

# A business for a new decade



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# Financial highlights

**Group sales (including VAT)\*** **+6.8%**

**Underlying profit before tax** **+10.1%**

**Group profit before tax** **+10.4%**

**Underlying diluted earnings per share\*\*** **+9.1%**

**Diluted earnings per share** **+9.8%**

**Dividend per share** **+9.1%**

All growth figures reported on a 52-week basis.

52 weeks ended 27 February 2010	2009/10	2008/9 <sup>‡</sup>	
		52 weeks	53 weeks
Group sales (£m) (including VAT)*	<b>62,537</b>	58,570	59,426
Group revenue (£m) (excluding VAT)	<b>56,910</b>	53,115	53,898
Group trading profit (£m)	<b>3,412</b>	3,039	3,086
Underlying profit before tax (£m)	<b>3,395</b>	3,083	3,124
Group profit before tax (£m)	<b>3,176</b>	2,876	2,917
Underlying diluted earnings per share (p)	<b>31.66</b>	28.50	28.87
Dividend per share (p)	<b>13.05</b>	–	11.96
Group enterprise value (£bn) (market capitalisation plus net debt)	<b>41.4</b>	–	35.9
Return on capital employed	<b>12.1%</b>	–	12.8%

\* Group sales (inc. VAT) excludes the accounting impact of IFRIC 13 (Customer Loyalty Programmes).

\*\* Growth in underlying diluted EPS calculated on a constant tax rate basis.

‡ Restated for the impact of IFRIC 13 and IFRS 2.

# Over the past decade Tesco has transformed itself into a diverse international business – and by following our consistent strategy we are well positioned for long-term growth.



**I am pleased to report that the Tesco team has once again delivered a good set of results – guided by experienced management who have steered the business through recessions before. As markets around the world are emerging from this recession each part of our business is well positioned to pursue our strategy for growth.**

We have continued to grow sales, profits and market share over the past year. We've also significantly strengthened our balance sheet.

Our acquisition in South Korea is performing well and delivering excellent results, we've opened our first three Tesco Lifespace shopping malls in China and we have made good progress building the infrastructure and developing new products for Tesco Bank.

I am also pleased to announce that we again increased our dividend – for the 26th consecutive year. This consistent track record of delivering dividend growth for shareholders is unrivalled in the FTSE 100.

The strong Group results over the last year have been achieved through a constant focus on what matters most to customers in challenging times around the world. A good example of this has been our renewed focus on rewarding loyalty – at home and abroad – which has been a great success with customers.

In the UK, we increased our Clubcard investment with Double Points – giving customers even greater reward for their loyalty.

Internationally, we launched Clubcard in three more countries during the year – in Poland, Slovakia and

Thailand – and for the first time we now have more Clubcard holders internationally than in the UK.

It has been another significant year for our work on the environment and within local communities. As we grow, our customers increasingly look to Tesco to take the lead in these areas – and we are.

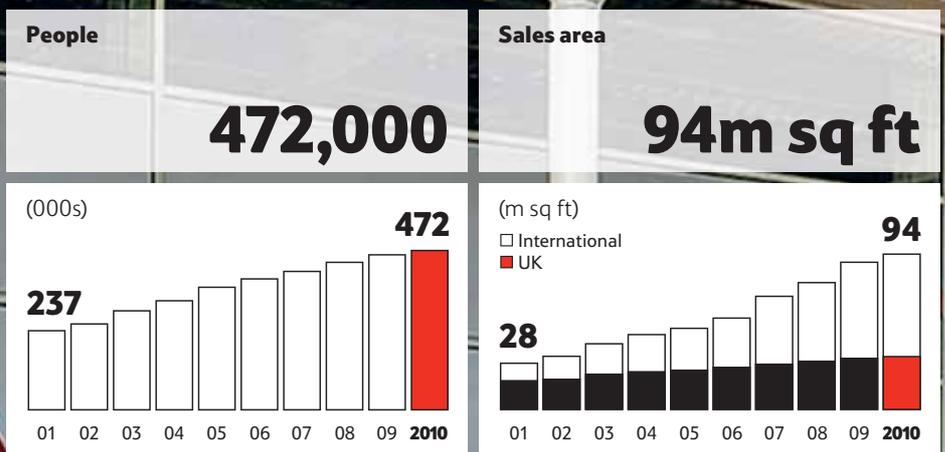
In January, we opened the world's first zero-carbon store at Ramsey in Cambridgeshire – the latest step in our journey to reduce the carbon footprint of our business. Over the past year we have made significant progress towards our long-term goals by reducing our emissions by 7.8% on our baseline 2006/7 store and distribution portfolio.

This year we donated over £60m to charities – once again exceeding our target to give the equivalent of 1% of our profits to good causes.

These good results are testament to the hard work of our people. The Tesco team is now 472,000 strong – and we remain united by our goal to improve the shopping trip for our customers. I would like to thank all our people for their hard work which I know will continue in the year ahead.

**David Reid**  
Chairman

# A growth busi



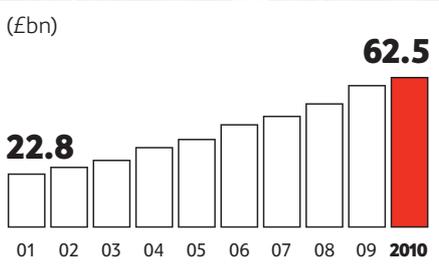
Our position amongst the leading global retailers hasn't happened by chance. For well over a decade, our long-term strategy has been delivering strong and consistent growth.



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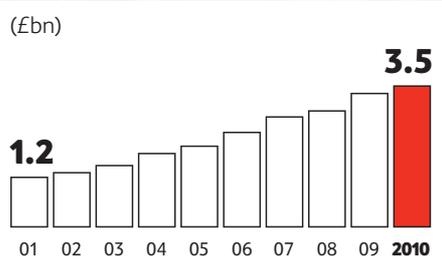
Group sales

**£62.5bn**



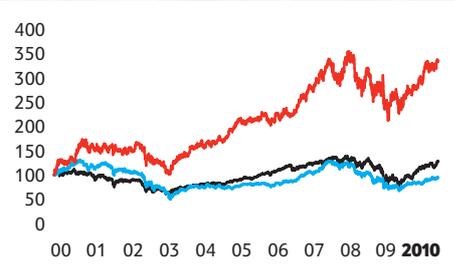
Operating profit

**£3.5bn**



Total shareholder return\*

— Tesco  
— FTSE 100  
— Eurofirst Food & Drug \* Index rebased to 100



Through diversification into new geographies, new product areas and new services, we're developing a business for the future – with sustainable growth for years to come.

# ...for a new de

**53%**

In 2000, Tesco was operating in markets representing 8% of global GDP; today it's **53%**.

**Zero**

We are committed to being **carbon-neutral** by **2050** and helping our customers halve their own carbon footprint by **2020**.

**65%**

Today **65%** of our selling space is outside the UK.



# cade

## Global

**We're starting to unlock the benefits of being a global Group:**

- Global sourcing volumes have grown **threefold** in six years
- Clubcard is now in **seven** countries
- F&F clothing is in **ten** countries
- Group shared services centre in Bangalore.

**48%**

**48%** of our space is less than five years old.

## No. 1

Customers expect to be able to shop where and when they want – as well as having great stores we're the **most profitable online grocery retailer in the world.**

## Multi-format

Our **flexible range of formats** helps us to adapt our approach to local customers – wherever they are – from Extra hypermarkets to Express convenience stores.

## Local

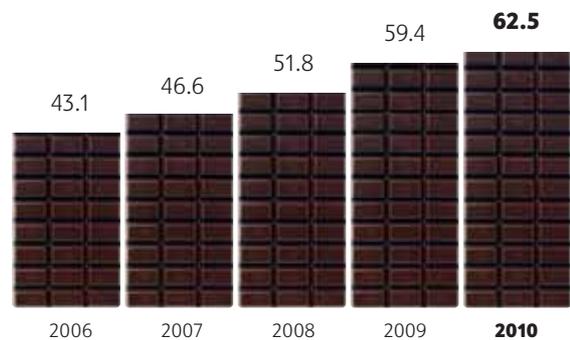
We've learnt how to be 'local'; in South Korea, our largest international business, we have **over 22,000 employees and just six UK expats.**

**By remaining focused on our strategy and helping customers to save money, Tesco has weathered the economic storm well.**

Group sales

**£62.5bn**

Group sales  
£bn



Underlying profit  
before tax

**£3.4bn**

Stores  
worldwide

**4,811**

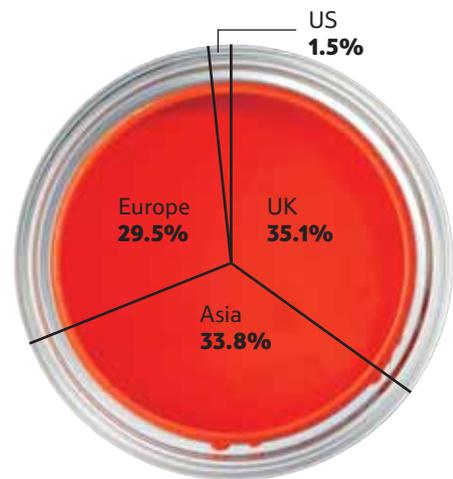
People  
worldwide

**472,000**

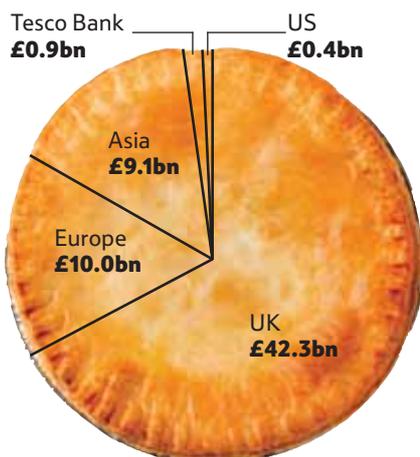
Countries

**14**

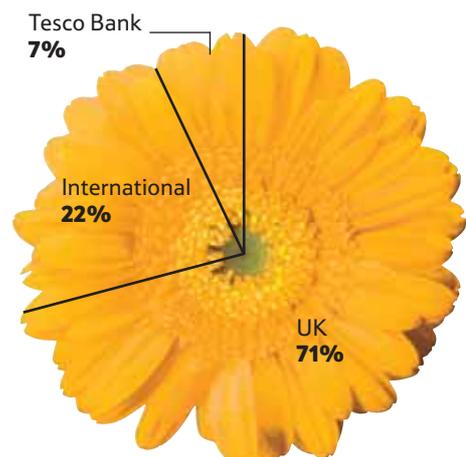
Group space  
by region



Group sales



Group profit



# Tesco around the world

## UK

	Revenue* £m	Stores	Employees
<b>Total</b>	<b>38,558</b>	<b>2,482</b>	<b>287,669</b>

## Europe

Region	Revenue* £m	Stores	Employees
<b>Republic of Ireland</b>	2,282	119	14,158
<b>Poland</b>	1,942	336	23,655
<b>Hungary</b>	1,698	176	20,079
<b>Czech Republic</b>	1,287	136	12,949
<b>Slovakia</b>	891	81	8,105
<b>Turkey</b>	595	105	7,630
<b>Total</b>	<b>8,695</b>	<b>953</b>	<b>86,576</b>



## US

	Revenue* £m	Stores	Employees
<b>Total</b>	<b>349</b>	<b>145</b>	<b>3,246</b>

## Asia

Region	Revenue* £m	Stores	Employees
<b>South Korea</b>	4,162	305	22,739
<b>Thailand</b>	2,344	663	34,775
<b>China</b>	844	88	22,668
<b>Malaysia</b>	633	32	9,423
<b>Japan</b>	449	142	4,636
<b>Total</b>	<b>8,432</b>	<b>1,230</b>	<b>94,241</b>

## India

In India, we have an exclusive franchise agreement with Trent, the retail arm of the Tata Group. We are supporting the development of their Star Bazaar format. We plan to open our first cash and carry store by the end of the year.

In 2009/10 there were an additional 362 people working in other locations such as international buying global hubs. Store numbers exclude one store in Calais, France. Total Revenue for Europe excludes France. Total Revenue for Asia excludes India.

\* Revenues are sales excluding VAT.

**This year's results show another solid performance from across the Group. By staying focused on doing the right thing for customers we have weathered the economic storm well. And by remaining committed to our long-term strategy we are emerging from recession stronger – with good building blocks in place for future growth.**



Each element of our strategy – UK, International, Non-food, Retailing Services and Community – is stronger now than this time last year.

In **International**, our businesses have made good progress in a challenging global economic environment. Our strategy is working – we've grown sales, profits and market shares and we've continued to invest in the drivers of future growth. Our performance in Asia was particularly pleasing, our business in Europe held up well despite the obvious economic challenges and I believe the start-up losses in our US business will now begin to reduce as Fresh & Easy establishes itself.

Our **UK** business had a good year. By remaining focused on helping customers spend less and encouraging loyalty with an increased investment in Clubcard, our UK business has delivered a solid performance. In our core grocery operations, we're growing ahead of the industry as a whole and we have been less affected by falling inflation than the market at large.

In **Non-food** we have made good progress. In the UK we achieved a particularly strong performance in electricals, entertainment and toys. Our clothing range is becoming an international success, led by our F&F range which is growing rapidly in our European markets and this year was launched in four countries in Asia.

Our **Retailing Services** have grown sales and profits once again. We've also been building the platforms for future growth, particularly in Tesco Bank, which is making good progress in developing its own systems and people capabilities as well as working on a broader product range as it moves towards becoming a full-service retail bank.

In the same way that we've stuck to our strategy in other parts of the business, we've also remained committed to our work on **Community** and the environment. In October, we set ourselves three challenging long-term targets: to become a zero-carbon

business by 2050; to reduce the carbon impact of the products in our supply chain by 30% by 2020; and to help our customers halve their own carbon footprint by 2020. And we're making good progress already.

We're delivering for all stakeholders: an improved shopping trip for customers; training and good careers for our staff; growth and innovation with our suppliers; in local communities we're supporting causes that matter to customers; and we're delivering good returns to shareholders.

### Looking forward

The outlook for shareholder returns is encouraging: we have a strong core UK business growing well; our international businesses offer significant upside from recovery in the short term and maturity in the longer term; our balance sheet is strengthening; and we're creating value through good property development.

Our positions in high-growth international economies and non-food meant we were always likely to face strong headwinds during the recession but it will be these parts of our business which will grow fastest in the recovery and beyond.

I am confident that with the prospect of an improving global economy and recent investments in acquisitions and new selling space making a greater contribution going forward, returns will improve significantly – starting this year.

**Sir Terry Leahy**  
Chief Executive

**Our well-established and consistent strategy for growth has given the business momentum to grow through the downturn.**

# Our strategy



## **Business Review**

This Business Review analyses the performance of the Tesco Group in the financial year ended 27 February 2010. It also explains other aspects of the Group's markets, results and operations, including strategy and risk management.

The Directors present their Annual Report to shareholders on the affairs of the Group and Company, together with the audited financial statements of the Company for the 52 weeks ended 27 February 2010.

## **Long-term strategy**

Tesco has a well-established and consistent strategy for growth. The rationale for the strategy is to broaden the scope of the business to enable it to deliver strong, sustainable long-term growth by following customers into large expanding markets at home – such as financial services, non-food

and telecoms – and new markets abroad, initially in Central Europe and Asia and more recently in the United States.

The strategy has five elements, reflecting our four established areas of focus plus Tesco's commitments on community and the environment:

- to be a successful international retailer;
- to grow the core UK business;
- to be as strong in non-food as in food;
- to develop retailing services; and
- to put community at the heart of what we do.

The strategy to diversify the business has been the foundation of Tesco's growth in recent years. It was laid down in 1997, with the fifth element – Community – being added in 2007. Many of the new businesses that have been created

and developed over the last 13 years as part of this strategy are now of significant scale and highly profitable – in fact we are now market leader in many of our markets outside the UK. In 1997 our International business generated 1.8% of the Group's profits and we had only just entered the Retailing Services markets; today these parts of our business represent 22% and 16% of profits respectively.

Importantly, the strategy has given the business momentum to grow well through the economic downturn. By continuing to invest through the recession – in the customer offer, in infrastructure and in our people – we are now well placed to grow faster and improve shareholder returns as the global economic environment improves.

# International at a glance

Our international business has delivered a strong performance despite many of our markets feeling the impact of the global recession.

Sales	<b>£19.4bn</b>	Trading profit	<b>£749m</b>
Sales up	<b>8.8%</b>	Trading profit up	<b>5.6%</b>
New space	<b>5.1m sq ft</b>	New stores	<b>324</b>

## Countries

China  
Czech Republic  
Hungary  
India  
Japan  
Malaysia  
Poland  
Republic of Ireland  
Slovakia  
South Korea  
Thailand  
Turkey  
United States

## Regional results



### Asia

	£m	Actual rates % growth	Constant rates % growth
<b>Sales (including VAT)</b>	<b>9,072</b>	19.7%	15.3%
<b>Trading profit</b>	<b>440</b>	23.9%	18.9%
<b>Trading margin</b>	<b>5.2%</b>	0.2%	0.2%

### Europe

	£m	Actual rates % growth	Constant rates % growth
<b>Sales (including VAT)</b>	<b>9,997</b>	(0.7)%	(0.9)%
<b>Trading profit</b>	<b>474</b>	(4.0)%	(5.7)%
<b>Trading margin</b>	<b>5.4%</b>	(0.2)%	(0.3)%

### US

	£m	Actual rates % growth	Constant rates % growth
<b>Sales (including VAT)</b>	<b>354</b>	72.7%	58.0%
<b>Trading profit</b>	<b>(165)</b>	(17.9)%	(7.9)%



## International

### Delivering great value for customers



**In International we have delivered a resilient performance in the face of challenging economic headwinds. Our businesses have made good progress – delivering for customers today and at the same time investing in the drivers of future growth. Our strategy is working – and we ended this year stronger than we started it.**

Each of our businesses has adapted itself to the demands of its local market – with strong local management teams finding ways to lower costs and deliver great value for customers. Increasingly our international businesses are also utilising the scale and skill of the Tesco Group – with more international sourcing, Discount Brands now in seven markets, F&F clothing now in ten countries, Clubcard introduced in seven countries with more Clubcard holders internationally than in the UK – and the Tesco Operating Model sharing our global best practice to the benefit of all our businesses.

After a very tough first half of the year we are now seeing encouraging sales trends across almost all our markets; we saw strong improvements in like-for-like sales in the fourth quarter compared to the third.

With clear signs that our international markets are starting to recover we are planning to resume a faster pace of new space opening in the coming year. In 2009/10 we opened 5.1m sq ft of new space and in 2010/11 we will open 8.5m sq ft in addition to nine shopping malls in China. The performance of our International businesses through this severe recession has provided reassurance



### Lifespace – our unique approach in China

The size and scale of China provides unique challenges for a retailer but also offers a huge opportunity for a business prepared to show flexibility and vision.

Our strategy is to expand into less developed second and third tier cities by opening hypermarkets in leading shopping malls. We've found it hard to find locations with the right facilities in some cities – giving us an opportunity to develop our own malls, to ensure they are the right size, location and design to meet the needs of the new Chinese consumer.

During the year we opened our first three Tesco Lifespace shopping malls in Fushun (pictured), Qingdao and Qinhuangdao and we will open nine more this year. Each mall comprises approximately 500,000 sq ft of retail space over five floors and is a one-stop

destination providing shopping (including a 100,000 sq ft Tesco hypermarket), entertainment, dining and leisure.

We are partnering with investors to share the capital commitment on some of these projects, enabling us to roll out more sites faster.



on the quality and resilience of our assets and local management teams and strengthens our confidence in our international strategy and long-term growth prospects.

#### Asia

We have delivered a strong performance in Asia despite challenging economic conditions in the region. We have grown sales and profits well – driven by new space and the excellent performance of the stores acquired in South Korea in 2008, which are now profitable. As economies generally in Asia start to recover we are seeing improving sales trends in all our businesses except Japan, where economic conditions remain subdued, with overall like-for-like sales for Asia turning positive in the fourth quarter. Profits in Asia grew by 24% with margins strengthening significantly in the second half (6.1% compared to 4.3% in the first half).

Our Asian markets offer a significant long-term opportunity. We have continued to invest through the downturn to ensure that we will be in an even stronger position as the economies recover. This year we opened 3.0m sq ft of new space across the region – an increase of more than 10% – and we plan to open 4.9m sq ft next year (excluding shopping malls). We have also continued to make good progress towards developing a strong brand in our most developed Asian markets with further expansion of Clubcard and our Retailing Services businesses.



## International continued

### Investing in the drivers of future growth



#### South Korea

Homeplus in South Korea delivered another very good performance this year with total sales growth of 33% (including 3% on a like-for-like basis) and profits up more than 50%. The integration of the former Homever stores has been completed successfully, ahead of plan, with the stores now trading profitably with double-digit like-for-like sales growth in the fourth quarter. South Korea also opened 63 new stores in the year. The acquisition in 2008 has helped Homeplus grow its market share and close the gap with the market leader. We opened our first franchise store in February 2010 with more scheduled to open in this financial year. South Korea is our largest international business with sales of £4.5bn and profits of almost £300m.



#### Thailand

Tesco Lotus in Thailand has delivered a good performance – despite a background of continued political uncertainty – with double-digit profit growth on a constant exchange rate basis. A strong store opening programme has helped drive our sales growth this year in a market in which we remain the clear market leader. Strong productivity gains have enabled us to make significant investments in lowering prices for customers whilst still delivering good margins and positive cash flow. The launch of Clubcard in August 2009 marked a new stage in the development of our business and take-up from customers has been excellent, with four million customers signed up so far.

#### China

In China, we are laying the foundations for long-term growth, with further investments in new stores, supply chain infrastructure and management. We have focused on three regions – each with its own management team – and with a focus on expansion into second and third tier cities. We opened 17 hypermarkets in the year, including in our first three Lifespace shopping centre developments in Fushun, Qingdao and Qinhuangdao, with average tenant occupancy over 80% at opening. We plan to open 23 hypermarkets in 2010/11 of which nine will be in new Lifespace malls. The mall development programme will be funded in part through joint ventures with third-party investors. The first such joint venture – incorporating three malls – was established in November 2009 with a syndicate of leading Asian investors.

#### Malaysia

Our business in Malaysia made good progress with sales growing 9% this year – increasing our market share. We continue to invest in Clubcard with more than one million customers signed up and with a dunnhumby team working with us locally to provide insight on pricing, range and promotions. We grew our space by 11% this year but with the economy starting to show signs of recovery we plan to step this up to 27% growth in 2010/11.

**There are more Clubcard holders internationally than in the UK**

#### Japan

In our 2008/9 Annual Report, we stated that with the challenging market conditions in Japan, we had only limited headroom on the carrying value of our Japan assets. Given the further deterioration in the retail market, it became appropriate to make impairments against the goodwill arising on the acquisition we made to enter the market in 2003, resulting in a £131m charge to the income statement (£82m in the first half and £49m in the second half).

Our team in Japan continues to make good progress in developing the business. Our new convenience format is receiving good feedback from customers who like the focus on fresh food and new features helping us to differentiate our offer, such as the in-store bakery, an extensive wine range and our first 400 own-label products – which after only a few months already account for 10% of sales.

#### India

Our early plans in India are progressing well. Our local management team is helping our franchise partner, Trent, to develop its Star Bazaar hypermarket operation which is currently achieving like-for-like sales of c.40% and buys more than 70% of its products from Tesco's wholesale business. Plans for our cash and carry business are also on track with our first store expected to open towards the end of this year.



Throughout the year we opened 63 new stores in South Korea, bringing our total number of stores to 305

**Watch the video:** [www.tesco.com/tescoworksforme](http://www.tesco.com/tescoworksforme)

“...I get special offers with my Member card”

**Ji**  
**Tesco customer**  
Shanghai, China

**Tesco works for me...**



## International continued



### Europe

Europe overall delivered a robust performance against strong economic headwinds in the form of a sharp downturn in economic activity causing a slow-down in customer expenditure. Sales growth varied across the region with a good contribution from new space helping sales grow in Poland and Turkey and stay stable in the Czech Republic and Hungary. Significant price deflation and cross-border shopping driven by rapid movements in exchange rates resulted in sales declining in Slovakia and Ireland. Overall, however, the sales trends are now improving; each of our European businesses showed an improvement in like-for-like sales growth in the fourth quarter.



We have made market share gains across our Central European markets by reducing costs and lowering prices for customers and by continuing to invest in new space. Profitability in the region as a whole declined slightly compared with last year but was resilient given the severity of recession.

We are continuing to invest in the region, opening 1.8m sq ft of new space during the year – less than originally expected, primarily as a result of the economic environment. With the outlook improving we will be stepping up the rate of opening with a plan to add 3.1m sq ft of new space across the region in 2010/11.

### Republic of Ireland

In Ireland we have made substantial changes to our business, which was facing the dual challenge of a severe recession and cross-border trading. By integrating more of our international brand buying with our UK business we have been able to reduce the prices of 12,500 products by an average of around 20%.

Customers are responding enthusiastically to our improved pricing and range; significant uplifts in volumes have now offset the impact of lower prices, resulting in positive like-for-like sales growth in the last few weeks of the year and a growing market share. These changes, combined with a substantial cost reduction programme, have enabled Tesco Ireland to deliver a steady financial performance despite the economic headwinds and significant self-imposed price deflation. The cost of the exceptional restructuring activities was £33m in total for the year.

### Hungary

Our business in Hungary continues to perform well – with sales levels being maintained despite a very weak economy in which unemployment levels increased by more than 25% and consumers were hit with a 5% increase in sales tax. We are continuing to execute our strategy of investing in the shopping trip for customers, helping our overall market share to grow again in the last year, further consolidating our market leadership.

**The first Tesco outside the UK opened just 15 years ago – in Hungary**

### Poland

In Poland, we have had another good year with strong growth in sales and profits on a constant exchange rate basis. A good performance from the converted Leader Price stores, the popularity of our Discount Brands – now in one in three baskets – and our clothing range, which achieved like-for-like sales growth of more than 20%, have helped our business maintain positive ex-petrol like-for-like sales growth overall. The launch of Clubcard in August 2009 has been very well received, with 1.8 million customers signing up so far.

### Czech Republic

In the Czech Republic our strong new store opening programme has helped us maintain sales at levels similar to last year and improve our share of a market affected by high unemployment and price deflation. Our Express and 10,000 sq ft format stores continue to do well with positive like-for-like sales growth, but as in most markets, growth in the larger stores remains subdued as customers curtail their spending on non-food in the current environment. The outstanding category in non-food has been clothing with double-digit sales growth. Our flagship My Narodni department store in Prague was reopened after a major refit project and we are pleased with the results to date.



**Our flagship My Narodni department store in Prague reopened in September 2009 after a major refit**



**Slovakia**

In Slovakia, the overall retail market has been very challenging with rising unemployment and sharp falls in industrial output. Cross-border shopping remained significant for much of the first half but abated in the second half after we reduced our prices within Slovakia to bring them more closely into line with neighbouring countries. Like-for-like sales growth is recovering strongly; from negative double digit for the first half to positive growth in the final few weeks of the year.

A good store opening programme combined with investments in the shopping trip and customer loyalty – with Clubcard launching in Slovakia in September 2009 – have helped us extend our market-leading position further during the year. We have recently refitted and rebranded one of our large hypermarkets in Bratislava as an ‘Extra’ adding new departments such as pharmacy, photo processing, opticians and phone shop. This is the first of its type in Central Europe.

**Turkey**

In Turkey, whilst we slowed our rate of new store growth, it remained strong enough to offset the like-for-like sales decline, helping us to grow overall sales during the year. With the economy showing early signs of recovery we are planning to resume a faster rate of expansion this year. Turkey remains an important strategic long-term opportunity for us as a large, growing and relatively underdeveloped retail market.

**United States**

In the United States, Fresh & Easy has been making good progress, despite prolonged weakness in the California, Nevada and Arizona economies. Customers are enthusiastic about our range, particularly the fresh food prepared in the Fresh & Easy kitchen, the store environment and the friendly service. As with any of our new businesses, we are adapting and improving our offer in response to customer feedback. During the year we’ve broadened the range in some key categories – like cereals and pet food – and added larger pack sizes for families. We have also introduced a range of lower-priced house brands to help families on a budget.

With the improvements to our range implemented and with the number of stores growing (145 stores by end of 2009/10), we launched media campaigns – in September 2009 and January 2010 – focusing on how Fresh & Easy can offer both high quality *and* low prices. A combination of increased customer awareness and the improvements we have made in-store helped to drive stronger positive like-for-like sales growth in the second half of the year.

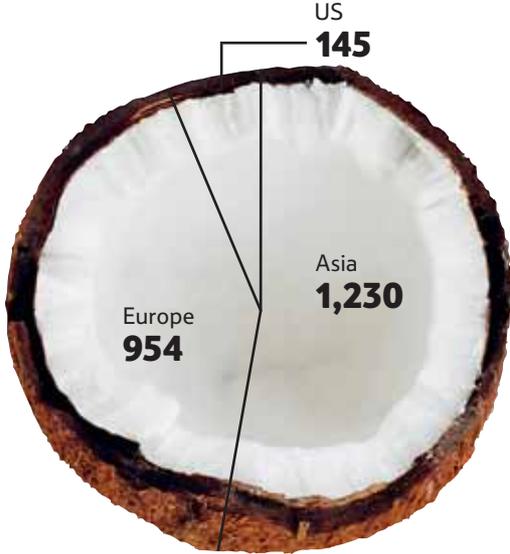
**145 Fresh & Easy stores by end of 2009/10**

With growing sales and improvements in productivity, waste and distribution costs, store economics are improving steadily. Overall trading losses were in line with guidance provided last year and reflect the fact that Fresh & Easy has been built with the infrastructure to support hundreds of stores.

We expect to open new stores at a rate of around one per week this year with a focus on areas where the local economy has been less severely hit and where we are seeing substantially stronger sales performance. One of the benefits of the downturn is a slightly softer property market; we are now able to buy more freehold properties and the overall cost of building a store has fallen by approximately 20%. A combination of new space and organic sales growth means that sales growth this year will be more than 50%.

Although we do not expect losses to be much lower in 2010/11 we believe they have now peaked.

**International stores**



# Core UK at a glance

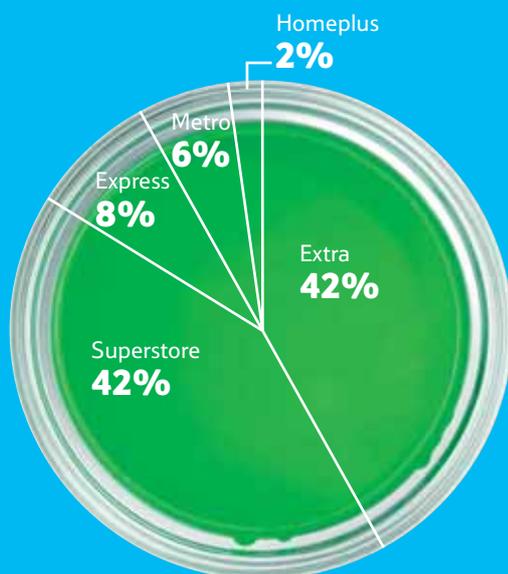
**Our market-leading UK business has continued to grow well by helping customers to spend less during the downturn.**

Sales	<b>£42.3bn</b>
Sales up	<b>4.2%</b>
Trading profit	<b>£2.4bn</b>
Trading profit up	<b>6.7%</b>

UK results <sup>1</sup>	£m	% growth
Sales (including VAT)	42,254	4.2%*
UK trading profit	2,413	6.7%
Trading margin	6.2%	0.1%

\* 5.5% sales growth ex-petrol.  
<sup>1</sup> Tesco.com, Tesco Telecoms and dunnhumby are included in the UK segment and Tesco Bank is excluded from the UK segment under IFRS 8.

### Space by format



# 15m

active Clubcard holders

## Clubcard – 15 years of loyalty

Clubcard is our unique way of saying thank you to our customers for shopping with us. Launched in 1995, Clubcard now has 15 million active members in the UK. Clubcard not only rewards our customers for their loyalty, but it also provides us with valuable insight into changing shopping patterns. By monitoring this data and spotting trends early we're able to respond quickly and ensure that we're always providing customers with what they want, when and where they want it.

This year Clubcard became even more rewarding. By increasing our investment with Double Points, customers earned £550m in total in vouchers. Double Points has encouraged more customers to sign up, a Clubcard is now used with a higher proportion of transactions than before and 18% more UK households are redeeming vouchers than a year ago.

The knowledge and expertise of operating Clubcard – combined with insight and analysis from dunnhumby – is now being adopted across our international businesses. We now have Clubcard in seven of our international markets – in fact we now have more Clubcard holders overseas than in the UK.





## Core UK

# Sustainable profitable growth

**2,600 new or improved own-label food lines launched this year**



**Our UK business delivered a solid performance in competitive market conditions. We are growing faster than the industry as a whole and we have achieved this by remaining focused – as always – on customers.**

Our strategy of earning their loyalty by helping them to spend less – with low prices and affordable new products such as the Discount Brands – deflated sales growth initially but it was the right thing to do for customers. By encouraging and rewarding loyalty – through an increased investment in Clubcard – we have maintained steadier sales growth during the year than the industry as a whole, which has seen a significant slowdown with the steep decline in inflation.

