Wm Morrison Supermarkets PLC for the 52 weeks ended 29 January 2017

CONSOLIDATED NON-STATUTORY FINANCIAL STATEMENTS

This does not constitute statutory financial statements within the meaning of section 434 of the Companies Act 2006. This financial information has been agreed with the auditor for release.

The full Annual Report and Financial Statements for the 52 weeks ended 29 January 2017 on which the auditor has given an unqualified report and which does not contain a statement under section 498 of the Companies Act 2006, will be delivered to the Registrar of Companies in due course.

Consolidated statement of comprehensive income

52 weeks ended 29 January 2017

	Note	2017 £m	2016 £m
Revenue	1.2	16,317	16,122
Cost of sales		(15,713)	(15,505)
Gross profit		604	617
Other operating income		76	72
Profit/loss on disposal and exit of properties and sale of businesses and investments	1.4, 4.3, 4.5	32	97
Administrative expenses		(244)	(472)
Operating profit	1.6	468	314
Finance costs	6.2	(160)	(112)
Underlying finance costs	6.2	(104)	(112)
Adjustments for:			
Costs associated with the repayment of borrowings	1.4	(56)	–
Finance income	6.2	15	13
Share of profit of joint venture (net of tax)	4.2	2	2
Profit before taxation		325	217
Analysed as:			
Underlying profit before tax		337	242
Adjustments for:			
Impairment and provision for onerous contracts	1.4	6	(87)
Profit/loss on disposal and exit of properties	1.4	19	131
Profit arising on disposal of investment	1.4, 4.3	13	–
Loss arising on disposal of business	1.4, 4.5	–	(34)
Costs associated with the repayment of borrowings	1.4	(56)	–
Pension scheme set-up costs	1.4, 8.6	–	(35)
Net pension income	1.4, 8.2	8	–
Other exceptional costs	1.4	(2)	–
		325	217
Taxation	2.2	(20)	5
Profit for the period attributable to the owners of the Company		305	222
Other comprehensive income			
Items that will not be reclassified to profit or loss:			
Remeasurement of defined benefit pension schemes	8.2	86	236
Tax on defined benefit pension schemes	2.3	(17)	(47)
		69	189
Items that may be reclassified subsequently to profit or loss:			
Cash flow hedging movement		30	16
Items reclassified from hedging reserve in relation to repayment of borrowings	1.4	6	–
Tax on items that may be reclassified subsequently to profit or loss	2.3	1	(4)
Exchange differences on translation of foreign operations		(1)	1
		36	13
Other comprehensive income for the period, net of tax		105	202
Total comprehensive income for the period attributable to the owners of the Company		410	424
Earnings per share (pence)			
– basic	1.5	13.11	9.51
– diluted	1.5	12.95	9.47

Consolidated balance sheet
29 January 2017

	Note	2017 £m	2016 £m
Assets			
Non-current assets			
Goodwill and intangible assets	3.2	445	483
Property, plant and equipment	3.3	7,227	7,161
Investment property	3.5	33	37
Pension asset	8.2	293	186
Investment in joint venture	4.2	56	63
Investments	4.3	–	31
Derivative financial assets	7.3	16	30
		8,070	7,991
Current assets			
Stock	5.2	614	616
Debtors	5.3	214	192
Derivative financial assets	7.3	22	12
Cash and cash equivalents	6.4	326	496
		1,176	1,316
Assets classified as held-for-sale	3.4	–	–
		1,176	1,316
Liabilities			
Current liabilities			
Creditors	5.4	(2,837)	(2,518)
Short term borrowings	6.3	–	(209)
Derivative financial liabilities	7.3	(3)	(17)
Current tax liabilities		(24)	(11)
		(2,864)	(2,755)
Non-current liabilities			
Borrowings	6.3	(1,550)	(2,003)
Derivative financial liabilities	7.3	(5)	(55)
Pension liability	8.2	(21)	–
Deferred tax liabilities	2.3	(417)	(429)
Provisions	5.5	(326)	(309)
		(2,319)	(2,796)
Net assets		4,063	3,756
Shareholders' equity			
Share capital	6.5	234	234
Share premium	6.5	128	127
Capital redemption reserve	6.6	39	39
Merger reserve	6.6	2,578	2,578
Retained earnings and other reserves	6.6	1,084	778
Total equity attributable to the owners of the Company		4,063	3,756

The notes on pages 65 to 101 form part of these financial statements.

The financial statements on pages 59 to 101 were approved by the Board of Directors on 8 March 2017 and were signed on its behalf by:

Trevor Strain
Chief Financial Officer

Consolidated cash flow statement

52 weeks ended 29 January 2017

	Note	2017 £m	2016 £m
Cash flows from operating activities			
Cash generated from operations	5.6	1,113	1,026
Interest paid		(100)	(99)
Taxation paid		(35)	(41)
Net cash inflow from operating activities		978	886
Cash flows from investing activities			
Interest received		6	4
Dividends received from joint venture	10.1	8	8
Proceeds from the sale of property, plant and equipment		79	300
Proceeds from the sale of businesses and investments	4.3, 4.5	44	20
Purchase of property, plant and equipment, investment property and assets classified as held-for-sale		(374)	(266)
Purchase of intangible assets		(45)	(99)
Net cash outflow from investing activities		(282)	(33)
Cash flows from financing activities			
Purchase of shares in subsidiary	4.4	–	(3)
Purchase of own shares for trust	6.5	(5)	(13)
Net repayment of revolving credit facility		–	(320)
Repayment of borrowings		(729)	(10)
Proceeds on settlement of derivative financial instruments		37	–
Costs incurred on repayment of borrowings		(42)	–
Dividends paid	1.8	(118)	(260)
Net cash outflow from financing activities		(857)	(606)
Net (decrease)/increase in cash and cash equivalents		(161)	247
Cash and cash equivalents at start of period		487	240
Cash and cash equivalents at end of period	6.4	326	487

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

	Note	2017 £m	2016 £m
Net (decrease)/increase in cash and cash equivalents		(161)	247
Cash outflow from decrease in debt		692	330
Non-cash movements		21	17
Opening net debt		(1,746)	(2,340)
Closing net debt	6.4	(1,194)	(1,746)

Consolidated statement of changes in equity

52 weeks ended 29 January 2017

	Note	Attributable to the owners of the Company						
		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 1 February 2016		234	127	39	2,578	(10)	788	3,756
Profit for the period		–	–	–	–	–	305	305
Other comprehensive income/(expense):								
Cash flow hedging movement		–	–	–	–	30	–	30
Items reclassified from hedging reserve in relation to repayment of borrowings	1.4	–	–	–	–	6	–	6
Exchange differences on translation of foreign operations		–	–	–	–	–	(1)	(1)
Remeasurement of defined benefit pension schemes	8.2	–	–	–	–	–	86	86
Tax in relation to components of other comprehensive income	2.3	–	–	–	–	(8)	(8)	(16)
Total comprehensive income for the period		–	–	–	–	28	382	410
Purchase of trust shares	6.5	–	–	–	–	–	(5)	(5)
Proceeds and settlements of employee share award	6.5	–	1	–	–	–	(1)	–
Employee share option schemes:								
Share-based payments	1.7	–	–	–	–	–	20	20
Dividends	1.8	–	–	–	–	–	(118)	(118)
Total transactions with owners		–	1	–	–	–	(104)	(103)
At 29 January 2017		**234**	**128**	**39**	**2,578**	**18**	**1,066**	**4,063**

	Note	Attributable to the owners of the Company						
		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 2 February 2015		234	127	39	2,578	(22)	638	3,594
Profit for the period		–	–	–	–	–	222	222
Other comprehensive income/(expense):								
Cash flow hedging movement		–	–	–	–	16	–	16
Exchange differences on translation of foreign operations		–	–	–	–	–	1	1
Remeasurement of defined benefit pension schemes	8.2	–	–	–	–	–	236	236
Tax in relation to components of other comprehensive income	2.3	–	–	–	–	(4)	(47)	(51)
Total comprehensive income for the period		–	–	–	–	12	412	424
Purchase of trust shares	6.5	–	–	–	–	–	(13)	(13)
Employee share option schemes:								
Share-based payments	1.7	–	–	–	–	–	11	11
Dividends	1.8	–	–	–	–	–	(260)	(260)
Total transactions with owners		–	–	–	–	–	(262)	(262)
At 31 January 2016		234	127	39	2,578	(10)	788	3,756

General information

Company information

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

Basis of preparation

The financial statements have been prepared for the 52 weeks ended 29 January 2017 (2016: 52 weeks ended 31 January 2016) in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Standards Interpretation Committee (IFRS IC) interpretations as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. IFRS and IFRS IC interpretations are issued by the International Accounting Standards Board (the IASB) and must be adopted into European Union law, referred to as endorsement, before they become mandatory under the IAS Regulation.

The financial statements have been prepared on a going concern basis.

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

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

Accounting reference date

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

New IFRS and amendments to IAS and interpretations

There have been no significant changes to accounting under IFRS which have affected the Group's results. The Group has considered the following amendments to published standards that are effective for the first time for the 52 weeks ended 29 January 2017 and concluded that they are either not relevant to the Group or they do not have a significant impact on the Group's financial statements. These amendments are:

- Amendments to IAS 1 'Presentation of Financial Statements';
- Amendments to IFRS 11 'Joint arrangements' on accounting for acquisitions of interests in joint operations;
- Amendments to IAS 16 'Plant, property and equipment' and IAS 38 'Intangible assets' on acceptable methods of depreciation and amortisation;
- Amendments to IAS 27 'Consolidated and separate financial statements' which allows entities to equity account for joint ventures and associates in their separate financial statements; and
- Annual improvements 2012-2014.

