported in equity is immediately transferred to the income statement.

Net debt

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

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where any Group company purchases the Company's equity share capital, the consideration paid, including directly attributable incremental costs, is deducted from retained earnings until the shares are cancelled. On cancellation, the nominal value of the shares is deducted from share capital and the amount is transferred to the capital redemption reserve.

Own shares held

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

The shares are deducted for the purpose of calculating the Group's earnings per share.

Use of critical accounting assumptions and estimates

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have significant risk of causing a material adjustment to the carrying value of assets and liabilities are discussed below.

a) Property provisions

Provisions have been made for onerous leases, dilapidations and decommissioning costs. These provisions are estimates based on the condition of each property and market conditions for the relevant location. The actual costs and timing of future cash flows are dependent on future events. Any difference between expectations and the actual future liability will be accounted for in the period when such determination is made.

b) Pension scheme assumptions and mortality table

The carrying value of defined benefit pension schemes is valued using actuarial valuations. These valuations are based on assumptions including the selection of mortality tables for the profile of members in each scheme. All these are estimates of future events. The mortality experience study conducted as part of the Safeway scheme triennial valuation is statistically significant and the longevity assumption is adjusted to reflect its results. As both of the Group's schemes have a similar composition and type of members, this adjustment is also made to the Morrisons scheme. The mortality assumptions, financial assumptions and mortality experience study are based on advice received from the schemes' actuaries. Where appropriate these are corroborated from time-to-time with benchmark surveys and ad-hoc analysis.

c) Determination of useful lives, residual values and carrying values of Intangible assets, Property, plant and equipment and Investment property

Depreciation and amortisation are provided so as to write down the assets to their residual values over their estimated useful lives as set out in the accounting policies for Intangible assets, Property, plant and equipment and Investment property. The selection of these residual values and estimated lives requires the exercise of judgement.

The Group is required to assess whether there is indication of impairment to the carrying values of assets. In making that assessment, judgements are made in estimating value in use in relation to future cash flows and discount rates. The Directors consider that the individual carrying values of stores and other operating assets are supportable either by value in use or market values.

Notes to the Group financial statements

52 weeks ended 29 January 2012

1 Underlying profit

The Directors consider that underlying earnings per share measures referred to in the Chairman's statement, Business and strategic review and Financial review provide additional useful information for shareholders on underlying trends and performance and reflects how the business is monitored internally. The adjustments are made to reported profit to (a) remove the impact of pension interest income volatility on profit for the period; (b) remove losses/profits arising on property transactions since they do not form part of the Group's principal activities; and (c) apply an effective tax rate of 29.3% (2011: 30%), being an estimated normalised tax rate.

	2012 £m	2011 £m
Profit after tax	690	632
Add back: tax charge for the period[1]	257	242
Profit before tax	947	874
Adjustments for:		
Net pension interest income (note 6)[1]	(13)	(6)
Loss arising on property transactions[1]	1	1
Underlying profit before tax	935	869
Taxation[1]	(274)	(261)
Underlying profit after tax charge	661	608
Underlying earnings per share (pence)		
– basic (note 9(b))	25.55	23.03
– diluted (note 9(b))	24.93	22.54

[1] Adjustments marked 1 equal £29m (2011: £24m) as shown in the reconciliation of earnings disclosed in note 9(b).

2 Sales analysis

This table is provided to reconcile the like-for-like sales described in the Business and strategic review with the total turnover:

	Like-for-like stores	Other	2012 Total £m	2011 Total £m
Sale of goods in-stores	13,112	324	13,436	12,937
Fuel	4,009	30	4,039	3,426
Total store based sales	17,121	354	17,475	16,363
Other sales	–	188	188	116
Total turnover	17,121	542	17,663	16,479

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

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.

Consideration of IFRS 8 Operating segments

The Group has made the following considerations in arriving at conclusions and the corresponding disclosure in these financial statements.

IFRS 8 requires consideration of the chief operating decision maker (CODM) within the Group. In line with the Group's internal reporting framework and management structure, the key operating decisions and resource allocations are made by the Management Board. The Directors therefore consider the Management Board to be the CODM.

Consideration in particular was given to retail outlets, the fuel resale operation, the manufacturing entities and multi-channel operations.

Key internal reports received by the CODM, primarily the Board 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. Given this, the Group has considered the overriding core principles of IFRS 8 and has determined that it has one operating segment.

3 Segmental reporting – continued

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

Performance is measured by the CODM based on profit as reported in the Board Management Accounts. This report presents the financial position before (a) income tax; (b) pension interest income volatility; and (c) profit/loss arising from property related transactions. This underlying profit figure is used to measure performance as management believes that this is the most relevant in evaluating the results of the Group relative to other entities that operate within the retail industry. This information and the reconciliation to the statutory position can be found in note 1. In addition, the Board Management Accounts present a Group balance sheet containing assets and liabilities. This balance sheet is as shown within the Consolidated balance sheet.

4 Employees and Directors

	2012 £m	2011 £m
Employee benefit expense for the Group during the period		
Wages and salaries	1,733	1,665
Social security costs	124	122
Share-based payments (note 26)	24	19
Pension costs	35	32
	1,916	1,838

	2012 No.	2011 No.
Average monthly number of people, including Directors		
Stores	116,750	117,821
Manufacturing	6,062	5,861
Distribution	5,489	5,679
Centre	2,906	2,713
	131,207	132,074

Directors' remuneration

A detailed analysis of Directors' remuneration, including salaries, bonuses and long term incentives, and the highest paid Director, is provided under the headings 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.

There are two Executive Directors (2011: two) who have retirement benefits accruing under the Group's defined benefit pension scheme.

Following the prior year internal reorganisation of the senior management structure, leading to the foundation of the Management Board, the Group considers members of the Management Board to be key management since October 2010.

The aggregate remuneration paid or accrued for in the prior year from the date which the Management Board formed in October 2010, excluding members already included in the Directors' remuneration report, are as stated in the financial statements 2011. Additional disclosure has been made to disclose the Management Board information on a full year basis to provide a meaningful comparative for the period ending 29 January 2012.

	2012 £m	Full year basis 2011 £m	As stated in the financial statements 2011 £m
Management Board			
Short term employee benefits	4.7	4.5	2.3
Post employment benefits	0.3	0.2	0.1
Share-based payments	2.1	1.9	0.7
	7.1	6.6	3.1

Notes to the Group financial statements
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5 Operating profit

	2012 £m	2011 £m
The following items have been included in arriving at operating profit:		
Employee costs (note 4)	1,916	1,838
Depreciation:		
– Property, plant and equipment – owned assets (note 11)	310	300
– Property, plant and equipment – under finance lease (note 11)	1	2
– Investment property (note 12)	8	7
Charge to profit for the period	319	309
Amortisation (note 10)	21	10
Operating lease rentals:		
– minimum lease payments – property	43	38
– other	9	6
– sublease receipts	(5)	(6)
Value of stock expensed	13,346	12,380

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

	2012 £m	2011 £m
Audit services		
Fees payable to the Group's auditor for the audit of the Group and the Company financial statements	0.4	0.5
Other services		
Fees payable to the Group's auditors and its associates for other services:		
– the audit of the Group's subsidiaries pursuant to legislation	0.2	0.2
– services relating to taxation	0.2	0.1
– other services	0.5	0.5
	1.3	1.3

Other services includes £0.4m (2011: £0.5m) in relation to independent project assurance and £0.1m (2011: £nil) in relation to transaction support.