Excluding petrol and adjusting for VAT, like-for-like sales were 3.7% in the first half and 2.7% in the second half, driven by a strong volume performance. Achieving our target of opening 2m sq ft of new space during the year ensured that sales from new space made a good contribution to total sales growth, which was 6.5% for the first half and 5.7% for the second half (excluding petrol and adjusted for VAT).

Delivering for customers through recession is not just about lowering prices and offering great promotions; it's about delivering all elements of the shopping trip. Consequently, we

have continued to invest in availability, service, range and quality with pleasing results:

### Availability

Availability has improved again this year as a result of a number of initiatives to improve stock management including more efficient ordering systems, a greater focus on clearing promotional and discontinued lines, better in-store monitoring processes and storing stock on the top of shelves on the shop floor rather than in the warehouse. The results have not only increased availability based on our dotcom picking measure and reduced evening gaps in fresh food by 18%, but the resulting reduction in stock across our store network has made a significant contribution to our improved working capital position.

### Service

Service remains a key differentiator. Our one-in-front initiative – where if there is more than one customer queuing at a single checkout we open another – and increased investment in self-service checkouts, which now account for a quarter of all transactions, continue to keep us ahead of the industry on customer measures of checkout service. We trained more than 200,000 staff to help them respond better to customer needs and our 'Every Comment Helps' initiative, which encourages customers to give instant feedback via text or email, has

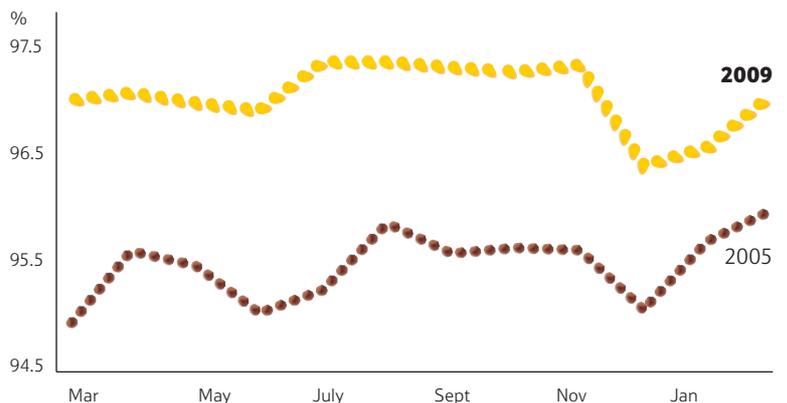
given us the benefit of 60,000 customer comments to help us improve our offer and service.

### Range

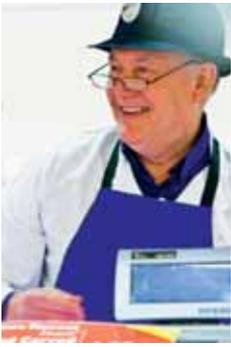
Tesco's diverse and adaptable range allows us to offer a wide choice for every customer whatever their budget. Through the recession we have helped customers with lower-priced ranges such as Discount Brands and Market Value and we have also offered them affordable treats such as the Finest Restaurant Collection ready meals, which have been very popular. We continue to innovate our range with over 2,600 new or improved own-label food lines launched this year. As the economy starts to emerge from recession we are seeing customers buy more from our Finest range, which returned to positive like-for-like sales growth in the year.

**200,000 staff trained in 'Every little helps' skills**

### Availability\*



\* Based on our dotcom picking availability measure.



## Core UK continued

### Delivering an 'Every little helps' shopping trip



#### Quality

Quality – particularly in fresh food – remains important to customers even in tough times and as we emerge from recession this will become even more important. That's why we have been investing in our fresh food offer with a wide-ranging change programme. Improved technical standards, additional specialist staff training, closer relationships with our suppliers and significant changes to the way we merchandise some key products are helping us deliver a stronger range and better shopping experience for customers. These and other initiatives helped Tesco win the 'Fresh Produce Retailer of the Year' Award in 2009.



#### Step Change

Our UK Step Change programme is in its thirteenth year and continues to go from strength to strength. This year we met our £550m savings target. Step Change is not just about generating savings – each project must be 'better' for customers, 'simpler' for staff and 'cheaper' for Tesco. Our stock reduction programme is an excellent example of this:

- it's better for customers because it has driven a large improvement in availability for both food and non-food;
- it's simpler for staff because it is now easier to locate stock to fill the shelves and stock errors can be identified more easily; and
- it's cheaper for Tesco because stores now hold less stock and fewer hours are needed to replenish the shelves. For example, a typical Tesco Extra now holds 8% less stock and we are now looking at releasing backroom space which can be redeployed for Retailing Services or Non-food.

### iPhone apps – making life easier for customers

At Tesco we're constantly striving to make things better, simpler and cheaper. That's why we've launched three innovative and popular iPhone apps.

Customers no longer have to worry about forgetting their Clubcard as our latest app enables them to scan their Clubcard on their iPhone. This app is proving extremely popular with customers with over 200,000 downloads in the first three weeks and there will soon be versions for other smartphones too.

Store Finder app enables customers to find their nearest stores and then locate products (complete with prices) within the store – to the exact aisle.

Our wine app allows customers to take a photo of a wine they like and uses image recognition software to identify

Customers earned £550m in Clubcard vouchers

the wine, providing full product information and allowing customers to order from their phone.

Coming soon is another tesco.com app which will enable customers to do their tesco.com grocery ordering from their phone.



This year we aim to complete a global programme that will deliver savings of £800m and we'll invest most of these savings back into our offer for customers.

#### New space

Through the experience and expertise of our property teams we have developed over a number of years a good pipeline of new space opportunities. As a result we have the opportunity to unwind some of the work-in-progress we have built up and will be stepping up the rate of expansion in 2010/11. We will be investing £1.6bn of capital in the UK economy this year and will create thousands of jobs for people, including the long-term unemployed through our Regeneration Partnerships.

#### Sustainable strategy

Our customer strategy is sustainable for the long term because we can differentiate Tesco in a unique way with Clubcard and because our low prices and improvements to the customer shopping trip are based on permanent productivity gains.

Our growth strategy for the UK is also sustainable as it is based on taking a balanced approach to the key building blocks of top-line growth; solid like-for-like performance and a consistent contribution from new stores.

£550m in Step Change savings

Watch the video: [www.tesco.com/tescoworksforme](http://www.tesco.com/tescoworksforme)

# “...Tesco Express – it’s the easiest thing at lunchtime”

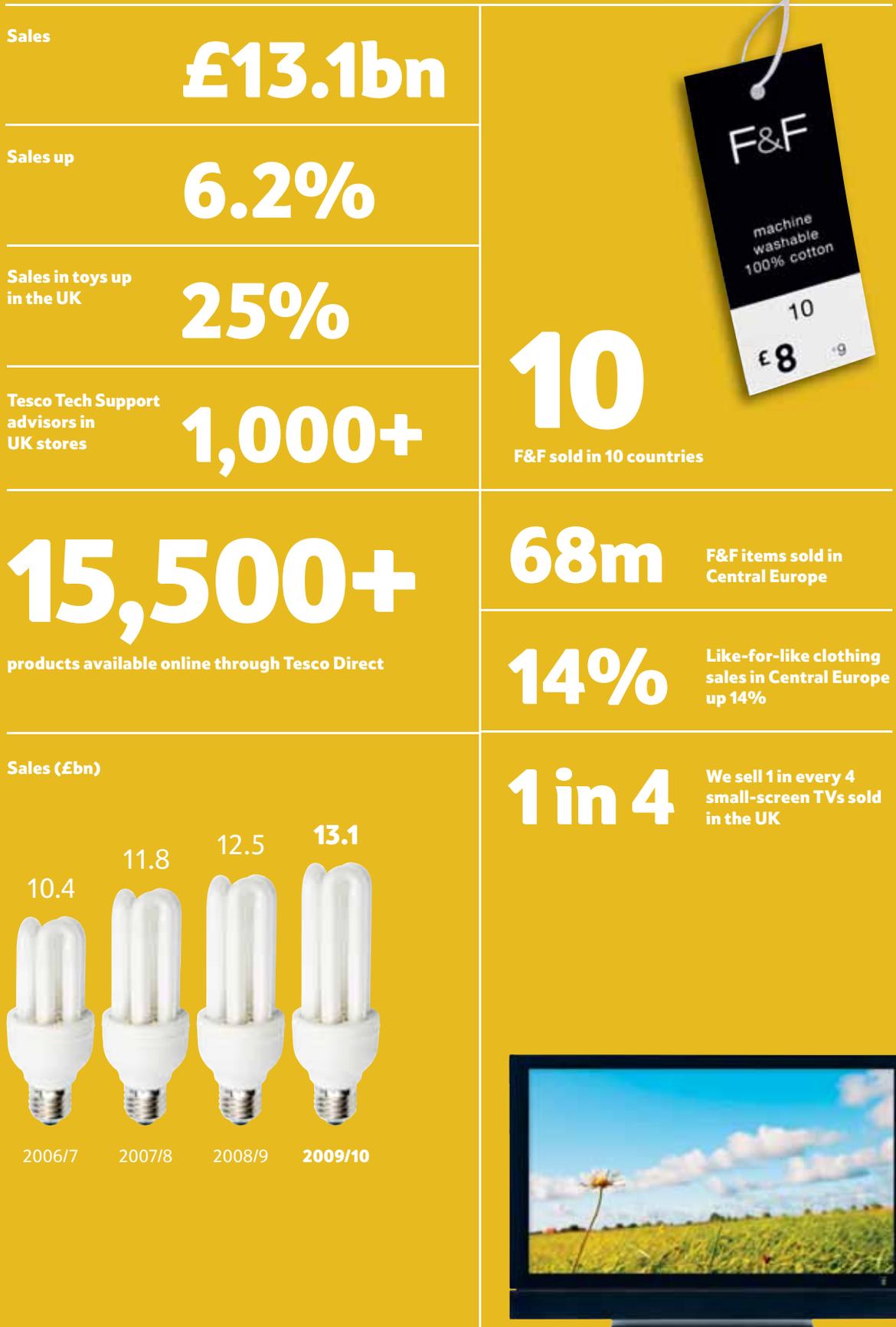


**Kevin and Allan**  
Tesco customers  
East Ham and Islington

**Tesco  
works  
for us...**

# Non-food at a glance

Our general merchandise offer is growing in sophistication with improved ranges and prices, more global sourcing and a stronger online presence.





## Non-food

### Significant market share gains in key categories

**Our non-food performance has been very resilient through the downturn. In some key categories we have made significant market share gains as more customers have been encouraged to try our non-food range in the search for great value and as some competitors have felt the strain.**

Group non-food sales rose 6.2% to £13.1bn, with £9.0bn in the UK and £4.1bn in International.

We delivered a very strong non-food performance in the UK with steadily improving like-for-like sales during the year. A number of categories had particularly strong growth:

#### Electricals

With competitive prices, a great range – in-store and online – and over 1,000 Tesco Tech Support advisors in our UK stores to help customers make their choice, we are rapidly growing our presence in the electricals market. We now sell one in every six microwaves in the UK and one in four small-screen TVs. Our sales in electricals have doubled in the last four years and around 20% are online.

#### Entertainment

Our market share in games has doubled in the last year as a result of allocating it more space in-store, revamping the range and layout and being more competitive on new releases.



**We sell 1 in 6 microwaves sold in the UK**

### Teesport – helping us get better, simpler and cheaper

As our UK non-food business continues to grow we've worked hard to create innovative solutions to increase storage and distribution capacity and efficiency whilst reducing our impact on the environment.

Our first ever purpose-built import storage facility, which opened in Middlesbrough in August, fulfils both these objectives whilst also creating 800 jobs in the local community.

The 910,000 sq ft Teesport distribution centre offers a traditional low bay assembly operation and high density storage within a fully automated high bay warehouse providing a capability of holding 160,000 pallets and assembling up to 4.5 million cases per week. The scale of Teesport, along with its port location and on-site rail infrastructure, has helped reduce costs in our

distribution network, which in turn helps us keep prices low for customers.

Teesport has also delivered major environmental benefits by removing over 12,000 lorry journeys per year from the UK's roads. This has made a significant step towards our target to halve distribution emissions of each case delivered by 2012, against a baseline of 2006.



As part of our drive to lower prices for customers, we make every effort to cut out the middlemen and source products from manufacturers or developers. For example, we teamed up with DreamWorks studio for the exclusive rights to sell the short animated Christmas film Merry Madagascar. This groundbreaking relationship was the first of its kind in the industry and enabled Tesco to sell over one million Merry Madagascar DVDs.

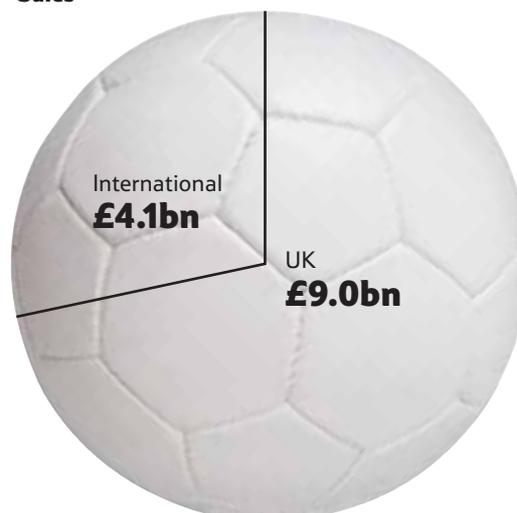
#### Toys

Our sales in toys have grown 25% this year with online sales up more than 60%.

#### Clothing

Sales grew by 7.3%, including positive like-for-like growth, to reach £1bn in sales for the first time, helped by a 15% increase in children's wear and the launch of our online clothing range.

#### Sales



Tesco  
works  
for me...

“...everything is in one  
location – I just bought  
a washing line”



## Non-food continued

### Resilient through the downturn



#### International clothing

Clothing is becoming a global strength and a good example of how we are bringing global scale and skill to our international businesses.

In our four Central European markets, clothing like-for-like sales grew 14% this year – following strong growth the previous year – in a market which has been declining overall in the recession. We've also introduced F&F ranges to four Asian markets this year – another step in developing F&F into a global brand.



Joint buying – whereby 95% of the supplier base in Central Europe is the same as Ireland and the UK – has brought the benefits of Group expertise and scale, helping to improve quality and costs.

#### Online

Shopping habits are changing – customers want to buy online as well as from stores and catalogues – and many will use a combination of these to research before buying. With an integrated multichannel approach we're making it easy for customers, whichever way they want to shop. In addition to the 15,500 products available online through Tesco Direct, we now have two new specialist websites launched in October:

1,000+ Tesco Tech Support advisors in UK stores

### F&F – a global brand

Our ambition is to make F&F a leading global fashion brand, offering unbeatable value for money, not compromised by quality, design or provenance.

F&F launched in the UK in 2001 and has expanded rapidly since then with sales last year of £540m in the UK – supported by the launch of our online clothing site in October.

F&F launched in Central Europe in 2008 and we're already making excellent progress. F&F is rapidly becoming established in the region with customer awareness of the brand growing from 34% to 61% in the last year.

Across our markets in Central Europe, Tesco is already one of the largest clothing retailers. In fact during the year we sold more F&F items – 68 million – than the combined populations of our

four countries in the region: Poland; Hungary; Czech Republic; and Slovakia.

We're now building on the success in the UK and Central Europe to launch F&F across our Asian markets. This year we launched in China, Malaysia, South Korea and Thailand.

As with any brand, F&F can't afford to stand still, which is why we're broadening the brand's appeal with new ranges – F&F Couture and F&F Jewellery.



- **www.tesco.com/clothing**  
Our new clothing site combines familiar Tesco labels such as Cherokee and F&F with some new Tesco lines exclusively offered online, plus a number of other brands. The site became one of the top ten most visited clothing websites within weeks of its launch. So far the customer feedback has been very strong, particularly on value for money and ease of shop.
- **www.tesco.com/entertainment**  
The launch of Tesco Entertainment brought together, for the first time, our entire physical and digital entertainment offer, in a new and easy-to-use one-stop site. Customers are now able to buy a CD, DVD or game and a film or album download, all in one transaction. From the outset the new website has proved popular with customers.

Watch the video: [www.tesco.com/tescoworksforme](http://www.tesco.com/tescoworksforme)



# Retailing Services at a glance

We've made good progress this year in our Retailing Services businesses: Tesco Bank; tesco.com; Telecoms; and dunnhumby.

Sales

**£3.6bn**

Trading profit up

**17.6%**

Tesco Bank

**13.1%** Trading profit up

**400,000** new customer accounts over the past year

tesco.com

**1bn** grocery items delivered last year

**26%** profits up

Telecoms

**2m+** Tesco Mobile customers

**100+** Phone Shops

dunnhumby

**26** dunnhumby serves other retailers and manufacturers in 26 international markets

## tesco.com – a leading online retailer

Including both our grocery and non-food offer, tesco.com is one of the largest online retailers in the UK, with sales of more than £2bn. Just as in our stores, our success comes from listening to customers and a constant drive to ensure that we provide an online 'Every little helps' shopping experience.

With more than a million active customers, our online grocery business is the market leader and the most profitable business of its kind in the world. It continues to grow strongly – last year we delivered over one billion items. We have put ease of use at the heart of our online shopping trip – for example, our 'favourites' feature, which makes shopping online easier by using Clubcard to remember a customer's favourite in-store and online purchases. We also continue to innovate with our 'price match' on any substituted products and our 'shorter than we'd like' code life guarantee.

Tesco Direct extends the reach of our non-food offer with over 15,500 products available to customers via the internet and catalogues. Customers can choose to have goods delivered to their home or they can pick them up at one of our 261 in-store Direct desks. This year we relaunched our online entertainment site, enabling customers to buy downloads alongside the physical product, and we launched our online clothing website with a range of 2,500 fashionable items, of which 1,000 were exclusively online.





## Retailing Services

### Laying the foundations for further growth



**Following the announcement in July 2008 of our intention to take full ownership of Tesco Bank, we set a target to grow the profitability of our Retailing Services businesses from a little under £400m in 2007/8 to £1bn. This year we made good progress in attracting new customers and growing sales and profits while at the same time laying the foundations for further growth.**



Total Retailing Services sales were £3.6bn, up 4.2% on last year and profits were £540m, up 17.6%.

#### Tesco Bank

Overall, Tesco Bank has delivered a good performance in a challenging retail banking market growing profits by 13% to £250m. Bad debt levels rose during the year but have now stabilised and throughout have remained below industry averages. We have absorbed additional costs as we begin the process of moving the business onto its own infrastructure and build the team as we prepare the business for faster growth.

**Double-digit customer growth in our banking products**

**6.2 million Tesco Bank customers**

#### Commercial performance

We grew the number of customer accounts by more than 400,000 in the last year – to a total of more than 6.2 million across all products. We have achieved double-digit customer growth in our banking products, including 27% growth in personal loans. In insurance we held our number of policies broadly flat in a very competitive market; the number of motor insurance policies declined – partly as a result of a planned reduction in our exposure to high-risk drivers – but the number of policies in home, pet and life insurance increased. Our 130 in-store travel bureaux saw an increase in transactions of more than 80% and the number of ATMs in our network grew to over 2,800.

#### Profit

Gross profit grew 19% to £749m with a good performance in banking being partly offset by lower profitability in insurance, primarily as a result of lower investment income linked to the current low interest rate environment. Trading profit was up 13.1% to £250m (compared to £221m in 2008/9 on a pro forma basis). Profit before tax was £114m – with the primary deduction from operating profit being the previously announced £127m non-cash amortisation of intangibles arising on acquisition. This profit performance was achieved after an increase in operating costs – as a result of the change of ownership as the business prepares for expansion – and against the background of a 32% increase in bad debts – to £177m which was in part offset by a credit relating to the unwind of the fair value adjustment created on acquisition.

#### Capital and liquidity

The Tier 1 capital ratio at the end of 2009/10 was 13.0%. The funding and liquidity position of the business remained robust throughout the period with customer deposits in

excess of customer lending. This is further supported by a high-quality liquid asset portfolio, net short-term wholesale cash and investment grade assets worth £1.3bn.

#### Management team

During the year good progress has been made in completing the recruitment of an experienced management team in all areas of the Bank: finance; risk; legal; commercial; treasury; and IT. All senior roles have now been filled.

#### Infrastructure

In September 2009 we entered into an agreement with Fortis (UK) Ltd to help us build the operational platform and technical expertise required to further develop our insurance business. We have also selected the core technology platforms for the banking products. The migration programmes for both sides of the business are progressing well and we expect to be writing business on the new systems by the end of 2010/11. We have secured new premises for banking and insurance operations in Glasgow and Newcastle, which will open in mid 2010, creating 1,800 jobs.

#### New product development

Subject to regulatory approval we anticipate launching new savings products and mortgages by the end of financial year 2010/11, with current accounts to follow in the second half of 2011.



## Retailing Services continued

### Growing sales and profits



#### tesco.com

Our online businesses – including dotcom grocery and Direct – delivered another strong performance, achieving a 14% increase in sales with profits rising 26% to £136m.

In a little over a decade we have built a substantial profitable business that has sales of £2.1bn and employs 20,000 people. Our website is the third most visited retail website in the UK and last year our online grocery business delivered over a billion items.



The number of active customers in our online grocery business has grown to over one million and basket size has increased. Record levels of availability and innovations such as price matching on substitutions are improving the customer experience and helping to reduce the number of lapsed customers and calls to the service centre. We are reducing costs and carbon emissions by improving fuel consumption per order by 10% for the second year running through implementing new technology to improve driving and routing efficiency.

Tesco Direct extends the reach of our non-food offer to customers via the internet, by phone and catalogues. Customers can choose to have goods delivered to their home or they can pick them up at one of our 261 in-store Direct desks. Tesco Direct had another good year making good progress on its customer service offer, growing sales by 28% and continuing on its path towards profitability.

#### Tesco Telecoms

Profit from our telecoms business grew, driven primarily by Tesco Mobile, which achieved a 14% increase in customer numbers – to more than two million – in a declining pre-pay phone market. Tesco Mobile also successfully entered the ‘pay monthly’ market this year with innovative tariffs and generous credit rewards, picking up the ‘best tariff’ accolade at the 2009 Mobile Choice Awards. Tesco Mobile remained the number one pay-as-you-go operator for customer satisfaction throughout 2009. In December 2009, Tesco Mobile broadened its appeal further by becoming only the third UK operator to offer the iPhone, for which sales have been encouraging.

We have made good progress in rolling out our in-store Phone Shops with 105 open at year end and a further 100 planned by the end of this year. The Phone Shops are transforming our ability to sell products that require an assisted sale – particularly contract mobile phones.

Also in 2009 we signed a wholesale broadband agreement with Cable & Wireless, which will enable us to relaunch our broadband offer to customers in 2010 with higher bandwidth speeds and lower prices.

### Tesco Mobile No.1 for customer satisfaction

Source: Customer Service Index

#### dunnhumby

This year marks dunnhumby’s 20th anniversary. In addition to supporting Tesco’s Clubcard in seven countries around the world, dunnhumby serves other retailers and manufacturers in 26 international markets; in fact Tesco now represents only around 15% of its sales.

dunnhumby is growing fast – with profits up 28% in the year – helped by new engagements in the United States (Macy’s), Canada (Metro) and Colombia (Exito). dunnhumby now touches the lives of over 350 million consumers through its client relationships.

**TESCO**  
**Telecoms**

**tesco.com**

**TESCO** Bank

**dunnhumby**  
essential customer genius

 **Watch the video:**  
[www.tesco.com/tescoworksforme](http://www.tesco.com/tescoworksforme)

**“...I have my cat insured with Tesco – they were very reasonable”**



**Tesco works for me...**

**Sue with Lexi**  
Tesco customer  
Muswell Hill

# Community at a glance

**We're continuing to lead the way in caring for the environment, supporting local communities and encouraging healthy lifestyles.**

# 100%

of store waste in the UK diverted from going directly to landfill

# Zero

We are committed to become a zero-carbon business by 2050

## Community promises

Caring for the environment

Actively supporting local communities

Buying and selling products responsibly

Giving customers healthy choices

Creating good jobs and careers

We helped 6.2 million people get active worldwide

# 6.2m

Community Champions

# 270

100% of eligible own-brand products now have nutritional labelling

# 100%

Jobs created in UK Regeneration Partnerships

# 380

Suppliers responding to our survey saying we treat them with respect

# 91%

Carbon-footprinted products in the UK and South Korea

# 500

Carbon emissions reduction from our baseline 2007 portfolio of stores and distribution centres

# 7.8%

## Ramsey – the world's first zero-carbon store

Tesco has been continuously developing stores with lower carbon footprints since 2005 and our new store at Ramsey in Cambridgeshire is the latest step on this journey. The store emits zero net CO<sub>2</sub> in its operations.

The building is designed to use as little energy as possible. The frame is made from sustainably sourced wood, which requires much less energy to produce than steel. We use roof windows and sun pipes to bring natural daylight flooding into the customer and staff areas.

Any energy that the store does need is generated by a combined heat and power plant on site, which is powered from renewable sources. We sell any excess electricity to the National Grid.



## Community

### Increasingly important for our growth



**We are committed to being a responsible neighbour within our local communities and taking a leadership role on the environment. This is something our customers expect and we believe is increasingly important for our growth.**

#### Caring for the environment

Over the past few years we have played a leadership role amongst large businesses in tackling climate change, through our own actions and in collaboration with our customers, suppliers, NGOs and governments around the world. We have made great progress this year in reducing CO<sub>2</sub> emissions across our business globally. Emissions from our baseline 2007 store and distribution centre portfolio have fallen by 7.8% over the past year and new stores and distribution centres built since 2006/7 are on average emitting 28.8% less CO<sub>2</sub> than their equivalents in 2006/7.

We have delivered on our promise to divert 100% of store waste in the UK from going directly to landfill.

In 2007 Tesco invested £25m to create a new Sustainable Consumption Institute (SCI) at the University of Manchester. The SCI aims to answer some of the fundamental questions about how to make a consumer society sustainable.

In October, the SCI held a conference to launch its first major report 'Consumers: The Key to a Low-Carbon World'. At that conference,

we committed ourselves to a new set of challenging long-term targets: to become a zero-carbon business by 2050; to reduce the carbon impact of products in our supply chain by 30% by 2020; and to help our customers halve their own footprints by 2020.

#### Actively supporting local communities

Our Values at Tesco mean that we listen to our customers and respond to what we hear. Customers tell us that being part of a local community is important to them and they look to us to play an active role. Being at the heart of successful, thriving neighbourhoods is not just in the interest of our customers. It is in our interest too. We aim to use our size as a force for good in society.

Throughout the year, we gave over £60m in donations to charities and contributions to community projects including cause-related marketing, gifts-in-kind, staff time and management costs. Once again we have donated the equivalent of more than 1% of our profits to good causes. Additionally, including our Charity of the Year partnerships, which go from strength to strength, this year our staff raised over £7m for charity across the Group.

We have continued to roll out Community Champions right across the Group. Community Champions are staff members who dedicate paid hours to coordinate store activities in their local communities. The Champions support local charities, organisations, schools and causes that local people really care about. We now have Champions in seven countries.

**We succeeded in getting 6.2 million people active across the world**

As part of the Tesco for Schools and Clubs scheme in the UK, this year we gave away £13.7m of equipment to 35,000 schools and clubs, a rise of about 50% in both the value of the equipment and the numbers participating.

In the US, we ran our 'Shop for Schools' project for a second year. In this scheme, we give participating schools US\$1 for every US\$20 spent at Fresh & Easy stores. The first year of the project helped raise over US\$130,000 for schools in California, Arizona and Nevada, with the school that raised the most money in each state receiving a US\$5,000 bonus.

In Turkey, our Computers for Schools programme distributed 264 products including computers, printers and projectors to 60 schools. In Poland, more than 600 schools took part in our Tesco for Schools programme, an environmental contest for schools where children create a piece of art with an environmental theme.

**Throughout the year we gave over £60m in donations to charities**



“..Tesco is environmentally friendly”

Tesco works for me...

**Julia with Krystian**  
Tesco customer  
Krakow, Poland



## Community continued

### We aim to act responsibly in everything we do



#### Buying and selling products responsibly

We are committed to buying and selling our products responsibly and treating our suppliers fairly. This is not just the right thing to do, it is also in our business interest. We know that if you treat people decently they perform better. This approach also helps to improve the sustainability of our supply chain. By investing for the long term in businesses that understand our needs, our customers benefit through better products and our suppliers' employees benefit through more stable and secure jobs.



In 2009, over 3,300 suppliers covering all our markets responded to our Group-wide anonymous supplier survey – Supplier Viewpoint. At least 90% agreed that we pay on time, we are professional, we treat them with respect and we are committed to meeting customer requirements.



We have launched our Trading Fairly programme and recruited our first ethical action managers in South Africa and Bangladesh, who work with our local suppliers to improve conditions across the supply chain. We have also introduced 'Trading Fairly' Awards for our produce and clothing suppliers, which reward suppliers making particularly strong efforts to improve conditions for their employees.

### We now have ethical action managers in South Africa and Bangladesh

At Tesco product safety is of paramount importance. We have a team of over 900 technical specialists working to raise standards in our supplier base around the world. They help ensure that all our products – from tagliatelle to TVs – are safe, legal, ethical and of the highest quality for our customers.

We know that many of our customers want to buy products that support their local businesses and economy, particularly in the current economic climate. They are also concerned about the environmental impact of the products they buy. In the UK, we have dedicated local buying, marketing and technical teams in each of our regional buying offices. We stock more than 4,000 local lines and work with over 400 local and national suppliers. We're also doing more local buying in our international businesses. For example, in Poland, we sell more than 6,000 regional products.

#### Giving customers healthy choices

We are committed to helping our customers and staff adopt healthy lifestyles. We aim to provide better information on the nutritional value of products so customers can make informed choices to improve their health. Across the Group we have exceeded our target of nutritional labelling on own-brand products – we now label 100% of eligible products – giving customers the tools they need to make healthy choices.

As part of our strategy to encourage customers to lead more active lives, we run a range of programmes around the world from aerobic competitions in Thailand to charity 'Runs for life' in Slovakia and the Czech Republic. This year we succeeded in getting 6.2 million people active across the world.

In Poland we sell more than 6,000 regional products

#### Creating good jobs and careers

We are dedicated to creating good jobs wherever we are.

During the year we opened a further three Regeneration Partnership stores in the UK, in Oldham, Birmingham and Litherland, near Liverpool, creating 380 jobs for the long-term unemployed. Since 2009, we have opened 26 Regeneration Partnership stores and created more than 3,200 jobs for people who have previously been long-term unemployed. Half the jobs for each partnership are reserved for local people who have been unemployed for at least six months, including those with low levels of numeracy and literacy skills and people with disabilities.

We were also one of the first companies to work with the UK Government in Local Employment Partnerships, designed to provide jobs for the long-term unemployed.

We will create 16,000 new jobs this year, including 9,000 in the UK.

# Our people at a glance

As we grow our business we're developing our people to become leaders for the future.

People	<b>472,000</b>	<b>4m</b> Improved attendance levels put an additional four million hours into UK stores and depots
	<b>£98m</b>	in shares awarded under Shares In Success scheme
	<b>195,000</b>	of our people have a personal stake in Tesco
	<b>50%</b>	of people on the boards of our international businesses are local to that country

New graduates recruited this year

# 810



## China Graduate Programme – recruiting tomorrow's leaders today

We believe that businesses perform best when they are run by local people for local customers. However, we also understand the importance of sharing knowledge and experience around the Group. Our China Graduate Programme helps balance both these requirements whilst ensuring that we recruit top talent for the future to grow with the business.

Each year we recruit a small number of high-potential graduates who are fluent in both English and Mandarin. The graduates spend seven months being trained, supported and developed in the UK before taking up a specific role in China. As with all our graduates, we are committed to equipping these individuals with both the technical and leadership skills they will need to progress through the business.

This unique scheme has been running for four years now and is gaining a strong reputation amongst university leavers. Last year we attracted almost 1,000 applicants for just 12 places. Previous years' graduates have gone on to managerial roles across a variety of functions in China.





## Our people

### Our people are crucial to our success



**Our Values are ‘No-one tries harder for customers’ and ‘We treat people how we like to be treated’. These values are interlinked and underpin everything we do at Tesco. We know that by managing our people well – in a culture of trust and respect – they will in turn try their hardest for customers.**

By offering competitive pay and benefits and an opportunity to develop a long-term varied career with good training, we are able to keep our people motivated, committed and excited about working at Tesco. In the UK, for example, in our internal ‘Viewpoint’ staff survey this year, we improved on 24 out of the 25 measures and attendance levels improved again, putting an additional four million hours into our stores and depots.



#### Rewards and benefits

Our people are crucial to our success and it is essential that they feel rewarded for the work they do and supported in their development. We offer good pay across all our businesses, as well as benefits in each market that reflect employees’ priorities.



Despite the tough global market in 2009 we continued to invest in pay at the annual review. We focused on our core rates and in a tough financial year our pay competitiveness improved in most markets.