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

- IFRS 9 'Financial Instruments' was published in July 2014 and will be effective for the Group from the period beginning 5 February 2018. The standard is applicable to financial assets and financial liabilities, and covers the classification, measurement, impairment and de-recognition of financial assets and financial liabilities together with a new hedge accounting model. Work on the impact of the new recognition, impairment and general hedge accounting requirements is in its early stages and we are assessing whether any changes to the Group's systems and processes are required to aid the implementation of the standard. It is not yet practicable to quantify the effect of IFRS 9 on the Group;
- IFRS 15 'Revenue from Contracts with Customers' will be effective for the Group from the period beginning 5 February 2018, replacing IAS 18 'Revenue', IAS 11 'Construction contracts' and related interpretations. The standard establishes a principles based approach for revenue recognition and is based on the concept of recognising revenue when a customer obtains control of a goods or service and has the ability to direct the use and obtain the benefits from the goods or services. It applies to all contracts with customers, except those in the scope of other standards. It replaces the separate models for goods, services and construction contracts under the current accounting standards. Based on the Group's preliminary assessment from work performed to date, the Group believes that the adoption of IFRS 15 will not have a material impact on the consolidated financial statements but work is still ongoing to fully quantify its impact, with particular focus on treatment of the Group's customer loyalty arrangements; and
- IFRS 16 'Leases' was published in January 2016 and will be effective for the Group from the period beginning 4 February 2019, replacing IAS 17 'Leases', subject to EU endorsement. The standard requires lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset is of low value. IFRS 16 represents a significant change in the accounting and reporting of leases and it will primarily change the balance sheet as well as impacting the income statement and lessee reporting as disclosed in note 6.8. Accounting requirements for lessors as disclosed in note 3.6 will be substantially unchanged from IAS 17. The Group is in the process of quantifying the impact of the new standard. The new standard is likely to have an impact on the Group's results and a material impact on the balance sheet, as the majority of arrangements that are currently accounted for as operating leases will come onto the Group's balance sheet. However, it is not yet practicable to fully quantify the effect of IFRS 16 on these consolidated financial statements.

General information continued

Basis of consolidation

Subsidiaries (including partnerships) are all entities over which the Group has control. The Group controls an entity when it has power over that entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date the control ceases. The financial statements of subsidiaries used in the consolidation are prepared for the same reporting period as the Company and are based on consistent accounting policies. Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions are eliminated on consolidation.

Foreign currencies

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

Critical accounting judgements and estimates

The judgements that have the most significant effect on the amounts recognised in these financial statements, and sources of estimation uncertainty that have a significant risk of resulting in material adjustment to carrying amounts in the next financial year, are:

- Impairment of property, plant and equipment and intangible assets and onerous property commitments (note 1.4, 3.1, 3.2, 3.3, 5.5);
- Commercial income (note 1.1, 1.6, 5.2, 5.3, 5.4);
- IT and intangible assets (note 3.2);
- Stock (note 5.1, 5.2); and
- Pensions (note 8).

These are also described within the Corporate governance report on page 29.

Alternative Performance Measures

The Directors measure the performance of the Group based on a range of financial measures, including measures not recognised by EU-adopted IFRS. These alternative performance measures may not be directly comparable with other companies' alternative performance measures and the Directors do not intend these to be a substitute for, or superior to, IFRS measures. For definitions of the alternative performance measures used, see the Glossary on page 122.

Notes to the Group financial statements

52 weeks ended 29 January 2017

1 Performance in the period

1.1 Accounting policies

Revenue recognition

Sale of goods in-store and online, and fuel

Revenue from the sale of goods in-store and online comprises cash from customers and excludes VAT. It is net of returns, colleague discounts, coupons, vouchers, 'More' points earned in-store and online, and the free element of multi-save transactions. Sale of fuel is recognised net of VAT and 'More' points earned on fuel. Revenue is recognised when transactions are completed in-store, or, in the case of food online, when goods are accepted by the customer on delivery.

Other sales

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

'More' points

The fair value of 'More' points is determined to be the value to the customer of the points issued, adjusted for factors such as the expected redemption rate. The Group continues to assess the appropriateness of the expected redemption rates against actual redemptions.

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

Cost of sales

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

Promotional funding

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

Commercial income

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

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

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

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

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

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

1 Performance in the period continued

1.1 Accounting policies continued

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

Other operating income

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

Profit/loss on disposal and exit of properties

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

1.2 Revenue

	Like-for-like sales £m	Other £m	2017 Total £m	2016 Total £m
Sale of goods in stores and online	12,727	20	12,747	12,811
Fuel	3,351	–	3,351	3,124
Total store-based and online sales	16,078	20	16,098	15,935
Other sales	–	219	219	187
Total revenue	16,078	239	16,317	16,122

1.3 Segmental reporting

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

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

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

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

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

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

1 Performance in the period continued

1.4 Underlying profit

The definition of underlying profit is defined in the Glossary on page 122.

The Directors consider that the underlying profit and underlying adjusted earnings per share measures referred to in the results provide useful information for shareholders on underlying trends and performance. The adjustments are made to reported profit/loss to: (a) remove impairment, provision for onerous contracts, or other items that do not relate to the Group's principal activities on an ongoing basis; (b) remove profit/loss arising on disposal and exit of properties and sale of businesses and investments; (c) remove the impact of pension volatility; and (d) apply a normalised tax rate of 25% (2016: 25%).

	2017 £m	2016 £m
Profit after tax	305	222
Add back: tax charge/(credit) for the period[1]	20	(5)
Profit before tax	325	217
Adjustments for:		
Impairment and provision for onerous contracts[1]	(6)	87
Profit/loss arising on disposal and exit of properties[1]	(19)	(131)
Profit arising on disposal of investment (note 4.3)[1]	(13)	–
Loss arising on disposal of convenience business (note 4.5)[1]	–	34
Costs associated with the repayment of borrowings[1]	56	–
Pension scheme set-up costs (note 8.6)[1]	–	35
Net pension income (note 8.2)[1]	(8)	–
Other exceptional costs[1]	2	–
Underlying profit before tax	337	242
Normalised tax charge at 25% (2016: 25%)[1, 2]	(84)	(61)
Underlying profit after tax	253	181
Underlying earnings per share (pence)		
– basic (note 1.5.2)	10.86	7.77
– diluted (note 1.5.2)	10.73	7.73

1 Adjustments marked[1] decrease post-tax underlying earnings by £52m (2016: decrease of £41m), as shown in the reconciliation of earnings disclosed in note 1.5.2.

2 Normalised tax is defined in the Glossary, see page 122 for details.

Following the Group's annual impairment and onerous contract review a net credit of £6m has been recognised, which is made up of £44m net impairment reversal and £38m charge in relation to provision for onerous contracts.

The net impairment reversal of £44m (£191m impairment reversal offset by £147m impairment charge) reflects fluctuations in store level performance (see note 3.3). This has been partially offset by a £38m additional charge relating to the Group's provision for onerous contracts primarily relating to onerous property contracts (see note 5.5). In the prior year the additional charge of £87m reflected changes in estimates related to provisions for stores in the new space pipeline.

Costs associated with the early repayment of borrowing facilities and other refinancing activities total £56m. This includes £33m relating to financing charges on redemption of financial instruments (primarily premiums), other fees incurred on the repayment of bonds and refinancing; write off of facility fees; the payment of £17m relating to the early settlement of the US Private Placement loan notes (USPP); and £6m relating to losses which had previously been recognised in reserves which have been reclassified to the income statement on termination of hedging arrangements.

Profits arising on disposal and exit of properties amounted to £19m (2016: £131m). A £13m profit has been recognised on the disposal of the Group's investment in Fresh Direct Inc (see note 4.3).

Other exceptional costs represent legal costs incurred in relation to cases which the Group pursued in respect of historic events. There are no contingent liabilities associated with these cases.

The 2016 underlying profit before tax included £60m relating to one-off restructuring costs. When adjusted to exclude these items, underlying profit before restructuring and tax for 2016 was £302m.

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

1 Performance in the period continued

1.4 Underlying profit continued

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

- impairment and provision for onerous contracts has been included within administrative expenses;
- profit/loss arising on disposal and exit of properties, profit arising on disposal of investments and loss arising on disposal of convenience business are classified within profit/loss arising on disposal and exit of properties and sale of businesses and investments;
- pension scheme set-up costs and other exceptional costs are classified within administrative expenses;
- costs associated with the repayment of borrowings are classified within finance costs; and
- net pension income is included within finance income.

2016/17 Impairment and provision for onerous contracts

Impairment and provision for onerous contracts resulted in a net credit of £6m. This includes a net impairment release of £44m (£191m impairment reversal offset by £147m impairment) and charge of £38m relating to provisions for onerous contracts (see notes 3.3 and 5.5).

2015/16 Impairment and provision for onerous contracts

Impairment and provision for onerous contracts in 2015/16 totalled £87m including £52m relating to onerous leases and £35m in relation to onerous commitments for changes in estimates related to provisions for stores in the new space pipeline. No impairment was recognised during 2015/16.

1.5 Earnings per share

Basic earnings per share (EPS) is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period excluding shares held in trust. For diluted EPS, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares.

The Company has two (2016: two) classes of instrument that are potentially dilutive: those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the period and contingently issuable shares under the Group's long term incentive plans (LTIP).