6 Finance costs and income

	2012 £m	2011 £m
Interest payable on short term loans and bank overdrafts	(12)	(6)
Interest payable on bonds	(39)	(36)
Interest capitalised	12	7
Total interest payable	(39)	(35)
Fair value movement of derivative instruments	(1)	(1)
Provisions: unwinding of discount	(4)	(5)
Other finance costs	(3)	(2)
Finance costs	(47)	(43)
Bank interest received	5	3
Amortisation of bonds	2	3
Other finance income	1	1
Pension liability interest cost	(127)	(120)
Expected return on pension assets	140	126
Net pension interest income (note 20)	13	6
Finance income	21	13
Net finance cost	(26)	(30)

Interest is capitalised at the effective interest rate incurred on borrowings before taxation of 4% (2011: 4%). Tax relief is obtained on interest paid and this reduces the tax charged for the period.

7 Taxation

a) Analysis of charge in the period

	2012 £m	2011 £m
Corporation tax		
– current period	292	280
– adjustment in respect of prior period	(20)	(5)
	272	275
Deferred tax		
– current period	(37)	(33)
– adjustment in respect of prior period	22	–
	(15)	(33)
Tax charge for the period	257	242

b) Tax on items (credited)/charged in other comprehensive income and equity

	2012 £m	2011 £m
Actuarial (loss)/gain arising in the pension scheme	(13)	10
Cash flow hedges	(6)	1
Total tax on items included in other comprehensive income	(19)	11
Share-based payments	(1)	–
Total tax on items included in other comprehensive income and equity	(20)	11
Analysis of items (credited)/charged to other comprehensive income:		
Current tax	–	(6)
Deferred tax (note 19)	(20)	17

c) Tax reconciliation

The tax for the period is higher (2011: lower) than the standard rate of corporation tax in the UK of 26.3% (2011: 28%). The differences are explained below:

	2012 £m	2011 £m
Profit before tax	947	874
Profit before tax at 26.3% (2011: 28%)	249	245
Effects of:		
Expenses not deductible for tax purposes	12	1
Non-qualifying depreciation	38	31
Deferred tax on Safeway acquisition assets	(12)	(11)
Effect of change in tax rate	(42)	(20)
Other	10	1
Prior period adjustments	2	(5)
Tax charge for the period	257	242

Factors affecting current and future tax charges

The standard rate of corporation tax in the UK changed from 28% to 26% with effect from 1 April 2011. Accordingly the Group's profits for this accounting period are taxed at an effective rate of 26.3% and will be taxed at 26% in the future. The impact of this change in tax rate is a credit of £42m to the income statement.

On 23 March 2011 it was announced that the rate of corporation tax will be reducing from 28% to 23% over a four year period. The first reduction to 26% is applicable for the period ending 29 January 2012. A further 1% reduction per year will bring the rate down to 23% by 2015. At 29 January 2012, a rate of 25% had been substantively enacted and has been used in calculating the Group's deferred tax liability.

Notes to the Group financial statements
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8 Dividends
Amounts recognised as distributed to equity holders in the period:

	2012 £m	2011 £m
Interim dividend for the period ended 29 January 2012 of 3.17p (2011: 1.23p)	81	32
Final dividend for the period ended 30 January 2011 of 8.37p (2010: 7.12p)	220	188
	301	220

The Directors are proposing a final dividend in respect of the financial period ending 29 January 2012 of 7.53p per share which will absorb an estimated £191m of shareholders' funds. Subject to approval at the AGM, it will be paid on 20 June 2012 to shareholders who are on the register on 18 May 2012.

9 Earnings per share
Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares. The Company has two (2011: 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 plan (LTIPs).

a) Basic and diluted earnings per share (unadjusted)
Reconciliations of the earnings and weighted average number of shares used in the calculations are set out below:

	2012			2011		
	Earnings £m	Weighted average number of shares millions	EPS pence	Earnings £m	Weighted average number of shares millions	EPS pence
Unadjusted EPS						
Basic EPS						
Earnings attributable to ordinary shareholders	690	2,586.6	26.68	632	2,640.5	23.93
Effect of dilutive instruments						
Share options and LTIPs	–	64.3	(0.65)	–	56.4	(0.50)
Diluted EPS	690	2,650.9	26.03	632	2,696.9	23.43

b) Underlying earnings per share
Given below is the reconciliation of the earnings used in the calculations of underlying earnings per share:

	2012			2011		
	Earnings £m	Weighted average number of shares millions	EPS pence	Earnings £m	Weighted average number of shares millions	EPS pence
Underlying EPS						
Basic EPS						
Earnings attributable to ordinary shareholders	690	2,586.6	26.68	632	2,640.5	23.93
Adjustments to determine underlying profit (see note 1)	(29)	–	(1.13)	(24)	–	(0.90)
	661	2,586.6	25.55	608	2,640.5	23.03
Effect of dilutive instruments						
Share options and LTIPs	–	64.3	(0.62)	–	56.4	(0.49)
Diluted EPS	661	2,650.9	24.93	608	2,696.9	22.54

The weighted average number of shares has decreased compared to the prior period as a result of the Group's equity retirement programme, see note 23.

10 Intangible assets

	Goodwill £m	Brands £m	Software development costs £m	Licences £m	Total £m
Current period					
Cost					
At 30 January 2011	7	–	173	20	200
Acquired in a business combination (note 27)	27	15	19	–	61
Additions	–	–	70	2	72
Interest capitalised	–	–	7	–	7
At 29 January 2012	34	15	269	22	340
Accumulated amortisation and impairment					
At 30 January 2011	–	–	9	7	16
Charge for the period	–	1	16	4	21
At 29 January 2012	–	1	25	11	37
Net book amount at 29 January 2012	34	14	244	11	303

The cumulative interest capitalised included within software development costs is £13m (2011: £6m). The cost of internal labour capitalised is not material for separate disclosure.

The goodwill acquired balance relates to the Group's acquisition of kiddicare.com Limited ('Kiddicare') (£24m) and Flower World Limited (£3m) and has been allocated to the respective cash-generating units (CGUs). The value of goodwill has been tested for impairment during the current financial year by comparing the recoverable amount on a value in use basis of each CGU to the carrying value of goodwill.