In many developing markets, employees place most value on good basic pay and being paid fairly for overtime and these are our priorities. In Malaysia, for example, where there is no legal minimum wage, the minimum a Tesco employee will receive is 30% more than the Poverty Line Index. In Thailand this year we introduced a staff discount linked to Clubcard.

In the UK, our reward package leads the market on pay and benefits. We are one of the few FTSE businesses to still have an open defined benefit pension scheme, which is greatly valued by staff. We regularly offer staff the opportunity to experience our brand. For example, we offer staff great deals on our Retailing Services – Tesco Mobile offers exclusive staff tariffs and Tesco Bank offers deals on Home Insurance, Life Insurance and Travel Money – which not only reward our staff but encourage them to become advocates for our services.

Through share ownership and share incentive schemes, 195,000 of our people have a personal stake in Tesco. Employees were awarded shares worth a record £98m last May through our Shares In Success scheme. Over 55,000 staff were able to benefit when Save As You Earn schemes matured in February, giving them access to shares worth £144m.

#### Training and development

We are committed to providing opportunities for our people to get on and turn their jobs into careers.

**‘No-one tries harder for customers’**

Last year we had more people on development programmes than ever before.

We have continued to develop our apprenticeship training in the UK. Since 2004, 83% of the employees who embarked on the scheme have been awarded an Apprenticeship in Retail Skills – equating to five GCSEs at grades A\* to C. This training is completed entirely in the workplace.

The first 17 students to complete the Tesco Foundation Degree graduated in July. The Foundation Degree in Retail – delivered and awarded by Manchester Metropolitan University – is a two-year development programme aimed at providing work-focused retail training to managers at Tesco. We now have 60 people on the scheme and are working on ways to make it grow.

We believe that even in difficult times it is essential to invest in future talent. That’s why this year, while many other businesses were cutting their graduate schemes, we increased our graduate intake to 810, including 535 in Asia.

#### Tesco Academy

As a leading global company, Tesco aims to offer the very best training and development for all its employees. The Tesco Academy helps provide an opportunity to get on for all our people. It develops thousands of world-class leaders through excellent training in leadership, management and technical skills.



## Our people continued

### Everyone is welcome at Tesco



Over the coming year we will be investing nearly £30m in a purpose-built, carbon neutral training facility in South Korea, set to become our Tesco Academy hub for Asia. The new Academy will help ensure that the development of our people in Asia keeps pace with the rapidly growing business.

In the UK, our European Academy provides a hub to bring our managers and directors from around the world to the UK. We annually bring our 100 most senior leaders together to share the long-term strategy, develop their leadership skills and build their network. The aim is to develop confident leaders and create a community of experts.

#### Developing leaders

As our business grows and diversifies we need more leaders to run the many substantial businesses and functions within the Group, several of which would rank as major companies in their own right.

We now have 480 people at Director level in the business. Of these, 50% work in our International business – a combination of local hires and people moving from the UK business.

We also understand the importance of increasing mobility. As a global business we're developing leaders with a global perspective and now have 34% of our Directors with at least one year of experience outside their home country.

This year we enrolled our second group of senior Directors on to our Advanced Leadership Programme – an 18-month course aiming to accelerate capability and prepare individuals to become future business leaders. The first intake graduated earlier this year. By July all will have been promoted, with two thirds working outside the UK.

Our Work Level 3 to 4 Options programme is our main vehicle for the internal development of our future directors. Programmes have been running very successfully in the UK for around three years, and we have rolled the programme out to Asia, Europe and the US in the last year.

#### Whistle-blowing

Our whistle-blowing policy and helpline is now in place in all countries. 'Protector Line' is a 24-hour confidential telephone line and email address for employees to raise ethical issues and also report grievances. All calls are logged and investigated by the appropriate function and all serious matters are brought to the attention of the CEO. The feedback is monitored by the compliance committee in each business. The Group Audit Committee annually reviews the number of calls and the quality of investigation and reviews plans to ensure our staff are aware of the facility.

**'We treat people how we like to be treated'**

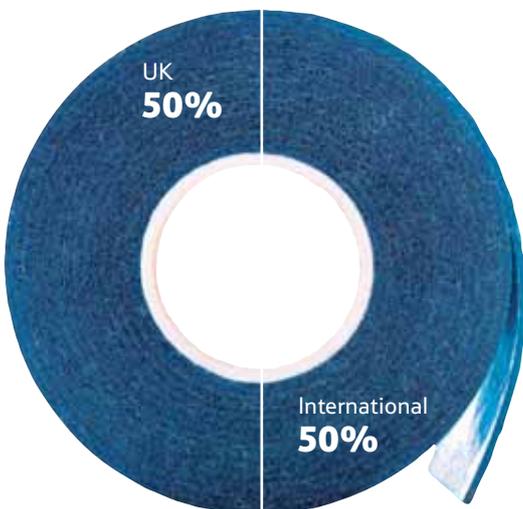
In 2009 we received around 1,700 employment-related calls to the helpline across the Group. This is an increase from last year, showing that employees are gaining confidence in the service. Most calls relate to personnel issues, commercial issues, security and trading law. Personnel issues are referred back to the store or resolved through grievance procedures.

#### Diversity and inclusivity

We strive to provide an inclusive environment where all difference is valued, people are able to be themselves, enjoy coming to work and realise their full potential, regardless of their gender, marital status, race, age, sexual orientation, creed, ethnic origin, religion or belief, or disability.

Three women in Tesco are currently being coached as part of the FTSE 100 Cross-Company Mentoring Programme. The Programme, launched in 2003, involves FTSE 100 Chairmen and CEOs acting as mentors to senior women just below board level in other FTSE companies. The mentors guide and advise women in the management of their careers so that they are better positioned to be considered for board appointments. Our Chairman, David Reid, is currently working with his second mentee from outside Tesco.

#### Location of our 480 Directors



**Watch the video:** [www.tesco.com/tescoworksforme](http://www.tesco.com/tescoworksforme)



**Tesco  
works  
for me...**

**Marcia**  
Tesco employee  
Cheshunt

**“...you are given  
the opportunity to  
go as far as you want”**

# Our Board of Directors

## Key

- = Member of the Nominations Committee
- ◆ = Member of the Audit Committee
- = Member of the Remuneration Committee

### David Reid – 63<sup>•</sup>

Non-executive Chairman  
David Reid became Non-executive Chairman on 2 April 2004. Prior to his appointment he was Deputy Chairman of Tesco PLC and has served on the Tesco Board since 1985. David is a Non-executive Director of Reed Elsevier Group PLC and Chairman of both Kwik-Fit Group and Whizz-Kidz.

### Rodney Chase CBE – 66<sup>◆■</sup>

Deputy Chairman and Senior Non-executive Director  
Rodney Chase was appointed a Non-executive Director on 1 July 2002. He is Non-executive Chairman of Petrofac Limited and a Non-executive Director of Computer Sciences Corporation in Los Angeles, Nalco Company in Chicago and Tesoro Corporation in San Antonio.

### Sir Terry Leahy – 53<sup>•</sup>

Chief Executive  
Terry Leahy became Chief Executive in 1997. Joining Tesco in 1979, he held a number of marketing and commercial positions prior to being appointed to the Board of Tesco PLC on 5 October 1992.

### Richard Brasher – 48

Commercial and Marketing Director  
Richard Brasher was appointed to the Board on 15 March 2004. He joined Tesco in 1986. He has held a number of marketing, commercial and store operations positions, most recently Non-food Commercial Director.

### Philip Clarke – 49

International and IT Director  
Philip Clarke was appointed to the Board on 16 November 1998. Prior to his appointment he held a number of roles in store operations, commercial and marketing. He is a Non-executive Director of Whitbread PLC.

### Andrew Higginson – 52

Chief Executive of Retailing Services and Group Strategy Director  
Andrew Higginson was appointed to the Board on 17 November 1997. He is now Chief Executive of Retailing Services, retaining his responsibilities for Tesco Group strategy. He is Chairman of Tesco Bank and a Non-executive Director of BSKyB plc.

### Tim Mason – 52

President and Chief Executive Officer, Fresh & Easy  
Tim Mason has been President and Chief Executive Officer, Fresh & Easy Neighborhood Market since January 2006. He was appointed to the Board on 16 February 1995. He joined Tesco in 1982.

### Laurie McIlwee – 47

Group Finance Director  
Laurie McIlwee was appointed to the Board on 27 January 2009. He joined Tesco in 2000 as UK Finance Director and became Distribution Director in 2005. Laurie is a Chartered Management Accountant.

### Lucy Neville-Rolfe, CMG – 57

Corporate & Legal Affairs Director  
Lucy Neville-Rolfe was appointed to the Board on 14 December 2006. She joined Tesco in 1997 from the Cabinet Office. She is Deputy Chair of the British Retail Consortium, a Non-executive Director of The Carbon Trust, and a member of the China Britain Business Council, the UK India Business Council and the Corporate Leaders Group on Climate Change.



Ken Hanna

Tim Mason

Rodney Chase

Lucy Neville-Rolfe

David Potts

Ken Hydon

Patrick Cescau

Terry Leahy

Jacqueline Tammenons Bakker

**David Potts – 52**

Retail and Logistics Director  
David Potts was appointed to the Board on 16 November 1998. He joined Tesco in 1973. From 1997 he directed the integration of our businesses in Northern Ireland and the Republic of Ireland before returning to the UK in 2000 as Director responsible for UK Retail Operations. From 2004 David's responsibilities have included the UK Supply Chain and the Republic of Ireland.

**Charles Allen CBE – 53**

Non-executive Director  
Charles Allen was appointed a Non-executive Director on 19 February 1999. He was Chief Executive of ITV plc from 2004 to 2007. He is Chairman of Global Radio, Chairman of EMI Music, a Non-executive Director of the Olympic Games and Paralympic Games Ltd and a Senior Advisor to Goldman Sachs.

**Patrick Cescau – 61**

Non-executive Director  
Patrick Cescau was appointed a Non-executive Director on 1 February 2009. He was Group Chief Executive of Unilever from 2005 to 1 January 2009, and prior to this he was Chairman of Unilever plc and Vice Chairman of Unilever NV. He has also been a Non-executive Director of Pearson plc since 2002. Patrick was appointed a Chevalier de la Légion d'honneur in 2005. In June 2009, Patrick joined the Board of INSEAD.

**Karen Cook – 56**

Non-executive Director  
Karen Cook was appointed a Non-executive Director on 1 October 2004. She is a Managing Director of Goldman Sachs International and President of Goldman Sachs, Europe. She is also a member of the firm's European Management Committee and Partnership Committee.

**Dr Harald Einsmann – 76**

Non-executive Director  
Dr Harald Einsmann was appointed a Non-executive Director on 1 April 1999. He is on the Board of Carlson Group of Companies, Harman International Industries Inc. and Checkpoint Systems Inc. in the United States. He is also on the Board of Rezidor AB in Sweden.

**Ken Hanna – 56**

Non-executive Director  
Ken Hanna was appointed a Non-executive Director on 1 April 2009. He is Chairman of Inchcape PLC. He was previously Chief Financial Officer of Cadbury plc until March 2009 and prior to that an Operating Partner of Compass Partners and CFO and then CEO of Dalgety PLC. He has also been CFO of United Distillers and Avis Europe plc.

**Ken Hydon – 65**

Non-executive Director  
Ken Hydon was appointed a Non-executive Director on 23 February 2004. He is also a Non-executive Director of Reckitt Benckiser plc, the Royal Berkshire NHS Foundation Trust and Pearson plc.

**Jacqueline Tammenoms Bakker – 56**

Non-executive Director  
Jacqueline Tammenoms Bakker was appointed a Non-executive Director on 1 January 2009. She was a Director General at the Ministry of Transport in the Netherlands from 2001 to 2007 and has held senior positions at Quest International, McKinsey & Co and Shell. Jacqueline was appointed a Chevalier de la Légion d'honneur in 2006.

**Jonathan Lloyd – 43**

Company Secretary  
Jonathan Lloyd was appointed Company Secretary to the Board in December 2006. He joined Tesco as Deputy Company Secretary in April 2005 from Freshfields Bruckhaus Deringer. Jonathan is also Company Secretary of Tesco Bank.



Philip Clarke Charles Allen Richard Brasher David Reid

Laurie Mcllwee Karen Cook Harald Einsmann Andrew Higginson Jonathan Lloyd

## Key performance indicators (KPIs)\*

We operate a balanced scorecard approach to managing the business that is known internally within the Group as our 'Steering Wheel'. This unites the Group's resources and in particular focuses the efforts of our staff around our customers, people, operations, finance and the community. Its prime focus is as a management tool for the Company so that there is appropriate balance in the trade-offs that need to be made between the main levers of management – such as operations measures, financial measures or delivery of customer metrics.

It therefore enables the business to be operated and monitored on a balanced basis with due regard to the needs of all stakeholders. For the owners of the business, it is simply based around the philosophy that if we look after customers and staff well and operate efficiently and effectively then shareholders' interests will always be best served by the inevitable outputs of those – growth in sales, profits and returns.



	2010	2009	2008
<b>Sales growth</b>			
Change in Group sales over the year (including value added tax)	<b>6.8%</b>	15.1%	11.1%
UK sales growth	<b>4.2%</b>	9.5%	6.7%
International sales growth	<b>8.8%</b>	30.6%	25.3%
International sales growth (at constant exchange rates)	<b>6.6%</b>	13.6%	22.5%
Retailing Services sales growth	<b>4.2%</b>	11%	–
Profit before tax	<b>£3,176m</b>	£2,917m**	£2,803m
Underlying profit before tax	<b>£3,395m</b>	£3,124m**	£2,846m
<b>Trading margin</b>			
UK trading margin	<b>6.2%</b>	6.2%	5.9%
International trading margin (excluding the United States)	<b>5.3%</b>	5.3%	5.6%
Trading margin is calculated from the trading profit expressed as a percentage of Group revenue (sales excluding value added tax) and excluding the impact of IFRIC 13. It is a measure of profit generation from sales and is a comparable performance measure with other companies. This is how much we made from trade in our stores, taking account of the cost of the products sold, wages and salaries, expenses associated with running the stores, depots and head office, and the cost of depreciation of the assets used to generate the profits. Trading profit is stated after adjusting operating profit for the impact of IAS 19, IAS 32 and IAS 39 (principally pension costs and the marking to market of financial instruments). It also excludes the non-cash elements of IAS 17 'Leases', relating to the impact of annual uplifts in rents and rent-free periods, and the IFRS 3 amortisation charge on intangible assets arising on the acquisition of Tesco Personal Finance (TPF).			
<b>Net cash (outflow)/inflow</b>	<b>£(739)m</b>	£1,601m	£801m
Net cash (outflow)/inflow is the cash received less cash spent during the financial period, after financing activities			
<b>Capital expenditure</b>	<b>£3.1bn</b>	£4.7bn	£3.9bn
This is the amount invested in purchasing fixed assets			
UK	<b>£1.5bn</b>	£2.6bn	£2.3bn
International	<b>£1.5bn</b>	£2.1bn	£1.6bn
Tesco Bank	<b>£0.1bn</b>	–	–
<b>Net borrowings and gearing</b>			
Net borrowings	<b>£7.9bn</b>	£9.6bn	£6.2bn
Gearing	<b>54%</b>	74%	52%
<b>Return on capital employed (ROCE)</b>	<b>12.1%</b>	12.8%**	12.9%‡
ROCE is calculated as profit before interest less tax divided by the average of net assets plus net debt plus dividend creditor less net assets held for sale. ROCE is a relative profit measurement that not only incorporates the funds shareholders have invested, but also funds invested by banks and other lenders, and therefore shows the productivity of the assets of the Group.			
<b>Underlying diluted earnings per share</b>	<b>31.66p<sup>§</sup></b>	28.87p**	27.02p
Underlying diluted earnings per share is the calculation of profit after tax and minority interest divided by the diluted weighted average number of shares in issue during the year. It is the amount which could be paid out on each share if the Company decided to distribute all its profits as dividends instead of retaining some for future expansion.			

\* All KPIs are for 52 weeks ended 27 February 2010, 53 weeks ended 28 February 2009 and 52 weeks ended 23 February 2008 unless otherwise stated.

\*\* Restated for IFRS 2 and IFRIC 13.

‡ Using 'normalised' tax rate before start-up costs in the US and Tesco Direct, and excludes the impact of foreign exchange in equity and our acquisition of a majority share of Dobbies.

§ Underlying diluted earnings per share grew by 9.7% on a statutory basis.

	2010	2009	2008
<b>Total shareholder return</b>	<b>9.5%</b>	8.0%	22.8%
Total shareholder return is the notional return from a share and is measured as the percentage change in the share price, plus the dividend paid. This is measured over the last five years.			
<b>Full year dividend per share</b>	<b>13.05p</b>	11.96p	10.09p
The dividend is paid in two instalments.			

We monitor a wide range of KPIs, both financial and non-financial. Individual business units have their own versions of the Steering Wheel which incorporate their own priorities and KPIs. Some of the Group KPIs below are tracked through the Steering Wheel and those above are tracked as a monitor of investor return.

Across the Group, KPIs are set for local markets, with oversight from the Executive Directors, to ensure they are tailored to drive the priorities of each business.

The following are some KPIs for the UK and Group operations:

	2010	2009	2008
<b>UK market share</b>			
Grocery market share***	<b>22.5%</b>	22.2%	21.8%
New non-food market share†	<b>4.1%</b>	3.6%	3.5%
<b>Employee retention</b>	<b>90%</b>	87%	84%
This measure shows the percentage of employees who have stayed with the business for longer than one year. It is one measure that we use to monitor employee loyalty and satisfaction and we aim to exceed 80% retention of experienced staff.			
<b>Reduction in CO<sub>2</sub> emissions††</b>			
UK	<b>6.9%</b>	3.6%	3.6%
Group	<b>7.8%</b>	4.8%	4.6%
This measure shows the overall year-on-year reduction in greenhouse gas emissions from existing stores and distribution centres built before 2006/7, adjusted to exclude emissions from acquisitions and extensions.			
<b>Reduction in CO<sub>2</sub> emissions intensity of new stores and distribution centres††</b>			
Group	<b>28.8%</b>	25.3%	14.7%
Intensity is measured as greenhouse gas emissions/sq ft. The measure indicates the average reduction in emissions intensity of all new stores and distribution centres built since 2006/7 (the base year). Carbon footprint reporting has been assured by Environmental Resources Management (ERM).			

\*\*\*This is measured as the share of all spend by all shoppers through Kantar Worldpanel (Total Till Roll) data.

† Source: Verdict Research, Non-food in Grocers. 'New non-food' defined as non-food retail sales excluding Household and Health & Beauty categories. All figures are reported on a calendar year basis.

†† 2009 figures adjusted for 52-week comparison.

# Group financials

These results are for the 52 weeks ended 27 February 2010. In the last full financial year, we reported a 53-week period for the UK, Republic of Ireland and the United States (US) and a 52-week period for the rest of the Group. Growth rates in these results are expressed for the UK, Republic of Ireland and US to coincide with the comparable 52 weeks last year.

Statutory numbers include the adoption of IFRIC 13 (Customer Loyalty Programmes). All other numbers are shown excluding IFRIC 13, consistent with internal management reporting. More information can be found in note 1 to the Group financial statements.

Group sales, including VAT, increased by 6.8% to £62.5bn. At constant exchange rates, sales increased by 6.1% (including petrol) and 7.7% (excluding petrol).

Underlying profit before tax rose to £3,395m, an increase of 10.1%. Group trading profit was £3,412m, up 12.3% on last year and Group trading margin, at 5.9%, rose 25 basis points. These were helped by the fact that Tesco Bank was fully consolidated in 2010 and accounted for as a joint venture for most of 2009.

Group operating profit rose by 10.7% to £3,457m. Group profit before tax increased 10.4% to £3,176m.

On a statutory 52-week basis (compared to 53 weeks last year), Group operating profit rose by 9.1% to £3,457m and Group profit before tax rose by 8.9% to £3,176m.

**Cash flow and balance sheet** Tesco liquidity has improved significantly during the year through strong cash generation, tight control of capital expenditure and working capital improvements arising from better inventory management. Net debt has consequently reduced by £1.7bn to £7.9bn.

Excluding the effects of currency fluctuations, we expect to reduce net debt to £7.5bn by the end of the 2010/11 financial year.

The strength of our property-backed balance sheet was further demonstrated with profitable market-leading sale and leaseback transactions.

Group capital expenditure was £3.1bn (last year £4.7bn). This reduced level of spend was achieved whilst still delivering 8% growth in Group selling space. This year we plan to invest around £3.5bn in capital expenditure.

Excluding Tesco Bank, cash flow from operating activities totalled £5.4bn (£5.1bn in 2009), including a £0.6bn improvement in working capital.

**Finance costs and tax** Net finance costs, after net favourable IFRS adjustments of £103m\*, reduced to £314m (£356m last year on a consistent 52-week basis). A reduction in the underlying interest charge is expected next year. Total Group tax has been charged at an effective rate of 26.4% (last year 26.7%). We expect the tax rate in 2010/11 to be around 26%.

**Dividend** Underlying diluted earnings per share increased by 9.2% to 16.62p in the second half, calculated using a constant tax rate. The Board has approved a final dividend of 9.16p per share, taking the full-year dividend to 13.05p. This represents an increase of 9.1% on last year's full-year dividend which is in line with the growth in underlying diluted earnings per share at constant exchange rates. The final dividend will be paid on 9 July 2010 to shareholders on the Register of Members at the close of business on 30 April 2010.

**Property** We are continuing to release value created through the long-term development of our property portfolio. In the year we completed deals with total proceeds of £1.8bn and we expect to divest a similar amount this year. The strong demand for these assets and the good yields achieved (initial yields between 5.0% and 5.2% for stores) demonstrate the strong underlying value of our property and the strength of the Tesco covenant. Profits from property in the year were £377m. Our property mix remains strong – over 70% of our property is freehold – supported by substantial new capital investment in freehold assets each year. Our latest property assets valuation of £34.6bn reflects recent firming yields across the market and confirms that our assets are worth well in excess of their book value.

**Pension** Our award-winning defined-benefit career-average pension scheme is an important part of our competitive benefits package, which helps Tesco recruit and retain the best people. In the UK we have 160,000 employees in the scheme. As at February 2010, under the IAS 19 methodology of pension liability valuation, the scheme had a deficit on a post-tax basis of £1.3bn, compared to £1.4bn at the half year. The last actuarial valuation of the scheme's assets and liabilities showed a small and manageable deficit.

**Return on capital employed** We have continued to invest during the recession, which has put pressure on returns in the short term but is enabling us to make good progress in all our markets. During the financial year 2010 our post-tax return on capital employed (ROCE) fell from 12.8%\*\* to 12.1%.

Having raised ROCE from 10.2% in 2003 to 12.6% in 2006, we committed in April 2006 to increase ROCE a further 200 basis points to 14.6%. We are reaffirming this commitment with confidence that with the prospect of an improving global economy and recent significant investments in acquisitions and new space making a greater contribution going forward, returns will improve in the coming few years, starting in 2010/11.

\* £151m benefit from IAS 32 and IAS 39 (Fair value of derivatives) partially offset by £48m cost as a result of IAS 19 (Pensions).

\*\* In 2009, ROCE on a 52-week comparable basis was 12.7%. On a 53-week basis it was 12.8% (restated for the impact of IFRIC 13, IFRS 2 and goodwill adjustments).

# Risks and uncertainties

**Introduction** Risk is an accepted part of doing business. The real challenge for any business is to identify the principal risks it faces and to develop and monitor appropriate controls. A successful risk management process balances risks and rewards and relies on a sound judgement of their likelihood and consequence. The Board has overall responsibility for risk management and internal control within the context of achieving the Group's objectives. Our process for identifying and managing risks is set out in more detail from page 49 of the Corporate Governance section of the Annual Report and Financial Statements. The key risks faced by the Group and relevant mitigating factors are set out below.

**Business strategy** If our strategy follows the wrong direction or is not effectively communicated then the business may suffer. We need to understand and properly manage strategic risk in order to deliver long-term growth for the benefit of all our stakeholders. Our strategy is based on five elements: to become a successful international retailer, to grow the core UK business, be as strong in non-food as in food, develop retailing services and put the community at the heart of what we do. Pursuit of this five-part strategy has allowed the business to diversify and, at a strategic level, diversification and pursuit of growth in emerging markets have the effect of reducing overall risk by avoiding reliance on a small number of business areas. However, by its very nature, diversification also introduces new risks to be managed in areas of the business that are less mature and less fully understood.

To ensure the Group continues to pursue the right strategy, the Board discusses strategic issues at every Board meeting and dedicates two full days a year to reviewing the Group's strategy. The Executive Committee also discusses strategy on a regular basis. We have structured programmes for engaging with all our stakeholders including customers, employees, investors, suppliers, government, media and non-governmental organisations. We also invest significant resources in ensuring our strategy is communicated well and understood by the parties who are key to delivering it. The business operates a Steering Wheel (a balanced scorecard process whereby we set goals for different areas of the business and assess our overall progress on a quarterly basis) in all countries and significant business units to help manage performance and deliver business strategy.

**Financial strategy and Group treasury risk** The main financial risks of the Group relate to the availability of funds to meet business needs, the risk of default by counterparties to financial transactions and fluctuations in interest and foreign exchange rates. The risks associated with operating Tesco Bank are covered under Financial services risks below.

The Treasury function is mandated by the Board to manage the financial risks that arise in relation to underlying business needs. The function has clear policies and operating parameters, and its activities are routinely reviewed and audited. The function does not operate as a profit centre and the undertaking of speculative transactions is not permitted. A description of the role of the Finance Committee, Internal Audit and External Audit is set out in the Corporate Governance section on page 50.

**Financial services risks** Through Tesco Bank, the Group is subject to certain risks relating to the personal financial services industry in the UK. Tesco Bank is subject to significant legislative and regulatory oversight. In particular, Tesco Bank is subject to supervision by the Financial Services Authority (FSA) which has substantial powers of intervention and requires it to satisfy certain capital adequacy and liquidity ratios. If Tesco Bank is unable to or fails to satisfy these ratios in the future it could lose its licence and, consequently, its ability to transact business.

Tesco Bank became a wholly owned subsidiary of Tesco on 19 December 2008. In preparation for this change its risk management and treasury capabilities were materially strengthened. All policies pertaining to risk within the Bank are now subject to Tesco Bank specific governance procedures which are owned by the Tesco Bank Board.

Tesco Bank has a banking business, predominantly in the UK, with the three main products being credit cards, unsecured personal loans and savings. It has also developed a significant insurance business, with motor, home and pet insurance being the main products.

Tesco Bank is subject to various risks associated with the provision of financial services. In relation to its insurance business Tesco Bank may experience a concentration of risks from natural or man-made disasters. In addition market conditions may not allow it to purchase the amount of re-insurance it considers necessary on terms it considers acceptable. Actual claims may exceed the claims provisions that have been made on the basis of past experience. Tesco Bank's credit card receivables and personal loan portfolio may be subject to changes in credit quality, due to a general deterioration in economic conditions or to failures in its credit assessment process, which could adversely impact its ability to recover amounts due. Furthermore, there is significant competition in the financial services industry which could adversely affect Tesco Bank's profitability. Legal developments, changes in legal interpretation or precedent and changes in public policy may result in new risks emerging in addition to those anticipated.

Tesco Bank is in the process of building new banking and insurance systems and until these are complete there is an increased element of operational risk as most operations are outsourced to Royal Bank of Scotland. Tesco Bank retains the risk to its insurance activities posed by external factors, such as a large weather-related event.

Tesco Bank is an FSA-regulated entity and so its treasury function is run independently from the rest of the Group. Tesco Bank's treasury risks include liquidity risk and interest rate risk (in particular, in the interest rate margin realised between lending and borrowing costs). Tesco Bank is also subject to the risk of unexpected losses arising from operational failure, whether as a result of human error, systems failures, fraud or inadequate controls.

Tesco Bank monitors these risks through its governance structures, assessing any potential impact and action required to manage them. The work of the Risk Committee focuses on systemic risks such as funding, credit risk and risks in the insurance business, while the Tesco Bank Audit Committee considers internal controls and assurance.

**Operational threats and performance risk in the business** There is a risk that our business may not deliver the stated strategy in full, particularly since, like all retailers, the business is susceptible to economic downturn that could affect consumer spending. The continuing acquisition and development of property sites also forms an intrinsic part of our strategy and this carries inherent risks.

## Risks and uncertainties continued

We aim to deliver what customers want better than our competitors by understanding and responding to their needs. All of our business units have stretching targets based on the Steering Wheel and the performance of business units is monitored continually and reported regularly to the Board. We manage the acquisition and development of our property assets carefully. We consider and assess in detail every site at each stage of acquisition and development and ensure that relevant action is taken to minimise any risks.

**Competition and consolidation** The retail industry is highly competitive. The Group competes with a wide variety of retailers of varying sizes and faces increased competition from UK retailers as well as international operators in the UK and overseas.

Failure to compete with competitors on areas including price, product range, quality and service could have an adverse effect on the Group's financial results.

We aim to have a broad appeal on price, range and store format in a way that allows us to compete in different markets. We track performance against a range of measures that customers tell us are critical to their shopping trip experience and we constantly monitor customer perceptions of ourselves and our competitors to ensure we can respond quickly if we need to.

**People capabilities** Employees are our greatest asset. It is critical to our success to attract, retain, develop and motivate the best people with the right capabilities at all levels of operations. We review our people policies regularly and are committed to investing in training and development and incentives for our people. Our 'Talent Planning' process helps individuals achieve their full potential. We also carry out succession planning to ensure that the future needs of the business are considered and provided for. There are clear processes for understanding and responding to employees' needs through our People Matters Group, staff surveys, regular performance reviews, involvement of trade unions in relevant markets and regular communication of business developments. We take a proactive approach to encouraging diversity at all levels within the business.

**Reputational risk** As the largest retailer in the UK, expectations of the Group are high. Failure to protect the Group's reputation and brand could lead to a loss of trust and confidence. This could result in a decline in the customer base and affect the ability to recruit and retain good people.

Like other companies we must consider potential threats to our reputation and the consequences of reputational damage. Emotional loyalty to the Tesco brand has helped us diversify into new areas like retail services and non-food and we recognise the commercial imperative to do the right thing for all our stakeholders and avoid the loss of such loyalty. The Tesco Values are embedded in the way we do business at every level and our Group Code of Business Conduct guides our behaviour in our dealings with customers, employees and suppliers.

We engage with stakeholders in every sphere to take into account their views and we try to ensure our strategy reflects them. Since the launch of the Community Plan in 2006 we have demonstrated our commitment to tackling a wide range of societal and environmental issues. We have high level committees, including the Executive Committee, Corporate Responsibility Committee and Group Compliance Committee to help guide and monitor our policies.

**Environmental risks** The main environmental risk we face is the threat of climate change and it is essential that we work to mitigate it through energy efficiency, the sustainable management of other resources and waste minimisation. We engage with key stakeholders and experts in developing environmental policy, including through the Sustainable Consumption Institute we have endowed at Manchester University.

Environmental strategy and policies are reviewed regularly by the Corporate Responsibility Committee. Our climate change strategy is driven by a belief that proactive environmental performance will be rewarded by consumers and that providing the means by which consumers can adopt low-carbon lifestyles will increasingly be a route to competitive advantage.

**Product safety** The safety and quality of our products is of paramount importance to Tesco as well as being essential for maintaining customer trust and confidence. A breach of confidence could affect the size of our customer base and hence financial results.

We have detailed and established procedures for ensuring product integrity at all times, especially for our own-label products. There are strict product safety processes and regular management reports. We work in partnership with suppliers to ensure mutual understanding of the standards required. We also monitor developments in areas such as health, safety and nutrition in order to respond appropriately to changing customer trends and new legislation. We have clear processes for crisis management, pulling together expert teams should we need to respond quickly on issues.

**Health and safety risks** The safety of our staff and customers is of the utmost importance to us. If we are unable to provide safe environments for our staff and customers this could lead to injuries or loss of life.

We operate stringent health and safety processes in line with best practice in our stores, distribution centres and offices which are monitored and audited regularly. KPIs for health and safety help prevent incidents and form an intrinsic part of our Steering Wheel across the business. Performance against these KPIs is reported quarterly. Our Group Compliance Committee and the Compliance Committees in our business units monitor the level of compliance with both health and safety laws and our internal policies on a regular basis.

**Ethical risks in the supply chain** Millions of people around the world work directly for suppliers to Tesco and the supply chain is made of complex relationships – from individual farmers and growers through to processors, manufacturers and distributors. At the heart of our Values is our belief that we should treat people as we like to be treated and we have a responsibility to help workers in our supply chain enjoy fair labour standards. We therefore require our suppliers to meet strict criteria on labour standards, and as a founder member of the Ethical Trading Initiative (ETI), we expect all our suppliers to follow the ETI Base Code and guarantee their workers the rights set out within it. There is, however, a risk that any part of the supply chain might not adhere to these high standards.

To minimise this risk we only work with suppliers who can demonstrate that they are committed to the ETI Base Code and share our Values. We use Supplier Ethical Data Exchange (SEDEX) to carry out risk assessment of all our direct suppliers and all medium and high-risk suppliers must undergo an extensive, independent ethical audit. We continue to operate a comprehensive programme of audit improvements, including more unannounced audits and an industry-leading Auditor Recognition programme. We have also sought to involve more multi-stakeholder representatives on our audits to improve workforce engagement and enable activists to see and give feedback on our approach. We work with suppliers to identify any problems and, where they exist, support suppliers in taking action to improve standards for their workers.