1.5.1 Basic and diluted EPS (unadjusted)

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

			2017			2016
	Earnings £m	Weighted average number of shares millions	EPS pence	Earnings £m	Weighted average number of shares millions	EPS pence
Unadjusted EPS						
Basic EPS						
Profit attributable to ordinary shareholders	305.0	2,327.1	13.11	221.8	2,332.5	9.51
Effect of dilutive instruments						
Share options and LTIPs	–	27.9	(0.16)	–	9.0	(0.04)
Diluted EPS	305.0	2,355.0	12.95	221.8	2,341.5	9.47

1 Performance in the period continued

1.5 Earnings per share continued

1.5.2 Underlying EPS

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

	2017			2016		
	Earnings £m	Weighted average number of shares millions	EPS pence	Earnings £m	Weighted average number of shares millions	EPS pence
Underlying EPS						
Basic EPS						
Profit attributable to ordinary shareholders	305.0	2,327.1	13.11	221.8	2,332.5	9.51
Adjustments to determine underlying profit (note 1.4)	(52.2)	–	(2.25)	(40.6)	–	(1.74)
	252.8	2,327.1	10.86	181.2	2,332.5	7.77
Effect of dilutive instruments						
Share options and LTIPs	–	27.9	(0.13)	–	9.0	(0.04)
Diluted EPS	252.8	2,355.0	10.73	181.2	2,341.5	7.73

1.6 Operating profit

	2017 £m	2016 £m
The following items have been included in arriving at operating profit:		
Employee costs (note 1.7)	1,925	1,944
Depreciation and impairment:		
– Property, plant and equipment (note 3.3)	305	286
– Investment property (note 3.5)	1	2
– Net impairment reversal (note 1.4 and 3.3)	(44)	–
Amortisation		
– Intangible assets (note 3.2)	93	96
Operating lease rentals:		
– Land and buildings	93	99
– Other	16	17
– Sublease receipts	(6)	(6)
Value of stock expensed	12,519	12,321

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

1 Performance in the period continued

1.6 Operating profit continued

Value of stock expensed

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

	2017		2016	
	£m	% of VSE	£m	% of VSE
Commercial income				
Marketing and advertising funding	52	0.4	260	2.1
Volume-based rebates	257	2.1	143	1.1
Total commercial income	309	2.5	403	3.2

Auditor remuneration

During the period PricewaterhouseCoopers LLP, the Group's auditor, provided the following services:

	2017 £m	2016 £m
Audit services		
Fees payable to the Group's auditor for the audit of the Group and the Company financial statements	0.5	0.4
Other services		
Fees payable to the Group's auditor and its associates for other services:		
– the audit of the Group's subsidiaries pursuant to legislation	0.2	0.2
– other services	0.2	0.4
	0.9	1.0

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

1.7 Employees and Directors

	2017 £m	2016 £m
Employee benefit expense for the Group during the period		
Wages and salaries	1,708	1,728
Social security costs	119	116
Share-based payments	20	11
Other pension costs	78	89
	1,925	1,944

1 Performance in the period continued

1.7 Employees and Directors continued

	2017 No.	2016 No.
Average monthly number of people, including Directors		
Stores	96,612	105,024
Manufacturing	8,207	8,033
Distribution	5,467	5,582
Centre	2,079	2,274
	112,365	120,913

Directors' remuneration

A detailed analysis of Directors' remuneration, including salaries, bonuses and long term incentives, and the highest paid Director, is provided in the Single total figure of remuneration table in the audited section of the Directors' remuneration report, which forms part of these financial statements (page 42). There are no Executive Directors (2016: none) who have retirement benefits accruing under any of the Group's defined benefit pension schemes.

Senior management remuneration

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

	2017 £m	2016 £m
Senior managers		
Wages and salaries	25	34
Social security costs	4	4
Share-based payments	8	4
Other pension costs	2	2
	39	44

1.8 Dividends

Amounts recognised as distributed to equity holders in the period:

	2017 £m	2016 £m
Interim dividend for the period ended 29 January 2017 of 1.58p (2016: 1.50p)	37	35
Final dividend for the period ended 31 January 2016 of 3.50p (2016: 9.62p)	81	225
	118	260

The Directors propose a final dividend in respect of the financial period ending 29 January 2017 of 3.85p per share which will absorb an estimated £90m of shareholders' funds. Subject to approval at the AGM, it will be paid on 29 June 2017 to shareholders who are on the register on 26 May 2017.

The dividends paid and proposed during the year are from cumulative realised distributable reserves of the Company.

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

2 Taxation

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

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

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

- The Netherlands: The Group has operations in the Netherlands as part of its produce supply chain. Local corporation taxes of £1.3m were paid during 2017 (2016: £1.0m);
- Hong Kong: Offices in Hong Kong were established in 2011 and source many of the Group's non-food products. Local corporation taxes of £0.3m were paid during 2017 (2016: £0.3m); and
- Isle of Man, Jersey and Guernsey: The Group's insurance company is based in the Isle of Man for regulatory reasons. Companies based in Jersey and Guernsey hold UK property assets with a net book value of £38m as a result of historic acquisitions. All profits arising in these companies are subject to UK tax.

2.1 Accounting policies

Current tax

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

Deferred tax

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

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

Deferred tax assets are recognised to the extent that it is probable that the asset can be utilised. Deferred tax assets are reviewed at each reporting date as judgement is required to estimate the probability of recovery. 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.

Uncertain tax positions

Uncertain tax positions are assessed with reference to Draft IFRIC Interpretation DI/2015/1 Uncertainty over Income Tax Treatments which provides guidance on the determination of taxable profit and tax bases.

The Group uses in-house tax specialists, professional advisors and relevant previous experience to assess tax risks. The Group recognises a tax provision when it is considered probable that there will be a future outflow of funds to a tax authority. Provisions are measured based on the single most likely outcome for each item unless there is a range of possible outcomes for a particular item where a weighted average measurement is more appropriate. Provisions are included in current liabilities.

2 Taxation continued

2.2 Taxation

2.2.1 Analysis of charge/(credit) in the period

	2017 £m	2016 £m
Current tax		
– UK corporation tax	57	35
– overseas tax	2	5
– adjustments in respect of prior periods	(11)	(8)
	48	32
Deferred tax		
– origination and reversal of timing differences	(10)	15
– adjustments in respect of prior periods	3	(8)
– impact of change in tax rate	(21)	(44)
	(28)	(37)
Tax charge/(credit) for the period	20	(5)

2.2.2 Tax on items charged in other comprehensive income and equity

	2017 £m	2016 £m
Remeasurements arising in the pension scheme	17	47
Cash flow hedges	8	4
Share-based payments	(9)	–
Total tax on items included in other comprehensive income and equity	16	51
Analysis of items charged to other comprehensive income and equity:		
Deferred tax (note 2.3)	16	51

2.2.3 Tax reconciliation

The reconciliation below shows how the tax charge of £20m (2016: tax credit of £5m) has arisen on profit before taxation of £325m (2016: £217m).

The tax for the period is lower (2016: lower) than the standard rate of corporation tax in the UK of 20% (2016: 20.2%). The differences are explained below:

	2017 £m	2016 £m
Profit before taxation	325	217
Profit before taxation at 20% (2016: 20.2%)	65	44
Effects of:		
Recurring items:		
Expenses not deductible for tax purposes	1	–
Disallowed depreciation on UK properties	20	24
Deferred tax on Safeway acquisition assets	(10)	(5)
Adjustments in respect of prior periods	(8)	(16)
Non-recurring items:		
Profit on property transactions	(6)	(14)
Loss on disposal of business	–	6
Tax impact of impairment and related items	(21)	–
Effect of change in tax rate	(21)	(44)
Tax charge/(credit) for the period	20	(5)

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

2 Taxation continued

2.2 Taxation continued

2.2.3 Tax reconciliation continued

Factors affecting current and future tax charges

The effective tax rate for the year was 6.2% (2016: (2.3)%). The normalised tax rate for the year (excluding the impact of property transactions, business disposals and tax rate changes) was 25% (2016: 25%).

The normalised tax rate was 5% above the UK statutory tax rate of 20%. The main factor increasing the normalised tax rate is disallowed depreciation on UK properties which reflects the Group's strategy to maintain a majority freehold estate.

Legislation to reduce the standard rate of corporation tax to 17% from 1 April 2020 was included in the Finance Bill 2016 and was enacted in the period. Accordingly, deferred tax has been provided at 19%, 18% or 17% depending upon when the temporary difference is expected to reverse (2016: 20%, 19% or 18%).

The reduction in tax rate at which deferred tax is provided has reduced the Group's deferred tax liabilities by £21m, resulting in a credit of £21m being recognised in the tax charge for the period.

There have been no indications of any further changes to the rate of corporation tax after 1 April 2020.

2.3 Deferred tax

	2017 £m	2016 £m
Net deferred tax liability	417	429

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

The movements in deferred tax liabilities during the period are shown below:

	Property, plant and equipment £m	Pensions £m	Other short term temporary differences £m	Total £m
Current period				
At 1 February 2016	392	33	4	**429**
(Credited)/charged to profit for the period	(31)	(4)	7	**(28)**
Charged/(credited) to other comprehensive income and equity	–	17	(1)	**16**
At 29 January 2017	361	46	10	**417**
Prior period				
At 2 February 2015	428	(8)	(5)	415
(Credited)/charged to profit for the period	(36)	(6)	5	(37)
Charged to other comprehensive income and equity	–	47	4	51
At 31 January 2016	392	33	4	429

The analysis of net deferred tax liabilities are as follows:

	2017 £m	2016 £m
Net deferred tax liabilities to be settled after more than 12 months	420	427
Net deferred tax (assets)/liabilities to be settled within 12 months	(3)	2
	417	429

3 Operating assets

3.1 Accounting policies

Intangible assets

Goodwill

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

Brands

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

Software development costs

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

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

Licences

Separately acquired pharmaceutical licences and software licences are recognised at historic cost less accumulated amortisation and impairment. Those acquired in a business combination are recognised at fair value at the acquisition date. Pharmaceutical licences and software licences are amortised over their useful lives (3 to 10 years) on a straight-line basis or over the life of the licence if shorter. Amortisation is charged in cost of sales

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Costs include directly attributable costs such as borrowing costs and employment costs of those people directly working on the construction and installation of property, plant and equipment.

Depreciation rates

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

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

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

Investment property

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

Non-current assets classified as held-for-sale

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

Lessor accounting – operating leases

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

Finance leases

Assets funded through finance leases are capitalised as property, plant and equipment and depreciated over their useful economic life or lease term, whichever is shorter. The amount capitalised is the lower of the fair value and the present value, calculated using the interest rate implicit in the lease, of the future minimum lease payments. The obligations to pay future rentals are included within liabilities. Rental payments are apportioned between the finance charge and the outstanding obligation so as to produce a constant rate of finance charge on the remaining balance.