The key assumptions for the Kiddicare value in use calculations are based on the latest Board approved cash flow projections for the next five years and for subsequent years; a long term growth assumption of 2% has been applied. These cash flows have been discounted at a pre-tax rate of 8%. Changes in income and expenditure are based on past experience and expectations of future changes in the market. No impairment arose during the year as a result of this test.

The remaining goodwill of £10m (2011: £7m) is allocated across the respective CGUs. Impairment tests have been performed on the remaining goodwill based on value in use and similar assumptions to those above or on a net asset basis where appropriate. No impairment loss was identified in the current financial year (2011: £nil).

The valuations indicate sufficient headroom such that a reasonably possible change to key assumptions is unlikely to result in an impairment of the related goodwill.

	Goodwill £m	Software development costs £m	Licences £m	Total £m
Prior period				
Cost				
At 31 January 2010	–	–	–	–
Acquired in a business combination	7	–	–	7
Transferred from property, plant and equipment	–	78	11	89
Additions	–	89	9	98
Interest capitalised	–	6	–	6
At 30 January 2011	7	173	20	200
Accumulated amortisation and impairment				
At 31 January 2010	–	–	–	–
Charge for the period	–	6	4	10
Transferred from property, plant and equipment	–	3	3	6
At 30 January 2011	–	9	7	16
Net book amount at 30 January 2011	7	164	13	184

During the prior period software development costs and licences previously held within Property, plant and equipment were reclassified and presented separately within Intangible assets.

Notes to the Group financial statements

52 weeks ended 29 January 2012

11 Property, plant and equipment

	Land and buildings			
	Freehold £m	Leasehold £m	Plant, equipment, fixtures & vehicles £m	Total £m
Current period				
Cost				
At 30 January 2011	7,152	886	1,845	9,883
Acquisition of subsidiary undertakings (note 27)	11	–	1	12
Additions at cost	438	46	233	717
Interest capitalised	5	–	–	5
Transfer to investment properties	(35)	–	–	(35)
Disposals	(6)	(2)	(6)	(14)
At 29 January 2012	7,565	930	2,073	10,568
Accumulated depreciation and impairment				
At 30 January 2011	885	125	1,316	2,326
Charge for the period	97	30	184	311
Transfer to investment properties	(4)	–	–	(4)
Disposals	(1)	(2)	(5)	(8)
At 29 January 2012	977	153	1,495	2,625
Net book amount at 29 January 2012	6,588	777	578	7,943
Assets under construction included above	187	1	62	250

The cost of financing property developments prior to their opening date has been included in the cost of the project. The cumulative amount of interest capitalised in the total cost above amounts to £251m (2011: £246m).

	Land and buildings			
	Freehold £m	Leasehold £m	Plant, equipment, fixtures & vehicles £m	Total £m
Prior period				
Cost				
At 31 January 2010	6,894	833	1,777	9,504
Acquisition of subsidiary undertakings	6	3	5	14
Additions at cost	242	53	186	481
Interest capitalised	1	–	–	1
Transfer from investment properties	17	–	–	17
Transfer to intangible assets	–	–	(89)	(89)
Disposals	(8)	(3)	(34)	(45)
At 30 January 2011	7,152	886	1,845	9,883
Accumulated depreciation and impairment				
At 31 January 2010	797	106	1,162	2,065
Charge for the period	90	21	191	302
Transfer from investment properties	1	–	–	1
Transfer to intangible assets	–	–	(6)	(6)
Disposals	(3)	(2)	(31)	(36)
At 30 January 2011	885	125	1,316	2,326
Net book amount at 30 January 2011	6,267	761	529	7,557
Assets under construction included above	110	2	25	137

11 Property, plant and equipment – continued

Analysis of assets held under finance leases:

	2012 £m	2011 £m
Leasehold land and buildings		
Cost	285	286
Accumulated depreciation	(14)	(13)
Net book value	271	273

12 Investment property

	2012 £m	2011 £m
Cost		
At start of period	283	277
Additions	7	23
Transfer from/(to) property, plant and equipment	35	(17)
At end of period	325	283
Accumulated depreciation		
At start of period	54	48
Charge for the period	8	7
Transfer from/(to) property, plant and equipment	4	(1)
At end of period	66	54
Net book amount at end of period	259	229

Included in other operating income is £23m (2011: £22m) of rental income generated from investment properties.

The fair value of investment properties at the end of the period was £277m (2011: £279m). The Directors do not believe that there has been a material change in yield since last year.

13 Investments

	2012 £m	2011 £m
Equity investments	31	–

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

14 Other financial assets

	2012 £m	2011 £m
Non-current assets		
Energy price contracts	1	3
Current assets		
Energy price contracts	2	4

Notes to the Group financial statements

52 weeks ended 29 January 2012

15 Debtors

	2012 £m	2011 £m
Trade debtors	196	201
Less: Provision for impairment of trade debtors	(5)	(4)
	191	197
Other debtors	46	18
Prepayments and accrued income	83	53
	320	268

The ageing analysis of trade debtors is as follows:

	2012 £m	2011 £m
Neither past due nor impaired	183	191
Past due but not impaired:		
Not more than 3 months	7	3
Greater than 3 months	1	3
Impaired debt	5	4
	196	201

As at 29 January 2012 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.

16 Creditors – current

	2012 £m	2011 £m
Trade creditors	1,409	1,400
Other taxes and social security payable	34	33
Other creditors	143	127
Accruals and deferred income	439	354
	2,025	1,914

17 Other financial liabilities

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

	2012 £m	2011 £m
Current		
Bank loans and overdrafts due within one year or on demand:		
Bank overdraft	29	–
Short term borrowings	80	–
	109	–
Energy price contracts	5	–
Forward foreign exchange contract	1	–
	115	–

17 Other financial liabilities – continued

	2012 £m	2011 £m
Non-current		
£150m Sterling bonds 6.50% August 2014	153	154
£200m Sterling bonds 6.00% January 2017	202	201
£200m Sterling bonds 6.12% December 2018	203	204
£400m Sterling bonds 4.625% December 2023	397	–
$250m US private placement loan notes 4.4% November 2026	156	–
Total non-current bonds and loan notes	1,111	559
Floating credit facility – 1.4% (2011: 1.13%)	470	475
Other loans – 9.38%	–	11
Cross-currency swaps	8	–
Energy price contracts	4	–
Finance lease obligations	7	7
	1,600	1,052

Borrowing facilities

Borrowings are denominated in Sterling and US dollars and bear fixed interest rates, with the exception of the floating credit facility which bears floating interest rates. All borrowings are unsecured.