We have invested heavily in building the labour standards capabilities of our suppliers and our own commercial teams in the last year, including rolling out extensive training to help them identify and avoid issues before they arise. We also work with businesses, governments, non-governmental organisations (NGOs) and others to tackle complex and systemic problems that we cannot solve on our own. As well as having a key role in the ETI we also work closely with the Global Social Compliance Programme and other groups in specific industries and regions.

**Fraud and compliance** As the business grows in size and geographical spread, the risk of the occurrence of fraudulent behaviour by our employees increases. Whilst the vast majority of our staff are completely honest, there remains the potential for fraud and other dishonest activity at all levels of the business, from the shop floor to senior management.

The Group takes extensive steps to reduce this risk. Relevant accounting and other procedures and controls at all levels are clearly set out and audited across the business to reduce the risk of fraud. The Group gives clear guidance on behaviour to employees through the Tesco Values and the Group Code of Business Conduct. Internal Audit undertakes detailed investigations into all areas of the business and highlights its findings to the Audit Committee. The Compliance Committee formulates and monitors the implementation of, and compliance with, appropriate policies on key areas of ethical behaviour, including fraud.

**Property** We have stretching targets for delivering new space in all of our markets and may face challenges in finding suitable sites and obtaining planning or other consents to enable sites to be acquired and developed. The complexity of many of our property developments is increasing, especially the growing number of malls and mixed-use schemes. We also have to comply with design and construction standards which vary significantly from country to country.

Our Property Acquisition Committee and other related committees in the UK, Europe, Asia and the US closely control all aspects of the property acquisition, planning and construction processes to ensure that applicable standards are met and financial risks are minimised. Our Group and country Compliance Committees also monitor compliance with applicable legal and regulatory requirements in all aspects of our property activities.

**Non-food risks** As the proportion of our business represented by non-food products increases, there is a risk that a downturn in consumer confidence may affect the level of demand for products which consumers may regard as non-essential.

We make every effort to ensure that our non-food products are competitively priced and offer a broad range of products ranging from value to the luxury end of the market in order to cater for the needs of as wide a range of customers as possible.

**IT systems and infrastructure** The business is dependent on efficient information technology (IT) systems. Any significant failure in the IT processes of our retail operations (e.g. barcode scanning or supply chain logistics) would impact our ability to trade. We recognise the essential role that IT plays across our operations in allowing us to trade efficiently and achieve commercial advantage through implementing IT innovations that improve the shopping trip for customers and make life easier for employees. We have extensive controls in place to maintain the integrity and efficiency of our IT infrastructure and we share systems from across our international operations to ensure consistency of delivery.

**Regulatory, political and economic environment** We are subject to a wide variety of regulations in the different countries in which we operate because of the diverse nature of our business. Tesco may be impacted by regulatory changes in key areas such as planning laws, trading hours and tax rules as well as by scrutiny by the competition authorities who have been carrying out enquiries in the UK, Ireland and elsewhere. We may also be impacted by political developments and the economic environment in the countries in which we operate. We consider these uncertainties in the external environment when developing strategy and reviewing performance. We remain vigilant to future changes. As part of our day-to-day operations we engage with governmental and non-governmental organisations to ensure the views of our customers and employees are represented and try to anticipate and contribute to important changes in public policy wherever we operate.

**Activism and terrorism** A major incident or terrorist event incapacitating management, systems or stores could impact on the Group's ability to trade. In addition to contingency plans, we have security systems and processes that reflect best practice.

**Pension risks** The Group's pension arrangements are an important part of our employees' overall benefits package. We see them as a strong contributor to our ability to attract and retain good people. Since the implementation of IAS 19 there is a risk that the accounting valuation deficit (which is recorded as a liability on the Group Balance Sheet) could increase if returns on corporate bonds are higher than the investment return on the pension scheme's assets. The Group has considered its pension risks and has taken action by reducing risk in its investment strategy.

#### Financial review

The main financial risks faced by the Group relate to the availability of funds to meet business needs, the risk of default by counterparties to financial transactions, fluctuations in interest and foreign exchange rates and credit rating risks. These risks are managed as described below. The Group Balance Sheet position at 27 February 2010 is representative of the position throughout the year.

**Funding and liquidity** The Group finances its operations by a combination of retained profits, long and medium-term debt, capital market issues, commercial paper, bank borrowings and leases. The objective is to ensure continuity of funding. The policy is to smooth the debt maturity profile, to arrange funding ahead of requirements and to maintain sufficient undrawn committed bank facilities and a strong credit rating so that maturing debt may be refinanced as it falls due. Tesco Group has a long-term rating of A3 with a negative outlook by Moody's and A- by Standard & Poor's. New funding of £2.3bn was arranged during the year, including a net £1.8bn from property transactions and £0.5bn from long-term debt. At the year end, net debt was £7.9bn (last year £9.6bn).

## Risks and uncertainties continued

**Interest rate risk management** Our objective is to limit our exposure to increases in interest rates while retaining the opportunity to benefit from interest rate reductions. Forward rate agreements, interest rate swaps, caps and collars are used to achieve the desired mix of fixed and floating rate debt.

Our policy is to fix or cap a minimum of 40% of actual and projected debt interest costs of the Group excluding Tesco Bank. At the year end, £5.6bn of debt was in fixed rate form (2009 – £6.3bn) with a further £0.1bn of debt capped or collared, therefore 72% (2009 – 72%) of net debt is fixed, capped or collared. The remaining balance of our debt is in floating rate form. The average rate of interest paid on an historic cost basis this year, excluding joint ventures and associates, was 5.4% (2009 – 5.2%).

**Foreign currency risk management** Our principal objective is to reduce the effect of exchange rate volatility on short-term profits. Transactional currency exposures that could significantly impact the Group Income Statement are hedged, typically using forward purchases or sales of foreign currencies and currency options. At the year end, forward foreign currency transactions, designated as cash flow hedges, equivalent to £1.083bn were outstanding (2009 – £2.11bn) as detailed in note 22. We hedge the majority of our investments in our international subsidiaries via foreign exchange transactions in matching currencies. Our objective is to maintain a low cost of borrowing and hedge against material movements in our Group Balance Sheet value. During the year, currency movements increased the net value of the Group's overseas assets by £477m (last year increase of £480m). We translate overseas profits at average foreign exchange rates which we do not currently seek to hedge.

**Credit risk** The objective is to reduce the risk of loss arising from default by parties to financial transactions across an approved list of counterparties of good credit quality. The Group's positions with these counterparties and their credit ratings are routinely monitored.

Credit risk arising from Tesco Bank's unsecured lending is managed using all the normal credit assessment and collections and recoveries systems. In terms of liquidity risk Tesco Bank has implemented a conservative approach to the minimum amount of liquid assets it holds and to its Net Stable Funding Ratio.

**Insurance** We purchased Assets, Earnings and Combined Liability protection from the open insurance market at 'catastrophe' level only. The risk not transferred to the insurance market is retained within the business by using our captive insurance companies, Tesco Insurance Limited in Guernsey and Valiant Insurance Company Limited in the Republic of Ireland. Tesco Insurance Limited covers Assets and Earnings, while Valiant Insurance Company Limited covers Combined Liability.

### Statement of compliance

This Business Review has been prepared in accordance with the requirements for a business review under the Companies Act 2006. The Business Review's intent is to provide information to shareholders and should not be relied on by any other party or for any other purpose.

### Cautionary statement regarding forward-looking information

Where this review contains forward-looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this report. These statements should be treated with caution due to the inherent risks and uncertainties underlying any such forward-looking information.

The Group cautions investors that a number of important factors, including those in this document, could cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to, those discussed under 'Risks and uncertainties' on pages 41 to 44 of this document.

# General information

**Principal activity, business review and future developments** The principal activity of the Group is retailing and associated activities in the UK, China, the Czech Republic, Hungary, the Republic of Ireland, India, Japan, Malaysia, Poland, Slovakia, South Korea, Thailand, Turkey and the US. The Group also provides retail banking and insurance services through its subsidiary Tesco Bank.

**Group results** Group revenue (excluding VAT) rose by £3bn to £56.9bn, representing an increase of 7.1%. Group profit before tax increased by £259m, to £3,176m. Profit for the year was £2,336m, of which £2,327m was attributable to equity holders of the parent company.

**Dividends** The Directors recommend the payment of a final dividend of 9.16p per ordinary share, to be paid on 9 July 2010 to members on the Register at the close of business on 30 April 2010. Together with the interim dividend of 3.89p per ordinary share paid in December 2009, the total dividend for the year will be 13.05p compared with 11.96p for the previous year, an increase of 9.1%.

**Fixed assets** Capital expenditure (excluding business combinations) amounted to £3.1bn compared with £4.7bn the previous year. In the Directors' opinion, the properties of the Group have an open market value well in excess of the carrying value of £24.8bn which has been included in these financial statements.

**Share capital and control of the Company** Details of the Company's share capital, including changes during the year in the issued share capital and details of the rights attaching to the Company's Ordinary shares, are set out in note 29 on page 116. Details of shares held by the Company's Employee Benefit Trusts are shown in note 27 on page 111. During the year no Ordinary shares were repurchased for cancellation. No shareholder holds securities carrying special rights with regards to control of the Company and there are no restrictions on voting rights. The Board has power to purchase the Company's shares and is seeking renewal of that power at the forthcoming AGM within the limits set out in the notice of that meeting.

Shares held by the Company's Employee Share Incentive Plan Trust, International Employee Benefit Trust and Tesco Ireland Share Bonus Scheme Trust rank *pari passu* with the shares in issue and have no special rights. Voting rights and rights of acceptance of any offer relating to the shares held in these trusts rests with the trustees, who may take account of any recommendation from the Company. Voting rights are not exercisable by the employees on whose behalf the shares are held in trust.

The Company is not party to any significant agreements that would take effect, alter or terminate following a change of control of the Company. The Company does not have agreements with any Director or Officer that would provide compensation for loss of office or employment resulting from a takeover, except that provisions of the Company's share plans may cause options and awards granted under such plans to vest on a takeover.

**Company's shareholders** The Company has been notified that as at the date of this report Blackrock, Inc. owns 5.24%, and Legal & General Investment Management Limited owns 3.71% of the issued share capital of the Company. The Company is not aware of any other shareholders with interests of 3% or more in the issued share capital of the Company.

**Articles of Association** The Company's Articles of Association may only be amended by special resolution at a General Meeting of the shareholders.

**Directors and their interests** The Directors who served during the year were: Charles Allen CBE; Richard Brasher; Patrick Cescau; Philip Clarke; Karen Cook; Rodney Chase CBE; Harald Einsmann; Ken Hanna; Andrew Higginson; Ken Hydon; Sir Terry Leahy; Tim Mason; Laurie McIlwee; Lucy Neville-Rolfe CMG; David Potts; David Reid and Jacqueline Tammenoms Bakker. The biographical details of the present Directors are set out on pages 36 and 37 of this Report. Ken Hydon, Tim Mason, Lucy Neville-Rolfe, David Potts and David Reid retire from the Board by rotation and, being eligible, offer themselves for re-election.

The interests of Directors and their immediate families in the shares of Tesco PLC, along with details of Directors' share options, are contained in the Directors' Remuneration Report set out on pages 52 to 66.

At no time during the year did any of the Directors have a material interest in any significant contract with the Company or any of its subsidiaries. A qualifying third-party indemnity provision as defined in Section 234 of the Companies Act 2006 is in force for the benefit of each of the Directors and the Company Secretary (who is also a Director of certain subsidiaries of the Company) in respect of liabilities incurred as a result of their office, to the extent permitted by law. In respect of those liabilities for which Directors may not be indemnified, the Company maintained a Directors' and officers' liability insurance policy throughout the financial year.

**Employment policies** The Group depends on the skills and commitment of its employees in order to achieve its objectives. Ongoing training programmes seek to ensure that employees understand the Group's customer service objectives and strive to achieve them. The Group's selection, training, development and promotion policies ensure equal opportunities for all employees regardless of factors such as gender, marital status, race, age, sexual preference and orientation, colour, creed, ethnic origin, religion or belief, disability or trade union affiliation. All decisions are based on merit. Internal communications are designed to ensure that employees are well informed about the business of the Group. Employees are encouraged to become involved in the financial performance of the Group through a variety of schemes, principally the Tesco employee profit-sharing scheme (Shares in Success), the savings-related share option scheme (Save As You Earn) and the partnership share plan (Buy As You Earn).

**Political and charitable donations** Cash donations to charities amounted to £31,221,573 (2009 – £28,278,867). Total contributions to community projects including cash, cause-related marketing, gifts-in-kind, staff time and management costs amounted to £61,592,464 (2009 – £57,094,208). There were no political donations (2009 – £nil). During the year, the Group made contributions of £49,365 (2009 – £55,468) in the form of sponsorship for political events: Labour Party £15,000; Liberal Democrat Party £6,300; Conservative Party £8,384; Scottish National Party £5,500; Plaid Cymru £2,000; trade unions £12,181.

**Supplier payment policy** Tesco PLC is a signatory to the Prompt Payment Code. More information about the Code can be found at [www.promptpaymentcode.org.uk](http://www.promptpaymentcode.org.uk). Payment terms and conditions are agreed with suppliers in advance. Tesco PLC has no trade creditors on its Balance Sheet. The Group pays its creditors on a pay on time basis which varies according to the type of product and territory in which the suppliers operate.

**Going concern** The Directors consider that the Group and the Company have adequate resources to remain in operation for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. As with all business forecasts, the Directors' statement cannot guarantee that the going concern basis will remain appropriate given the inherent uncertainty about future events.

**Events after the Balance Sheet date**  
There were no material events after the Balance Sheet date.

**Auditors** A resolution to re-appoint PricewaterhouseCoopers LLP as auditors of the Company and the Group will be proposed at the Annual General Meeting.

**Directors' statement of disclosure of information to auditors**  
Having made the requisite enquiries, the Directors in office at the date of this Annual Report and Financial Statements have each confirmed that, so far as they are aware, there is no relevant audit information (as defined by Section 418 of the Companies Act 2006) of which the Group's auditors are unaware, and each of the Directors has taken all the steps he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Group's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

# Corporate governance

## Directors' report on corporate governance

Tesco PLC is committed to the highest standards of corporate governance as we recognise that strong governance is crucial in helping the business to deliver its strategy, generating shareholder value and safeguarding our shareholders' long-term interests.

Below Board level, the company fosters a strong culture of good governance, including maintaining high ethical standards and strong personal integrity. This is formalised in the Group Code of Business Conduct which sets out our expectations of employees clearly. All businesses within the Group are required to monitor their compliance with the Group governance framework and this information is reviewed at Board level.

## Compliance with the Combined Code

The Combined Code on Corporate Governance sets out guidance in the form of principles and provisions on how companies should be directed and controlled to follow good governance practice. The Financial Services Authority (FSA) requires companies listed in the UK to disclose, in relation to Section 1 of the Combined Code, how they have applied the principles and whether they have complied with its provisions throughout the financial year. Where the provisions have not been complied with companies must provide an explanation for this.

The Board considers that Tesco PLC complied in full with the Combined Code principles of Corporate Governance and Code of Best Practice for the whole of the year ended 27 February 2010, with the exception of provision A.3.2, in respect of which the company was not in compliance for part of the year.

Provision A.3.2 requires that at least half of the Board, excluding the Chairman, should comprise Non-executive Directors determined by the Board to be independent. The Board recognises the importance of a balanced board with an appropriate level of independence. Due to unexpected changes to the Board in the previous year, with the resignation of Carolyn McCall and Mervyn Davies as Non-executive Directors, the Board was not in balance at the beginning of the year.

At that stage, Ken Hanna's impending appointment to the Board had already been announced, and he joined the Board with effect from 1 April 2009, at which point the Board became balanced and once again fully compliant with provision A.3.2.

Further information on the Combined Code can be found at [www.frc.org.uk](http://www.frc.org.uk).

## Board composition and independence

As at 27 February 2010, the Board of Tesco PLC comprised eight Executive Directors, eight independent Non-executive Directors and David Reid, Non-executive Chairman. Rodney Chase is Deputy Chairman and Senior Independent Director. The size of the Board is appropriate given the diverse markets the business operates in and the breadth of operations and services offered in each market.

The structure of the Board and the integrity of the individual Directors ensure that no single individual or group dominates the decision making process.

Biographies for the Directors can be found on pages 36 and 37 of this report.

Changes to the Board since 1 March 2009 are as follows:

Ken Hanna	Non-executive Director	Appointed 1 April 2009
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## Election of Directors

All Directors have to submit themselves for re-election at least every three years if they wish to continue serving and are considered by the Board to be eligible. The Company's Articles of Association require all new Directors to be submitted for election by shareholders in their first year following appointment.

## The Chairman

Clear divisions of accountability and responsibility exist and operate effectively for the positions of Chairman and Chief Executive. The Chairman has primary responsibility for leading the Board and setting

its agenda, while the Chief Executive has executive responsibilities for the operations and results of the Group and making proposals to the Board for the strategic development of the Group.

## Senior Independent Director

The Board has appointed one Non-executive Director, Rodney Chase, to act as Senior Independent Director. The Senior Independent Director is available to shareholders to assist in resolving concerns, should the alternative channels be inappropriate. The Senior Independent Director is also required to lead the discussion in relation to assessing the effectiveness of the Chairman's performance.

## Non-executive Directors

The Non-executive Directors bring a wide range of skills and experience, as well as independent judgement on strategy, risk and performance to the Company.

The independence of each Non-executive Director is assessed at least annually. The Combined Code suggests that a Non-executive Director should be independent in character and judgement and be free from relationships or circumstances which are likely to affect, or could appear to affect, the Director's judgement.

The terms and conditions of appointment of Non-executive Directors are available for inspection at the Company's registered office.

## Board responsibilities

The Board held 8 meetings in the year. It also held a two day off-site meeting which considered the Group's strategy. The Board has set out a clear Schedule of Matters Reserved for Board Decision in order to ensure its overall control of the Group's affairs. These include the approval of:

- the Company's strategic and operating plans;
- annual and interim financial statements;
- major acquisitions and disposals;
- authority levels for expenditure;
- treasury policies;
- risk management and internal control systems;
- group governance policies; and
- succession planning for senior executives.

The Board delegates to management the detailed planning and implementation of these matters in accordance with appropriate risk parameters. The Board monitors compliance with policy and achievement against objectives by holding management accountable for its activities through regular updates. In addition, each substantial business within the Group is required to present to the Board on a regular basis, giving it the opportunity to understand and explore issues as deemed necessary.

During the year ended 27 February 2010, the Board's scheduled activities included the following:

- approving interim and full year results;
- receiving reports from the Remuneration Committee, Audit Committee and Nominations Committee;
- receiving reports from other key committees within the Group, including the Compliance Committee, Corporate Responsibility Committee and Finance Committee;
- receiving reports on governance issues affecting the group, including stakeholder management;
- receiving regular reports on risk management within the Group, including the Key Risk Register;
- discussing and approving Group strategy;
- receiving a report on the effectiveness of the Board;
- receiving reports from key businesses within the Group; and
- receiving regular reports on the financial position of the Group and the various businesses within the Group.

All Directors have access to the services of the Company Secretary and may take independent professional advice at the Company's expense in conducting their duties. The Company provides insurance cover and indemnities for its Directors and officers.

### Attendance at meetings

The Board scheduled 8 meetings in the year ended 27 February 2010, and ad hoc meetings were also convened to deal with matters between scheduled meetings as appropriate. It is expected that all Directors attend Board and relevant Committee meetings, unless they are prevented from doing so by prior commitments, and that all Directors will attend the AGM. Where Directors are unable to attend meetings due to conflicts in their schedules, they receive the papers scheduled for discussion in the relevant meetings, giving them the opportunity to relay any comments to the Chairman in advance of the meeting. Directors leave the meeting where matters relating to them, or which may constitute a conflict of interest to them, are being discussed. The table below shows the attendance of Directors at scheduled Board meetings and at meetings of the Audit, Remuneration and Nominations Committees during the year.

Number of meetings	Full Board meetings		Audit Committee		Remuneration Committee		Nomination Committee	
	Actual	Possible	Actual	Possible	Actual	Possible	Actual	Possible
<b>Non-Executive Directors</b>								
David Reid (Chairman)	8	8	–	–	–	–	1	1
Charles Allen CBE	8	8	–	–	7	7	1	1
Patrick Cescau	8	8	4	4	7	7	1	1
Rodney Chase CBE (Senior Independent Director)	8	8	4	4	7	7	1	1
Karen Cook	8	8	–	–	6	7	1	1
Harald Einsmann	8	8	–	–	6	7	1	1
Ken Hanna (appointed 1.4.09) <sup>1</sup>	6	8	3	4	6	7	1	1
Ken Hydon	8	8	4	4	–	–	1	1
Jacqueline Tammenoms Bakker	8	8	–	–	–	–	1	1
<b>Executive Directors</b>								
Sir Terry Leahy	8	8	–	–	–	–	1	1
Richard Brasher	8	8	–	–	–	–	–	–
Philip Clarke	8	8	–	–	–	–	–	–
Andrew Higginson	8	8	–	–	–	–	–	–
Tim Mason	8	8	–	–	–	–	–	–
Laurie McIlwee	8	8	–	–	–	–	–	–
Lucy Neville-Rolfe CMG	8	8	–	–	–	–	–	–
David Potts	8	8	–	–	–	–	–	–

<sup>1</sup> Ken Hanna was unable to attend two Board meetings, one Audit Committee meeting and one Remuneration Committee meeting due to prior commitments arranged before he commenced his role at Tesco.

### Board processes

The Board governs through a number of Board Committees – in particular, the Audit, Remuneration and Nominations Committees – to which certain responsibilities and duties are delegated. These Committees are properly authorised under the constitution of the Company to take decisions and act on behalf of the Board within the parameters laid down by the Board. The Board is kept fully informed of the work of these Committees and any issues requiring resolution are referred to the full Board as appropriate. A summary of the operations of these Committees is set out below. The effectiveness of the Audit, Remuneration and Nominations Committees is underpinned by their Non-executive Director membership, which provides independent insight on governance matters. A copy of each Committee's Terms of Reference is available on our website [www.tesco.com/boardprocess](http://www.tesco.com/boardprocess). The Board is serviced by the Company Secretary, who reports to the Chairman in respect of his core duties to the Board.



\* Reports are discussed by the PLC Board on a regular basis.

## Nominations Committee

Members:

- David Reid (Chairman)
- Charles Allen
- Patrick Cescau
- Rodney Chase
- Karen Cook
- Dr Harald Einsmann
- Ken Hanna (from 1 April 2009)
- Ken Hydon
- Jacqueline Tammenoms Bakker
- Sir Terry Leahy

The Nominations Committee leads the process for Board appointments and the re-election and succession of Directors, as well as making recommendations for the membership of the Audit and Remuneration Committees.

The Committee is chaired by David Reid and the Company Secretary also attends meetings in his capacity as Secretary of the Committee. Where matters discussed relate to the Chairman, the Senior Independent Director chairs the meeting.

The Nominations Committee met formally once in the year to discuss the ongoing shape and capability of the Board. There were also a number of ad hoc meetings during the year. As well as reviewing the performance and development of the Executive Directors and the senior executive levels below the Board, the Committee also regularly considers:

- the Board structure, size, and composition;
- the skills, experience and knowledge of the Board and identifies candidates to fill Board vacancies and enhance its capability;
- succession planning for directors and other senior executives in the course of its work, taking into account the challenges and opportunities facing the company, and what skills and expertise are therefore needed on the Board in the future;
- the time commitment required from Non-executive Directors;
- the leadership needs of the organisation, both executive and non-executive, with a view to ensuring the continued ability of the organisation to compete effectively in the marketplace; and
- strategic issues and commercial changes affecting the Group and the market in which it operates.

Individual members of the Committee were involved during the year in interviewing candidates for Board and senior executive positions.

Full terms of reference of the Tesco PLC Nominations Committee are available at [www.tesco.com/boardprocess](http://www.tesco.com/boardprocess)

## Remuneration Committee

Members (all independent Non-executive Directors):

- Charles Allen (Chairman)
- Patrick Cescau
- Rodney Chase
- Karen Cook
- Dr Harald Einsmann
- Ken Hanna (from 1 April 2009)

The Remuneration Committee's role is to determine and recommend to the Board the remuneration of the Executive Directors. It also monitors the levels and structure of remuneration for senior management and seeks to ensure that the remuneration arrangements are designed to attract, retain and motivate the Executive Directors needed to run the Company successfully.



David Reid  
Chairman

At the invitation of the Committee, the Chairman of the Board normally attends meetings and the Chief Executive attends as appropriate. Representatives of the Group's Personnel and Finance functions attend as appropriate to provide support and the Company Secretary also attends in his capacity as Secretary of the Committee.

The Committee met seven times this year. Each year it conducts a review of the Committee's own effectiveness and its Terms of Reference. The responsibilities of the Remuneration Committee and an explanation of how it applies the Directors' remuneration principles of the Combined Code, are set out in the Directors' Remuneration Report on pages 52 to 66.

Full terms of reference of the Tesco PLC Remuneration Committee are available at [www.tesco.com/boardprocess](http://www.tesco.com/boardprocess)

## Audit Committee

Members (all independent Non-executive Directors):

- Ken Hydon (Chairman)
- Patrick Cescau
- Rodney Chase
- Ken Hanna (from 1 April 2009)

Other regular attendees at the invitation of the Committee include:

- Chairman of the Board
- Finance Director and his representatives
- Head of Internal Audit
- Corporate and Legal Affairs Director
- Relevant Executive Directors
- External Auditors

The Company Secretary also attends in his capacity as Secretary of the Committee.

The Combined Code requires the Audit Committee to include at least one member with recent and relevant financial experience. The Committee Chairman fulfils this requirement, and all other Committee members have an appropriate understanding of financial matters.

The Audit Committee's primary responsibilities are:

- to review the financial statements;
- to review the Group's internal control and risk assurance processes;
- to consider the appointment of the external auditors, their reports to the Committee and their independence, which includes an assessment of their appropriateness to conduct any non-audit work; and
- to review the programme of Internal Audit.

The Committee met formally four times this year. There was also an additional ad hoc meeting. While fulfilling the above responsibilities, during the year the Committee received presentations from significant businesses within the Group, as well as on fraud, bribery and corruption, business continuity, IT controls and governance and whistleblowing. Each year the Committee conducts a review of its own effectiveness and its Terms of Reference. The Committee also had regular private meetings with the external auditors and the Head of Internal Audit during the year.

The need for training is kept under review and the annual agenda ensures time is dedicated to technical updates which are generally provided by external experts. This year training was provided on accounting and reporting developments under IFRS and IAS and governance developments proposed by the FRC. With respect to Tesco Bank, training was provided on regulatory, accounting, governance and risk management requirements. Training is also provided to meet specific individual needs of Committee members.

Full terms of reference of the Tesco PLC Audit Committee are available at [www.tesco.com/boardprocess](http://www.tesco.com/boardprocess)



Ken Hydon  
Chairman

### Management of the Group – Executive Committee

The Board delegates responsibility for formulating and implementing the Group's strategic plan and for management of the Group to the Executive Committee, which is chaired by the Chief Executive and comprises the eight Executive Directors and a senior executive, Colin Holmes, who was appointed as a member of the Committee on 7 September 2009. The Committee has authority for decision-making in all areas except those set out in the Schedule of Matters Reserved for Board Decision and meets formally on a regular basis. A number of other senior executives also attend the Committee and their valuable operational experience helps broaden the debate. Their attendance facilitates the communication of the Committee's decisions to the rest of the Group. The Company Secretary attends in his capacity as Secretary of the Committee.

The Executive Committee is responsible for implementing Group strategy and policy and for monitoring the performance and compliance of the business, drawing on the work of relevant committees, and reporting on these matters in full to the Board.

The Executive Committee has set up further committees – including the Finance, Compliance and Corporate Responsibility Committees (which are described in more detail below) – and operational groups which have responsibility for implementing the key elements of the Group's strategic plan and managing its UK and international operations, joint ventures, property acquisitions, finance, funding and people matters. These committees and groups have as members an appropriate mixture of Executive Directors and senior management from relevant functions.

### Procedures to deal with Directors' conflicts of interest

The Company has procedures in place to deal with the situation where a Director has a conflict of interest. As part of these procedures members of the Board are required to:

- consider each conflict situation separately on its particular facts;
- consider the conflict situation in conjunction with the rest of their duties under Companies Act 2006;
- keep records and Board minutes as to authorisation granted by Directors and the scope of any approvals given; and
- regularly review conflict authorisation.

### Training and development

All new Directors receive a personalised induction programme, tailored to their experience, background and particular areas of focus, which is designed to develop their knowledge and understanding of the Group's culture and operations. The programme has evolved taking into account feedback from new directors, and will usually include an overview of the business model and Board processes, meetings with the Executive team and senior managers, site visits at home and abroad and briefings on key issues (including social, ethical and environmental (SEE) issues). Directors also receive an induction to those Board Committees he or she will serve on.

The need for Director training is regularly assessed by the Board and regular training sessions are arranged to provide an opportunity for upskilling of the Directors on a variety of areas relevant to the Group's business, including SEE issues. In the last year the Board received training focusing, inter alia, on the regulatory and governance issues associated with operating a financial services business, following the acquisition of Tesco Bank in the previous year.

The Board usually meets overseas once each year to facilitate the Directors' understanding of the Group's international operations. In February 2010, the Board visited China and Korea to view first hand the progress and direction of the business in these markets. In July 2009, the Company held its Annual General Meeting in Scotland and the Board took the opportunity to visit some strategically significant parts of the business in this region.

### Board performance evaluation

The performance of the Board is a fundamental component of the Group's success. The Board regularly reviews its own performance. During the year ended 27 February 2010, the Board assessed its own performance. This assessment was co-ordinated and directed by the Chairman with the support of the Company Secretary. The Chairman and the Company Secretary carried out in-depth interviews with each Director. The results of the evaluation were considered by the Board, and confirmed the strength of the strategic and entrepreneurial leadership of the Company, a sound governance framework and practices compliant with the Combined Code.

The Chief Executive reviews the performance of each Executive Director. The Chairman reviews the performance of the Chief Executive and each Non-executive Director. During the year, the Chairman met several times with the Non-executive Directors, without the Executive Directors present, to discuss Board issues and how to build the best possible team. The Senior Independent Director met with the Non-executive Directors, in the absence of the Chairman, to assess the Chairman's performance.

### Risk management and internal controls

#### Accountabilities

Accepting that risk is an inherent part of doing business, our risk management systems are designed both to encourage entrepreneurial spirit and also provide assurance that risk is fully understood and managed. The Board has overall responsibility for risk management and internal control within the context of achieving the Group's objectives. Executive management is responsible for implementing and maintaining the necessary control systems. The role of Internal Audit is to monitor the overall internal control systems and report on their effectiveness to Executive management, as well as to the Audit Committee, in order to facilitate its review of the systems.

#### Background

The Group has a five-year rolling business plan to support the delivery of its strategy of long-term growth and returns for shareholders. Every business unit and support function derives its objectives from the five-year plan and these are cascaded to managers and staff by way of personal objectives.

Key to delivering effective risk management is ensuring our people have a good understanding of the Group's strategy and our policies, procedures, values and expected performance. We have a structured internal communications programme that provides employees with a clear definition of the Group's purpose and goals, accountabilities and the scope of permitted activities for each business unit, as well as individual line managers and other employees. This ensures that all our people understand what is expected of them and that decision-making takes place at the appropriate level. We recognise that our people may face ethical dilemmas in the normal course of business so we provide clear guidance based on the Tesco Values. The Values set out the standards that we wish to uphold in how we treat people. These are supported by the Group Code of Business Conduct which was launched this year, replacing the Code of Ethics, and offers guidance on relationships between the Group and its employees, suppliers and contractors.

We operate a balanced scorecard approach that is known within the Group as our Steering Wheel. This unites the Group's resources around our customers, people, operations, community and finance. The Steering Wheel operates at all levels throughout the Group. It enables the business to be operated and monitored on a balanced basis with due regard for all stakeholders.

#### Risk management

The Group maintains a Key Risk Register. The Register contains the key risks faced by the Group including their impact and likelihood, as well as the controls and procedures implemented to mitigate these risks. The content of the Register is determined through regular discussions with senior management and reviewed by the Executive Committee and the full Board. A balanced approach allows the degree of controllability to be taken into account when we consider the effectiveness of mitigation, recognising that some necessary activities carry inherent risk which may be outside

the Group's control. Where our risk management process identifies opportunities to improve the business these are built into our future plans. Our key risks are summarised on pages 41 to 44 of the Business Review.

The risk management process is cascaded through the Group with operating subsidiary boards maintaining their own risk registers and assessing their own control systems. The same process also applies functionally in those parts of the Group requiring greater oversight. For example, the Audit Committee's Terms of Reference require it to oversee the Finance Risk Register. The Board assesses significant Social, Ethical and Environmental (SEE) risks to the Group's short-term and long-term value, and incorporates SEE risks on the Key Risk Register where they are considered material or appropriate.