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

3 Operating assets continued

3.1 Accounting policies continued

Impairment of non-financial assets

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

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

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

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

3.2 Goodwill and intangible assets

Current period	Goodwill £m	Software development costs £m	Licences £m	Total £m
Cost				
At 1 February 2016	10	647	31	688
Additions	–	41	14	55
Fully written down assets	–	(41)	(14)	(55)
At 29 January 2017	10	647	31	688
Accumulated amortisation				
At 1 February 2016	–	187	18	205
Charge for the period	–	83	10	93
Fully written down assets	–	(41)	(14)	(55)
At 29 January 2017	–	229	14	243
Net book amount at 29 January 2017	10	418	17	445

Included within software development costs are assets under construction of £3m (2016: £16m).

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

As in previous years, fully amortised assets are retained in the Group's fixed asset register. In order to provide greater understanding of the Group's annual amortisation charge, assets which have become fully amortised in the year have been removed from both cost and accumulated amortisation.

Goodwill

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

Impairment testing of goodwill

Goodwill of £10m is allocated to the grocery group of CGUs. This group of CGUs has been tested for impairment via the value in use calculation described in note 3.3. The pre-tax discount rate used is 9.0% (2016: 9.0%) and the growth rate applied to the period after five years is 2.0% (2016: 2.0%).

Software development costs

The cumulative interest capitalised included within software development costs is £41m (2016: £41m). The cost of internal labour capitalised is not material for separate disclosure.

3 Operating assets continued

3.2 Goodwill and intangible assets continued

Prior period	Goodwill £m	Software development costs £m	Licences £m	Total £m
Cost				
At 2 February 2015	10	633	33	676
Additions	–	58	7	65
Interest capitalised	–	4	–	4
Disposals	–	(14)	(1)	(15)
Fully written down assets	–	(34)	(8)	(42)
At 31 January 2016	10	647	31	688
Accumulated amortisation and impairment				
At 2 February 2015	–	138	18	156
Charge for the period	–	87	9	96
Disposals	–	(4)	(1)	(5)
Fully written down assets	–	(34)	(8)	(42)
At 31 January 2016	–	187	18	205
Net book amount at 31 January 2016	10	460	13	483

3.3 Property, plant and equipment

Current period	Freehold land £m	Freehold buildings £m	Leasehold land and buildings £m	Plant, equipment, fixtures & vehicles £m	Total £m
Cost					
At 1 February 2016	3,978	4,290	978	1,306	10,552
Additions	2	10	9	346	367
Interest capitalised	–	1	–	–	1
Reclassifications	3	11	(14)	–	–
Transfers to investment properties	–	(4)	–	–	(4)
Transfers to assets held-for-sale	(35)	(30)	–	(4)	(69)
Disposals	–	(9)	(24)	(76)	(109)
Fully written down assets	–	(18)	(5)	(163)	(186)
At 29 January 2017	3,948	4,251	944	1,409	10,552
Accumulated depreciation and impairment					
At 1 February 2016	657	1,645	510	579	3,391
Depreciation charge for the period	–	99	16	190	305
Impairment	55	38	18	36	147
Impairment reversal	(92)	(53)	(39)	(7)	(191)
Reclassifications	–	9	(9)	–	–
Transfers to assets held-for-sale	(19)	(26)	–	(4)	(49)
Disposals	–	(4)	(22)	(66)	(92)
Fully written down assets	–	(18)	(5)	(163)	(186)
At 29 January 2017	601	1,690	469	565	3,325
Net book amount at 29 January 2017	3,347	2,561	475	844	7,227
Assets under construction included above	4	–	–	2	6

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

3 Operating assets continued

3.3 Property, plant and equipment continued

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

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

Included within the table on page 77 are leasehold land and buildings held under finance lease with a cost of £294m (2016: £308m) and accumulated depreciation of £80m (2016: £94m).

The cost of financing property developments prior to their opening date has been included in the cost of the asset. The cumulative amount of interest capitalised in the total cost above amounts to £198m (2016: £197m).

Impairment

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

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

- use the actual cash flows for each store in the current year;
- allocate a proportion of the Group's central costs to each store on an appropriate basis;
- project each store's cash flows over the next five years by applying forecast sales and cost growth assumptions;
- project cash flows beyond year five for the remaining useful life of each store by applying a long term growth rate; and
- discount the cash flows using a pre-tax rate of 9.0% (2016: 9.0%). The discount rate takes into account the Group's weighted average cost of capital.

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

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

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

Having applied the above methodology and assumptions, the Group has recognised a net impairment reversal of £44m during the year (2016: £nil) (£191m impairment reversal offset by £147m impairment charge). This movement reflects fluctuations expected from store level trading performance and local market conditions. At 29 January 2017, the key assumption to which the value in use calculation is most sensitive to is the discount rate. Specific sensitivity analysis with regard to this assumption shows that an increase of 1% in the discount rate would result in an additional impairment charge of £56m.

3 Operating assets continued

3.3 Property, plant and equipment continued

Prior period	Freehold land £m	Freehold buildings £m	Leasehold land and buildings £m	Plant, equipment, fixtures & vehicles £m	Total £m
Cost					
At 2 February 2015	3,989	4,330	1,055	1,301	10,675
Additions	5	13	14	256	288
Reclassifications	–	(8)	8	–	–
Transfers from investment properties	–	5	–	–	5
Transfers to assets held-for-sale	(3)	(5)	–	(3)	(11)
Disposals	(13)	(44)	(91)	(90)	(238)
Fully written down assets	–	(1)	(8)	(158)	(167)
At 31 January 2016	3,978	4,290	978	1,306	10,552
Accumulated depreciation					
At 2 February 2015	660	1,576	548	639	3,423
Charge for the period	–	102	18	166	286
Transfers from investment properties	–	5	–	–	5
Transfers to assets held-for-sale	–	(4)	–	(3)	(7)
Disposals	(3)	(33)	(48)	(65)	(149)
Fully written down assets	–	(1)	(8)	(158)	(167)
At 31 January 2016	657	1,645	510	579	3,391
Net book amount at 31 January 2016	3,321	2,645	468	727	7,161
Assets under construction included above	–	7	3	2	12

3.4 Assets classified as held-for-sale

	2017 £m	2016 £m
At start of period	–	84
Additions	19	–
Transfers from property, plant and equipment at net book value	20	4
Transfers from investment property at net book value	7	30
Disposals	(46)	(118)
At end of period	–	–

Assets transferred from property, plant and equipment had a cost of £69m (2016: £11m) and accumulated depreciation of £49m (2016: £7m). Assets transferred from investment property had a cost of £10m (2016: £45m) and accumulated depreciation of £3m (2016: £15m).

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

3 Operating assets continued

3.5 Investment property

	2017 £m	2016 £m
Cost		
At start of period	59	108
Additions	–	3
Transfers from/(to) property, plant and equipment	4	(5)
Transfers to assets classified as held-for-sale	(10)	(45)
Disposals	–	(2)
At end of period	53	59
Accumulated depreciation and impairment		
At start of period	22	40
Charge for the period	1	2
Transfers from/(to) property, plant and equipment	–	(5)
Transfers to assets classified as held-for-sale	(3)	(15)
Disposals	–	–
At end of period	20	22
Net book amount at end of period	33	37

Included in other operating income is £7m (2016: £12m) of rental income generated from investment properties. At the end of the period the fair value of investment properties, was £51m (2016: £68m). Investment properties are valued by independent surveyors on a vacant possession basis using observable inputs (fair value hierarchy level 2).

3.6 Operating leases – lessor

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

	2017 £m	2016 £m
Within one year	16	18
More than one year and less than five years	55	61
After five years	27	73
	98	152

3.7 Capital commitments

	2017 £m	2016 £m
Contracts placed for future capital expenditure not provided in the financial statements (property, plant and equipment and intangible assets)	28	26

4 Interests in other entities

4.1 Accounting policies

Joint ventures

The Group applies IFRS 11 'Joint Arrangements' to all joint arrangements. Under IFRS 11 investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor. The Group has assessed the nature of its joint arrangements and determined them to be joint ventures. Joint ventures are accounted for under the equity method and are initially recognised at cost.

The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of the equity accounted investees, from the date that joint control commences until the date that joint control ceases.

Investments

Investments comprise investments in equity instruments held for long term investment. They are measured at fair value through other comprehensive income, where the fair value can be measured reliably. Where the fair value of the instruments cannot be measured reliably, for example, when there is variability in the range of estimates, the investments are recognised at cost less accumulated impairment losses. When the Group disposes of an investment, the fair value of the consideration received less the carrying value of the investment at the date of disposal is recognised in profit or loss, along with any amounts previously recognised in other comprehensive income in respect of the investment.

Business combinations

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

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

Disposal of subsidiaries

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

4.2 Joint ventures

The Group and Ocado Group plc are sole investors in a company (MHE JV Co), which owns the plant and equipment at the Dordon Customer Fulfilment Centre. Each party owns 50% of the equity of MHE JV Co and decisions regarding MHE JV Co require the unanimous consent of both parties. The Directors have considered the impact of IFRS 11 and determined that the Group continues to jointly control MHE JV Co.

MHE JV Co	2017 £m	2016 £m
Non-current assets	96	125
Current assets	22	7
Current liabilities	(6)	(7)
Net assets	112	125
Group's share of net assets	56	63
Profit	4	4
Group's share of profit	2	2

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

4 Interests in other entities continued

4.3 Investments

	2017 £m	2016 £m
At start of period	31	31
Fair value adjustments	14	–
Disposals	(45)	–
At end of period	–	31

On 16 August 2016, the Group disposed of its 10% stake in Fresh Direct Inc, a US internet grocer for cash consideration of £45m, net of £1m of transaction costs. In line with IAS 39 'Financial Instruments: Recognition and Measurement', the asset was remeasured to fair value before the sale completed, resulting in a £14m increase in the book value of the investment. On disposal the £14m revaluation gain was recognised in profit or loss net of £1m of transaction costs. This profit is one-off in nature and therefore has been excluded from reported underlying earnings (see note 1.4).