On 8 December 2011, the Group issued £400m of Sterling bonds at a fixed rate of 4.625%, expiring in December 2023. The issue is part of a £3,000m Euro Medium Term Note Programme where the Group can from time-to-time issue notes denominated in any agreed currency.

On 2 November 2011, the Group issued $250m US private placement loan notes at a fixed rate of 4.4%, expiring in November 2026. The Group has put in place cross-currency swaps to swap the principal and fixed rate interest of the US dollar private placement loan notes into fixed rate sterling interest liabilities. The maturity dates of the cross-currency swaps match the underlying loan notes.

On 4 March 2011, the Group agreed terms on its new floating credit finance. During the period the Group repaid the previous facility of £476m and drew down £475m of the new facility. The expiry date for the floating credit facility, March 2016, is consistent with the undrawn element of the facility disclosed below.

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

The Group has the following undrawn floating committed borrowing facilities available in respect of which all conditions present had been met at that date:

	2012 £m	2011 £m
Undrawn facilities expiring:		
Between 1 and 2 years	–	625
Between 4 and 5 years	725	–

18 Financial instruments

a) Financial risk management

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

The Group's principal financial liabilities, other than derivatives, comprise bank loans and overdrafts, bonds, other borrowings, finance leases and trade and other creditors. The main purpose of these financial liabilities is to raise finance for the Group's operations. The Group has various financial assets such as trade debtors and cash and short term deposits which arise directly from its operations.

The Group enters into derivative transactions, in the form of forward currency contracts, cross-currency swaps and energy price contracts. The purpose of these derivative instruments is to manage risks arising from the Group's operations and its sources of finance. As part of normal banking arrangements, the Group utilises letters of credit in order to facilitate contracts with third parties. The financial derivatives relating to commitments entered into during the year are to manage the risks arising from its usage of energy and foreign currency. It remains the Group's policy not to engage in speculative trading of financial instruments.

Notes to the Group financial statements
52 weeks ended 29 January 2012

18 Financial instruments – continued
The objectives, policies and processes for managing these risks are stated below:

i) Foreign currency risk
The Group makes the majority of its purchases in Sterling however it incurs currency exposure in respect of overseas trade purchases made in currencies other than Sterling, primarily being Euro and US Dollar. The Group's objective is to reduce risk to short term profits and losses from exchange rate fluctuations. It is Group policy that any transactional currency exposures recognised to have a material impact on short term profits and losses will be hedged through the use of derivative financial instruments. At the balance sheet date, the Group had entered into forward foreign exchange contracts to mitigate foreign currency exposure on up to 50% (2011: 50%) of its forecasted purchases within the next six months.

Cross-currency swaps are used to mitigate the Group's currency exposure arising from payments of interest and repayment of the principal in relation to US dollar private placement loan notes.

The sensitivity to a reasonably possible change (+/- 10%) in the US Dollar/Euro exchange rate has been determined as being immaterial.

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

The Treasury Committee monitors rolling forecasts of the Group's liquidity reserve on a quarterly basis, which comprises committed and uncommitted borrowing facilities on the basis of expected cash flow. At 29 January 2012, the Group had undrawn committed facilities of £725m (note 17). These facilities remain available to the Group.

The table below summarises the maturity profile of the Group's other financial liabilities based on contractual undiscounted payments, which includes interest payments.

Creditors and current tax liabilities have been excluded from this analysis. These balances are due within 12 months and their contractual undiscounted payments equal their carrying balances as the impact of discounting is not significant.

Where borrowings are subject to a floating rate, an estimate for interest has been made. The amounts included in the table are the contractual undiscounted cash flows, and therefore do not agree to the amounts disclosed on the balance sheet for borrowings.

	2012 £m	2011 £m
Less than one year	149	41
One to two years	68	516
Two to three years	224	42
Three to four years	57	185
Four to five years	732	25
More than five years	988	468

The table below analyses the Group's derivative financial instruments into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

At 29 January 2012	< 1 year £m	1 – 5 years £m	5 + years £m
Derivatives settled on a gross basis			
Cross-currency swaps – cash flow hedges			
– Outflow	(8)	(31)	(234)
– Inflow	7	28	230
Forward contracts – cash flow hedges			
– Outflow	(67)	-	-
– Inflow	66	-	-
Derivatives settled on a net basis			
Energy price contracts – cash flow hedges			
– Outflow	(4)	(3)	-
– Inflow	2	-	-

18 Financial instruments – continued

At 30 January 2011	< 1 year £m	1 – 5 years £m	5+ years £m
Derivatives settled on a gross basis			
Forward contracts – cash flow hedges			
– Outflow	(54)	–	–
– Inflow	54	–	–
Derivatives settled on a net basis			
Energy price contracts – cash flow hedges			
– Outflow	(4)	(3)	–

iii) Credit risk
Credit risk is managed on a Group basis. Credit risk arises from cash and cash equivalents, deposits with banking groups as well as credit exposures from other sources of income such as supplier income and tenants of investment properties.

The Group maintains deposits with banks and financial institutions who must possess a long term credit rating of A1 or higher with Moody's for a period not exceeding six months. Further, the Group has specified limits that can be deposited with any banking group or financial institution at any point. The maximum exposure on cash and cash equivalents and deposits is equal to the carrying amount of these instruments. The Group does not expect any significant performance losses from counterparties.

The Group trades only with recognised third parties. It is the Group's policy that tenants of investment properties who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in note 15. There are no significant concentrations of credit risk within the Group.

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

The Treasury Committee reviews the Group's market price exposure to these commodities on a quarterly basis and determines a strategy for utilising derivative financial products in order to mitigate the volatility of energy prices. A +/- 10 % change in the fair value of the commodity price at the balance sheet date impacts the cash flow reserve by £16m.

The Group intends to hold derivatives to maintain cover of its energy purchases of up to 75% over an appropriate timescale.

Cash flow interest rate risk: The Group's long term policy is to protect itself against adverse movements in interest rates by maintaining approximately 60% of its consolidated total net debt in fixed rate borrowings. As at the balance sheet date 70% (2011: 55%) of the Group's borrowings are at fixed rate, thereby substantially reducing the Group's exposure to adverse movements in interest rates.

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

The Group's objectives are to safeguard its ability to continue as a going concern providing returns to shareholders, through the optimisation of the debt and equity balances, maintaining a strong investment grade credit rating and having adequate liquidity headroom. The Group manages its capital structure and makes appropriate decisions in light of the current economic conditions and strategic objectives of the Group. Initiatives available to achieve the Group's desired capital structure include adjusting the amount of dividends paid to shareholders, issuing new shares and buying back share capital. During the current financial year the proportion of debt relative to equity has increased, resulting from both £368m incurred on the equity retirement programme, and a strategy of pursuing a more diversified funding portfolio. In recent months, £400m additional funding has been obtained following the Group's successful inaugural Bond issuance, and a further £156m from a US Private Placement with Metlife Insurance. As these were issued for 12 and 15 years respectively this has contributed to a significant increase in average maturity period of the Group's debt.