We recognise the value of the ABI Guidelines on Responsible Investment Disclosure and confirm that, as part of its regular risk assessment procedures, the Board takes account of the significance of SEE matters to the business of the Group. We recognise that a number of investors and other stakeholders take a keen interest in how companies manage SEE matters and so we report more detail on our SEE policies and approach to managing material risks arising from SEE matters and the KPIs we use both on our website ([www.tesco.com/cr2010](http://www.tesco.com/cr2010)) and in our Corporate Responsibility Report 2010. To provide further assurance, the Group's Corporate Responsibility KPIs are audited on a regular basis by Internal Audit.

### Internal controls

The Board is responsible for the Company's system of internal control and for reviewing the effectiveness of such a system. We have a Group-wide process for clearly establishing the risks and responsibilities assigned to each level of management and the controls which are required to be operated and monitored.

The CEOs of subsidiary businesses are required to certify by way of annual governance returns that appropriate governance and compliance processes have been adopted. For certain joint ventures, the Board places reliance upon the internal control systems operating within our partners' infrastructures and the obligations upon partners' boards relating to the effectiveness of their own systems.

Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board has reviewed the effectiveness of internal controls and is satisfied that the controls in place remain appropriate.

### Monitoring

The Board oversees the monitoring system and has set specific responsibilities for itself and the various committees as set out below. Both Internal Audit and our external auditors play key roles in the monitoring process, as do several other committees including the Finance Committee, Compliance Committee and Corporate Responsibility Committee. The Minutes of the Audit Committee and the various other committees (Finance, Compliance and Corporate Responsibility Committees) are distributed to the Board and each Committee submits a report for formal discussion at least once a year. These processes provide assurance that the Group is operating legally, ethically and in accordance with approved financial and operational policies.

### Audit Committee

The Audit Committee reports to the Board each year on its review of the effectiveness of the internal control systems for the financial year and the period to the date of approval of the financial statements. Throughout the year the Committee receives regular reports from the external auditors covering topics such as quality of earnings and technical accounting developments. The Committee also receives updates from Internal Audit and has dialogue with senior managers on their control responsibilities. It should be understood that such systems are designed to provide reasonable, but not absolute, assurance against material misstatement or loss.

### Internal Audit

The Internal Audit department is fully independent of business operations and has a Group-wide mandate. It undertakes a programme to address internal control and risk management processes with particular reference to the Turnbull Guidance. It operates a risk-based methodology, ensuring that the Group's key risks receive appropriate regular examination. Its responsibilities include maintaining the Key Risk Register, reviewing and reporting on the effectiveness of risk management systems and internal control with the Executive Committee, the Audit Committee and ultimately to the Board. Internal Audit facilitates oversight of risk and control systems across the Group through risk committees in Asia and Europe and audit committees in a number of our international businesses and joint ventures. The Head of Internal Audit also attends all Audit Committee meetings.

### External audit

PricewaterhouseCoopers LLP, who have been the Company's external auditor for a number of years, contributes a further independent perspective on certain aspects of our internal financial control systems arising from its work, and reports to both the Board and the Audit Committee. Our policy in relation to the reappointment of the external auditors is to consider their engagement and independence annually. The Committee has satisfied itself that PricewaterhouseCoopers LLP is independent and there are adequate controls in place to safeguard its objectivity. One such measure is the non-audit services policy that sets out criteria for employing external auditors and identifies areas where it is inappropriate for PricewaterhouseCoopers LLP to work. Non-audit services work carried out by PricewaterhouseCoopers LLP is predominantly the review of subsidiary undertakings' statutory accounts, transaction work and corporate tax services, where their services are considered to be the most appropriate. PricewaterhouseCoopers LLP also follows its own ethical guidelines and continually reviews its audit team to ensure its independence is not compromised.

### Finance Committee

Membership of the Finance Committee includes Non-executive Directors with relevant financial expertise, Executive Directors and members of senior management. The Committee is chaired by Sir Terry Leahy, CEO. The Committee usually meets twice a year and its role is to review and agree the Finance Plan on an annual basis, review reports of the Treasury and Tax functions and to review and approve Treasury limits and delegations.

### Compliance Committee

Membership of the Compliance Committee includes three Executive Directors and members of senior management. The Committee is chaired by Lucy Neville-Rolfe, Corporate and Legal Affairs Director. The Committee normally meets six times a year and its remit is to ensure that the Group complies with all necessary laws and regulations and other compliance policies in all of its operations world-wide. The Committee has established a schedule for the regular review of operational activities and legal exposure. Each business in the Group has a Compliance Committee designed to ensure compliance with both local and Group policies, and each Compliance Committee reports to the Group Compliance Committee at least once a year.

### Corporate Responsibility Committee

The Corporate Responsibility Committee is chaired by the Corporate and Legal Affairs Director, Lucy Neville-Rolfe and membership is made up of senior executives from across the Group. It meets at least four times a year to support, develop and monitor policies on SEE issues and to review threats and opportunities for the Group. Progress in developing Community initiatives is monitored by the use of relevant KPIs for the businesses within the Group. The Board formally discusses the work of the Committee on a regular basis, including progress in implementing our Community Plan.

The Corporate and Legal Affairs department and the Trading Law and Technical department provide assurance and advice on legal compliance, health and safety, and SEE matters. These functions report on their work on a regular basis and escalate matters as appropriate.

### Whistleblowing

The Group operates a whistleblowing policy and has a confidential 'Protector Line' service accessible to concerned employees where they can report, anonymously if necessary, on issues of malpractice within the business. Such issues include illegal and unethical behaviour such as fraud, dishonesty and any practices that endanger our staff, customers or the environment.

Complaints made are treated as confidential and are investigated. Where appropriate, matters will be escalated to the Director of Group Security for further action.

### Management

In our fast moving business, trading is tracked on a daily and weekly basis, financial performance is reviewed weekly and monthly and the Steering Wheel is reviewed quarterly. Steering Wheels are operated in business units across the Group and reports are prepared of performance against target KPIs covering the five segments of the Steering Wheel (Customer, Operations, Community, People and Finance) on a quarterly basis, enabling management to measure performance. All major initiatives require business cases normally covering a minimum period of five years. Post-investment appraisals, carried out by management, determine the reasons for any significant variance from expected performance.

### Relations with stakeholders

We are committed to having a constructive dialogue with stakeholders to ensure we understand what is important to them and allow ourselves the opportunity to present our position. Engagement helps us identify new risks and opportunities to ensure that our long-term strategy is sustainable. In some instances we find that working with stakeholders in partnership can help deliver shared goals. We might not be able to satisfy all stakeholder concerns all the time but through engagement we can do our best to balance competing demands. We know that customers need to be able to trust our business and they will only trust us if they believe that we are engaging on an appropriate basis with our stakeholders.

Our programme of engaging with stakeholders including customers, staff, suppliers, investors, government, regulators, non-governmental organisations and others, is set out in more detail in our Corporate Responsibility Report 2010 and on our website ([www.tesco.com/cr2010](http://www.tesco.com/cr2010)).

### Shareholder engagement

We are committed to maintaining a good dialogue with shareholders through proactively organising meetings and presentations as well as responding to a wide range of enquiries. We seek shareholder views on a range of issues from strategy to corporate governance and SEE issues. We recognise the importance of communicating appropriately any significant Company developments.

During the year, the Chairman, Chief Executive and Finance Director met with most of our leading shareholders to discuss issues relating to the Board, strategy and governance matters, as well as new developments within the business. The Chairman's meetings with major shareholders took place independently from the Executive team. In addition to this, our Investor Relations team engage with shareholders on a regular basis, and on a wide range of issues. The Corporate Secretariat team also organise regular meetings, on both a one-to-one and group basis, with socially responsible investors (SRIs) to discuss the work the Group is doing on corporate responsibility and governance-related issues. These meetings are attended as appropriate by Directors and other members of senior management.

An Investor Relations report is produced for the Board periodically. This report summarises feedback from shareholders particularly in terms of our management and strategy, and ensures the Board has a balanced perspective on the views of our major shareholders.

It is normal that institutional shareholders may be in more regular contact with the Group than other shareholders, but care is exercised to ensure that any price-sensitive information is released to all shareholders, institutional and private, at the same time in accordance with applicable legal and regulatory requirements. All major presentations to institutional shareholders are made available to private shareholders through the Tesco PLC website.

Every shareholder may choose to receive a full Annual Report and Financial Statements or the Annual Review and Summary Financial Statements, either in paper or electronic form. These reports, together with publicly-made trading statements, are available on the Group's website, [www.tesco.com/annualreport2010](http://www.tesco.com/annualreport2010)

### The Tesco PLC AGM

The Annual General Meeting offers the opportunity for the Board to communicate directly to shareholders. Our last Annual General Meeting in July 2009 was held in Glasgow. The 2010 AGM will be held in London at 10.30am on Friday 2 July. The choice of location is based on our policy of widening the opportunity for our shareholders around the country to attend the AGM, by moving to a different location in the UK each year.

The whole Board attends the meeting and is available to answer questions from shareholders present. To encourage shareholder participation, we offer electronic proxy voting and voting through the CREST electronic proxy appointment service. At our last Annual General Meeting, all resolutions were voted by way of electronic poll. This follows best practice guidelines and allows the Company to count all votes, not just those of shareholders attending the meeting. The Chairman announces the provisional voting results at the meeting, and the final results are announced the same day through the Regulatory News Services and the Tesco PLC website.

By Order of the Board  
**Mr Jonathan Lloyd**  
 Company Secretary  
 5 May 2010

Tesco PLC  
 Registered Number: 445790  
 Registered in England and Wales  
 Registered Office: Tesco House, Delamare Road, Cheshunt,  
 Hertfordshire EN8 9SL  
 VAT Registration Number: GB 220 4302 3

# Directors' remuneration report

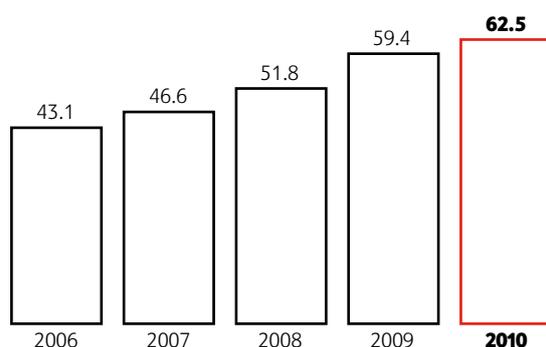
This report sets out the remuneration policy for the Executive and Non-executive Directors of Tesco PLC and describes the individual remuneration of the Directors for the year ended 27 February 2010. The report has been drawn up in accordance with the Combined Code on Corporate Governance, Schedule 8 of the Large and Medium sized Companies and Groups (Accounts and Reports) Regulations 2008 and the Financial Services Authority Listing Rules.

## Executive summary

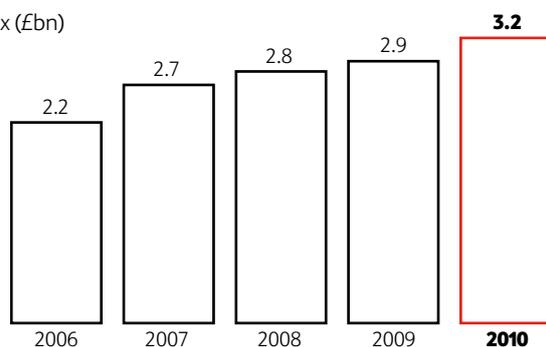
Tesco aims to deliver, sustainable and profitable long-term growth. Despite challenging economic conditions across our markets, Tesco has again delivered a strong performance against targets this year. In doing so, Tesco has continued to build on the track record it has established over several years.

## Sales, Profit and ROCE Performance over 5 years

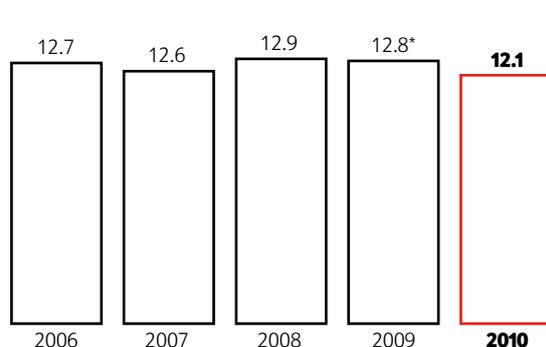
Sales (£bn)



Profit before tax (£bn)



ROCE (%)



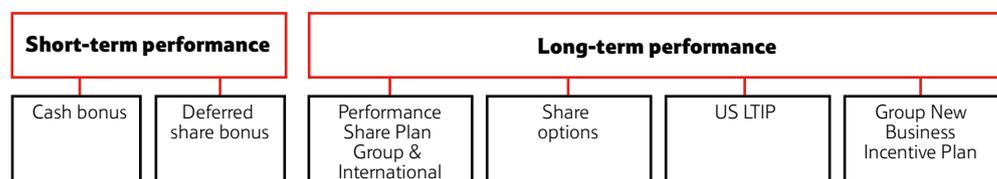
\* Restated for the impact of IFRIC 13 and IFRS 2.

## Balance of fixed and performance related remuneration

Fixed element



Performance-related elements



c.12%-33% depending on individual incentive arrangements and performance

c.67%-88% depending on individual incentive arrangements and performance

Tesco is already a large and profitable company. A 10% increase in Company value equates to some £3bn in additional shareholder value, equivalent to the value of a top 50 FTSE organisation. Over the last 5 years, Tesco has delivered more than £10bn of additional shareholder value through dividends and share price growth. Continuing to grow profitability from such a high base is demanding but forms the core of Tesco's strategy and its supporting processes including executive remuneration. Our remuneration strategy is intended to foster a culture of outstanding performance, taking into account both the short-term and long-term needs of the business.

In determining the level of executive reward, the Remuneration Committee continues to be conscious of the economic background and widespread concern about executive remuneration being appropriately justified by company performance. It has therefore sought to ensure reward outcomes are proportionate to Tesco's performance outcome.

The strong result against targets in 2009/10 included improvement on most of the underlying performance measures relating to productivity and growth. Against this performance background, the main aspects of executive remuneration policy and practice for the year are as follows:

- Operational Executive Director salaries were increased from 1 July 2009 by an average of 2.58% after the normal review (against an average across the Group of 2.5%);
- annual bonus payouts ranged from 75% to 95% of maximum reflecting strong performance during the year against financial and strategic milestones. The maximum potential bonus was 250% of salary for the Group CEO, 300% of salary for the US CEO and 200% of salary for other Executive Directors;
- long-term incentive payout was 124 of a potential maximum of 150% of salary;
- share options vested in full reflecting sustained strong earnings delivery;
- no material changes were made to policy, remuneration mix or scale of incentives;
- deferred awards, already earned from prior years, representing 4.5 million shares became available to Directors;
- there have been no substantial changes to the commercial structure of the terms of existing awards, however, a number of shares have been released from awards already earned from prior years to satisfy tax liabilities crystallised in the year;
- minor changes to remuneration arrangements relating to leaving conditions were approved by shareholders; and
- there continued to be a high level of share ownership by Executive Directors.

## Executive Director remuneration strategy

Tesco has a long-standing policy of valuing talent and experience. We seek to provide incentives for delivering high, sustainable and profitable growth which leads to a strong increase in additional value for shareholders. We operate in a keenly competitive and rapidly changing retail environment. Business success depends on the skills of each member of the key team, but outstanding business performance comes from teamwork. Tesco has a stable and successful management team, and incentivising and rewarding that team at senior levels to deliver ever higher levels of performance is vital to our ongoing success and our ability to create shareholder value. We believe our incentives should support the continued progress and the strengthening of our returns from across the Group, as well as the creation and development of significant new businesses.

The Remuneration Committee believes that the majority of total remuneration should be performance-related and delivered largely in shares closely to align the interests of shareholders and Executive Directors. In determining the balance between the fixed and variable elements of the Executive Directors' remuneration packages, the Committee takes into account both policy and market practice.

Total remuneration levels for Executive Directors are reviewed annually by the Committee taking into account their value to the Company in terms of continuing strong performance, potential and competitive market practice. Consideration is also given to reward levels at the next tier of management and across the Group in order to sustain a common sense of purpose and sharing of success as well as to ensure that executive arrangements remain appropriate in the context of wider Group remuneration. When setting the remuneration of Executive Directors, the Committee considers the Group's performance against a mixture of corporate objectives and financial measures. These corporate objectives include specific measures based on environmental, social and governance (ESG) factors, an integral part of the corporate strategy. Inclusion of these specific measures in a number of parts of the remuneration structure helps to reinforce positive and responsible behaviour by senior management. To find out more go to [www.tesco.com/annualreport2010](http://www.tesco.com/annualreport2010)

### Performance related remuneration

The remuneration structures for Executive Directors and other key executives are tailored to emphasise the delivery of strong year-on-year earnings growth as well as sustained performance in the longer term. More than two-thirds of total remuneration (excluding pension) is linked to the performance of the business. Long-term performance is rewarded through delivery of shares and short-term performance through a combination of cash and compulsorily deferred shares. This combines emphasis on strong year-on-year performance with long-term executive share ownership, providing a strong link between the incentives received and shareholder value.

### Performance measures

The Executive Directors have a range of performance targets across the various incentive plans which reflect the objectives of the Group and their own responsibilities and are aligned with long-term shareholder value creation. Targets are generally set to reward performance improvement compared to prior periods, with maximum awards only paying out for delivery of strong performance.

The measures are summarised in the table below and are based on:

- delivery of improved bottom-line financial results, measured through earnings, both in the present year and sustainably over time;
- enhancement of efficient profitability, measured through return on capital, whilst growing the business;
- improving share price via the use of share options throughout the organisation;
- achievement of durable improvements in the underlying drivers of performance such as cost reduction, energy efficiency, reduced environmental impact and sales growth captured through various corporate measures; and
- laying foundations for future performance through measures such as accessing new sales footage, developing people and implementing community programmes which are also captured through the corporate measures.

The sustainability of our business is key and the Remuneration Committee is satisfied that the measures and targets do not incentivise Executive Directors to take an inappropriate level of risk.

Short-term Performance Measures					
Measures	Participation	Incentivises	Maximum potential % of salary	Performance period	Delivered via
Earnings per share	All Executive Directors	Year on year earnings growth	125% (US CEO 62.5%)	One year	Annual cash and annual deferred share bonuses (3-year deferral)
Corporate objectives	All Executive Directors	Delivery of strategic business priorities, entrepreneurial spirit and building framework for future growth	55% (US CEO 27.5%)	One year	Annual cash and annual deferred share bonuses (3-year deferral)
Total shareholder return	All Executive Directors	Share price and dividend growth versus competitors	20% (US CEO 10%)	One year	Annual deferred share bonuses (3-year deferral)
Specific US objectives	US CEO	Delivery against financial and strategic milestones for US business	200%	One year	Annual cash and annual deferred share bonuses (3-year deferral)
Specific US objectives	Group CEO	Delivery against financial and strategic milestones for US business	50%	One year	Annual deferred share bonuses (3-year deferral)

# Directors' remuneration report continued

Long-term Performance Measures					
Measures	Participation	Incentivises	Maximum potential % of salary (unless otherwise stated)	Performance period	Delivered via
EPS relative to RPI	All Executive Directors	Longer-term earnings growth	200%*	Three years	Executive share options
Group ROCE	All Executive Directors	Long-term business success and shareholder returns	100%	Three years	Performance Share Plan
International ROCE	All Executive Directors except US CEO	Long-term business success and shareholder returns	50%	Three years	Performance Share Plan
US EBIT and ROCE	US CEO	Establishment of successful US business	2 million shares**	2010/11 – 2013/14	US Long Term Incentive Plan
US EBIT and ROCE Group ROCE International ROCE	Group CEO	Entrepreneurial spirit and establishment of new businesses within whole Group performance	2.5 million shares**	2010/11 – 2013/14	Group New Business Incentive Plan

\* This is the amount on which the number of shares under option is calculated. The actual realisable value of these options will depend on any growth in share price between the date of grant and the date of exercise.

\*\* Dividends accrue on these awards in the form of dividend equivalents.

Participation in the various elements is governed by the Remuneration Committee and individual Executive Directors are awarded incentives under the elements which are most relevant to their sphere of responsibility.

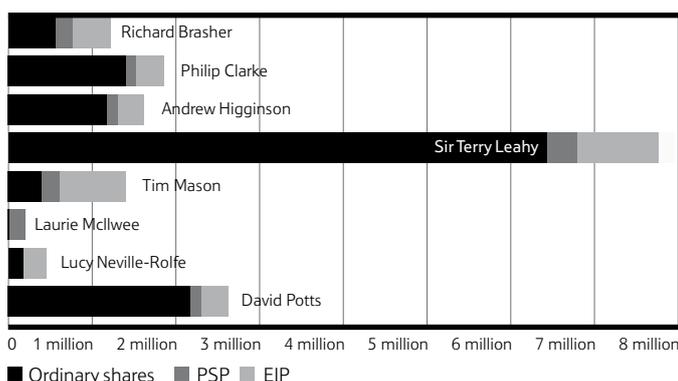
If performance is lower than the maximum targets, incentive payments will reduce accordingly and will be zero if threshold levels of performance are not attained. The Committee has reviewed the performance conditions for each of the incentive arrangements against the Group's business strategy, its growing global leadership, its position as one of the companies at the top of the FTSE 100 and the intensely competitive sector in which it operates, and has concluded that they provide a set of comprehensive and robust measures of management's effort and success in creating shareholder value.

## Share ownership guidelines

The Remuneration Committee believes that Executive Directors holding shares aligns their interests with shareholders and reinforces their commitment to the business. Executive Directors are required to build and maintain a shareholding with a value at least equal to their basic salary. Shares held in plans which are not subject to forfeiture are included in this measurement. New appointees will typically be allowed three years to establish this shareholding. Full participation in the long-term Performance Share Plan is conditional upon maintaining the minimum shareholding. All Executive Directors satisfy this requirement, apart from Laurie McIlwee, who was appointed to the Board on 27 January 2009.

## Shares held by Executive Directors

as at 27 February 2010



Includes ordinary shares and awards of shares and nil cost options made to Directors which remain subject only to a holding period. Excludes unexercised vested executive share options.

## Funding of equity awards

Executive incentive arrangements are funded by a mix of newly issued shares and shares purchased in the market. Where shares are newly issued the Company complies with ABI dilution guidelines on their issue. Currently shares to be issued in respect of executive plans are equivalent to c.4% of shares in issue.

## Fixed remuneration

### Basic pay

Basic pay is designed to attract and retain talented individuals. It needs to reflect individual capability and any changes in responsibilities as the Group faces new opportunities and challenges. As the Group continues to diversify into new product areas and services, as well as expanding internationally, it seeks to reflect this in the benchmarking that is used. We examine salary levels at the major retailers, the leading FTSE companies and ensure consideration is given to key international competitors. We also take into account pay conditions throughout the Group as well as the prevailing economic climate in deciding executive annual salary increases. The average increase for senior management below Board level last year was 2.58%, in line with the average increase for other staff which was typically around 2.5%. Pay levels Group-wide are determined with consideration to a number of factors, including the prevailing economic environment, discussions with employee representation groups and market practice.

Basic salaries are typically increased with effect from 1 July each year and the Remuneration Committee will again be taking into account the prevailing economic climate in setting Executive Director salaries for the coming year.

Director	Basic salary 1 July 2009 £000
Richard Brasher	812
Philip Clarke	812
Andrew Higginson	812
Sir Terry Leahy	1,410
Tim Mason	812
Laurie McIlwee*	609
Lucy Neville-Rolfe*	609
David Potts	812

\* Laurie McIlwee and Lucy Neville-Rolfe's basic salaries were increased by 10.7% and 9.9% respectively reflecting their increased experience since their appointment.

## Pensions

Pension provision is central to our ability to foster loyalty and retain experience which is why Tesco wants to ensure that the Tesco PLC Pension Scheme is a highly valued benefit. All Executive Directors are members of the Tesco PLC Pension Scheme which provides a pension of up to two-thirds of base salary on retirement, normally at age 60, dependent on service. The Final Salary Scheme is now closed to new entrants but has been replaced throughout the organisation by a different defined-benefit pension scheme based on career average earnings. Since April 2006, following implementation of the regulations contained within the Finance Act 2004, Executive Directors have been eligible to receive the maximum pension that can be provided from the registered pension scheme. The balance of any pension entitlement for all Executive Directors is delivered through an unapproved retirement benefits scheme (SURBS). Except for Tim Mason, the SURBS is 'secured' by using a fixed charge over a cash deposit in a designated account.

Over the last few years pension contributions by our Executive Directors have been increasing progressively. In 2009/10 the level of contribution was 8% of salary which is in line with senior management's contribution levels. Contributions will rise over the next two years to 10% by 2011/12. Further details of the pension benefits earned by the Directors can be found on page 58.

## All employee share schemes

The Executive Directors are eligible to participate in the Company's all employee share schemes on the same terms as other UK employees.

- **Shares In Success.** Shares in the Company are allocated to participants in the scheme up to HMRC approved limits (currently £3,000 per annum). The amount of profit allocated to the scheme is determined by the Board, taking account of Company performance.
- **Buy as You Earn.** An HMRC approved share purchase scheme under which employees invest up to a limit of £110 on a four-weekly basis to buy shares at market value in Tesco PLC.
- **Save as You Earn.** An HMRC approved savings-related share option scheme under which employees save up to a limit of £250 on a four weekly basis via a bank/building society with an option to buy shares in Tesco PLC at the end of a three-year or five-year period at a discount of up to 20% of the market value. There are no performance conditions attached to SAYE options.

## Other benefits

The Executive Directors are eligible for car benefits, life assurance, disability and health insurance and staff discount.

## 2009/10 Performance measurement

### Short-term performance 2009/10

#### Earnings per share

The reported underlying diluted Group EPS for 2009/10 was 31.66p, an increase of 9.1% on last year.

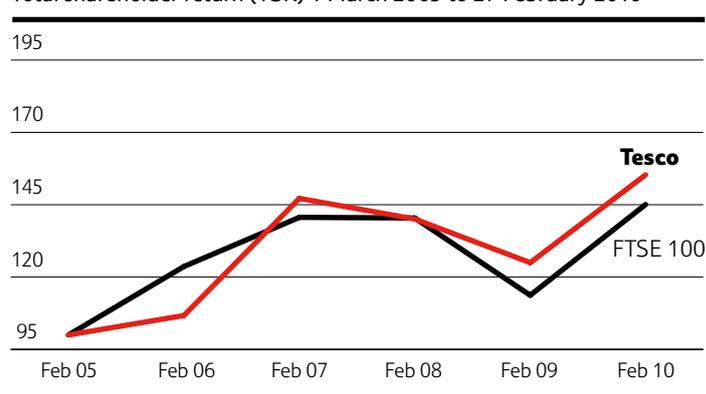
#### Corporate objectives

The corporate objectives are based on our balanced scorecard, known as the Steering Wheel. Corporate objectives for the awards made in respect of the financial year 2009/10 included increasing sales from new space; specific profit targets for international businesses and for retailing services; like-for-like sales growth and the development of the non-food business; focus on developing trading models internationally; enhancing talent management and capability; embedding the new international Community Plans and Community Promises; and reducing our environmental impact. Performance against most targets was within the target range.

#### Total shareholder return

The graph below highlights the Group's total shareholder return performance over the last five financial years, relative to the FTSE 100 index of companies. This index has been selected to provide an established and broad-based comparator group of retail and non-retail companies of a similar scale to Tesco.

Total shareholder return (TSR) 1 March 2005 to 27 February 2010



TSR is the notional return from a share or index based on share price movements and declared dividends.

The Committee considers TSR performance against the FTSE 100 and a comparator group of international retailers that includes Ahold, Carrefour, J Sainsbury, Metro, Morrisons, Safeway Inc, Target and Walmart.

Following the Remuneration Committee's consideration of the extent to which the various performance measures (EPS, corporate objectives and TSR) in respect of the 2009/10 award were achieved, the Executive Directors have been awarded 95% of the potential maximum for the cash element and 94% of the potential maximum for the deferred shares element of their annual bonus. The Committee believes that this level of bonus appropriately reflects the strong performance against financial and strategic milestones.

## US objectives

Additional awards are made to Tim Mason and Sir Terry Leahy subject to performance conditions which measure the progress of the US business against a range of aggressive targets related to the development of this business. During 2009/10 advances were made on most measures including store development, sales growth, cost management and customer factors. However, the ongoing economic downturn did continue to act as a constraint over the year on the pace of growth against the demanding development objectives.

The Remuneration Committee has assessed the bonus outturn for 2009/10 and Tim Mason has been awarded 65% of the potential maximum for both the cash and deferred shares elements of that part of his annual bonus which is measured by reference to US-specific targets. Sir Terry Leahy has been awarded 65% of the potential maximum for that part of his annual bonus which is measured by reference to US-specific targets and which is satisfied in deferred shares.

## Long-term performance 2009/10

### Earnings per share

The three-year performance period for the 2007/8 Executive Option grant over shares with a value of 200% of salary at the date of grant ended at the financial year end 2009/10. Vesting of these options was conditional on the achievement of earnings per share performance conditions, with the first 100% subject to the achievement of underlying diluted EPS growth of at least RPI plus 9% over three years with the balance vesting for achieving growth of at least RPI plus 15%. There is no re-testing of performance. The increase in underlying diluted EPS relative to RPI over the three years from 2007/8 to 2009/10 exceeded 15% and these options will therefore vest in full on the third anniversary of their grant.

### Return on capital employed

Following the completion of the three-year performance period for the 2007/8 PSP award, the Committee considered the level of performance against the target for the first 75% of the PSP award of achieving post-tax Group ROCE of 14.2% by the end of 2009/10. Post-tax ROCE (calculated on a like-for-like basis with the target originally set) at the end of 2009/10 was 14.2%, so the full amount of the first 75% of the award will vest. The Committee also exercised its judgement as to the extent to which the remaining 25% of the PSP award should vest as a result of superior ROCE performance, taking into account factors including the level of

# Directors' remuneration report continued

ROCE achieved, the expected ROCE for additional and existing capital investment, whether capital spend was in line with strategic objectives and balanced short-term and long-term investment needs, the level of sales and underlying profit growth and whether this reflected other developments in the marketplace. Having considered these factors in detail the Committee concluded that all of the remaining 25% of the award should vest. A total of 100% of the 2007/8 PSP award measured on group performance will therefore vest.

For the 50% of salary award which related to International ROCE performance, the Committee considered the level of performance against the target for the first 75% of the International PSP award of achieving post-tax International ROCE of 8.1% by the end of 2009/10. Post-tax International ROCE (calculated on a like-for-like basis with the target originally set) at the end of 2009/10 was 6.9% so 23.1 of the first 75% of the award will vest. The Committee also exercised its judgement as to the extent to which the remaining 25% of the PSP award should vest as a result of superior ROCE performance, taking into account the factors outlined above, the Committee concluded that all of the remaining 25% of the International PSP award should vest. A total of 48.1% of the 2007/8 PSP award measured on international performance will therefore vest.

## Future performance measures

The Committee has determined that no change is required for the coming year in the form of incentive arrangements, nor in the relative balance between them. The maximum opportunity under incentive arrangements will remain the same for the 2010/11 year (as set out on pages 53 and 54). The same principles as described earlier were also adopted in the determination of performance targets.

## Short-term performance targets

We do not disclose specific future targets for reasons of commercial sensitivity. However it is intended that performance will continue to be measured against stretching EPS, TSR and Corporate Objective targets aligned with the delivery of our strategy. The continuing difficult market conditions in the US have led to the start-up phase of the US business lasting longer than originally envisaged and so the Group CEO and US CEO will continue to have the opportunity to receive an annual bonus relating to the achievement of financial, strategic and operational targets which measure the early-stage development of the US business. Success against these measures will contribute to building a strong platform for long-term sustainable growth of the US business.

## Long-term performance

### Earnings per share

Options were granted in 2009/10 to Executive Directors over shares with a value of 200% of salary, with an exercise price equal to the market value at the date of grant, and any gain is therefore dependent on increasing the share price between the date of grant and exercise. Vesting of these options is conditional on the achievement of earnings per share performance conditions, with the first 100% subject to the achievement of underlying diluted EPS growth of at least RPI plus 9% over three years and the balance vesting for achieving growth of at least RPI plus 15%. Performance against this target will be measured at the end of 2011/12 to determine the level of vesting.

### Return on capital employed – Group and international

The rules of the Performance Share Plan allow awards to be made over shares up to 150% of salary. In the year ended 27 February 2010 awards were made to all the Executive Directors except Tim Mason over Tesco PLC shares equal to a total of 150% of salary. An award was made to Tim Mason over Tesco PLC shares equal to a total of 100% of salary. For all the Executive Directors, awards over up to 100% of salary will vest (together with reinvested dividends) subject to the achievement of Group ROCE targets. The awards over the equivalent of a further 50% of salary made to the Executive Directors other than Tim Mason will vest (together with reinvested dividends) subject to the achievement of targets based on International ROCE in order to incentivise and reward delivery of higher returns from invested capital outside the UK (but excluding the US).

The first 75% of the awards will vest on a straight-line basis at the end of the three-year performance period, with 25% vesting for baseline performance and the full 75% vesting for maximum performance against target. The target in respect of the first 75% of the 2009/10 PSP award is

achievement of 13.3% Group ROCE and 7.0% International ROCE at the end of the three-year performance period in 2011/12. The remaining 25% of the awards will vest for superior ROCE performance as judged by the Remuneration Committee taking into account the factors outlined above.