Following the transaction the undrawn loan facility provided to Fresh Direct Inc ceased.

4.4 Business combinations

52 weeks ended 29 January 2017

In the 52 weeks ended 29 January 2017 there were no business combinations.

52 weeks ended 31 January 2016

On 7 December 2015, Wm Morrison Produce Limited exercised an option to acquire the remaining 49% of the issued share capital of Wm Morrison Bananas Limited from Global Pacific Group, for a cash consideration of £3m. Due to the existence of the put and call option, the Group had previously treated Wm Morrison Bananas Limited as a 100% subsidiary.

For part of the year the Group was part of a joint venture in respect of The Morrisons Farm at Dumfries House Limited (the Farm). The Group terminated this agreement on 13 November 2015 when Wm Morrison Supermarkets PLC acquired the remaining 50% of the issued share capital of the Farm. On 6 January 2016, the Farm was renamed Neerock Farming Limited. The Farm's results are immaterial to the Group.

4.5 Disposals of businesses

52 weeks ended 29 January 2017

In the 52 weeks ended 29 January 2017 there were no disposals of businesses.

52 weeks ended 31 January 2016

On 26 October 2015, the Group disposed of its subsidiary Wm Morrison Convenience Stores Limited and associated assets to MLCG Limited for cash consideration of £20m. This resulted in a loss on disposal of £34m. This loss was one-off in nature and was excluded from reported underlying earnings in the 52 weeks ended 31 January 2016 (see note 1.4).

Following the sale, the Group continues to guarantee certain leases relating to its former convenience stores. At 31 January 2016, the Group made an assessment of the likelihood and amount of future rental commitments should these leases revert, and recognised a liability on the balance sheet reflecting the estimated cash outflow. In the event of lessee default the Group will look to minimise its liability by finding alternative occupiers as soon as possible.

On 29 June 2016, MLCG Limited announced it was entering administration. The Group has subsequently reassessed the liability it recognised in the 52 weeks ended 31 January 2016 and considers this still to be appropriate.

5 Working capital and provisions

5.1 Accounting policies

Stock

Stock represents goods for resale and is measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale. Cost is calculated on a weighted average basis and comprises purchase price, import duties and other non-recoverable taxes, reduced by promotional funding and commercial income and a provision for estimated losses relating to shrinkage and markdowns. Losses relating to shrinkage in stores are based on historical losses verified by physical stock counts conducted by an independent third party. Provision is made for obsolete and slow moving items.

Trade and other debtors

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

Cash and cash equivalents

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

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

Trade and other creditors

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

Provisions

Provisions are created where the Group has a present obligation as a result of a past event, where it is probable that it will result in an outflow of economic benefits to settle the obligation, and where it can be reliably measured. For petrol filling station decommissioning costs this is when the filling station is first constructed and for dilapidations on leased buildings, when the lease is entered into. Provisions for onerous leases and other onerous contracts are recognised when the Group believes that the unavoidable costs of meeting the obligations exceed the economic benefits expected to be received under the contract. The amounts provided are based on the Group's best estimate of the least net cost of exit. Where material, these estimated outflows are discounted to net present value using a pre-tax rate that reflects current market assumptions. The unwinding of this discount is recognised as a financing cost in the income statement.

5.2 Stock

	2017 £m	2016 £m
Finished goods	614	616

Unearned elements of commercial income are deducted from finished goods as the stock has not been sold.

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

5 Working capital and provisions continued

5.3 Debtors

	2017 £m	2016 £m
Trade debtors:		
– Commercial income trade debtors	4	13
– Accrued commercial income	38	26
– Other trade debtors	101	99
Less: provision for impairment of trade debtors	(6)	(6)
	137	132
Prepayments and accrued income	68	56
Other debtors	9	4
	214	192

The ageing analysis of trade debtors is as follows:

	2017 £m	2016 £m
Neither past due nor impaired	137	132
Past due but not impaired:		
Not more than three months	–	–
Greater than three months	–	–
Impaired debt	6	6
	143	138

As at 29 January 2017 and 31 January 2016, trade debtors that were neither past due nor impaired related to a number of debtors for whom there is no recent history of default. The other classes of debtors do not contain impaired assets.

As of 5 March 2017, £4m of the £4m commercial income trade debtor balance had been settled and £28m of the £38m accrued commercial income balance had been invoiced and settled.

5.4 Creditors – current

	2017 £m	2016 £m
Trade creditors	2,160	1,775
Less: commercial income due, offset against amounts owed	(34)	(85)
	2,126	1,690
Other taxes and social security payable	68	86
Other creditors	198	267
Accruals and deferred income	445	475
	2,837	2,518

Included within accruals and deferred income is £3m (2016: £5m) in respect of deferred commercial income.

As of 5 March 2017, £25m of the £34m commercial income due above had been offset against payments made.

5 Working capital and provisions continued

5.5 Provisions

	Onerous leases and onerous contracts £m	Other property provisions £m	Total £m
At 1 February 2016	289	20	309
Charged to profit for the period	38	–	38
Utilised/released during the period	(34)	–	(34)
Unwinding of discount	13	–	13
At 29 January 2017	306	20	326

Part of the onerous leases relate to sublet and vacant properties, with commitments ranging from one to 56 years. The provision is revised regularly in response to market conditions. During the year, £38m has been charged to onerous lease and onerous contracts provisions as detailed in note 1.4. The utilisation of provisions relates to the ongoing utilisation of onerous contracts and the assignment of onerous leases.

Other property provisions include a petrol filling station decommissioning reserve for the cost of decommissioning petrol tanks, and provisions for dilapidations on leased buildings, for the cost of restoring assets to their original condition.

5.6 Cash generated from operations

	2017 £m	2016 £m
Profit for the period	305	222
Net finance costs	145	99
Taxation charge/(credit)	20	(5)
Share of profit of joint venture	(2)	(2)
Operating profit	468	314
Adjustments for:		
Depreciation and amortisation	399	384
Impairment	147	–
Impairment reversal	(191)	–
Profit arising on disposal and exit of properties and sale of businesses and investments	(32)	(97)
Adjustment for non-cash element of pension charges	7	11
Share-based payments	20	11
Other non-cash charges	2	1
Decrease in stock[1]	2	40
(Increase)/decrease in debtors[1]	(19)	30
Increase in creditors[1]	306	313
Increase in provisions[1]	4	19
Cash generated from operations	1,113	1,026

Total working capital inflow (the sum of items marked[1] in the table) is £293m in the year. This includes £38m as a result of the current year onerous contract charge, net of £94m of onerous payments and other non-operating payments of £11m. When adjusted to exclude these items, the working capital inflow is £360m.

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

6 Capital and borrowings

6.1 Accounting policies

Borrowings

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

Borrowing costs

All borrowing costs are recognised in the Group's profit for the period on an effective interest rate basis except for interest costs that are directly attributable to the construction of buildings and other qualifying assets, which are capitalised and included within the initial cost of the asset. Capitalisation commences when both expenditure on the asset and borrowing costs are being incurred, and necessary activities to prepare the asset for use are in progress. In the case of new stores, this is generally once planning permission has been obtained. Capitalisation ceases when the asset is ready for use. Interest is capitalised at the effective rate incurred on borrowings before taxation of 5% (2016: 5%). Capitalised interest is included within interest paid in cash flow from operating activities.

Leases

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

Sale and leaseback of properties

The accounting treatment of the sale and leaseback depends upon the substance of the transaction (by applying the lease classification principles described above). For sale and operating leasebacks, the assets are sold at fair value, and accordingly the profit or loss from the sale is recognised immediately in the Statement of comprehensive income. When forming the conclusion of operating lease classification, consideration was given to the key lease classification indicators of IAS 17. The leases are typically for a 25 year period. The Directors have reviewed the remaining useful lives for these particular properties and concluded they are significantly longer than the period of the lease. As disclosed on page 78 a review of the useful economic lives of each of the property, plant and equipment categories has been performed in the year with no changes made. Other key indicators considered in reaching an operating lease classification were the present value of the minimum lease payments and the ownership clauses in the contracts upon expiry of the lease.

Share capital

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

Own shares held

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

Net debt

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

6 Capital and borrowings continued

6.2 Finance costs and income

	2017 £m	2016 £m
Interest payable on short term loans and bank overdrafts	(3)	(4)
Interest payable on bonds	(86)	(98)
Interest capitalised	1	4
Total interest payable	(88)	(98)
Provisions: unwinding of discount	(13)	(11)
Other finance costs	(3)	(3)
Underlying finance costs[1]	(104)	(112)
Costs associated with the repayment of borrowings (note 1.4)	(56)	–
Finance costs	(160)	(112)
Bank interest received	6	5
Amortisation of bonds	1	1
Other finance income	–	7
Underlying finance income[1]	7	13
Net pension income (note 1.4 and 8.2)	8	–
Finance income	15	13
Net finance cost	(145)	(99)

1 Underlying net finance costs marked [1] amount to £97m (2016: £99m).

6.3 Borrowings

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

	2017 £m	2016 £m
Current		
Bank overdraft	–	9
£200m Sterling bonds 6.00% January 2017	–	200
	–	209

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

	2017 £m	2016 £m
Non-current		
£135m Sterling bonds 6.12% December 2018 (2016: £200m)	136	202
£365m Sterling bonds 4.625% December 2023 (2016: £400m)	363	398
£384m Sterling bonds 3.50% July 2026 (2016: £400m)	411	416
£300m Sterling bonds 4.75% July 2029 (2016: £300m)	292	291
US Private Placement loan notes (USPP) 4.4% November 2026 (2016: $250m)	–	174
€411m Euro bond 2.25% June 2020 (2016: €700m)	348	527
Total non-current bonds and loan notes	1,550	2,008
Revolving credit facility	–	(5)
	1,550	2,003

The £200m 2017 Sterling bond was repaid in January 2017 on maturity. The movements on the nominal value of the other bonds and the US Private Placement loan notes (USPP) are due to early repayment during the 52 weeks ended 29 January 2017.