A key objective of the Group's capital management is to maintain compliance with the covenants set out in the revolving credit facility.

The Group's covenants require maintenance of a gearing ratio of less than 3.5 and interest cover of at least 3.0 times. Throughout the year, the Group has comfortably complied with these covenants.

Notes to the Group financial statements

52 weeks ended 29 January 2012

18 Financial instruments – continued

c) Fair values

i) Financial assets

All financial derivatives are held at fair value which has been determined by reference to prices available from the markets on which the instruments are traded.

Cash and cash equivalents and Debtors are held at book value which equals the fair value. The values of other financial assets are disclosed within note 14.

ii) Financial liabilities

All financial liabilities are carried at amortised cost. The US dollar private placement loan notes are retranslated at balance sheet date spot rates. The fair value of the Sterling bonds and US dollar private placement loan notes are measured using closing market prices. These compare to carrying values as follows:

	2012		2011	
	Amortised Cost £m	Fair Value £m	Amortised cost £m	Fair value £m
Total bonds: non-current	955	1,057	559	621
Total loan notes: non-current	156	164	–	–
	1,111	1,221	559	621

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

d) Hedging activities

Cash flow hedge

At 29 January 2012, the Company held cross-currency swaps which have been designated as cash flow hedges. Prior to this the cross-currency swaps were designated as fair value hedges against the commitment to issue US private placement loan notes. This derivative financial instrument is used to minimise risk from potential movements in foreign exchange rates inherent in cash flow of certain liabilities.

The cross-currency swaps cover the Group from currency exposure arising from payments of interest and repayment of the principal in relation to US dollar private placement loan notes (note 17). The notional principal amount of the outstanding cross-currency swaps at 29 January 2012 was $273m (2011: $nil).

To minimise the risk from potential movements in energy prices, the Group has energy price contracts which are also designated as cash flow hedges.

The Group uses forward foreign exchange contracts to hedge the cost of future purchases of goods for resale, where those purchases are denominated in a currency other than the functional currency of the purchasing company. The hedging instruments are primarily used to hedge purchases in Euros and US dollars. The cash flows hedged will occur within six months of the balance sheet date.

At 29 January 2012, the total notional amount of outstanding forward foreign exchange contracts to which the Group has committed was £67m (2011: £54m). The fair value of these outstanding forward exchange contracts at the balance sheet date was a liability of £1m (2011: £nil).

e) Fair value hierarchy

IFRS 7 requires an analysis of financial instruments carried at fair value, by valuation method. All financial instruments carried at fair value within the Group at 29 January 2012 and 30 January 2011 are financial derivatives and all are categorised as Level 2 instruments.

19 Deferred tax

	2012 £m	2011 £m
Deferred tax liability	(509)	(544)
Deferred tax asset	45	45
Net deferred tax liability	(464)	(499)

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.

19 Deferred tax – continued

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

	Property, plant and equipment £m	Pensions £m	Share-based payments £m	Other short term temporary differences £m	Total £m
Current period					
At 30 January 2011	(534)	(10)	3	42	(499)
Credited/(charged) to profit for the period	25	(1)	2	(11)	15
Credited to other comprehensive income and equity	–	13	1	6	20
At 29 January 2012	(509)	2	6	37	(464)
Prior period					
At 31 January 2010	(563)	5	3	40	(515)
Credited/ (charged) to profit for the period	29	(5)	–	9	33
Charged to other comprehensive income and equity	–	(10)	–	(7)	(17)
At 30 January 2011	(534)	(10)	3	42	(499)

Included within the total credited/(charged) to profit for the period is an amount credited of £42m (2011: £20m) and within the total charged to other comprehensive income of £2m (2011: £2m) in respect of the change in the tax rate at which deferred tax balances are expected to reverse.

20 Pensions

a) Defined benefit pension scheme

The Group operates two defined benefit pension schemes, the 'Morrison' and 'Safeway' schemes, providing benefits defined on retirement based on age at date of retirement, years of service and a formula using either the employee's compensation package or career average revalued earnings (CARE). The assets of the schemes are held in separate trustee administered funds; no part of the schemes is wholly unfunded. The latest full actuarial valuations, which were carried out at 6 April 2010 and 1 April 2010 for the Morrison and Safeway schemes respectively, were updated for IAS 19 Employee benefits purposes for the period to 29 January 2012 by a qualified independent actuary.

On 8 July 2010 the Government announced that the Consumer Price Index (CPI) rather than the Retail Price Index (RPI) will be used as the basis for inflationary increases to pensions in its next update of the statutory requirement. Following this, the Accounting Standards Board has issued UITF 48 'Accounting implications of the replacement of the retail prices index with the consumer prices index for retirement benefits' clarifying the required accounting treatment and indicating the use of CPI rather than RPI where the scheme rules allow. In the absence of specific guidance issued under IFRS, the requirements of this UITF have been applied in accounting for this change. The Group has consulted with its advisors and based on review of certain clauses in the schemes' trust deeds, has concluded that this change is applicable to certain deferred members within the Group's defined benefit schemes. The trust deeds state that, for those members affected, a statutory index should be used and therefore the actuarial assumptions applied within this financial report have been updated accordingly. This resulted in a credit of £72m recognised in Other comprehensive income within actuarial gains/(losses) during the prior year.

The Deed and Rules of the Morrison Pension Scheme gives the Trustees power to set the level of contributions. In the Safeway Scheme this power is given to the Group, subject to regulatory override.

The current best estimate of employer contributions to be paid for the year commencing 30 January 2012 is £31m (2011: £36m).

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52 weeks ended 29 January 2012

20 Pensions – continued

b) Assumptions

The major assumptions used in this valuation to determine the present value of the schemes' defined benefit obligation are shown below:

i) Financial

	2012	2011
Rate of increases in salaries	4.55%	5.05%
Rate of increase in pensions in payment and deferred pensions	2.50%–3.30%	3.30% – 3.80%
Discount rate applied to scheme liabilities	4.75%	5.60%
Inflation assumption	3.30%	3.80%

ii) Longevity

The average life expectancy in years of a member who reaches normal retirement age of 65 and is currently aged 45 is as follows:

	2012	2011
Male	24.4	24.2
Female	25.3	25.1

The average life expectancy in years of a member retiring at the age of 65 at balance sheet date is as follows:

	2012	2011
Male	22.0	21.8
Female	23.0	22.8

Assumptions regarding future mortality experience are set based on actuarial advice and in accordance with published statistics. The longevity assumption considers how long a member will live when they reach the age of retirement. 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. This means that a 45-year-old today is assumed to live on average longer than a 65-year-old today. This particular adjustment, described in the mortality tables below, is known as 'Long Cohort' and is in-line with the latest advice from the Pension Regulator.