If the Remuneration Committee exercises its judgement to allow some, or all, of the remaining 25% of the PSP awards to vest, we will describe in the Directors' Remuneration Report in the relevant year those factors taken into account in determining the level of the award which would vest. There is no re-testing of performance in respect of any targets.

## Return on capital employed – US

The Group is seeking to build a substantial presence in the US, which in time has the potential to become a significant source of value for our shareholders.

The Tesco PLC US Long Term Incentive Plan 2007 (the US LTIP) has been designed to deliver reward only if the US business realises this potential. The US CEO was made an award of two million shares under the US LTIP in 2007. Awards were also made to other senior members of the US management team. No other Executive Directors will participate in the Plan. Awards under the plan vest based on the ROCE and EBIT performance of the US business as set out on page 63.

A key part of the Group's long-term strategy is to consider new business ventures which have the potential for significant long-term value creation for our shareholders. The Group New Business Incentive Plan (Group Plan) supports this initiative. Initially only the Group CEO will participate in the Group Plan. However, awards may be made to other employees at the discretion of the Remuneration Committee in the future where this is appropriate to do so in order to support the Group's new business ventures.

As the Company's US venture is currently the most developed new business initiative, the award made to the Group CEO under the Group Plan is focused on the performance of the US venture, although the Remuneration Committee has the flexibility to consider and include other new business development opportunities within the proposed award. An award of 2.5 million shares was made to the Group CEO in November 2007. This award will vest based on the ROCE and EBIT performance of the US business as set out on page 63, however the plan also requires Group and International ROCE targets to be met and any payouts under this plan will be scaled back on a pro rata basis to the extent they are not met. In addition, the Remuneration Committee will consider the findings of the Governance Oversight Committee (described below) and opinions of the Audit Committee as to whether the level of reported results achieved reflects the underlying financial performance of the Company when considering if, and the extent to which, the award made to the Group CEO will vest.

## Service agreements

The Executive Directors all have rolling service agreements with no fixed expiry date. These contracts are terminated on notice of 12 months by the Company and six months' notice by the Executive. If an Executive Director's employment is terminated (other than pursuant to the notice provisions in the service agreement or by reason of resignation or unacceptable performance or conduct) the Company will pay a sum calculated on the basis of basic salary and the average annual bonus paid for the last two years. No account will be taken of pension. Termination payments will be subject to mitigation. This means that amounts will be paid in instalments to permit mitigation. If the termination occurs within one year of retirement, the termination payment will be reduced accordingly. To reflect his length of service with Tesco and the early age of his appointment as CEO, Sir Terry Leahy's service agreement provides for his full pension entitlement to become available on retirement on or after his 57th birthday.

The Remuneration Committee has agreed that new appointments of Executive Directors will normally be on a notice period of 12 months. The Committee reserves the right to vary this period to 24 months for the initial period of appointment and for the notice period to then revert to 12 months. The service agreements are available to shareholders to view on request from the Company Secretary.

## Outside appointments

Tesco recognises that its Executive Directors may be invited to become Non-executive Directors of other companies. Such Non-executive duties can broaden experience and knowledge which can benefit Tesco.

Subject to approval by the Board, Executive Directors are allowed to accept Non-executive appointments and retain the fees received, provided that these appointments are not likely to lead to conflicts of interest.

Executive Directors' biographies which include details of any outside appointments can be found on pages 36 and 37 of this Report. Fees retained for any Non-executive directorships are set out below.

Director	Company in which Non-executive directorship held	Fee retained in 2009/10 £000
Philip Clarke	Whitbread PLC	55
Andrew Higginson	BSkyB PLC	63
Lucy Neville-Rolfe	The Carbon Trust	18

## Non-executive Directors

Non-executive Directors have letters of appointment setting out their duties and the time commitment expected. The letters are available to shareholders to view from the Company Secretary upon request.

The Chairman meets with each Non-executive Director separately to review individual performance. All Non-executive Directors are subject to re-election by shareholders every three years at the Annual General Meeting and their appointment can be terminated by either party without notice. The remuneration of the Non-executive Directors is determined by the Chairman and the Executive Committee after considering external market research and individual contribution. Non-executive Directors receive a basic fee of £65,000 per annum. The Chairs of the Audit and Remuneration Committees receive £30,000 (in addition to their basic Non-executive fee) and Non-executive Directors who are members of these Committees receive an additional £12,000 for each Committee. The Senior Independent Director, Rodney Chase, who is also the Deputy Chairman, receives a total fee of £135,000 per annum. The Remuneration Committee determines the Chairman's remuneration, having regard to time commitment and packages awarded to Chairmen of other companies of a similar size and complexity. David Reid, Non-executive Chairman, receives an annual fee of £610,000 and has the benefit of a company car and chauffeur.

## The Remuneration Committee

The Remuneration Committee (the Committee) is governed by formal Terms of Reference which are reviewed annually. The Terms of Reference are available from the Company Secretary upon request or can be viewed at [www.tesco.com/boardprocess](http://www.tesco.com/boardprocess)

## Composition of the Committee

The Committee consists entirely of independent Non-executive Directors. The members of the Committee during the year were Charles Allen (Chairman of the Committee), Patrick Cescau, Rodney Chase, Karen Cook, Harald Einsmann and Ken Hanna. Ken Hanna was appointed a member of the Remuneration Committee effective from 1 April 2009. The Directors' biographies can be found on pages 36 and 37 of this Report.

No member of the Committee has any personal financial interest in the matters being decided, other than as a shareholder, nor any day-to-day involvement in running the business of Tesco. Jonathan Lloyd, the Company Secretary, is Secretary to the Committee. David Reid, Non-executive Chairman, Sir Terry Leahy, Chief Executive of the Group and Laurie McIlwee, Group CFO, all attend meetings at the invitation of the Committee. They are not present when their own remuneration is being discussed.

The Committee is supported by the Group Personnel and Finance functions and has continued to use the services of Deloitte LLP whom it appointed as an external, independent advisor. Deloitte LLP also provided advisory services in respect of corporate tax planning, share schemes, international taxation, corporate finance and treasury to the Group during the year. Members' attendance at Committee meetings is listed in the Corporate Governance section on page 47 of this Report.

To find out more go to [www.tesco.com/annualreport2010](http://www.tesco.com/annualreport2010)

## Role of the Committee

The Committee's purpose is to:

- determine and recommend to the Board the remuneration policy for the Chairman and Executive Directors;
- ensure the level and structure of remuneration is designed to attract, retain, and motivate the Executive Directors needed to run the Company;
- agree performance frameworks and targets, and review performance against these;
- monitor the level and structure of remuneration for senior management ensuring it is aligned with shareholders interests; and
- ensure the remuneration relationship between the Executive Directors and senior executives of the Company below this level is appropriate.

The Committee normally meets at least four times a year and has a rolling schedule of items within its remit. In the financial year ended 27 February 2010 the Committee met 7 times, and there was also an off-site meeting to consider remuneration strategy.

## Key activities

During the year, the key activities of the Committee included:

- approval of the 2008/09 Directors' Remuneration Report;
- review and approval of awards made under the Executive Incentive Plan, Performance Share Plan and Discretionary Share Option Plan;
- annual review of all elements of the Executive Directors' reward packages, and those of senior management;
- review of all share plan performance measures against 2008/09 performance targets;
- agreement of final vesting amounts of the 2006 Performance Share Plan Award, and 2006 Discretionary Share Option Plan award;
- design and targets for 2009/10 Annual Bonus;
- consideration of targets for the 2009 Performance Share Plan;
- review of its performance and agreement of steps to enhance its effectiveness;
- review of compliance with director shareholding guidelines ;
- consideration of developments in best practice and updated guidelines on executive compensation from shareholder advisory bodies; and
- review of the Chairman's pay and benefits.

## Governance Oversight Committee

The Governance Oversight Committee (GOC) has been established to review and report at the end of each financial year on the allocation of capital and other Group resources. The GOC comprises the Senior Independent Director of the Company (who chairs the GOC), the Chairman of the Audit Committee and the Chairman of the Remuneration Committee. The Chairman of the Group also attends the GOC and the Company Secretary serves as its secretary. The GOC reports its findings to the Remuneration Committee each year. The Remuneration Committee takes these into account, along with the view of the Audit Committee, to ensure that financial performance against targets is indicative of strong and robust business performance. If appropriate, vesting under the plans may be adjusted by the Remuneration Committee (in respect of Executive Directors) or the Board (in respect of all other employees who are participants). In accordance with the Combined Code, any such adjustments to vesting for Executive Directors will be reported to shareholders in the Directors' Remuneration Report at the relevant time.

## Compliance

In carrying out its duties, the Remuneration Committee gives full consideration to best practice. The Committee was constituted and operated throughout the period in accordance with the principles outlined in the Listing Rules of the Financial Services Authority derived from the Combined Code on Corporate Governance. The auditors' report, set out on page 69, covers the disclosures referred to in this report that are specified for audit by the Companies Act 2006. This report also complies with disclosures required by the Director Remuneration Report Regulations 2002. Details of Directors' emoluments and interests are set out on pages 58 to 66 of this Report.

## Charles Allen

Chairman of the Remuneration Committee

# Directors' remuneration report continued

Tables 1-11 are audited information

**Table 1** Directors' emoluments

	Fixed emoluments			Performance-related emoluments			Total 2009/10 £000	Total 2008/9 £000
	Salary £000	Allowances £000	Benefits <sup>2</sup> £000	Short-term cash £000	Short-term deferred shares £000	Long-term <sup>3</sup> £000		
<b>Executive Directors</b>								
Richard Brasher	805	–	63	771	763	–	<b>2,402</b>	2,267
Philip Clarke	805	–	38	771	763	324	<b>2,701</b>	2,720
Andrew Higginson	805	–	56	771	763	329	<b>2,724</b>	2,754
Sir Terry Leahy	1,398	–	115	1,340	1,784	583	<b>5,220</b>	5,102
Tim Mason – base salary <sup>1</sup>	816	305	343	914	909	329	<b>3,616</b>	3,225
Tim Mason – supplement <sup>1</sup>	200	–	–	225	224	–	<b>649</b>	560
Tim Mason – total	1,016	305	343	1,139	1,133	329	<b>4,265</b>	3,785
Laurie McIlwee	588	–	50	579	572	–	<b>1,789</b>	91
Lucy Neville-Rolfe	589	–	69	579	572	–	<b>1,809</b>	1,606
David Potts	805	–	45	771	763	324	<b>2,708</b>	2,719
<b>Non-Executive Directors</b>								
Charles Allen	95	–	–	–	–	–	<b>95</b>	91
Patrick Cescau	89	–	–	–	–	–	<b>89</b>	5
Rodney Chase	135	–	–	–	–	–	<b>135</b>	129
Karen Cook	77	–	–	–	–	–	<b>77</b>	73
Harald Einsmann	77	–	–	–	–	–	<b>77</b>	73
Ken Hanna <sup>4</sup>	79	–	–	–	–	–	<b>79</b>	–
Ken Hydon	95	–	–	–	–	–	<b>95</b>	91
David Reid (Chairman)	610	–	67	–	–	–	<b>677</b>	657
Jacqueline Tammenoms Bakker	65	–	–	–	–	–	<b>65</b>	9
<b>Total</b>	<b>8,133</b>	<b>305</b>	<b>846</b>	<b>6,721</b>	<b>7,113</b>	<b>1,889</b>	<b>25,007</b>	<b>22,172</b>

- 1 Tim Mason's salary is made up of a base salary and a non-pensionable salary supplement (shown separately). Allowances are made up of compensation payments for additional tax due on equity awards made prior to his move to the US. Tim Mason's benefits are made up of car, travel, medical, tax related costs and services and free shares awarded under the all employee Share Incentive Plan.
- 2 With the exception of Tim Mason, benefits are made up of car benefits, chauffeurs, disability and health insurance, staff discount, gym/leisure club membership and free shares awarded under the all employee Share Incentive Plan.
- 3 The long-term bonus figures shown in table 1 relate to the additional 12.5% enhancements allocated in April 2009 and February 2010 on long-term awards under the old bonus scheme. The long-term bonuses awarded on 15 October 2009 under the Performance Share Plan were awarded in the form of nil cost options with the exception of Tim Mason who received an unfunded promise to deliver shares. Details of these awards are shown in table 6.
- 4 Ken Hanna was appointed during the year. The figure in table 1 is from his date of appointment.

**Table 2** Directors' pension details

Executive Directors are members of the Tesco PLC Pension Scheme which provides a pension of up to two-thirds of base salary on retirement, normally at the age of 60, dependent upon service. The scheme also provides for dependants' pensions and lump sums on death in service. The scheme is a defined benefit pension scheme, which is approved by HMRC.

	Age at 27 February 2010	Years of Company service	Total accrued pension at 27 February 2010 <sup>1,2</sup> £000	Increase in accrued pension during the year £000	(a) Increase in accrued pension during the year (net of inflation) <sup>5</sup> £000	Transfer value of (a) at 27 February 2010 (less Director's contributions) £000	Transfer value of total accrued pension at 28 February 2009 (old basis) <sup>3</sup> £000	Transfer value of total accrued pension at 28 February 2009 (new basis) <sup>3</sup> £000	Transfer value of total accrued pension at 27 February 2010 £000	Increase in transfer value (less Director's contributions) £000
Richard Brasher	48	23	359	27	27	366	3,030	4,133	<b>4,842</b>	709
Philip Clarke	49	35	390	27	27	384	3,530	4,793	<b>5,579</b>	786
Andrew Higginson	52	12	329	37	37	581	3,354	4,265	<b>5,202</b>	937
Sir Terry Leahy <sup>4</sup>	53	31	832	57	57	1,014	12,130	13,767	<b>15,924</b>	2,157
Tim Mason	52	28	424	29	29	450	4,493	5,734	<b>6,662</b>	928
Laurie McIlwee	47	9	178	73	73	944	918	1,257	<b>2,306</b>	1,049
Lucy Neville-Rolfe	57	13	244	39	39	722	3,216	3,442	<b>4,452</b>	1,010
David Potts	52	37	428	29	29	465	4,705	5,932	<b>6,891</b>	959

- 1 The accrued pension is that which would be paid annually on retirement at 60 based on service to 27 February 2010.
- 2 Some of the Executive Directors' benefits are payable from an unapproved pension arrangement. This is secured by a fixed and floating charge on a cash deposit.
- 3 The basis used for calculating transfer values was revised during the year because changes in financial conditions meant that the previous basis for calculating transfer values, used since 2008, no longer produced reasonable values. Transfer values at 28 February 2009 have been restated using the new basis for comparative purposes.
- 4 Sir Terry Leahy is entitled to retire at any age from 57 to 60 inclusive with an immediate pension of two-thirds of base salary.
- 5 Inflation over the year has been allowed for using the September 2009 statutory revaluation order.

**Table 3** Gains made on executive share options<sup>2,3</sup>

	Date of grant	Date exercisable	Date of exercise	Number of options exercised	Option price (pence)	Market price at exercise (pence)	Value realisable <sup>1</sup>	
							2009/10 £000	2008/9 £000
Richard Brasher	26.06.00	26.06.03	24.11.09	106,613	205.00	427.36	<b>237</b>	–
	26.04.01	26.04.04	24.11.09	101,215	247.00	427.36	<b>183</b>	–
	15.04.02	15.04.05	24.11.09	100,386	259.00	427.36	<b>169</b>	–
	14.04.03	14.04.06	24.11.09	151,900	197.50	427.87	<b>350</b>	–
	30.04.04	30.04.07	24.11.09	296,150	253.25	427.87	<b>517</b>	–
	22.04.05	22.04.08	24.11.09	255,795	312.75	427.87	<b>294</b>	–
	08.05.06	08.05.09	24.11.09	345,261	318.60	427.87	<b>377</b>	–
Philip Clarke	–	–	–	–	–	–	–	–
Andrew Higginson	30.04.04	30.04.07	28.07.09	434,353	253.25	369.13	<b>503</b>	–
Sir Terry Leahy	30.11.99	30.11.02	27.11.09	228,901	173.00	426.86	<b>581</b>	260
	20.04.00	20.04.03	23.02.10	17,673	209.50	423.88	<b>38</b>	–
	26.06.00	26.06.03	23.02.10	780,487	205.00	423.88	<b>1,708</b>	–
Tim Mason	15.04.02	15.04.05	12.01.10	358,301	259.00	426.40	<b>600</b>	–
	30.04.04	30.04.07	12.01.10	434,353	253.25	426.40	<b>752</b>	–
	22.04.05	22.04.08	12.01.10	379,856	312.75	426.40	<b>432</b>	–
	08.05.06	08.05.09	12.01.10	404,896	318.60	426.40	<b>436</b>	–
Laurie McIlwee	22.04.05	22.04.08	23.02.10	105,500	312.75	423.88	<b>117</b>	–
	08.05.06	08.05.09	23.02.10	108,286	318.60	423.88	<b>114</b>	–
Lucy Neville-Rolfe	22.04.05	22.04.09	17.11.09	108,050	312.75	430.64	<b>127</b>	–
	08.05.06	08.05.09	17.11.09	116,133	318.60	430.64	<b>130</b>	–
David Potts	–	–	–	–	–	–	–	–
<b>Total</b>				<b>4,834,109</b>			<b>7,665</b>	<b>260</b>

1 The value realisable from shares acquired on exercise is the difference between the market value at exercise and the exercise price of the option, although the shares may have been retained.

2 Gains made on Save As You Earn share options are not included above. These are detailed in table 5.

3 Gains made on nil cost options awarded under the Performance Share Plan and the Executive Incentive Plan are not included above. These are detailed in table 6 and table 9.

**Table 4** Share options held by Directors and not exercised at 27 February 2010

Executive Share Option Schemes (1994) and (1996) and Discretionary Share Option Plan (2004)

	Date of grant	Options as at 28 February 2009	Options granted in year <sup>1</sup>	Options exercised in year <sup>2</sup>	Options as at 27 February 2010	Exercise price (pence)	Date from which exercisable	Expiry date
Richard Brasher	26.06.2000	106,613	–	106,613	–	205.00	26.06.2003	26.06.2010
	26.04.2001	101,215	–	101,215	–	247.00	26.04.2004	26.04.2011
	15.04.2002	100,386	–	100,386	–	259.00	15.04.2005	15.04.2012
	14.04.2003	151,900	–	151,900	–	197.50	14.04.2006	14.04.2013
	30.04.2004	296,150	–	296,150	–	253.25	30.04.2007	30.04.2014
	22.04.2005	255,795	–	255,795	–	312.75	22.04.2008	22.04.2015
	08.05.2006	345,261	–	345,261	–	318.60	08.05.2009	08.05.2016
	08.05.2007	278,627	–	–	<b>278,627</b>	473.75	08.05.2010	08.05.2017
	12.05.2008	353,114	–	–	<b>353,114</b>	427.00	12.05.2011	12.05.2018
	06.05.2009	–	467,848	–	<b>467,848</b>	338.40	06.05.2012	06.05.2019
<b>Total</b>		<b>1,989,061</b>	<b>467,848</b>	<b>1,357,320</b>	<b>1,099,589</b>			
Philip Clarke	22.04.2005	379,856	–	–	<b>379,856</b>	312.75	22.04.2008	22.04.2015
	08.05.2006	404,896	–	–	<b>404,896</b>	318.60	08.05.2009	08.05.2016
	08.05.2007	298,844	–	–	<b>298,844</b>	473.75	08.05.2010	08.05.2017
	12.05.2008	353,114	–	–	<b>353,114</b>	427.00	12.05.2011	12.05.2018
	06.05.2009	–	467,848	–	<b>467,848</b>	338.40	06.05.2012	06.05.2019
<b>Total</b>		<b>1,436,710</b>	<b>467,848</b>	<b>–</b>	<b>1,904,558</b>			
Andrew Higginson	30.04.2004	434,353	–	434,353	–	253.25	30.04.2007	30.04.2014
	22.04.2005	379,856	–	–	<b>379,856</b>	312.75	22.04.2008	22.04.2015
	08.05.2006	404,896	–	–	<b>404,896</b>	318.60	08.05.2009	08.05.2016
	08.05.2007	298,844	–	–	<b>298,844</b>	473.75	08.05.2010	08.05.2017
	12.05.2008	353,114	–	–	<b>353,114</b>	427.00	12.05.2011	12.05.2018
	06.05.2009	–	467,848	–	<b>467,848</b>	338.40	06.05.2012	06.05.2019
<b>Total</b>		<b>1,871,063</b>	<b>467,848</b>	<b>434,353</b>	<b>1,904,558</b>			

# Directors' remuneration report continued

**Table 4** Share options held by Directors and not exercised at 27 February 2010 continued

Executive Share Option Schemes (1994) and (1996) and Discretionary Share Option Plan (2004)

	Date of grant	Options as at 28 February 2009	Options granted in year <sup>1</sup>	Options exercised in year <sup>2</sup>	Options as at 27 February 2010	Exercise price (pence)	Date from which exercisable	Expiry date
Sir Terry Leahy	30.11.1999	228,901	–	228,901	–	173.00	30.11.2002	30.11.2009
	20.04.2000	17,673	–	17,673	–	209.50	20.04.2003	20.04.2010
	26.06.2000	780,487	–	780,487	–	205.00	26.06.2003	26.06.2010
	26.04.2001	647,773	–	–	<b>647,773</b>	247.00	26.04.2004	26.04.2011
	15.04.2002	642,471	–	–	<b>642,471</b>	259.00	15.04.2005	15.04.2012
	14.04.2003	939,747	–	–	<b>939,747</b>	197.50	14.04.2006	14.04.2013
	30.04.2004	766,041	–	–	<b>766,041</b>	253.25	30.04.2007	30.04.2014
	22.04.2005	658,673	–	–	<b>658,673</b>	312.75	22.04.2008	22.04.2015
	08.05.2006	709,353	–	–	<b>709,353</b>	318.60	08.05.2009	08.05.2016
	08.05.2007	523,556	–	–	<b>523,556</b>	473.75	08.05.2010	08.05.2017
12.05.2008	618,548	–	–	<b>618,548</b>	427.00	12.05.2011	12.05.2018	
06.05.2009	–	812,647	–	<b>812,647</b>	338.40	06.05.2012	06.05.2019	
<b>Total</b>		<b>6,533,223</b>	<b>812,647</b>	<b>1,027,061</b>	<b>6,318,809</b>			
Tim Mason	15.04.2002	358,301	–	358,301	–	259.00	15.04.2005	15.04.2012
	30.04.2004	434,353	–	434,353	–	253.25	30.04.2007	30.04.2014
	22.04.2005	379,856	–	379,856	–	312.75	22.04.2008	22.04.2015
	08.05.2006	404,896	–	404,896	–	318.60	08.05.2009	08.05.2016
	10.08.2007	333,319	–	–	<b>333,319</b>	424.75	10.08.2010	10.08.2017
	12.05.2008	353,114	–	–	<b>353,114</b>	427.00	12.05.2011	12.05.2018
	06.05.2009	–	467,848	–	<b>467,848</b>	338.40	06.05.2012	06.05.2019
<b>Total</b>		<b>2,263,839</b>	<b>467,848</b>	<b>1,577,406</b>	<b>1,154,281</b>			
Laurie McIlwee <sup>2</sup>	22.04.2005	105,500	–	105,500	–	312.75	22.04.2008	22.04.2015
	08.05.2006	108,286	–	108,286	–	318.60	08.05.2009	08.05.2016
	08.05.2007	77,192	–	–	<b>77,192</b>	473.75	08.07.2010	08.05.2017
	12.05.2008	91,335	–	–	<b>91,335</b>	427.00	12.05.2011	12.05.2018
	06.05.2009	–	325,059	–	<b>325,059</b>	338.40	06.05.2012	06.05.2019
<b>Total</b>		<b>382,313</b>	<b>325,059</b>	<b>213,786</b>	<b>493,586</b>			
Lucy Neville-Rolfe	22.04.2005	108,050	–	108,050	–	312.75	22.04.2008	22.04.2015
	08.05.2006	116,133	–	116,133	–	318.60	08.05.2009	08.05.2016
	08.05.2007	189,973	–	–	<b>189,973</b>	473.75	08.05.2010	08.05.2017
	12.05.2008	231,850	–	–	<b>231,850</b>	427.00	12.05.2011	08.05.2018
	06.05.2009	–	327,494	–	<b>327,494</b>	338.40	06.05.2012	06.05.2019
<b>Total</b>		<b>646,006</b>	<b>327,494</b>	<b>224,183</b>	<b>749,317</b>			
David Potts	22.04.2005	379,856	–	–	<b>379,856</b>	312.75	22.04.2008	22.04.2015
	08.05.2006	404,896	–	–	<b>404,896</b>	318.60	08.05.2009	08.05.2016
	08.05.2007	298,844	–	–	<b>298,844</b>	473.75	08.05.2010	08.05.2017
	12.05.2008	353,114	–	–	<b>353,114</b>	427.00	12.05.2011	12.05.2018
	06.05.2009	–	467,848	–	<b>467,848</b>	338.40	06.05.2012	06.05.2019
<b>Total</b>		<b>1,436,710</b>	<b>467,848</b>	<b>–</b>	<b>1,904,558</b>			
<b>Total</b>		<b>16,558,925</b>	<b>3,804,440</b>	<b>4,834,109</b>	<b>15,529,256</b>			

<sup>1</sup> Executive share options are subject to performance conditions measured over three years as set out on page 56. EPS growth for the period 2006/7 to 2008/9 exceeded RPI by 31%, therefore share options awarded on 8 May 2006 vested in full on 8 May 2009. Executives have until the tenth anniversary of the date of grant to exercise their options.

<sup>2</sup> The market price at exercise is shown in Table 3. The share price as at 27 February 2010 was 420.00p. The share price during the 52 weeks to 27 February 2010 ranged from 301.40p to 437.05p.

**Table 5** Share options held by Directors and not exercised at 27 February 2010

Savings-related share option scheme (1981)

	Date of grant	As at 28 February 2009	Options granted in year	Options exercised in year <sup>1</sup>	As at 27 February 2010	Exercise price (pence)	Value realisable 2009/10 £000	Value realisable 2008/9 £000
Richard Brasher	04.11.2004	1,424	–	1,424	–	232.0	3	–
	02.11.2005	1,298	–	–	<b>1,298</b>	248.0	–	–
	08.11.2006	1,066	–	–	<b>1,066</b>	307.0	–	–
	07.11.2007	819	–	–	<b>819</b>	410.0	–	–
	05.11.2008	1,077	–	–	<b>1,077</b>	311.0	–	–
	11.11.2009	–	948	–	<b>948</b>	328.0	–	–
			5,684	948	1,424	<b>5,208</b>		3
Philip Clarke	04.11.2004	1,424	–	1,424	–	232.0	3	–
	02.11.2005	1,298	–	–	<b>1,298</b>	248.0	–	–
	08.11.2006	1,066	–	–	<b>1,066</b>	307.0	–	–
	07.11.2007	819	–	–	<b>819</b>	410.0	–	–
	05.11.2008	1,077	–	–	<b>1,077</b>	311.0	–	–
	11.11.2009	–	948	–	<b>948</b>	328.0	–	–
			5,684	948	1,424	<b>5,208</b>		3
Andrew Higginson	04.11.2004	1,424	–	1,424	–	232.0	3	–
	02.11.2005	1,298	–	–	<b>1,298</b>	248.0	–	–
	08.11.2006	1,066	–	–	<b>1,066</b>	307.0	–	–
	07.11.2007	819	–	–	<b>819</b>	410.0	–	–
	05.11.2008	1,077	–	–	<b>1,077</b>	311.0	–	–
	11.11.2009	–	948	–	<b>948</b>	328.0	–	–
			5,684	948	1,424	<b>5,208</b>		3
Sir Terry Leahy	04.11.2004	1,424	–	1,424	–	232.0	3	–
	02.11.2005	1,298	–	–	<b>1,298</b>	248.0	–	–
	08.11.2006	1,066	–	–	<b>1,066</b>	307.0	–	–
	07.11.2007	819	–	–	<b>819</b>	410.0	–	–
	05.11.2008	1,077	–	–	<b>1,077</b>	311.0	–	–
	11.11.2009	–	948	–	<b>948</b>	328.0	–	–
			5,684	948	1,424	<b>5,208</b>		3
Tim Mason	04.11.2004	1,424	–	1,424	–	232.0	3	–
	02.11.2005	1,298	–	–	<b>1,298</b>	248.0	–	–
	08.11.2006	1,066	–	–	<b>1,066</b>	307.0	–	–
	07.11.2007	819	–	–	<b>819</b>	410.0	–	–
	05.11.2008	1,077	–	–	<b>1,077</b>	311.0	–	–
	11.11.2009	–	948	–	<b>948</b>	328.0	–	–
			5,684	948	1,424	<b>5,208</b>		3
Laurie McIlwee	08.11.2006	615	–	615	–	307.0	1	–
	07.11.2007	819	–	–	<b>819</b>	410.0	–	–
	05.11.2008	1,077	–	–	<b>1,077</b>	311.0	–	–
	11.11.2009	–	948	–	<b>948</b>	328.0	–	–
		2,511	948	615	<b>2,844</b>		1	3
Lucy Neville-Rolfe	04.11.2004	1,424	–	1,424	–	232.0	3	–
	02.11.2005	1,298	–	–	<b>1,298</b>	248.0	–	–
	08.11.2006	1,066	–	–	<b>1,066</b>	307.0	–	–
	07.11.2007	819	–	–	<b>819</b>	410.0	–	–
	05.11.2008	1,077	–	–	<b>1,077</b>	311.0	–	–
	11.11.2009	–	948	–	<b>948</b>	328.0	–	–
		5,684	948	1,424	<b>5,208</b>		3	2
David Potts	04.11.2004	1,424	–	1,424	–	232.0	3	–
	02.11.2005	1,298	–	–	<b>1,298</b>	248.0	–	–
	08.11.2006	1,066	–	–	<b>1,066</b>	307.0	–	–
	07.11.2007	819	–	–	<b>819</b>	410.0	–	–
	05.11.2008	1,077	–	–	<b>1,077</b>	311.0	–	–
	11.11.2009	–	948	–	<b>948</b>	328.0	–	–
		5,684	948	1,424	<b>5,208</b>		3	2
<b>Total</b>		<b>42,299</b>	<b>7,584</b>	<b>10,583</b>	<b>39,300</b>		<b>3</b>	<b>2</b>

<sup>1</sup> Save As You Earn is an all employee share scheme. Options are not subject to performance conditions. All options are exercisable from 1 February in the year which is 6 years from the year of grant. All options expire 6 months from their exercise date (i.e. on 1 August of the relevant year). All directors exercised their 04.11.04 options on 1 February 2010 when the market price was 422.30p. No options lapsed in the year.