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

6 Capital and borrowings continued

6.3 Borrowings continued

Borrowing facilities

Borrowings are denominated in sterling and euro, and bear fixed interest rates. All borrowings are unsecured.

In September 2016 the Group extended its syndicated committed revolving credit facility of £1.35bn by a further year, resetting its five year term and resulting in a maturity date of September 2021. The revolving credit facility incurs commitment fees and drawdowns bear interest at floating interest rates at a spread above LIBOR. There were no borrowings under the revolving credit facility at the balance sheet date. In the year, the Group did not renew a further credit facility of £150m that was in place during 2016. Therefore the Group had £1.35bn of undrawn committed borrowing facilities available (2016: £1.5bn).

In the event of default of covenants the principal amounts of borrowings and any interest accrued become repayable on demand.

Maturity of borrowings

The table below summarises the maturity profile of the Group's borrowings based on contractual, undiscounted payments, which include interest payments. As a result, amounts shown below do not agree to the amounts disclosed on the balance sheet for borrowings. Creditors (note 5.4) are excluded from this analysis.

	2017 £m	2016 £m
Less than one year	61	291
One to two years	195	79
Two to three years	52	278
Three to four years	400	67
Four to five years	45	593
More than five years	1,248	1,574

Fair values

The fair value of the sterling and euro denominated bonds is measured using closing market prices (level 1). The fair value of the USPP at 2016 was estimated by comparing the interest rate to market rates available to the Group at the balance sheet date (level 2). The fair values of borrowings included in level 2 are based on the net present value of the anticipated future cash flows associated with these instruments using rates currently available for debts on similar terms, credit risk and equivalent maturity dates.

These compare to carrying values as follows:

	2017		2016	
	Amortised cost £m	Fair value £m	Amortised cost £m	Fair value £m
Total bonds: non-current and current	1,550	1,676	2,034	2,019
Total loan notes: non-current	–	–	174	167
	1,550	1,676	2,208	2,186

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

6 Capital and borrowings continued

6.4 Analysis of net debt

	Note	2017 £m	2016 £m
Cash and cash equivalents per balance sheet		326	496
Bank overdrafts	6.3	–	(9)
Cash and cash equivalents per cash flow statement		326	487
Cross-currency contracts and interest rate swaps		6	30
Fuel and energy price contracts		10	–
Non-current financial assets	7.3	16	30
Foreign exchange forward contracts		11	12
Fuel and energy price contracts		11	–
Current financial assets	7.3	22	12
Foreign exchange forward contracts	7.3	(2)	–
Fuel and energy price contracts	7.3	(1)	(17)
Bonds	6.3	–	(200)
Current financial liabilities		(3)	(217)
Bonds	6.3	(1,550)	(1,834)
Private placement loan notes	6.3	–	(174)
Revolving credit facility	6.3	–	5
Cross-currency contracts and interest rate swaps	7.3	–	(46)
Fuel and energy price contracts	7.3	(5)	(9)
Non-current financial liabilities		(1,555)	(2,058)
Net debt		(1,194)	(1,746)

Cash and cash equivalents include restricted balances of £9m (2016: £16m) which is held by Farock Insurance Company Limited, a subsidiary of Wm Morrison Supermarkets PLC.

In March 2016, the IFRS Interpretations Committee issued an agenda decision regarding the treatment of offsetting and cash-pooling arrangements in accordance with IAS 32 'Financial instruments: Presentation'. This provided additional guidance on when bank overdrafts in cash-pooling arrangements would meet the requirements for offsetting in accordance with IAS 32. Following this additional guidance, the Group has reviewed its cash-pooling arrangements and recognised £nil of cash-pooling facilities within bank overdrafts and short term borrowings in the current period that would previously have been offset against cash and cash equivalent balances. Comparatives at 31 January 2016 have been restated by £8m. There is no impact of this change in presentation on cash flows or net debt.

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

6 Capital and borrowings continued

6.5 Called-up share capital

	Number of shares millions	Share capital £m	Share premium £m	Total £m
At 1 February 2016	2,335.2	234	127	361
Share options exercised	0.4	–	1	1
At 29 January 2017	2,335.6	234	128	362

The total authorised number of ordinary shares is 4,000 million shares (2016: 4,000 million shares) with a par value of 10p per share (2016: 10p per share). All issued shares are fully paid. The Group did not acquire any of its own shares for cancellation in the 52 weeks ended 29 January 2017 or 31 January 2016.

The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at the meetings of the Company.

Trust shares
Included in retained earnings is a deduction of £14m (2016: £13m) in respect of own shares held at the balance sheet date. This represents the cost of 8,458,487 (2016: 8,401,491) of the Group's ordinary shares (nominal value of £0.8m (2016: £0.8m)). These shares are held in a trust and were acquired by the business to meet obligations under the Group's employee share plans using funds provided by the Group. The market value of the shares at 29 January 2017 was £20m (2016: £15m). The trust has waived its right to dividends. These shares are not treasury shares as defined by the London Stock Exchange.

During the period the Group acquired 2,790,045 (2016: 8,612,819) of its own shares to hold in trust for consideration of £5m (2016: £13m), and utilised 2,733,049 (2016: 3,118,702) trust shares to satisfy awards under the Group's employee share plans.

Issue of new shares
The Group issued 381,043 (2016: 70,480) new shares to satisfy options exercised by employees during the period. Proceeds received on exercise of these shares amounted to £0.6m (2016: £0.1m).

6.6 Reserves

	2017 £m	2016 £m
Capital redemption reserve	39	39
Merger reserve	2,578	2,578
Hedging reserve	18	(10)
Retained earnings	1,066	788
Total	3,701	3,395

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

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

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

6.7 Capital management

The Group defines the capital that it manages as the Group's total equity and net debt balances, as well as its lease commitments.

The Group's capital management objectives are to safeguard its viability taking into consideration the risks that it faces whilst maintaining an investment grade credit rating and having adequate liquidity headroom. The Group manages its capital structure by managing the balance of debt and shares outstanding. It does this by seeking an effective balance between debt and equity. During the current financial year, net debt has reduced by £552m, reflecting strong operating cash flow driven by working capital management and property and business disposals. Throughout the year, the Group has comfortably complied with the gearing and fixed charge cover covenants attaching to its revolving credit facility.

6 Capital and borrowings continued

6.8 Operating leases – lessee

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

	2017		2016	
	Property £m	Vehicles, plant and equipment £m	Property £m	Vehicles, plant and equipment £m
Within one year	121	14	119	15
More than one year and less than five years	466	34	451	25
After five years	1,851	–	1,854	–
	2,438	48	2,424	40

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

	£m
At 1 February 2016	119
Net impact of disposal programme	(4)
New lease commitments	4
Other	2
At 29 January 2017	121

7 Financial risk and hedging

7.1 Accounting policies

Derivative financial instruments and hedge accounting

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

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

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

Cash flow hedges

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

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 on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs at which point the net cumulative gain or loss recognised in equity is transferred to profit or loss in the period.

Fair value hedge

The Group designates derivatives into a fair value hedge relationship when they hedge the Group's exposure to changes in the fair value of a recognised asset or liability, or a firm commitment. The change in fair value of the hedged asset or liability that is attributable to the hedged risk is recognised in profit or loss for the period as well as the gain or loss from changes in the fair value of the derivative.

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

7 Financial risk and hedging continued

7.2 Financial risk management

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

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

Foreign currency risk

The majority of purchases made by the Group are denominated in sterling, however some trade purchases are made in other currencies, primarily the euro and US dollar. The Group's objective is to reduce short term profit volatility from exchange rate fluctuations. It is Group policy that a minimum of 80% of committed and highly probable exposures within the next six months are hedged and at least 40% of exposures in the following six months.

Cross-currency interest rate swaps are used to mitigate the Group's currency exposure arising from payments of interest and principal in relation to foreign currency funding.

At the reporting date, the sensitivity to a reasonable possible change (+/– 10%) in the US dollar and euro exchange rates would equate to a £10m post-tax profit or loss exposure in relation to the euro and £7m in relation to the US dollar, for the unhedged forecast foreign currency exposures over the next 12 months. A weakening of the pound sterling by 10% against the euro and US dollar exchange rates would impact other comprehensive income by £19m.

Liquidity risk

The Group policy is to maintain an appropriate maturity profile across its borrowings and a sufficient level of committed headroom to meet obligations. The Group finances its operations using a diversified range of funding providers including banks and bondholders.

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

The Treasury Committee compares the committed liquidity available to the Group against the forecast requirements including policy headroom. This policy includes a planning assumption that supply chain finance facilities are not available.

Interest rate risk

The Group seeks to protect itself against adverse movements in interest rates by maintaining at least 60% of its total borrowings at fixed interest rates. As at the balance sheet date, 100% (2016: 91%) of the Group's borrowings are at fixed rate.

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

Credit risk

As a retailer, the majority of the Group's revenue is received in cash at the point of sale and therefore credit risk is not considered significant to the Group. Some credit risk does arise from cash and cash equivalents, deposits with banking groups and exposures from other sources of income such as commercial income and tenants of investment properties.

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

There are no significant concentrations of credit risk within the Group.

Commodity price risk

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

The Group has adopted a capital at risk model for hedging its fuel and power consumption. The Treasury Committee reviews the Group's exposure to commodity prices and ensures it remains within policy limits. A change of +/– 10 % in the market value of the commodity price at the balance sheet date would affect other comprehensive income by £18m (2016: £8m).