In calculating the present value of the liabilities the actuary selects the appropriate mortality table that reflects the longevity assumption. The most up to date tables are used in each period. The current mortality table used is S1PMA/S1PFA-Heavy YOB (2011: S1PMA/S1PFA-Heavy YOB). As disclosed in the Critical accounting assumptions on page 69, the results of the experience study conducted for the Safeway scheme have been used to adjust the longevity assumption for both schemes.

iii) Expected return on assets

The major assumptions used to determine the expected future return on the schemes' assets, were as follows:

	2012	2011
Long term rate of return on:		
Equities	5.90%	7.45%
Corporate bonds	4.75%	5.60%
Gilts	2.90%	4.44%
Property related funds	–	5.60%
Cash	1.50%	1.50%

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice. The expected return on plan assets is based on market expectation at the beginning of the period for returns over the entire life of the benefit obligation.

20 Pensions – continued

c) Valuations

Assets of the schemes are held in order to generate cash to be used to satisfy the schemes' obligations, and are not necessarily intended to be realised in the short term. The allocation of assets between categories is governed by the investment principles of each scheme and is the responsibility of the trustees of each respective scheme. The trustees should take due consideration of the Group's views and a representative of the Group attends Trustee Investment Committees. The fair value of the schemes' assets, which may be subject to significant change before they are realised, and the present value of the schemes' liabilities which are derived from cash flow projections over long periods and are inherently uncertain, are as follows:

	2012 £m	2011 £m
Equities	1,054	1,001
Corporate bonds	724	667
Gilts	805	622
Property and property related funds	–	4
Cash	6	10
Total fair value of schemes' assets	2,589	2,304
Present value of defined benefit funded obligation	(2,600)	(2,266)
Net pension (liability)/asset recognised in the balance sheet	(11)	38
Related deferred tax asset/(liability) (note 19)	2	(10)
Net (deficit)/surplus	(9)	28

The movement in the fair value of the schemes' assets over the year was as follows:

	2012 £m	2011 £m
Fair value of scheme assets at start of period	2,304	2,111
Expected return on scheme assets	140	126
Actuarial gain recognised in other comprehensive income	148	62
Employer contributions	31	41
Employee contributions	10	10
Benefits paid	(44)	(46)
Fair value of scheme assets at end of period	2,589	2,304

The above pension scheme assets do not include any investments in the Parent Company's own shares or property occupied by any member of the Group.

The movement in the present value of the defined benefit obligation during the period was as follows:

	2012 £m	2011 £m
Defined benefit obligation at start of period	(2,266)	(2,128)
Current service cost	(28)	(26)
Employee contributions	(10)	(10)
Interest on defined benefit obligation	(127)	(120)
Actuarial loss recognised in other comprehensive income	(213)	(28)
Benefits paid	44	46
Defined benefit obligation at end of period	(2,600)	(2,266)

d) Sensitivities

Below is listed the impact on the liabilities at 29 January 2012 of changing key assumptions whilst holding other assumptions constant:

Discount factor	+/– 0.1%	£65m
Longevity	+/– 1 year	£80m

Notes to the Group financial statements
52 weeks ended 29 January 2012

20 Pensions – continued
e) Profit for the period
The following amounts have been charged in employee benefits in arriving at operating profit:

	2012 £m	2011 £m
Current service cost	28	26

The amounts for current service cost and pensions credit have been charged in the following Statement of comprehensive income lines:

	2012 £m	2011 £m
Cost of sales	(22)	(21)
Administrative expenses	(6)	(5)
	(28)	(26)

The following amounts have been included in finance income:

	2012 £m	2011 £m
Expected return on pension scheme assets	140	126
Interest on pension scheme liabilities	(127)	(120)
	13	6

f) Actuarial gains and losses recognised in other comprehensive income
The amounts included in the other comprehensive income were:

	2012 £m	2011 £m
Actual return less expected return on scheme assets	148	62
Experience gains and losses arising on scheme obligation	2	(128)
Changes in financial assumptions underlying the present value of scheme obligations	(215)	100
Actuarial movement recognised in other comprehensive income	(65)	34
Taxation on actuarial movement in other comprehensive income (note 19)	13	(10)
Net actuarial movement recognised in other comprehensive income	(52)	24

	2012 £m	2011 £m
Cumulative gross actuarial movement recognised in other comprehensive income	(190)	(125)
Taxation on cumulative actuarial movement recognised in other comprehensive income	47	34
Cumulative net actuarial movement recognised in other comprehensive income	(143)	(91)

The actual return on schemes' assets can therefore be summarised as follows:

	2012 £m	2011 £m
Expected return on schemes' assets	140	126
Actuarial movement recognised in other comprehensive income reflecting the difference between expected and actual return on assets	148	62
Actual return on schemes' assets	288	188

The expected return on schemes' assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date. Expected returns on equity and property investments reflect long term real rates of return experienced in the respective markets.

20 Pensions – continued

g) History of experience gains and losses

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Difference between the expected and actual return on scheme assets:					
– Amount	148	62	245	(425)	(113)
– Percentage of scheme assets	5.7%	2.7%	11.6%	(24.2%)	(5.8%)
Experience gains and losses arising on scheme liabilities:					
– Amount	2	(128)	–	(4)	83
– Percentage of present value of scheme obligation	0.1%	(5.6%)	–	(0.2%)	4.1%
Effects to changes in the demographic and financial assumptions underlying the present value of the scheme liabilities:					
– Amount	(215)	100	(316)	328	(6)
– Percentage of present value of scheme obligation	(8.3%)	4.4%	(14.8%)	18.2%	(0.3%)
Total amount recognised in other comprehensive income:					
– Amount	(65)	34	(71)	(101)	(36)
– Percentage of present value of scheme obligation	(2.5%)	1.5%	(3.3%)	(5.6%)	(1.8%)
Total value of schemes' assets	2,589	2,304	2,111	1,758	1,939
Present value of defined benefit obligation	(2,600)	(2,266)	(2,128)	(1,807)	(2,007)
Net pension (liability)/asset recognised in the balance sheet	(11)	38	(17)	(49)	(68)

h) Defined contribution pension scheme

Employees joining the Company after September 2000 are no longer eligible to gain automatic entry into the defined benefit pension scheme. In June 2001, the Company established a stakeholder pension scheme, open to all employees, to which the Company makes matching contributions of a maximum of 5% of eligible earnings. Pension costs for the defined contribution scheme are as follows:

	2012 £m	2011 £m
Stakeholder pension scheme	(5)	(4)
Life assurance scheme	(2)	(2)
Total costs	(7)	(6)

21 Provisions

	Property provisions £m
At 30 January 2011	92
Charged to profit for the period	4
Unused amounts reversed during the period	(11)
Utilised in period	(5)
Unwinding of discount	4
At 29 January 2012	84

Property provisions comprise onerous leases provision, petrol filling station decommissioning reserve and provisions for dilapidations on leased buildings.