# Directors' remuneration report continued

**Table 6** Long-Term Performance Share Plan<sup>1</sup>

	Date of award/ grant	Share price on award date (pence)	As at 28 February 2009	Shares awarded/ options granted in year	Options exercised/ shares released in year <sup>7</sup>	Shares lapsed <sup>4</sup>	As at 27 February 2010	Date of release/date from which exercisable	Expiry date
Richard Brasher	28.07.2004	253.45	118,367	–	118,367	–	–	28.07.2008	–
	12.10.2005	302.75	197,648	7,721	205,369	–	–	12.07.2009	–
	20.07.2006 <sup>5</sup>	346.25	203,056	7,694	–	20,861	<b>189,889</b>	20.07.2010	–
	14.11.2007	471.10	247,667	9,674	–	–	<b>257,341</b>	14.07.2010	14.11.2017
	08.07.2008	353.76	339,360	13,256	–	–	<b>352,616</b>	08.07.2011	08.07.2018
	15.10.2009	374.00	–	329,382	–	–	<b>329,382</b>	15.07.2012	15.10.2019
<b>Total</b>			<b>1,106,098</b>	<b>367,727</b>	<b>323,736</b>	<b>20,861</b>	<b>1,129,228</b>		
Philip Clarke	28.07.2004	253.45	175,774	–	175,774	–	–	28.07.2008	–
	12.10.2005	302.75	231,787	9,055	240,842	–	–	12.07.2009	–
	20.07.2006 <sup>6</sup>	346.25	217,789	8,253	83,503	22,375	<b>120,164</b>	20.07.2010	–
	14.11.2007	471.10	247,667	9,674	–	–	<b>257,341</b>	14.07.2010	14.11.2017
	08.07.2008	353.76	339,360	13,256	–	–	<b>352,616</b>	08.07.2011	08.07.2018
	15.10.2009	374.00	–	329,382	–	–	<b>329,382</b>	15.07.2012	15.10.2019
<b>Total</b>			<b>1,212,377</b>	<b>369,620</b>	<b>500,119</b>	<b>22,375</b>	<b>1,059,503</b>		
Andrew Higginson	28.07.2004	253.45	175,774	–	175,774	–	–	28.07.2008	–
	12.10.2005	302.75	231,787	6,339	238,126	–	–	12.07.2009	–
	20.07.2006 <sup>6</sup>	346.25	217,789	8,253	83,503	22,375	<b>120,164</b>	20.07.2010	–
	14.11.2007	471.10	247,667	9,674	–	–	<b>257,341</b>	14.07.2010	14.11.2017
	08.07.2008	353.76	339,360	13,256	–	–	<b>352,616</b>	08.07.2011	08.07.2018
	15.10.2009	374.00	–	329,382	–	–	<b>329,382</b>	15.07.2012	15.10.2019
<b>Total</b>			<b>1,212,377</b>	<b>366,904</b>	<b>497,403</b>	<b>22,375</b>	<b>1,059,503</b>		
Sir Terry Leahy	28.07.2004	253.45	304,794	–	304,794	–	–	28.07.2008	–
	12.10.2005	302.75	406,080	15,865	421,945	–	–	12.07.2009	–
	20.07.2006 <sup>5</sup>	346.25	381,553	14,459	–	39,199	<b>356,813</b>	20.07.2010	–
	14.11.2007	471.10	433,836	16,948	–	–	<b>450,784</b>	14.07.2010	14.11.2017
	08.07.2008	353.76	589,465	23,029	–	–	<b>612,494</b>	08.07.2011	08.07.2018
	15.10.2009	374.00	–	571,958	–	–	<b>571,958</b>	15.07.2012	15.10.2019
<b>Total</b>			<b>2,115,728</b>	<b>642,259</b>	<b>726,739</b>	<b>39,199</b>	<b>1,992,049</b>		
Tim Mason <sup>2</sup>	28.07.2004	253.45	90,431	–	90,431	–	–	28.07.2008	–
	12.10.2005	302.75	124,226	4,852	129,078	–	–	12.07.2009	–
	25.08.2006	346.25	217,789	8,253	–	22,375	<b>203,667</b>	20.07.2010	–
	14.11.2007	471.10	165,111	6,450	–	–	<b>171,561</b>	14.07.2010	–
	08.07.2008	353.76	226,240	8,838	–	–	<b>235,078</b>	08.07.2011	–
	15.10.2009	374.00	–	219,588	–	–	<b>219,588</b>	15.07.2012	–
<b>Total</b>			<b>823,797</b>	<b>247,981</b>	<b>219,509</b>	<b>22,375</b>	<b>829,894</b>		
Laurie McIlwee <sup>3</sup>	20.07.2006	346.25	52,808	1,221	48,748	5,281	–	20.07.2009	–
	10.10.2007	465.50	41,890	1,354	–	–	<b>43,244</b>	10.07.2010	–
	08.07.2008	353.76	62,141	2,092	–	–	<b>64,233</b>	08.07.2011	–
	15.10.2009	374.00	–	247,036	–	–	<b>247,036</b>	15.07.2012	15.10.2019
<b>Total</b>			<b>156,839</b>	<b>251,703</b>	<b>48,748</b>	<b>5,281</b>	<b>354,513</b>		
Lucy Neville-Rolfe <sup>3</sup>	20.07.2006	346.25	59,235	1,370	54,901	5,704	–	20.07.2009	–
	14.11.2007	471.10	162,613	6,352	–	–	<b>168,965</b>	14.07.2010	14.11.2017
	08.07.2008	353.76	237,552	9,280	–	–	<b>246,832</b>	08.07.2011	08.07.2018
	15.10.2009	374.00	–	247,036	–	–	<b>247,036</b>	15.07.2012	15.10.2019
<b>Total</b>			<b>459,400</b>	<b>264,038</b>	<b>54,901</b>	<b>5,704</b>	<b>662,833</b>		
David Potts	28.07.2004	253.45	175,774	–	175,774	–	–	28.07.2008	–
	12.10.2005	302.75	231,787	9,055	240,842	–	–	12.07.2009	–
	20.07.2006 <sup>6</sup>	346.25	217,789	8,253	83,503	22,375	<b>120,164</b>	20.07.2010	–
	14.11.2007	471.10	247,667	9,674	–	–	<b>257,341</b>	14.07.2010	14.11.2017
	08.07.2008	353.76	339,360	13,256	–	–	<b>352,616</b>	08.07.2011	08.07.2018
	15.10.2009	374.00	–	329,382	–	–	<b>329,382</b>	15.07.2012	15.10.2019
<b>Total</b>			<b>1,212,377</b>	<b>369,620</b>	<b>500,119</b>	<b>22,375</b>	<b>1,059,503</b>		
<b>Total</b>			<b>8,298,993</b>	<b>2,879,852</b>	<b>2,871,274</b>	<b>160,545</b>	<b>8,147,026</b>		

<sup>1</sup> The Performance Share Plan replaced the Long-term Executive Incentive Scheme. The first award under the new plan was made in 2004. All awards except those described in notes 2-3 and 5-6 have been made in the form of nil cost options.

<sup>2</sup> Tim Mason's awards since 2006 have been made in the form of unfunded promises to deliver shares.

<sup>3</sup> Laurie McIlwee was appointed on 27 January 2009. His 2006, 2007 and 2008 awards were made in the form of conditional shares under the senior management Performance Share Plan. Lucy Neville-Rolfe's 2006 award was also made in the form of conditional shares under the senior management Performance Share Plan. On 20 July 2009, 53,531 shares were released to Lucy Neville-Rolfe and 47,527 shares were released to Laurie McIlwee at a share price of 369.95p. On 12 August 2009, 1,370 shares were released to Lucy Neville-Rolfe and 1,221 shares were released to Laurie McIlwee at a share price of 369.05p.

**Table 6 Long-Term Performance Share Plan<sup>1</sup> continued**

- 4 The awards are subject to performance conditions based on Return on Capital Employed targets. The Group ROCE for 2008/9 was 13.34%, therefore targets for PSP awards granted on 20 July 2006 were partially met and 90% of these awards vested. The balance of the awards (10%) lapsed. Executives are required to retain the vested awards for a further 12 months with the exception of the circumstances covered in notes 5 and 6. Shareholder approval was obtained at the 2007 AGM for the removal of the requirement for any vested shares to be retained for a further 12 months and this applies to awards made after July 2007. All awards are increased to reflect dividend equivalents as each dividend is paid with the exception of the 2004 award on which no dividends accrue.
- 5 Following approval by the Remuneration Committee, Executives were offered the opportunity to surrender the nil cost options awarded on 20 July 2006 in exchange for an equivalent number of restricted shares, and to fund the income tax and national insurance due on these awards at the point of exchange (27 November 2009). The balance of shares shown is in the form of restricted shares, and remains subject to the retention period which ends on 20 July 2010.
- 6 Following approval by the Remuneration Committee, Executives were given the opportunity to surrender the nil cost options awarded on 20 July 2006 in exchange for an award of an equivalent number of restricted shares on 25 February 2010, and to sell sufficient shares to cover the tax liability due. The post tax number of shares under award remains subject to the retention period and will not be released until 20 July 2010. The share price on 25 February 2010 was 416.175p.
- 7 Directors exercised PSP awards as follows:

Director	Date	Price (pence)	Options exercised	Value realised £000	Director	Date	Price (pence)	Options exercised	Value realised £000
Richard Brasher	24.11.09	428.325	321,420	1,377	Sir Terry Leahy	27.11.09	429.275	721,980	3,099
	23.02.10	421.225	2,316	10		23.02.10	421.225	4,759	20
Philip Clarke	12.05.09	350.85	175,774	617	Tim Mason	19.05.09	355.03	90,431	321
	29.12.09	430.00	238,126	1,024		18.11.09	424.85	127,623	542
	23.02.10	421.225	2,716	11	23.02.10	421.225	1,455	6	
Andrew Higginson	25.02.10	416.175	83,503	348	David Potts	23.02.10	421.225	416,616	1,755
	28.07.09	368.40	413,900	1,525		25.02.10	416.175	83,503	348
	25.02.10	416.175	83,503	348					

**Table 7 Group New Business Incentive Plan**

	Date of award/grant	Share price on award date (pence)	As at 28 February 2009	Shares awarded/ options granted in year	Options exercised/ shares released in year	As at 27 February 2010	Date from which exercisable	Expiry date
Sir Terry Leahy	14.11.2007	482.00	2,579,393	100,779	–	<b>2,680,172</b>	Four tranches 2011-2014	14.11.2017
<b>Total</b>				<b>100,779</b>	<b>–</b>	<b>2,680,172</b>		

- 1 The Group New Business Incentive Plan (2007) was approved by shareholders on 29 June 2007. The awards made under this plan will normally vest in four tranches, four, five, six and seven years after the date of award for nil consideration. The award is in the form of nil cost options. Awards may be adjusted to take account of any dividends paid or that are payable in respect of the number of shares earned.
- 2 The vesting of the award made to the Group CEO under this plan will be conditional upon achievement against Group and International performance conditions. The performance conditions under this award will be aligned with the targets set for awards made under the Performance Share Plan (PSP) in each of the years 2007 to 2009, which will become capable of vesting between 2010 and 2012. If less than threshold performance is achieved for each of these PSP awards then no portion of the Group Plan award will become capable of vesting. If maximum Group and International performance is achieved for each of these PSP awards (i.e. the 2007 – 2009 PSP awards vest in full in 2010 – 2012, then the whole of the Group Plan award will become eligible for vesting, subject to achievement of the appropriate new business performance targets referred to below. If Group and International performance for any of these PSP awards is between threshold and maximum levels then the Group award will become eligible for vesting on a pro rata basis, subject always to the achievement of the appropriate new business targets referred to below.
- 3 Once performance against the Group and International targets has been determined, the extent to which the award made to the Group CEO under this Plan is capable of vesting will be conditional on the financial performance of the specified new business venture, as determined by the Remuneration Committee.

**Summary of US business performance conditions**

ROCE hurdle	2010/11	2011/12	2012/13	2013/14
Maximum performance	6% ROCE	9% ROCE	11% ROCE	12% ROCE
Target performance	4% ROCE	6% ROCE	8% ROCE	10% ROCE
<b>Vesting percentage (% of maximum award)</b>				
Vesting levels at maximum performance	Up to 25%	Up to 50%	Up to 75%	Up to 100%
Vesting levels at target performance	Up to 6.25%	Up to 10%	Up to 12.5%	Up to 18.75%

**Table 8 US Long Term Incentive Plan**

	Date of award/grant	Share price on award date (pence)	As at 28 February 2009	Shares awarded in year	Shares released in year	As at 27 February 2010	Date of release
Tim Mason	14.11.2007	482.00	2,063,514	80,622	–	<b>2,144,136</b>	Four tranches 2011-2014
<b>Total</b>				<b>80,622</b>	<b>–</b>	<b>2,144,136</b>	

- 1 The US Long Term Incentive Plan (2007) was approved by shareholders on 29 June 2007. The awards made under this plan will normally vest in four tranches, four, five, six and seven years after the date of award for nil consideration. Vesting will normally be conditional on the achievement of specified performance targets related to the return on capital employed in the US business over the seven-year plan. The targets are set out under table 7.
- 2 The maximum number of shares which may be awarded under the US LTIP is two million shares to the US CEO and 1.5 million shares to any other participant. An award of two million shares was made to Tim Mason, US CEO, in November 2007. Awards may be adjusted to take account of any dividends paid or that are payable in respect of the number of shares earned. The extent to which awards will vest under the US LTIP is conditional on the financial performance of the Company's US business, based on the achievement of stretching Earnings Before Interest and Tax (EBIT) and Return On Capital Employed (ROCE) targets set by reference to the US long-term business plan.
- 3 A percentage of the EBIT of the US business for the relevant years may be allocated to an EBIT pool (the 'profit pool'). The profit pool will be capped at 10% in any one year and is expected to be approximately 5% of cumulative EBIT over the four measurement years (2010/11 to 2013/14). The portion of an award which may vest will be determined by reference to the value of the EBIT pool as well as performance against the ROCE hurdles for the relevant year, as outlined in the table above. To the extent that the ROCE hurdles for any one year are met (either in full or in part), but there is insufficient value in the profit pool to fund the vesting of awards, then the actual vesting in that year will be scaled back so that the profit pool is not exceeded. That portion of the award that has not paid out in that year due to the profit pool being restricted may vest in future years, provided that the profit pool in any later year permits this.
- 4 The targets for the US LTIP have been based on the business plan in respect of the initial phase of the US business. The Remuneration Committee has the responsibility to review these targets in light of the scale and scope of the US business in order to ensure that they remain appropriate and challenging. In particular, the Remuneration Committee will seek the input of the Audit Committee and the Governance Oversight Committee in order to ensure that financial performance against the targets is indicative of strong and robust business performance. Any material adjustments made in respect of the targets will be reviewed and approved by the Audit Committee and will be disclosed in the Directors' Remuneration Report.

# Directors' remuneration report continued

**Table 9** Executive Incentive Plan<sup>1</sup>

	Date of award/grant	Share price on award (pence)	As at 28 February 2009	Shares awarded/ options granted <sup>3</sup>	Shares released/ options exercised <sup>4,6,7</sup>	As at 27 February 2010	Date of release/date from which exercisable
Richard Brasher	20.05.2005	311.00	105,865	4,133	109,998	–	20.05.2008
	26.05.2006	318.50	178,436	6,971	185,407	–	26.05.2009
	24.05.2007 <sup>5</sup>	456.75	150,216	5,868	–	<b>156,084</b>	24.05.2010
	02.05.2008 <sup>5</sup>	424.05	149,192	5,828	–	<b>155,020</b>	02.05.2011
	19.05.2009	351.16	–	204,291	79,336	<b>124,955</b>	19.05.2012
<b>Total</b>			<b>583,709</b>	<b>227,091</b>	<b>374,741</b>	<b>436,059</b>	
Philip Clarke	20.05.2005	311.00	157,210	4,321	161,531	–	20.05.2008
	26.05.2006	318.50	209,257	8,175	217,432	–	26.05.2009
	24.05.2007 <sup>6</sup>	456.75	161,118	6,294	68,639	<b>98,773</b>	24.05.2010
	02.05.2008 <sup>6</sup>	424.05	149,192	5,828	63,559	<b>91,461</b>	02.05.2011
	19.05.2009	351.16	–	204,291	79,336	<b>124,955</b>	19.05.2012
<b>Total</b>			<b>676,777</b>	<b>228,909</b>	<b>590,497</b>	<b>315,189</b>	
Andrew Higginson	20.05.2005	311.00	157,210	4,272	161,482	–	20.05.2008
	26.05.2006	318.50	209,257	5,723	214,980	–	26.05.2009
	24.05.2007 <sup>6</sup>	456.75	161,118	6,294	68,639	<b>98,773</b>	24.05.2010
	02.05.2008 <sup>6</sup>	424.05	149,192	5,828	63,559	<b>91,461</b>	02.05.2011
	19.05.2009	351.16	–	204,291	79,336	<b>124,955</b>	19.05.2012
<b>Total</b>			<b>676,777</b>	<b>226,408</b>	<b>587,996</b>	<b>315,189</b>	
Sir Terry Leahy	20.05.2005	311.00	272,606	10,645	283,251	–	20.05.2008
	26.05.2006	318.50	366,610	14,323	380,933	–	26.05.2009
	24.05.2007 <sup>5</sup>	456.75	282,268	11,028	–	<b>293,296</b>	24.05.2010
	02.05.2008 <sup>5</sup>	424.05	403,030	15,746	–	<b>418,776</b>	02.05.2011
	19.05.2009	351.16	–	443,564	172,255	<b>271,309</b>	19.05.2012
<b>Total</b>			<b>1,324,514</b>	<b>495,306</b>	<b>836,439</b>	<b>983,381</b>	
Tim Mason <sup>2</sup>	20.05.2005	311.00	157,210	4,321	161,531	–	20.05.2008
	24.05.2007	456.75	183,105	7,154	–	<b>190,259</b>	24.05.2010
	02.05.2008	424.05	299,078	11,685	–	<b>310,763</b>	02.05.2011
	19.05.2009	351.16	–	257,040	–	<b>257,040</b>	19.05.2012
<b>Total</b>			<b>639,393</b>	<b>280,200</b>	<b>161,531</b>	<b>758,062</b>	
Lucy Neville-Rolfe	24.05.2007 <sup>5</sup>	456.75	76,815	3,000	–	<b>79,815</b>	24.05.2010
	02.05.2008 <sup>5</sup>	424.05	97,957	3,827	–	<b>101,784</b>	02.05.2011
	19.05.2009	351.16	–	143,003	55,535	<b>87,468</b>	19.05.2012
<b>Total</b>			<b>174,772</b>	<b>149,830</b>	<b>55,535</b>	<b>269,067</b>	
David Potts	20.05.2005	311.00	157,210	6,138	163,348	–	20.05.2008
	26.05.2006	318.50	209,257	8,175	217,432	–	26.05.2009
	24.05.2007 <sup>6</sup>	456.75	161,118	6,294	68,639	<b>98,773</b>	24.05.2010
	02.05.2008 <sup>6</sup>	424.05	149,192	5,828	63,559	<b>91,461</b>	02.05.2011
	19.05.2009	351.16	–	204,291	79,336	<b>124,955</b>	19.05.2012
<b>Total</b>			<b>676,777</b>	<b>230,726</b>	<b>592,314</b>	<b>315,189</b>	
<b>Total</b>			<b>4,752,719</b>	<b>1,838,470</b>	<b>3,199,053</b>	<b>3,392,136</b>	

1 The Executive Incentive Plan replaced the Short-term Executive Incentive Scheme. The first award under the new plan was made in 2005. The awards are subject to performance conditions based on TSR, earnings per share and corporate objectives.

2 Since 2007 Tim Mason's awards have been made in the form of an unfunded promise to deliver shares. His 2005 award was made in the form of nil cost options.

3 The awards are increased to reflect dividends equivalents as each dividend is paid.

4 No options lapsed in the year under the Executive Incentive Plan.

5 Following approval by the Remuneration Committee, Executives were offered the opportunity to surrender the nil cost options awarded on 24 May 2007 and 2 May 2008 in exchange for awards of an equivalent number of restricted shares, and to fund the income tax and national insurance due on these awards at the point of exchange (27 November 2009). The balance of shares shown is in the form of restricted shares, and will not be released until the date specified in the table.

6 Following approval by the Remuneration Committee, Executives were given the opportunity to surrender the nil cost options awarded on 24 May 2007 and 2 May 2008 in exchange for awards of an equivalent number of restricted shares on 25 February 2010, and to sell sufficient shares to cover the tax liability due. The post tax number of shares under award remains subject to the retention period and will not be released until the date specified in the table. The share price on 25 February 2010 was 416.175p.

7 For all Directors except for Tim Mason, the 2009 award was made in the form of restricted shares. The Remuneration Committee gave approval for Executives to sell sufficient shares to cover the tax liability due at the time of award. The post tax number of shares will not be released until 19 May 2012.

8 Directors exercised EIP awards as follows:

Director	Date	Price (pence)	Options exercised	Value realised £000
Richard Brasher	24.11.09	428.325	292,058	1,251
	23.02.10	421.225	3,347	14
Philip Clarke	12.05.09	350.85	157,210	552
	29.12.09	430.00	219,252	943
	23.02.10	421.225	2,501	11
	25.02.10	416.175	132,198	550
Andrew Higginson	28.07.09	368.40	376,462	1,276
	25.02.10	416.175	132,198	550

Director	Date	Price (pence)	Options exercised	Value realised £000
Sir Terry Leahy	27.11.09	429.275	656,652	2,819
	23.02.10	421.225	7,532	32
Tim Mason	19.05.09	355.03	157,210	558
	18.11.09	424.85	4,272	18
	23.02.10	421.225	49	0
David Potts	23.02.10	421.225	380,780	1,604
	25.02.10	416.175	132,198	550

**Table 10** Directors' interests in the Long-Term Incentive Plan<sup>1</sup>

	Year of release	Award date	Number of shares as at 28 February 2009	Shares awarded	Shares released	Number of shares as at 27 February 2010	Value of shares released £000	Release date <sup>3</sup>	Market price on release (pence)
Philip Clarke	2010	09.04.03	252,901	40,811	293,712	–	1,258	18.02.10	428.275
	2011	04.05.04	208,291	63,849	272,140	–	1,166	18.02.10	428.275
Total			461,192	104,660	565,852	–	2,424		
Andrew Higginson	2010	09.04.03	264,143	42,625	306,768	–	1,314	18.02.10	428.275
	2011	04.05.04	208,291	63,849	272,140	–	1,166	18.02.10	428.275
Total			472,434	106,474	578,908	–	2,480		
Sir Terry Leahy	2010	09.04.03	474,135	76,512	550,647	–	2,358	18.02.10	428.275
	2011	04.05.04	367,350	112,609	479,959	–	2,056	18.02.10	428.275
Total			841,485	189,121	1,030,606	–	4,414		
Tim Mason	2010	09.04.03	264,143	42,625	306,768	–	1,314	18.02.10	428.275
	2011	04.05.04	208,291	63,849	272,140	–	1,166	18.02.10	428.275
Total			472,434	106,474	578,908	–	2,480		
Laurie Mcllwee <sup>2,3,4</sup>	2010	24.05.07	58,863	1,902	24,914	<b>35,851</b>	104	24.05.10	–
	2011	21.05.08	62,383	2,206	26,482	<b>38,107</b>	110	21.05.11	–
	2012	20.05.09	–	80,230	32,894	<b>47,336</b>	137	20.05.12	–
Total			121,246	84,338	84,290	<b>121,294</b>	351		
David Potts	2010	09.04.03	252,901	40,811	293,712	–	1,258	18.02.10	428.275
	2011	04.05.04	208,291	63,849	272,140	–	1,166	18.02.10	428.275
Total			461,192	104,660	565,852	–	2,424		
Total			2,829,983	695,727	3,404,416	<b>121,294</b>	14,573		

1 This Plan has been replaced by the Performance Share Plan and Executive Incentive Plan.

2 Bonus shares shown for Laurie Mcllwee were awarded under the senior management bonus scheme before he joined the Board. These shares cannot be retained for an additional three year period and enhanced.

3 Following approval by the Remuneration Committee, all remaining shares awarded under this plan were released, and executives were allowed to sell a sufficient number of shares to cover the tax liability due on release. Executives agreed not to sell the post tax number of shares until the original release date.

4 Following approval by the Remuneration Committee, Laurie Mcllwee surrendered his conditional shares for an equivalent number of restricted shares on 25 February 2010, and sold sufficient shares to cover the tax liability due. The post tax number of shares for each award remains subject to the original holding period. The share price on 25 February 2010 was 416.175p and the total value of shares sold to settle the tax liability was £351,278.

Date of award	09.04.03	04.05.04	24.05.07	21.05.08	20.05.09
Award price (pence)	197.25	248.75	456.63	415.45	356.05

# Directors' remuneration report continued

**Table 11** Disclosable interests of the Directors, including family interests, in Tesco PLC 5p Ordinary shares

	27 February 2010		28 February 2009 (or on appointment if later)	
	Ordinary shares <sup>1,3</sup>	Options to acquire ordinary shares <sup>2,3</sup>	Ordinary shares <sup>1</sup>	Options to acquire ordinary shares <sup>2</sup>
<b>Executive Directors</b>				
Richard Brasher	<b>1,186,704</b>	<b>2,044,136</b>	189,825	3,684,552
Philip Clarke	<b>1,811,821</b>	<b>2,849,105</b>	1,344,598	3,331,548
Andrew Higginson	<b>1,586,895</b>	<b>2,849,105</b>	1,287,438	3,765,901
Sir Terry Leahy	<b>7,806,736</b>	<b>10,639,425</b>	5,992,724	12,558,542
Tim Mason	<b>4,134,570</b>	<b>1,159,489</b>	4,365,664	2,641,390
Laurie McIlwee	<b>237,241</b>	<b>743,466</b>	320,878	384,824
Lucy Neville-Rolfe	<b>443,091</b>	<b>1,417,358</b>	197,903	1,226,627
David Potts	<b>2,559,979</b>	<b>2,849,105</b>	1,737,555	3,331,548
<b>Non-Executive Directors</b>				
Charles Allen	–	–	–	–
Patrick Cescau <sup>5</sup>	–	–	–	–
Rodney Chase	–	–	–	–
Karen Cook	–	–	–	–
Harald Einsmann <sup>5</sup>	<b>355,984</b>	–	303,209	–
Ken Hanna <sup>4</sup>	–	–	–	–
Ken Hydon	<b>30,093</b>	–	30,093	–
David Reid	<b>194,080</b>	–	193,825	–
Jacqueline Tammenoms Bakker	–	–	–	–
<b>Total</b>	<b>20,347,194</b>	<b>24,551,189</b>	15,963,712	30,924,932

- 1 Ordinary shares shown in this table include restricted shares held under the Performance Share Plan shown in table 6, restricted shares held under the Executive Incentive Plan shown in table 9, shares held under the Long-Term Incentive Plan shown in table 10 and shares held under a promise by Tim Mason under the Performance Share Plan, US Long-Term Incentive Plan and Executive Incentive Plan shown in tables 6, 8 and 9 respectively. Between 28 February 2010 and 30 April 2010, 353 shares were purchased by Executive Directors as part of the Buy As You Earn scheme, Tim Mason sold 157,520 shares at 440.1p on 22 April 2010, and David Potts exercised options over 784,752 shares on 22 April 2010 and sold the shares at 440.00p.
- 2 Options to acquire Ordinary shares shown in this table comprise options held under the Executive Share Option Scheme and Discretionary Share Option Plan shown in table 4, Save As You Earn scheme shown in table 5, and nil cost options held under the Performance Share Plan, Group New Business Incentive Plan and Executive Incentive Plan shown in tables 6, 7 and 9 respectively.
- 3 During the year a number of awards were reclassified from nil cost options to restricted shares after Executive Directors agreed to exchange awards already earned under the Performance Share Plan and the Executive Incentive Plan to crystallise their tax due. While the commercial structure of the awards remained the same, the restricted shares are now classified under Ordinary shares.
- 4 Ken Hanna was appointed on 1 April 2009.
- 5 On 21 April 2009, Patrick Cescau purchased a nominal amount of £160,000 of Tesco PLC 6.625% 12/10/10 bonds at a price of 105.75p per bond. On 15 May 2009, Harald Einsmann purchased a nominal amount of £110,000 Tesco PLC 5.00% 24/02/14 bonds at a price of 104.40p per bond. Further information on Tesco bonds can be found in note 21 of the Group financial statements.

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# Statement of Directors' responsibilities

The Directors are required by the Companies Act 2006 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group for the financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as endorsed by the European Union (EU) and have elected to prepare the Company financial statements in accordance with UK Accounting Standards.

In preparing the Group and Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make reasonable and prudent judgements and estimates;
- for the Group financial statements, state whether they have been prepared in accordance with IFRS, as endorsed by the EU;
- for the Company financial statements state whether applicable UK Accounting Standards have been followed; and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time, the financial position of the Company and the Group, and which enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006, and as regards the Group financial statements, Article 4 of the IAS Regulation.

The Business Review includes a fair review of the business and important events impacting it, as well as a description of the principal risks and uncertainties of the business.

The Directors are responsible for the maintenance and integrity of the Annual Review and Summary Financial Statement and Annual Report and Financial Statements published on the Group's corporate website. Legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and of the Company and to prevent and detect fraud and other irregularities.

# Independent auditors' report to the members of Tesco PLC

We have audited the Group financial statements of Tesco PLC for the 52 weeks ended 27 February 2010 which comprise the Group Income Statement, the Group Statement of Comprehensive Income, the Group Balance Sheet, the Group Cash Flow Statement, the Group Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

## Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' responsibilities set out on page 68, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

## Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 27 February 2010 and of its profit and cash flows for the 52 weeks then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

## Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the information given in the Directors' Report for the 52 weeks ended 27 February 2010 for which the Group financial statements are prepared is consistent with the Group financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- a corporate governance statement has not been prepared by the Parent Company.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 45, in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

## Other matter

We have reported separately on the Parent Company financial statements of Tesco PLC for the 52 weeks ended 27 February 2010 and on the information in the Directors' Remuneration Report that is described as having been audited.

## Richard Winter (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
5 May 2010

# Group income statement

Year ended 27 February 2010	notes	52 weeks 2010 £m	53 weeks 2009 Restated* £m
<b>Continuing operations</b>			
Revenue (sales excluding VAT)	2	<b>56,910</b>	53,898
Cost of sales		<b>(52,303)</b>	(49,713)
<b>Gross profit</b>		<b>4,607</b>	4,185
Administrative expenses		<b>(1,527)</b>	(1,252)
Profit arising on property-related items	3	<b>377</b>	236
<b>Operating profit</b>		<b>3,457</b>	3,169
Share of post-tax profits of joint ventures and associates	13	<b>33</b>	110
Finance income	5	<b>265</b>	116
Finance costs	5	<b>(579)</b>	(478)
<b>Profit before tax</b>	3	<b>3,176</b>	2,917
Taxation	6	<b>(840)</b>	(779)
<b>Profit for the year</b>		<b>2,336</b>	2,138
<b>Attributable to:</b>			
Owners of the parent		<b>2,327</b>	2,133
Minority interests		<b>9</b>	5
		<b>2,336</b>	2,138
<b>Earnings per share</b>			
Basic	9	<b>29.33p</b>	27.14p
Diluted	9	<b>29.19p</b>	26.96p

\* See note 1 Accounting policies.

<b>Non-GAAP measure: underlying profit before tax</b>			
	notes	52 weeks 2010 £m	53 weeks 2009 Restated* £m
<b>Profit before tax</b>		<b>3,176</b>	2,917
<b>Adjustments for:</b>			
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	1/5	<b>(151)</b>	88
IAS 19 Non-cash Income Statement charge for pensions	28	<b>24</b>	27
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	1	<b>41</b>	27
IFRS 3 Amortisation charge from intangible assets arising on acquisition	1	<b>127</b>	32
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	1	<b>14</b>	33
<b>Exceptional items:</b>			
IAS 36 Impairment of goodwill arising on acquisitions	1	<b>131</b>	–
Restructuring costs	1	<b>33</b>	–
<b>Underlying profit before tax</b>	1	<b>3,395</b>	3,124

\* See note 1 Accounting policies.

The notes on pages 75 to 120 form part of these financial statements.

# Group statement of comprehensive income

Year ended 27 February 2010	notes	52 weeks 2010 £m	53 weeks 2009 Restated* £m
Change in fair value of available-for-sale financial assets and investments		<b>1</b>	3
Currency translation differences		<b>343</b>	(275)
Total loss on defined benefit pension schemes	28	<b>(322)</b>	(629)
(Losses)/gains on cash flow hedges:			
Net fair value (losses)/gains		<b>(168)</b>	505
Reclassified and reported in the Group Income Statement		<b>5</b>	(334)
Tax relating to components of other comprehensive income	6	<b>54</b>	375
<b>Total other comprehensive income</b>		<b>(87)</b>	(355)
Profit for the year		<b>2,336</b>	2,138
<b>Total comprehensive income for the year</b>		<b>2,249</b>	1,783
<b>Attributable to:</b>			
Owners of the parent		<b>2,222</b>	1,784
Minority interests		<b>27</b>	(1)
		<b>2,249</b>	1,783

\* See note 1 Accounting policies.

# Group balance sheet

	notes	27 February 2010 £m	28 February 2009 Restated* £m	24 February 2008 Restated* £m
<b>Non-current assets</b>				
Goodwill and other intangible assets	10	4,177	4,076	2,336
Property, plant and equipment	11	24,203	23,152	19,787
Investment property	12	1,731	1,539	1,112
Investments in joint ventures and associates	13	152	62	305
Other investments	14	863	259	4
Loans and advances to customers	17	1,844	1,470	–
Derivative financial instruments	22	1,250	1,478	216
Deferred tax assets	6	38	49	104
		<b>34,258</b>	32,085	23,864
<b>Current assets</b>				
Inventories	15	2,729	2,669	2,430
Trade and other receivables	16	1,888	1,820	1,311
Loans and advances to customers	17	2,268	1,918	–
Loans and advances to banks and other financial assets	18	144	1,541	–
Derivative financial instruments	22	224	382	97
Current tax assets		6	9	6
Short-term investments		1,314	1,233	360
Cash and cash equivalents	19	2,819	3,509	1,788
		<b>11,392</b>	13,081	5,992
Non-current assets classified as held for sale	7	373	398	308
		<b>11,765</b>	13,479	6,300
<b>Current liabilities</b>				
Trade and other payables	20	(9,442)	(8,665)	(7,359)
<b>Financial liabilities</b>				
Borrowings	21	(1,529)	(3,471)	(2,084)
Derivative financial instruments and other liabilities	22	(146)	(525)	(443)
Customer deposits	24	(4,357)	(4,538)	–
Deposits by banks	25	(30)	(24)	–
Current tax liabilities		(472)	(362)	(455)
Provisions	26	(39)	(10)	(4)
		<b>(16,015)</b>	(17,595)	(10,345)
<b>Net current liabilities</b>		<b>(4,250)</b>	(4,116)	(4,045)
<b>Non-current liabilities</b>				
<b>Financial liabilities</b>				
Borrowings	21	(11,744)	(12,391)	(5,972)
Derivative financial instruments and other liabilities	22	(776)	(302)	(322)
Post-employment benefit obligations	28	(1,840)	(1,494)	(838)
Deferred tax liabilities	6	(795)	(676)	(791)
Provisions	26	(172)	(200)	(23)
		<b>(15,327)</b>	(15,063)	(7,946)
<b>Net assets</b>		<b>14,681</b>	12,906	11,873
<b>Equity</b>				
Share capital	29	399	395	393
Share premium account		4,801	4,638	4,511
Other reserves		40	40	40
Retained earnings		9,356	7,776	6,842
<b>Equity attributable to owners of the parent</b>		<b>14,596</b>	12,849	11,786
Minority interests		85	57	87
<b>Total equity</b>		<b>14,681</b>	12,906	11,873

\* See note 1 Accounting policies.