7 Financial risk and hedging continued

7.3 Derivative financial assets and liabilities

Derivative financial assets	2017 £m	2016 £m
Current		
Foreign exchange forward contracts	11	12
Fuel and energy price contracts	11	–
	22	12
Non-current		
Cross-currency contracts and interest rate swaps	6	30
Fuel and energy price contracts	10	–
	16	30

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

Derivative financial liabilities	2017 £m	2016 £m
Current		
Foreign exchange forward contracts	2	–
Fuel and energy price contracts	1	17
	3	17
Non-current		
Cross-currency contracts and interest rate swaps	–	46
Fuel and energy price contracts	5	9
	5	55

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

	2017 £m		2016 £m		
Maturity analysis of derivatives	< 1 year £m	1-5 years £m	< 1 year £m	1-5 years £m	5+ years £m
Derivatives settled on a gross basis					
Cross-currency swaps – cash flow hedges					
– Outflow	(10)	(381)	(25)	(694)	(203)
– Inflow	8	376	20	613	223
Interest rate swaps – fair value hedges					
– Outflow	–	–	(3)	(11)	(16)
– Inflow	–	–	7	28	39
Forward contracts – cash flow hedges					
– Outflow	(246)	–	(184)	–	–
– Inflow	251	–	194	–	–
Derivatives settled on a net basis					
Energy price contracts – cash flow hedges					
– Inflow/(outflow)	8	7	(18)	(8)	–

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

7 Financial risk and hedging continued

7.4 Hedging activities

Cash flow hedges

At 29 January 2017 and 31 January 2016, the Group held cross-currency swaps designated as cash flow hedges. The notional principal amount of the outstanding cross-currency swaps at 29 January 2017 was $nil (2016: $250m) and €413m (2016: €700m).

The fuel and energy price contracts and foreign currency derivatives shown in note 7.3 are designated as cash flow hedges.

Fair value hedges

The valuation of fixed-to-floating interest rate swaps designated in fair value hedges are £nil (2016: £21m). These financial instruments were terminated during the period. Early termination costs have been included in costs associated with repayment of borrowings as an adjustment to underlying earnings (see note 1.4).

8 Pensions

8.1 Accounting policies

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

8.1.1 Defined benefit schemes

Pension scheme assets are valued at fair market value as required by IAS 19. Pension scheme obligations are an estimate of the amount required to pay the benefits that employees have earned in exchange for current and past service, assessed and discounted to present value using the assumptions shown in note 8.4.1. The net pension liability or asset recognised in the Consolidated balance sheet is the net of the schemes' assets and obligations, which are calculated separately for each scheme.

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

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

Remeasurements comprise of actuarial gains and losses on the obligations and the return on scheme assets (excluding interest). They are recognised immediately in other comprehensive income. Amounts shown within note 8 are before any adjustments for deferred taxation.

8.2 Defined benefit schemes: Summary and description

The Group operates a number of defined benefit retirement schemes (together 'the Schemes') providing benefits based on a benefit formula that depends on factors including the employee's age and number of years of service. The Morrison and Safeway Schemes provide pension benefits based on either the employee's compensation package and/or career average revalued earnings (CARE) (the 'CARE Schemes'). The CARE Schemes are not open to new members and were closed to future accrual in July 2015. The RSP is a cash balance scheme, which provides a lump sum benefit based upon a defined proportion of an employee's annual earnings in each year, which is revalued each year in line with inflation subject to a cap.

The position of each scheme at 29 January 2017 is as follows:

	2017 £m	2016 £m
CARE Schemes	293	178
RSP	(21)	8
Net pension asset	272	186

8 Pensions continued

8.2 Defined benefit schemes: summary and description continued

The disclosures below show the details of the schemes combined:

Balance sheet:	2017 CARE £m	2017 RSP £m	2016 CARE £m	2016 RSP £m
Fair value of scheme assets	4,455	219	3,812	138
Present value of obligations	(4,162)	(240)	(3,634)	(130)
Net pension asset/(liability)	293	(21)	178	8

Consolidated statement of comprehensive income	2017 CARE £m	2017 RSP £m	2016 CARE £m	2016 RSP £m
Current service cost – recognised in cost of sales	–	42	21	42
Current service cost – recognised in administrative expenses	–	29	3	20
Administrative costs paid by the Schemes – recognised in administrative expenses	3	1	3	1
Curtailment gain	(1)	–	(3)	–
Net interest on net pension asset – finance income	(6)	(2)	–	–
Total expense (credited)/charged to statement of comprehensive income	(4)	70	24	63
Statement of other comprehensive income:				
Remeasurements in other comprehensive income (credit)/charge	(101)	15	(236)	–

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

8.3 Scheme assets

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

Currently, the investment strategy of the CARE Schemes is to maintain a balance of growth assets (equities and diversified growth funds), income assets (comprising credit investments, corporate bonds and absolute return bonds) and protection assets (comprising an LDI portfolio), with a weighting towards protection assets. There are no direct investments in the parent Company's own shares or property occupied by any member of the Group.

Fair value of Scheme assets:

	2017 CARE £m	2017 RSP £m	2016 CARE £m	2016 RSP £m
Equities (quoted)	770	107	681	98
Corporate bonds (quoted)	382	–	833	–
Absolute return bonds (quoted)	382	–	–	–
Diversified growth funds (quoted)	489	50	734	–
Credit funds (unquoted)	417	–	271	–
Liability driven investments (unquoted)	1,998	61	1,286	34
Cash (quoted)	17	1	7	6
Total	4,455	219	3,812	138

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

8 Pensions continued

8.3 Scheme assets continued

Liability driven investments (LDI)

Part of the investment objective of the Schemes is to minimise fluctuations in the Schemes' funding levels due to changes in the value of the liabilities. This is primarily achieved through the use of 'liability driven investments' (LDI), whose main goal is to align movements in the value of assets with movements in the Schemes' liabilities arising from changes in market conditions. The Schemes have hedging that broadly covers interest rate movements and inflation movements, as measured on the Trustees' funding assumptions which use a discount rate derived from gilt yields.

LDI primarily involves the use of government fixed and inflation linked bonds (including re-purchase agreements). Derivatives such as interest rate and inflation swaps are also used. There are no annuities or longevity swaps.

Diversified growth funds

The Schemes employ diversified growth funds in order to reduce their exposure to equity markets. These funds typically invest in a range of public and private market assets, including equities, bonds, commodities, property and other assets.

Credit funds

The Schemes invest in credit funds in order to improve returns available from their bond assets. These funds typically lend directly to corporations on a senior secured basis, rather than purchasing debt issued in the public markets.

Absolute return bonds

The Schemes employ absolute return bond managers to target a moderate investment return whilst aiming to preserve capital in most market environments. These funds typically invest in a range of fixed income instruments and derivatives, across different countries and currencies, actively managing their exposure according to their market views and opportunities available.

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

	2017 CARE £m	2017 RSP £m	2016 CARE £m	2016 RSP £m
Fair value of scheme assets at start of period	3,812	138	4,050	87
Interest income	138	7	123	3
Return on scheme assets excluding interest	612	20	(299)	(5)
Employer contributions	10	56	27	49
Employee contributions	–	3	1	6
Benefits paid	(114)	(4)	(87)	(1)
Administrative expenses	(3)	(1)	(3)	(1)
Fair value of scheme assets at end of period	4,455	219	3,812	138

Scottish Limited Partnership

The Group has previously entered into a pension funding partnership structure. In January 2013, Wm Morrison Supermarkets PLC made a contribution to the CARE Schemes of £90m. On the same day, the CARE Schemes invested £90m in the Wm Morrison Property Partnership ("SLP") as a limited partner. The SLP holds properties which have been leased back to the Group in return for rental income payments. The Group retains control over these properties, including the flexibility to substitute alternative properties.

As partners in the SLP, the CARE Schemes are entitled to receive a fixed distribution of £6.6m per annum from the profits of the SLP for 20 years from 2013, subject to certain conditions. The distributions shared with the Schemes are reflected in the Group financial statements as Employer pension contributions.

In July 2015, the SLP was amended to enhance the security provided to the Schemes by including additional properties. The terms of these additional properties are such that the CARE Schemes have no entitlement to receive a distribution.

The CARE Schemes' interests in the SLP reduce the respective deficits on a funding basis, although the agreements do not affect the position directly on an IAS 19 accounting basis because the investments held by the CARE Schemes do not qualify as assets for IAS 19 purposes.

8 Pensions continued

8.4 Present value of obligations

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

	2017 CARE £m	2017 RSP £m	2016 CARE £m	2016 RSP £m
Defined benefit obligation at start of period	(3,634)	(130)	(4,093)	(83)
Current service cost	–	(71)	(24)	(62)
Interest expense	(132)	(5)	(123)	(3)
Actuarial gain – demographic assumptions	94	–	–	–
Actuarial (loss)/gain – financial assumptions	(852)	(40)	517	18
Actuarial gain – experience	247	5	–	5
Curtailment gain	1	–	3	–
Employee contributions	–	(3)	(1)	(6)
Benefits paid	114	4	87	1
Defined benefit obligation at end of period	(4,162)	(240)	(3,634)	(130)

The durations of the defined benefit obligations at the end of the 2017 reporting period are: RSP 20 years; Morrison CARE 26 years; Safeway CARE 24 years. The weighted average duration of all three Schemes is 24 years.