Onerous leases relate to sublet and vacant properties. Where the rent receivable on the properties is less than the rent payable, a provision based on present value of the net cost is made to cover the expected shortfall. The lease commitments range from 1 to 61 years. Market conditions have a significant impact and hence the assumptions on future cash flows are reviewed regularly and revisions to the provision made where necessary.

Other property provisions comprise petrol filling station decommissioning reserve and dilapidations cost. Provision is made for decommissioning costs for when the petrol filling station tanks reach the end of their useful life or when they become redundant and is based on the present value of costs to be incurred to decommission the petrol tanks. Dilapidation costs are incurred to bring a leased building back to the condition in which it was originally leased. Provision is made for these costs, which are incurred on termination of the lease.

Notes to the Group financial statements

52 weeks ended 29 January 2012

22 Called-up share capital

	Number of shares millions	Share capital £m	Share premium £m	Total £m
Current period				
At 30 January 2011	2,658	266	107	373
Shares cancelled	(126)	(13)	–	(13)
At 29 January 2012	2,532	253	107	360
Prior period				
At 31 January 2010	2,651	265	92	357
Share options exercised	7	1	15	16
At 30 January 2011	2,658	266	107	373

The total authorised number of ordinary shares is 4,000 million shares (2011: 4,000 million shares) with a par value of 10p per share (2011: 10p per share). All issued shares are fully paid.

There were 245,378 shares issued pursuant to the exercise of options (2011: 6,666,293) with a nominal value of £0.02m (2011: £1m) and an aggregate consideration of £0.5m (2011: £16m). Shares cancelled of 125,699,939 relate to the equity retirement programme (note 23).

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.

23 Reserves

	2012 £m	2011 £m
Capital redemption reserve	19	6
Merger reserve	2,578	2,578
Hedging reserve	(12)	5
Retained earnings	2,452	2,458
Total	5,037	5,047

Included in retained earnings is a deduction of £21m (2011: £31m) in respect of own shares held at the balance sheet date. This represents the cost of 8,887,915 (2011: 13,181,346) of the Company's ordinary shares (nominal value of £0.9m (2011: £1.3m)). These shares are held by a trust using funds provided by the Group and were acquired to meet obligations under the Group's share option schemes. The market value of the shares at 29 January 2012 was £26m (2011: £35m). The trust has waived its rights to dividends. These shares are not treasury shares as defined by the London Stock Exchange.

a) Capital redemption reserve

The capital redemption reserve at the start of the period related to 57,788,600 of the Company's own shares which it purchased on the open market for cancellation between 31 March 2008 and 21 November 2008 at a cost of £146m. The shares repurchased represented 2.15% of the ordinary share capital of the Company at 3 February 2008.

The movement in the period of £13m, relates to 125,699,939 of the Company's own shares which it purchased on the open market for cancellation between 10 March 2011 and 27 January 2012. The total amount paid to acquire the shares, net of tax, was £368m and has been deducted from retained earnings within shareholders' equity. The shares purchased represent 5% of the ordinary share capital at 29 January 2012.

b) 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.

c) Hedging reserve

This represents the gains and losses arising on derivatives used for cash flow hedging, principally from the Group's cross-currency swaps, energy price contracts and forward exchange contracts (note 17).

24 Cash flow from operating activities

	2012 £m	2011 £m
Profit for the period	690	632
Adjustments for:		
Taxation	257	242
Depreciation	319	309
Amortisation	21	10
Loss on disposal of property, plant and equipment	2	1
Net finance cost	26	30
Other non-cash changes	25	16
Excess of contributions over pension service cost	(3)	(15)
Increase in stocks	(117)	(61)
Increase in debtors	(49)	(75)
Increase in creditors	101	60
Decrease in provisions	(8)	(8)
Cash generated from operations	1,264	1,141

25 Analysis of net debt

	2012 £m	2011 £m
Cash and cash equivalents per balance sheet	241	228
Bank overdrafts (note 17)	(29)	–
Cash and cash equivalents per cash flow	212	228
Energy price contracts	3	7
Other financial assets (note 14)	3	7
Short term borrowings	(80)	–
Energy price contracts	(5)	–
Forward foreign exchange contracts	(1)	–
Current financial liabilities (note 17)	(86)	–
Bonds	(955)	(559)
Private placement loan notes	(156)	–
Floating credit facility	(470)	(475)
Other unsecured loans	–	(11)
Cross-currency swaps	(8)	–
Energy price contracts	(4)	–
Finance lease obligations	(7)	(7)
Non-current financial liabilities (note 17)	(1,600)	(1,052)
Net debt	(1,471)	(817)

Cash and cash equivalents include restricted balances of £67m (2011: £78m) held by the Group's captive insurer subsidiary, Farock Insurance Company Limited. The cash is held to cover the liabilities of this entity.

26 Share-based payments

The Group operates a number of share-based payments schemes; the Executive share option scheme, the Sharesave scheme, an equity-settled Long Term Incentive Plan (LTIP), restricted share awards and deferred share awards.

The total charge for the period relating to employee share-based payment plans was £24m (2011: £19m), all of which related to equity-settled share-based payment transactions. The total charge to equity for the period, net of tax, was £25m (2011: £17m).

a) Share option schemes

i) Executive share option scheme

In May 1995, the Group adopted the 1995 Senior Executive Share Option Scheme which was made available to Directors and other senior employees. The scheme was terminated on 25 May 2005.

There are no options outstanding at the end of the period (2011: 157,000) due to all options being exercised. The weighted average exercise price of the options exercised during the period was £2.04 (2011: £1.89).

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52 weeks ended 29 January 2012

26 Share-based payments – continued
ii) Sharesave scheme
The Sharesave scheme has been in operation since 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 only subject to service conditions and is equity-settled. The scheme launched in May 2011 was under the new scheme rules approved by the shareholders in June 2010.