8.4.1 Significant actuarial assumptions

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

Financial assumptions	2017 CARE	2017 RSP	2016 CARE	2016 RSP
Discount rate applied to scheme liabilities (% p.a.)	2.9%	2.8%	3.7%	3.7%
Inflation assumption (RPI) (% p.a.)	3.5%	3.5%	3.2%	3.2%

Life expectancies	2017 CARE	2017 RSP	2016 CARE	2016 RSP
Longevity in years from age 65 for current pensioners				
Male	22.3	n/a	22.6	n/a
Female	23.8	n/a	24.1	n/a
Longevity in years from age 65 for current members aged 45				
Male	24.5	n/a	24.9	n/a
Female	26.2	n/a	26.5	n/a

Assumptions regarding future mortality experience are set based on actuarial advice and in accordance with published statistics. Following analysis completed as part of the 2016 actuarial valuations, the 2017 year-end mortality tables used have been updated to the S2PMA/S2PFA-Heavy tables (males/females) based on year of birth with a scaling factor of 110%/100% applied to the mortality rates in the Morrison/Safeway Schemes respectively, with CMI 2015 projections and a long term rate of improvement of 1.5% per annum.

Related actuarial assumptions (expressed as weighted averages)

	2017 CARE	2017 RSP	2016 CARE	2016 RSP
Rate of increases in salaries (% p.a.)	–	2.4%	–	2.2%
Rate of increase of pensions in payment: RPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	2.2%/3.3%	–	2.1%/3.2%	–
Pre-retirement revaluation for active members (% p.a.)	–	1.9%	–	1.8%
Rate of increase of pensions in deferment: CPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	–/2.4%	2.4%/–	–/2.2%	2.2%/–
CPI inflation (% p.a.)	2.4%	2.4%	2.2%	2.2%

Notes to the Group financial statements continued

52 weeks ended 29 January 2017

8 Pensions continued

8.4 Present value of obligations continued

8.4.2 Sensitivity analysis on significant actuarial assumptions

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

		2017 CARE £m	2017 RSP £m	2016 CARE £m	2016 RSP £m
Discount rate applied to Scheme obligations	+/– 0.1% p.a.	–/+105	–/+5	–/+83	–/+3
Inflation assumption (RPI and associated assumptions)	+/– 0.1% p.a.	+/–95	+/–3	+/–76	+/–2
Longevity	+/– one year	+180	–	+141	–

8.5 Funding

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

The latest full actuarial valuations were carried out as at 1 April 2016 for the Safeway Scheme and 5 April 2016 for the Morrison Scheme and the RSP. The valuations indicated that, on the agreed funding basis, the Safeway, Morrison and RSP Schemes had surpluses of £100m, £1m and £10m respectively. As a result of these funding positions there are currently no deficit contributions payable. As such there is no 'minimum funding requirement' in force.

The results of the 2016 actuarial valuations for the CARE Schemes have been used and updated for IAS 19 'Employee benefits' purposes for the period to 29 January 2017 by a qualified independent actuary. For the RSP an actuarial valuation for the purposes of IAS 19, based on member data as at 31 December 2016, has been completed and updated to 29 January 2017 by a qualified independent actuary. The Schemes expose the Group to inflation risk, interest rate risk and market investment risk. In addition, the CARE Schemes expose the Group to longevity risk.

At the year end, schemes in surplus have been disclosed within the assets on the balance sheet. The Group has taken legal advice with regard to the recognition of a pension surplus and also recognition of a minimum funding requirement under IFRIC 14 'IAS 19 – The limit on a defined benefit asset, minimum funding requirement and their interaction'. This advice concluded that recognition of a surplus is appropriate on the basis that the Group has an unconditional right to a refund of a surplus. In respect of the RSP this is on the basis that paragraph 11(a) of IFRIC 14 applies enabling a refund of surplus during the life of the RSP. In respect of the Morrison Scheme, this is on the basis that paragraph 11(b) or 11(c) of IFRIC 14 applies enabling a refund of surplus assuming the gradual settlement of the scheme liabilities over time until all members have left the scheme or the full settlement of the Scheme's liabilities in a single event (i.e. as a scheme wind up). In respect of the Safeway Scheme, a refund is available on the basis that paragraph 11(b) of IFRIC 14 applies. Amendments to the current version of IFRIC 14 are currently being considered. The legal advice received by the Group has considered the proposed new wording to paragraph 12(A) of IFRIC 14 concerning whether other parties have a unilateral power to use a scheme's surplus to settle in full the scheme's liabilities and has concluded that the above accounting treatment should not be affected by the current exposure draft of the revised wording to IFRIC 14.

The current best estimate of Group contributions to be paid to the defined benefit schemes for the accounting period commencing 29 January 2017 is £79m (2016: £67m). This estimate includes amounts payable from the SLP and salary sacrificed contributions from employees.

8.6 Defined contribution scheme set-up costs

As previously announced the Group intends to open a new defined contribution pension scheme for colleagues during the accounting period commencing 30 January 2017. This scheme will become the Auto Enrolment scheme and as such the Group will be liable for backdated contributions for eligible colleagues to 1 October 2012. The estimated set up costs relating to backdated contributions of £35m were initially recognised in the 52 weeks to 31 January 2016. The accrual has been updated to 29 January 2017 to reflect a further year's contribution for eligible colleagues and changes to accounting assumptions.

9 Share-based payments

9.1 Accounting policy

Share-based payments

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

The fair value of share options is measured by use of the Black-Scholes model. The expected life used in the model has been adjusted, based on management's best estimate, for effects of non-transferability, exercise restrictions and behavioural considerations. The charge in the period for share-based payments was £20m (2016: £11m).

9.2 Share save schemes

The Share save scheme began in May 2000 and all employees (including Executive Directors) are eligible once the necessary service requirements have been met. The scheme allows participants to save up to a maximum of £350 each month for a fixed period of three years. Options are offered at a discount to the mid-market closing price on the day prior to the offer and are exercisable for a period of six months commencing after the end of the fixed period of the contract. The exercise of options under this scheme is subject only to service conditions. The schemes that launched in May 2011 and subsequently are under the new scheme rules approved by the shareholders in June 2010.

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

Grant date	16 May 2016	19 May 2015	20 May 2014	13 May 2013
Share price at grant date	£1.91	£1.81	£2.10	£2.83
Fair value of options granted	£5.1m	£4.8m	£11.6m	£8.1m
Exercise price	£1.70	£1.64	£1.64	£2.25
Dividend yield	2.62%	5.15%	6.21%	4.17%
Annual risk free interest rate	0.87%	1.06%	1.00%	0.45%
Expected volatility[1]	26.8%	22.7%	18.3%	16.8%

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

	2017		2016	
	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	1.72	48,827	1.85	50,785
Granted	1.70	13,478	1.64	21,729
Exercised	1.69	(381)	1.66	(70)
Forfeited	1.89	(15,159)	1.93	(23,617)
Outstanding at end of period	1.66	46,765	1.72	48,827
Exercisable at end of period	2.25	52	2.36	17

	2017			2016		
	Weighted average share price at date of exercise £	Weighted average option price at date of exercise £	Number of shares thousands	Weighted average share price at date of exercise £	Weighted average option price at date of exercise £	Number of shares thousands
Share options exercised in the financial period	2.14	1.69	381	1.74	1.66	70

	2017	2016
Share options outstanding at the end of the period		
Range of exercise prices	£1.64 to £2.25	£1.64 to £2.36
Weighted average remaining contractual life	1.1 years	2.2 years

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52 weeks ended 29 January 2017

9 Share-based payments continued

9.3 Long term incentive plans

In May 2007, a discretionary LTIP for the benefit of certain employees was introduced. The awards have no exercise price and accrue the value of dividends over the vesting period with the exception of senior employees within the schemes granted this year.

LTIP grants issued between 2013 and 2016 had associated performance conditions for Executive Committee members, whilst other senior employees eligible for LTIPs had to satisfy a service condition only. The LTIP schemes granted in April, May and October 2016 have service and performance conditions for all employees. The performance conditions associated with all awards are measured through free cash flow, sales and earnings per share performance.

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

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

Grant date	25 Oct 2016	13 May 2016	06 Apr 2016	01 Oct 2015	23 Apr 2015	16 Oct 2014	20 Jun 2014	22 Apr 2014	17 Oct 2013	22 Apr 2013
Option fair value at grant date	£2.28	£1.90	£2.00	£1.74	£1.97	£1.57	£1.91	£2.02	£2.79	£2.80
Fair value of share awards	£9.2m	£1.9m	£73.6m	£1.8m	£5.3m	£0.9m	£3.0m	£16.7m	£1.5m	£18.8m

	2017 Share awards thousands	2016 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	20,279	18,793
Granted	42,258	3,711
Exercised	(2,459)	–
Forfeited	(13,596)	(2,225)
Outstanding at end of period	46,482	20,279
Exercisable at end of period	–	–

The weighted average remaining contractual life of the share awards is 1.96 years (2016: 1.1 years).

9.4 One-off share awards

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

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

Grant date	10 July 2015
Share price at grant date	£1.72
Assumed leavers	–
Fair value of share awards granted	£0.1m

There are 62,332 share awards outstanding at the end of the period (2016: 175,029). The movement during the period is entirely the result of options vesting in the period. The weighted average remaining contractual life of the share awards is 1.09 years (2016: 0.8 years).

9 Share-based payments continued

9.5 Restricted share award

	2017 Share awards thousands	2016 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	1	2,340
Exercised	–	(1,808)
Lapsed	(1)	(531)
Outstanding at end of period	–	1

9.6 Deferred share bonus plan

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

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

Grant date	2016/17 scheme	2015/16 scheme
Share price at grant date	£2.02	£2.05
Assumed leavers	–	–
Exercise price	£nil	£nil
Fair value of share awards granted	£2.0m	£1.1m

	2017 Share awards thousands	2016 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	413	815
Granted	947	559
Exercised	–	(432)
Lapsed	–	(529)
Outstanding at end of period	1,360	413

The weighted average remaining contractual life of the share awards is 1.8 years (2016: 1.9 years).

10 Other

10.1 Related party transactions

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

During the year, the Group received a dividend of £8m (2016: £8m) from MHE JVCo. The Group owns 50% of the equity of MHE JVCo (see note 4.2).