Options which have been granted to those eligible employees, including Directors, who chose to participate in the scheme have been fair valued using a binomial stochastic option pricing model. The fair value of options granted and the assumptions were as follows:

Grant date	17 May 2011	18 May 2010	14 May 2009	18 May 2007
Share price at grant date	£3.01	£2.70	£2.43	£3.26
Fair value of options granted	£11.5m	£9.7m	£17.4m	£12.3m
Exercise price	£2.28	£2.37	£1.98	£2.47
Dividend yield	3.20%	3.04%	2.38%	1.23%
Annual risk free interest rate	1.65%	1.63%	2.10%	5.58%
Expected volatility*	24.2%	26.5%	28.0%	23.5%

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

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

	2012		2011	
	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	2.14	38,701	2.07	32,218
Granted	2.28	15,380	2.37	17,450
Exercised	2.09	(88)	2.46	(5,764)
Forfeited	2.25	(5,591)	2.15	(5,203)
Outstanding at end of period	2.17	48,402	2.14	38,701
Exercisable at end of period	–	–	2.47	20

26 Share-based payments – continued

	2012		2011	
	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	£2.94	88	£2.70	5,764

	2012	2011
Share options outstanding at the end of the period		
Range of exercise prices	£1.98 – £2.37	£1.98 – £2.47
Weighted average remaining contractual life	1.7 years	2.3 years

b) Long term incentive plans

In May 2007, a discretionary LTIP for the benefit of certain employees as approved by the Remuneration Committee was introduced. The awards are free share-based awards, with non-market vesting conditions attached, that accrue the value of dividends over the vesting period.

The maximum total market value of shares over which awards may be granted to any employee during any financial year of the company is 300% of salary. Awards normally vest three years after the original grant date providing the relevant performance criteria have been met.

The fair value at the date of grant, which is being charged to profit for the period over the three year vesting period, has been calculated based on the following assumptions:

Grant date	1 Oct 2011	18 Apr 2011	14 Oct 2010	22 Apr 2010	29 Jan 2010	20 Oct 2009	9 April 2009	14 Oct 2008	14 Apr 2008
Share price at grant date	£3.02	£2.85	£2.96	£2.97	£2.93	£2.71	£2.50	£2.42	£2.77
Assumed leavers	5%	5%	8%	8%	–	5%	5%	5%	5%
Performance criteria	77%	77%	80%	80%	90%	90%	90%	90%	90%
Fair value of share awards granted	£1.4m	£23.3m	£1.1m	£14.4m	£1.1m	£1.0m	£18.8m	£0.6m	£12.5m

	Share awards thousands	Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	19,725	17,976
Granted	8,651	7,862
Exercised	(4,258)	(3,423)
Forfeited	(1,412)	(2,690)
Outstanding at end of period	22,706	19,725
Exercisable at end of period	–	–

	2012	2011
Share awards outstanding at the end of the period		
Weighted average remaining contractual life	1.8 years	1.4 years

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26 Share-based payments – continued
c) Restricted 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 only subject to service conditions and is equity settled.

The fair value at the date of grant, which is being charged to profit for the period over the vesting period, has been calculated based on the following assumptions:

Grant date	2012	2011
Share price at grant date	£2.71	£2.95
Assumed leavers	0%	0%
Exercise price	£nil	£nil
Fair value of share awards granted	£1.9m	£0.4m

Share awards outstanding at the end of the period are 817,000 (2011: 121,000). The movement in share awards during the period relates to new awards being granted. No awards have vested during the period.

The weighted average remaining contractual life of the share awards is 1 year (2011: 1.2 years).

d) Deferred share bonus plan
As part of the annual bonus plan certain members of senior management are eligible for the deferred share bonus plan which allows 33% to 50% of any bonus payable to be deferred in shares for three years from the date the deferred shares are made. Dividend equivalents accrue over the vesting period, to be paid when the shares vest. Vesting of these share awards is only subject to service conditions and is equity settled.

The fair value at the date of grant, which is being charged to profit for the period over the vesting period, has been calculated based on the following assumptions:

Grant date	2012
Share price at grant date	£2.76
Assumed leavers	0%
Exercise price	£nil
Fair value of share awards granted	£1.8m

Share awards outstanding at the end of the period are 659,000. The movement in share awards during the period relates to new awards being granted. No awards have vested during the period.

The weighted average remaining contractual life of the share awards is 2.2 years.

27 Business combinations
IFRS 3 (revised) Business combinations has been applied to the two acquisitions completed during the period.

On 28 February 2011, the Group acquired the trade and assets of kiddicare.com Limited ('Kiddicare'), a multi-channel online retailer. The total cash consideration for the purchase was £70m.

Assets and liabilities recognised as a result of the acquisition:	Fair values on acquisition £m
Property, plant and equipment (note 11)	9
Brand (included in intangibles) (note 10)	15
IT hardware and software	20
Other assets	2
Net identifiable assets acquired	46
Goodwill	24
Total cash consideration	70

Goodwill relates to the technological know-how and potential future multi-channel sales. The acquisition will provide the Group with further expertise in relation to online retailing. The goodwill arising on the acquisition is tax deductible.

The revenue included in the consolidated statement of comprehensive income since 28 February 2011 contributed by Kiddicare was £43m. Kiddicare also contributed operating profit of £1m over the same period. Given the close proximity of the acquisition date to the beginning of the financial year, it is not considered material to disclose annualised revenue and profit results since 31 January 2011.

27 Business combinations – continued

On 10 June 2011, the Group acquired 100% of the ordinary share capital of Flower World Limited, a wholesale flower business. This will provide the Group with the capacity to handle all flower requirements in-house. Total consideration (including deferred consideration) was £6m. Goodwill and intangible assets acquired were £3m and other assets acquired were £3m.

28 Capital commitments

	2012 £m	2011 £m
Contracts placed for future capital expenditure not provided in the financial statements	103	178

29 Operating lease arrangements

a) Lessee arrangements

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:

	2012		2011	
	Property £m	Vehicles, plant and equipment £m	Property £m	Vehicles, plant and equipment £m
Within one year	50	10	44	10
More than one year and less than five years	184	9	202	14
After five years	669	–	518	–
	903	19	764	24

b) Lessor arrangements

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

	2012 £m	2011 £m
Within one year	28	27
More than one year and less than five years	95	92
After five years	127	138
	250	257

30 Post balance sheet events

On 31 January 2012, the Group exchanged contracts on the Winsford site from Vion Food Group Limited, a meat packing business based in Cheshire. Total cash consideration of £20m is attributable to the net assets acquired; there is no goodwill arising. The acquisition will strengthen the Group's ability to provide pre-packed retail fresh meat, to supplement our in-store butcheries.

Notes to the Group financial statements
52 weeks ended 29 January 2012

31 Principal subsidiaries

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

The Group has taken advantage of the exemption under Section 410(2) of Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements.

All of the above companies are registered in England and Wales and the principal area of trading for all the above companies is the United Kingdom.

The Group currently owns 51% of the share capital of Farmers Boy (Deeside) Limited. However, due to the nature of options in place to purchase the remaining 49% share capital in 2013, the subsidiary has been treated as if it were already 100% owned for accounting purposes. Deferred consideration of £13m, in relation to these options, is held within other creditors.

The Company is also part of a joint venture, with The Great Steward of Scotland Dumfries House Trust, to form 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. This has been accounted for as a joint venture in accordance with IFRS, however, as the results are not material to the Group, no further disclosure has been made of the accounting policies within the consolidated financial statements.

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.