**Sir Terry Leahy**  
**Laurie McIlwee**

## Directors

The financial statements on pages 70 to 120 were authorised for issue by the Directors on 5 May 2010 and are subject to the approval of the shareholders at the Annual General Meeting on 2 July 2010.

# Group statement of changes in equity

	Attributable to owners of the parent										Total equity £m
	Issued share capital £m	Share premium £m	Other reserves £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Treasury shares £m	Retained earnings £m	Total £m	Minority interests £m	
At 28 February 2009 (restated*)	395	4,638	40	13	175	173	(229)	7,644	12,849	57	12,906
Profit for the year	–	–	–	–	–	–	–	2,327	2,327	9	2,336
<b>Other comprehensive income</b>											
Change in fair value of available-for-sale financial assets	–	–	–	–	–	–	–	1	1	–	1
Currency translation differences	–	–	–	–	–	325	–	–	325	18	343
Loss on defined benefit schemes	–	–	–	–	–	(2)	–	(320)	(322)	–	(322)
Loss on cash flow hedges	–	–	–	–	(163)	–	–	–	(163)	–	(163)
Tax on components of other comprehensive income	–	–	–	–	–	(33)	–	87	54	–	54
<b>Total other comprehensive income</b>	–	–	–	–	(163)	290	–	(232)	(105)	18	(87)
<b>Total comprehensive income</b>	–	–	–	–	(163)	290	–	2,095	2,222	27	2,249
<b>Transactions with owners</b>											
Purchase of treasury shares	–	–	–	–	–	–	(24)	–	(24)	–	(24)
Share-based payments	–	–	–	–	–	–	73	168	241	–	241
Issue of shares	4	163	–	–	–	–	–	–	167	–	167
Purchase of minority interest	–	–	–	–	–	–	–	91	91	3	94
Dividends paid to minority interests	–	–	–	–	–	–	–	–	–	(2)	(2)
Dividends authorised in the year	–	–	–	–	–	–	–	(968)	(968)	–	(968)
Tax on items charged to equity	–	–	–	–	–	–	–	18	18	–	18
<b>Transactions with owners</b>	4	163	–	–	–	–	49	(691)	(475)	1	(474)
<b>At 27 February 2010</b>	<b>399</b>	<b>4,801</b>	<b>40</b>	<b>13</b>	<b>12</b>	<b>463</b>	<b>(180)</b>	<b>9,048</b>	<b>14,596</b>	<b>85</b>	<b>14,681</b>

	Attributable to owners of the parent										Total equity £m
	Issued share capital £m	Share premium £m	Other reserves £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Treasury shares £m	Retained earnings £m	Total £m	Minority interests £m	
At 23 February 2008	393	4,511	40	12	4	245	(204)	6,814	11,815	87	11,902
IFRIC 13 restatement	–	–	–	–	–	–	–	(29)	(29)	–	(29)
At 23 February 2008 (restated*)	393	4,511	40	12	4	245	(204)	6,785	11,786	87	11,873
Profit for the year	–	–	–	–	–	–	–	2,133	2,133	5	2,138
<b>Other comprehensive income</b>											
Change in fair value of available-for-sale investments	–	–	–	–	–	–	–	3	3	–	3
Currency translation differences	–	–	–	–	–	(269)	–	–	(269)	(6)	(275)
Loss on defined benefit schemes	–	–	–	–	–	(2)	–	(627)	(629)	–	(629)
Gains on cash flow hedges	–	–	–	–	171	–	–	–	171	–	171
Tax on components of other comprehensive income	–	–	–	–	–	199	–	176	375	–	375
<b>Total other comprehensive income</b>	–	–	–	–	171	(72)	–	(448)	(349)	(6)	(355)
<b>Total comprehensive income</b>	–	–	–	–	171	(72)	–	1,685	1,784	(1)	1,783
<b>Transactions with owners</b>											
Purchase of treasury shares	–	–	–	–	–	–	(165)	–	(165)	–	(165)
Share-based payments	–	–	–	–	–	–	140	68	208	–	208
Issue of shares	3	127	–	–	–	–	–	–	130	–	130
Share buy-backs	(1)	–	–	1	–	–	–	–	–	–	–
Purchase of minority interest	–	–	–	–	–	–	–	–	–	(26)	(26)
Dividends paid to minority interests	–	–	–	–	–	–	–	–	–	(3)	(3)
Fair value reserve arising on acquisition of Tesco Bank	–	–	–	–	–	–	–	(71)	(71)	–	(71)
Dividends authorised in the year	–	–	–	–	–	–	–	(883)	(883)	–	(883)
Tax on items charged to equity	–	–	–	–	–	–	–	60	60	–	60
<b>Transactions with owners</b>	2	127	–	1	–	–	(25)	(826)	(721)	(29)	(750)
<b>At 28 February 2009 (restated*)</b>	<b>395</b>	<b>4,638</b>	<b>40</b>	<b>13</b>	<b>175</b>	<b>173</b>	<b>(229)</b>	<b>7,644</b>	<b>12,849</b>	<b>57</b>	<b>12,906</b>

\* See note 1 Accounting policies.

# Group cash flow statement

Year ended 27 February 2010	notes	52 weeks 2010 £m	53 weeks 2009 £m
<b>Cash flows from operating activities</b>			
Cash generated from operations	31	<b>5,947</b>	4,978
Interest paid		<b>(690)</b>	(562)
Corporation tax paid		<b>(512)</b>	(456)
<b>Net cash from operating activities</b>		<b>4,745</b>	3,960
<b>Cash flows from investing activities</b>			
Acquisition of subsidiaries, net of cash acquired		<b>(65)</b>	(1,275)
Proceeds from sale of property, plant and equipment		<b>1,820</b>	994
Purchase of property, plant and equipment and investment property		<b>(2,855)</b>	(4,487)
Proceeds from sale of intangible assets		<b>4</b>	–
Purchase of intangible assets		<b>(163)</b>	(220)
Increase in loans to joint ventures		<b>(45)</b>	(242)
Investments in joint ventures and associates		<b>(4)</b>	(30)
Investments in short-term and other investments		<b>(1,918)</b>	(1,233)
Proceeds from sale of short-term investments		<b>1,233</b>	360
Dividends received		<b>35</b>	69
Interest received		<b>81</b>	90
<b>Net cash used in investing activities</b>		<b>(1,877)</b>	(5,974)
<b>Cash flows from financing activities</b>			
Proceeds from issue of ordinary share capital		<b>167</b>	130
Increase in borrowings		<b>862</b>	7,387
Repayment of borrowings		<b>(3,601)</b>	(2,733)
Repayment of obligations under finance leases		<b>(41)</b>	(18)
Dividends paid		<b>(968)</b>	(883)
Dividends paid to minority interests		<b>(2)</b>	(3)
Own shares purchased		<b>(24)</b>	(265)
<b>Net cash from financing activities</b>		<b>(3,607)</b>	3,615
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(739)</b>	1,601
Cash and cash equivalents at beginning of year		<b>3,509</b>	1,788
Effect of foreign exchange rate changes		<b>49</b>	120
<b>Cash and cash equivalents at end of year</b>	19	<b>2,819</b>	3,509

## Reconciliation of net cash flow to movement in net debt note

Year ended 27 February 2010	note	52 weeks 2010 £m	53 weeks 2009 £m
Net (decrease)/increase in cash and cash equivalents		<b>(739)</b>	1,601
Investment in Tesco Bank		<b>(230)</b>	–
Elimination of net increase in Tesco bank cash and cash equivalents		<b>(167)</b>	(37)
Debt acquired on acquisition of Homever		–	(611)
Transfer of joint venture loan receivable on acquisition of Tesco Bank		–	(91)
<b>Net cash inflow/(outflow) from debt and lease financing</b>		<b>2,780</b>	(4,636)
Dividend received from Tesco Bank		<b>150</b>	–
Increase in short-term investments		<b>81</b>	873
Increase in joint venture loan receivables		<b>45</b>	242
Other non-cash movements		<b>(249)</b>	(759)
<b>Decrease/(increase) in net debt in the year</b>		<b>1,671</b>	(3,418)
Opening net debt	32	<b>(9,600)</b>	(6,182)
<b>Closing net debt</b>	32	<b>(7,929)</b>	(9,600)

NB. The reconciliation of net cash flow to movement in net debt note is not a primary statement and does not form part of the cash flow statement and forms part of the notes to the financial statements.

# Notes to the Group financial statements

## Note 1 Accounting policies

### General information

Tesco PLC is a public limited company incorporated and domiciled in the United Kingdom under the Companies Act 2006 (Registration number 445790). The address of the registered office is Tesco House, Delamare Road, Cheshunt, Hertfordshire, EN8 9SL, UK.

The financial year represents the 52 weeks ended 27 February 2010 (prior financial year 53 weeks ended 28 February 2009 and includes 53 weeks of trading for the UK, Republic of Ireland (ROI) and United States of America (US) businesses).

As described in the Report of the Directors, the main activity of the Group is that of retailing, retailing services and financial services.

### Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretation Committee (IFRIC) interpretations as endorsed by the European Union, and those parts of the Companies Act applicable to companies reporting under IFRS.

### Basis of preparation

The financial statements are presented in Pounds Sterling, generally rounded to the nearest million. They are prepared on the historical cost basis, except for certain financial instruments, share-based payments, customer loyalty programmes and pensions that have been measured at fair value.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

### Basis of consolidation

The Group financial statements consist of the financial statements of the ultimate Parent Company (Tesco PLC), all entities controlled by the Company (its subsidiaries) and the Group's share of its interests in joint ventures and associates.

Where necessary, adjustments are made to the financial statements of subsidiaries, joint ventures and associates to bring the accounting policies used into line with those of the Group.

### Subsidiaries

A subsidiary is an entity whose operating and financing policies are controlled, directly or indirectly, by Tesco PLC.

The accounts of the Parent Company's subsidiary undertakings are prepared to dates around the Group year end.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

### Joint ventures and associates

A joint venture is an entity in which the Group holds an interest on a long-term basis and which is jointly controlled by the Group and one or more other venturers under a contractual agreement.

An associate is an undertaking, not being a subsidiary or joint venture, over which the Group has significant influence and can participate in the financial and operating policy decisions of the entity.

The Group's share of the results of joint ventures and associates is included in the Group Income Statement using the equity method of accounting. Investments in joint ventures and associates are carried in the Group Balance Sheet at cost plus post-acquisition changes in the Group's share of the net assets of the entity, less any impairment in value. The carrying values of investments in joint ventures and associates include acquired goodwill.

If the Group's share of losses in a joint venture or associate equals or exceeds its investment in the joint venture or associate, the Group does

not recognise further losses, unless it has incurred obligations to do so or made payments on behalf of the joint venture or associate.

Unrealised gains arising from transactions with joint ventures and associates are eliminated to the extent of the Group's interest in the entity.

### Use of assumptions and estimates

The preparation of the consolidated financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical estimates and assumptions are made in particular with regard to establishing uniform depreciation and amortisation periods for the Group, impairment testing (including loans), provisions for onerous leases and other provisions, assumptions for measuring pension provisions and fair value of share-based payments, determination of the fair value of obligations to purchase minority interests and fair value of derivative financial instruments, classification of leases as operating leases versus finance leases (including on sale and leasebacks), the likelihood that tax assets can be realised and the classification of certain operations as held for sale.

### Changes in accounting policy and disclosure

The Group has adopted the following new and amended standards and interpretations as of 1 March 2009:

- IFRIC 13 'Customer Loyalty Programmes', effective for annual periods beginning on or after 1 July 2008, requires customer loyalty awards to be accounted for as a separate component of the sales transaction in which they are granted. Part of the fair value of the consideration received relating to the customer loyalty awards is deferred and subsequently recognised over the period in which the awards are redeemed. The results for the 53 weeks ended 28 February 2009 have been restated accordingly. The impact on the Group Income Statement for the year ended 28 February 2009, is a £429m reduction in total revenue, £396m reduction in cost of sales and a £9m decrease to the taxation charge for the year. The net impact is a decrease of £33m to profit before tax and £24m to profit after tax. The net impact to the Group Balance Sheet as at 28 February 2009 is a £53m reduction in shareholders' equity, £73m increase in trade and other payables and a £20m reduction in the provision for deferred tax. The net impact to the Group Balance Sheet as at 24 February 2008 is a £29m reduction in shareholders' equity, £40m increase in trade and other payables and an £11m reduction in the provision for deferred tax. The prior year effect of the restatement on basic and diluted earnings per share is a reduction of 0.36p per share, and 0.35p per share, respectively.
- Amendment to IFRS 2 'Share-Based Payment' – Vesting Conditions and Cancellations, effective for annual periods beginning on or after 1 January 2009 clarifies that only service and performance conditions are vesting conditions. Any other conditions are non-vesting conditions which have to be taken into account to determine the fair value of the equity instruments granted. The award must be treated as a cancellation where the award does not vest as a result of a failure to meet a non-vesting condition that is within the control of either the Group or the counterparty. Cancellations are treated as accelerated vestings and all remaining future charges are immediately recognised in the Group Income Statement with the credit recognised directly in equity. The results for the year ended 28 February 2009 have been restated accordingly. The impact on the Group Income Statement, Group Balance Sheet, basic and diluted earnings per share for the prior year was not material.

# Notes to the Group financial statements continued

## Note 1 Accounting policies continued

- IFRS 8 'Operating Segments', effective for annual periods beginning on or after 1 January 2009 replaces IAS 14 'Segment Reporting' and requires operating segments to be reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for resource allocation and assessing performance of the operating segments, the key performance measure being trading profit, has been identified as the Executive Committee of the Board of Directors.
- IAS 1 (revised) 'Presentation of Financial Statements', effective for annual periods beginning on or after 1 January 2009, prohibits the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the Group Statement of Changes in Equity, and requiring 'non-owner changes in equity' to be presented in a performance statement. The Group has elected to present two statements: a Group Income Statement and a Group Statement of Comprehensive Income. The consolidated financial information has been prepared under the revised disclosure requirements. There was no impact on the results or net assets of the Group. Due to the adoption of IFRIC 13 and the amendments to IFRS 2, a Group Balance Sheet as at 24 February 2008 has been presented as required by IAS 1 (revised) when there is a retrospective restatement.
- Amendments to IFRS 7 'Financial Instruments – Disclosures', effective for annual periods beginning on or after 1 January 2009 requires enhanced disclosures about fair value measurement and liquidity risk.

### Sale and repurchase agreement (Tesco Bank)

- In order to align with emerging industry practice the Treasury Bills and related Medium Term Notes previously recognised have been restated in Group Balance Sheet as at 28 February 2009. These balances arose as a result of a securitisation and associated sale and repurchase agreement entered into as part of the Special Liquidity Scheme during the year ended 28 February 2009. The effect of the change in the prior year is a reduction in loans and advances to banks and other financial assets of £588m, with a related reduction in current borrowings.

### IFRS 3 Business combinations

Under IFRS 3 'Business Combinations', any adjustments to the provisional fair values allocated within 12 months of an acquisition date are calculated as if the fair value at the acquisition date had been recognised from that date. As a result, goodwill relating to the following acquisitions has been restated:

- Homever (acquired 30 September 2008) – the net impact of the restatement is an increase in goodwill of £14m, increase in trade and other receivables of £22m, increase in trade and other payables of £2m and increase in non-current provisions of £34m.
- Tesco Bank (acquired on 19 December 2008) – the net impact of the restatement is an increase in goodwill of £35m, increase in deferred tax assets of £28m, increase in non-current provisions of £99m and a decrease in retained earnings of £36m.

### Revenue

#### Retailing

Revenue consists of sales through retail outlets.

Revenue is recorded net of returns, relevant vouchers/offers and value-added taxes, when the significant risks and rewards of ownership have been transferred to the buyer. Relevant vouchers/offers include: money-off coupons, conditional spend vouchers and offers such as buy one get one free (BOGOF) and 3 for 2.

Commission income is recorded based on the terms of the contracts and is recognised when the service is provided.

#### Financial Services

Revenue consists of interest, fees and commission receivable.

Interest income on financial assets that are classified as loans and receivables is determined using the effective interest rate method. This is the method of calculating the amortised cost of a financial asset or for a

group of assets, and of allocating the interest income over the expected life of the asset. The effective interest rate is the rate that discounts the estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees receivable, that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs.

Fees in respect of services are recognised on an accruals basis as service is provided. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. Significant fee types include credit card related services fees such as interchange, late payment and balance transfer fees.

The Group receives insurance commission from the sale of general insurance policies, which is dependent on the profitability of the underlying insurance policies.

#### Clubcard and loyalty initiatives

The cost of Clubcard and loyalty initiatives is treated as a deduction from sales and part of the fair value of the consideration received is deferred and subsequently recognised over the period that the awards are redeemed.

The fair value of the points awarded is determined with reference to the fair value to the customer and considers factors such as redemption via Clubcard deals versus money-off-in-store including Double Up and redemption rate.

Computers for Schools and Sport for Schools and Club vouchers are issued by Tesco for redemption by participating schools/clubs and are part of our overall Community Plan. The cost of the redemption (i.e. meeting the obligation attached to the vouchers) is treated as a cost rather than a deduction from sales.

#### Other income

Finance income, excluding income arising from financial services, is recognised in the period to which it relates using the effective interest rate method. Dividends are recognised when a legal entitlement to receive payment arises.

#### Operating profit

Operating profit is stated after profit arising on property-related items but before the share of results of joint ventures and associates, finance income and finance costs.

#### Property, plant and equipment

Property, plant and equipment assets are carried at cost less accumulated depreciation and any recognised impairment in value.

Property, plant and equipment assets are depreciated on a straight-line basis to their residual value over their anticipated useful economic lives.

The following depreciation rates are applied for the Group:

- freehold and leasehold buildings with greater than 40 years unexpired – at 2.5% of cost;
- leasehold properties with less than 40 years unexpired are depreciated by equal annual instalments over the unexpired period of the lease; and
- plant, equipment, fixtures and fittings and motor vehicles – at rates varying from 9% to 50%.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, when shorter, over the term of the relevant lease.

All property, plant and equipment are reviewed for impairment in accordance with IAS 36 'Impairment of Assets' when there are indications that the carrying value may not be recoverable.

## Note 1 Accounting policies continued

### Borrowing costs

Borrowing costs directly attributable to the acquisition or construction of qualifying assets are capitalised. Qualifying assets are those that necessarily take a substantial period of time to prepare for their intended use. All other borrowing costs are recognised in the Group Income Statement in finance costs, excluding those arising from financial services, in the period in which they occur. For Tesco Bank finance cost on financial liabilities is determined using the effective interest rate method and is recognised in cost of sales.

### Investment property

Investment property is property held to earn rental income and/or for capital appreciation rather than for the purpose of Group operating activities. Investment property assets are carried at cost less accumulated depreciation and any recognised impairment in value. The depreciation policies for investment property are consistent with those described for owner-occupied property.

### Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

#### The Group as a lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment in the lease.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

#### The Group as a lessee

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the Group Balance Sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligations so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the Group Income Statement.

Rentals payable under operating leases are charged to the Group Income Statement on a straight-line basis over the term of the relevant lease.

#### Sale and leaseback

A sale and leaseback transaction is one where a vendor sells an asset and immediately reacquires the use of that asset by entering into a lease with the buyer. The accounting treatment of the sale and leaseback depends upon the substance of the transaction (by applying the lease classification principles described above) and whether or not the sale was made at the asset's fair value.

For sale and finance leasebacks, any apparent profit or loss from the sale is deferred and amortised over the lease term. For sale and operating leasebacks, generally the assets are sold at fair value, and accordingly the profit or loss from the sale is recognised immediately in the Group Income Statement.

Following initial recognition, the lease treatment is consistent with those principles described above.

### Business combinations and goodwill

All business combinations are accounted for by applying the purchase method.

On acquisition, the assets (including intangible assets), liabilities and contingent liabilities of an acquired entity are measured at their fair value. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognised.

The Group recognises intangible assets as part of business combinations at fair value on the date of acquisition. The determination of these fair values is based upon management's judgement and includes assumptions on the timing and amount of future incremental cash flows generated by the assets acquired and the selection of an appropriate cost of capital. The useful lives of intangible assets are estimated, and amortisation charged on a straight-line basis.

Goodwill arising on consolidation represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets/net liabilities of the acquired subsidiary, joint venture or associate at the date of acquisition. If the cost of acquisition is less than the fair value of the Group's share of the net assets/net liabilities of the acquired entity (i.e. a discount on acquisition) then the difference is credited to the Group Income Statement in the period of acquisition.

At the acquisition date of a subsidiary, goodwill acquired is recognised as an asset and is allocated to each of the cash-generating units expected to benefit from the business combination's synergies and to the lowest level at which management monitors the goodwill. Goodwill arising on the acquisition of joint ventures and associates is included within the carrying value of the investment.

Goodwill is reviewed for impairment at least annually by assessing the recoverable amount of each cash-generating unit to which the goodwill relates. The recoverable amount is the higher of fair value less costs to sell, and value in use. When the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Any impairment is recognised immediately in the Group Income Statement and is not subsequently reversed.

On disposal of a subsidiary, joint venture or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before 29 February 2004 (the date of transition to IFRS) was retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been restated and will not be included in determining any subsequent profit or loss on disposal.

### Intangible assets

#### Acquired intangible assets

Acquired intangible assets, such as software, pharmacy licences, customer relationships, contracts and brands, are measured initially at cost and are amortised on a straight-line basis over their estimated useful lives, at 2%-100% of cost per annum.

#### Internally-generated intangible assets – Research and development expenditure

Research costs are expensed as incurred.

Development expenditure incurred on an individual project is carried forward only if all the criteria set out in IAS 38 'Intangible Assets' are met, namely:

- an asset is created that can be identified (such as software or new processes);
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the project's estimated useful life, usually at 14%-25% of cost per annum.

#### Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets are impaired. If such indication exists, the recoverable

# Notes to the Group financial statements continued

## Note 1 Accounting policies continued

amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell, and value in use. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of the recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised as a credit to the Group Income Statement immediately.

### Other investments

Other investments in the Group Balance Sheet comprise loan receivable and available-for-sale financial assets. Refer to the financial instruments accounting policy for further detail.

Loan receivables are recognised at amortised cost and available-for-sale financial assets are recognised at fair value.

### Inventories

Inventories comprise goods held for resale and properties held for, or in the course of, development and are valued at the lower of cost and fair value less costs to sell using the weighted average cost basis.

### Short-term investments

Short-term investments in the Group Balance Sheet consist of deposits with money market funds.

### Cash and cash equivalents

Cash and cash equivalents in the Group Balance Sheet consist of cash at bank, in hand and demand deposits with banks together with short-term deposits with an original maturity of three months or less.

### Non-current assets held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through sale rather than continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and it should be expected to be completed within one year from the date of classification.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

### Pensions and similar obligations

The Group accounts for pensions and other post-employment benefits (principally private healthcare) under IAS 19 'Employee Benefits'.

In respect of defined benefit plans, obligations are measured at discounted present value (using the projected unit credit method) whilst plan assets are recorded at fair value. The operating and financing costs of such plans are recognised separately in the Group Income Statement; service costs are spread systematically over the expected service lives of employees and financing costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised immediately in the Group Statement of Comprehensive Income.

Payments to defined contribution schemes are recognised as an expense as they fall due.

### Share-based payments

Employees of the Group receive part of their remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions) or in exchange for entitlements to cash payments based on the value of the shares (cash-settled transactions).

The fair value of employee share option plans is calculated at the grant date using the Black-Scholes model. In accordance with IFRS 2 'Share-Based Payment', the resulting cost is charged to the Group Income Statement over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

### Taxation

The tax expense included in the Group Income Statement consists of current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted by the balance sheet date. Tax is recognised in the Group Income Statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised other comprehensive income or equity, respectively.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is calculated at the tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited in the Group Income Statement, except when it relates to items charged or credited directly to equity or other comprehensive income, in which case the deferred tax is also recognised in equity, or other comprehensive income, respectively.

Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset against each other when there is a legally enforceable right to set-off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

### Foreign currencies

Transactions in foreign currencies are translated at the exchange rate on the date of the transaction. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. All differences are taken to the Group Income Statement for the period.

The financial statements of foreign subsidiaries are translated into Pounds Sterling according to the functional currency concept of IAS 21 'The Effects of Changes in Foreign Exchange Rates'. Since the majority of consolidated companies operate as independent entities within their local economic environment, their respective local currency is the functional currency. Therefore, assets and liabilities of overseas subsidiaries denominated in foreign currencies are translated at exchange rates prevailing at the date of the Group Balance Sheet; profits and losses are translated into Pounds Sterling at average exchange rates for the relevant accounting periods. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or expenses in the period in which the operation is disposed of.

## Note 1 Accounting policies continued

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

### Financial instruments

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

#### Trade receivables

Trade receivables are non interest-bearing and are recognised initially at fair value, and subsequently at amortised cost using the effective interest rate method, reduced by appropriate allowances for estimated irrecoverable amounts.

#### Investments

Investments are recognised at trade date. Investments are classified as either held for trading or available-for-sale, and are recognised at fair value.

There are no investments classified as held for trading.

For available-for-sale investments, gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net result for the period. Interest calculated using the effective interest rate method is recognised in the Group Income Statement. Dividends on an available-for-sale equity instrument are recognised in the Group Income Statement when the entity's right to receive payment is established.

#### Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and include amounts due from customers and amounts due from other banks. The Group has no intention of trading these loans and advances and consequently they are not classified as held for trading or designated as fair value through profit and loss. Loans and advances are initially recognised at fair value plus directly related transaction costs. Subsequent to initial recognition, these assets are carried at amortised cost using the effective interest method less any impairment losses. Income from these financial assets is calculated on an effective yield basis and is recognised in the Group Income Statement.

#### Impairment of loans and advances

At each balance sheet date, the Group reviews the carrying amounts of its loans and advances to determine whether there is any indication that those assets have suffered an impairment loss. An impairment loss has been incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and advances has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. Impairment losses are assessed individually for financial assets that are individually significant and collectively for assets that are not individually significant. In making collective assessments of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of current observable data, to reflect the effects of current conditions not affecting the period of historical experience.

Impairment losses are recognised in the Group Income Statement and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If in a subsequent

period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Loan impairment provisions are established on a portfolio basis taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing the provisions are the expected loss rates and the related average life. The portfolios include credit card receivables and other personal advances. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends.

#### Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that gives a residual interest in the assets of the Group after deducting all of its liabilities.

#### Interest-bearing borrowings

Interest-bearing bank loans and overdrafts are initially recorded at fair value, net of attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the Group Income Statement over the period of the borrowings on an effective interest basis.

#### Trade payables

Trade payables are non interest-bearing and are stated at amortised cost.

#### Equity instruments

Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

#### Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments to hedge its exposure to foreign exchange, interest rate and commodity risks arising from operating, financing and investing activities. The Group does not hold or issue derivative financial instruments for trading purposes, however, if derivatives do not qualify for hedge accounting they are accounted for as such.

Derivative financial instruments are recognised and stated at fair value. The fair value of derivative financial instruments is determined by reference to market values for similar financial instruments, by discounted cash flows, or by the use of option valuation models. Where derivatives do not qualify for hedge accounting, any gains or losses on remeasurement are immediately recognised in the Group Income Statement. Where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the hedge relationship and the item being hedged.

In order to qualify for hedge accounting, the Group is required to document from inception the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is performed at each period end to ensure that the hedge remains highly effective.

Derivative financial instruments with maturity dates of more than one year from the balance sheet date are disclosed as non-current.

# Notes to the Group financial statements continued

## Note 1 Accounting policies continued

### Fair value hedging

Derivative financial instruments are classified as fair value hedges when they hedge the Group's exposure to changes in the fair value of a recognised asset or liability. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Group Income Statement, together with any changes in the fair value of the hedged item that is attributable to the hedged risk.

Derivative financial instruments qualifying for fair value hedge accounting are principally interest rate swaps and cross currency swaps.

### Cash flow hedging

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

The effective element of any gain or loss from remeasuring the derivative instrument is recognised directly in equity.

The associated cumulative gain or loss is removed from equity and recognised in the Group Income Statement in the same period or periods during which the hedged transaction affects the Group Income Statement. The classification of the effective portion when recognised in the Group Income Statement is the same as the classification of the hedged transaction. Any element of the remeasurement of the derivative instrument which does not meet the criteria for an effective hedge is recognised immediately in the Group Income Statement within finance income or costs.

Derivative instruments qualifying for cash flow hedging are principally forward foreign exchange transactions and interest rate swaps.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs or the original hedged item affects the Group Income Statement. If a forecasted hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the Group Income Statement.

### Net investment hedging

Derivative financial instruments are classified as net investment hedges when they hedge the Group's net investment in an overseas operation. The effective element of any foreign exchange gain or loss from remeasuring the derivative instrument is recognised directly in equity. Any ineffective element is recognised immediately in the Group Income Statement. Gains and losses accumulated in equity are included in the Group Income Statement when the foreign operation is disposed of.

Derivative instruments qualifying for net investment hedging are principally forward foreign exchange transactions.

### Treatment of agreements to acquire minority interests

The Group has entered into a number of agreements to purchase the remaining shares of subsidiaries with minority shareholdings.

Under IAS 32 'Financial Instruments: Presentation', the net present value of the expected future payments are shown as a financial liability. At the end of each period, the valuation of the liability is reassessed with any changes recognised in the Group Income Statement within finance income or costs for the year. Where the liability is in a currency other than Pounds Sterling, the liability has been designated as a net investment hedge. Any change in the value of the liability resulting from changes in exchange rates is recognised directly in equity.

### Provisions

Provisions are recognised when there is a present legal or constructive obligation as a result of a past event, for which it is probable that a transfer of economic benefits will be required to settle the obligation and where a reliable estimate can be made of the amount of the obligation.

Provisions for onerous leases are recognised when the Group believes that the unavoidable costs of meeting the lease obligations exceed the economic benefits expected to be received under the lease. Where material, these leases are discounted to their present value. Provisions for dilapidation costs are recognised on a lease by lease basis.

### Other recent accounting developments

#### Standards, amendments and interpretations effective in 2010 or issued and early adopted:

In preparing the Group financial statements for the current year, the Group has adopted the following new and amended standards and interpretations which have no impact on the results or net assets of the Group (unless otherwise stated):

- Amendment to IAS 23 'Borrowing Costs', effective for annual periods beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset.
- Amendment to IAS 32 'Financial Instruments: Presentation' and IAS 1 'Presentation of Financial Statements' – Puttable Instruments and Instruments with Obligations Arising on Liquidation, effective for annual periods beginning on or after 1 January 2009.
- Amendment to IAS 32 'Financial Instruments: Presentation' – Presentation on Classification of Rights Issues, effective for annual periods beginning on or after 1 January 2009.
- Amendments to IFRS 1 'First-time Adoption of IFRSs' and IAS 27 'Consolidated and Separate Financial Statements' – Cost of an Investment of a Subsidiary, Jointly Controlled Entity or Associate, effective for annual reporting periods beginning on or after 1 January 2009.
- IFRIC 9 'Reassessment of embedded derivatives' and IAS 39 'Financial Instruments: Recognition and Measurement – Embedded Derivatives (amendments)' effective for annual periods beginning on or after 1 July 2008.
- IFRIC 14 'The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', effective for annual periods beginning on or after 1 January 2008.
- IFRIC 15 'Agreements for the Construction of Real Estate', effective for annual periods beginning on or after 1 January 2009.
- IFRIC 16 'Hedges of a Net Investment in a Foreign Operation', effective for annual periods beginning on or after 1 October 2008.

#### Standards, amendments and interpretations not yet effective and under review as to their impact on the Group:

- Amendments to IFRS 2 'Share-Based Payment' – Group Cash-Settled Transactions, effective for annual periods beginning on or after 1 January 2010. In addition to incorporating IFRIC 8 'Scope of IFRS 2', and IFRIC 11 'IFRS 2 – Group and treasury share transactions', the amendments expand on the guidance of IFRIC 11 to address the classification of group arrangements that were not covered by that interpretation. The new guidance is not expected to have a material impact on the Group's financial statements.
- IAS 27 (revised) 'Consolidated and Separate Financial Statements', effective for annual periods beginning on or after 1 July 2009. The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control of an entity is lost. Any remaining interest in the entity is remeasured to fair value, and a gain or loss is recognised in the Income Statement. The Group will apply IAS 27 (revised) prospectively to transactions with non-controlling interests from 28 February 2010.

## Note 1 Accounting policies continued

- IFRS 3 (revised) 'Business Combinations', effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. The revised standard continues to apply the acquisition method to business combinations, with some significant changes, including: all payments to purchase a business are to be recorded at fair value at the acquisition date, with the contingent payments that are classified as debt subsequently remeasured through the Group Income Statement. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquirer's net assets. All acquisition-related costs should be expensed. The Group will apply IFRS 3 (revised) prospectively to all business combinations from 28 February 2010.
- Amendment to IAS 39 'Financial Instruments: Recognition and Measurement' – Eligible Hedged Items, effective for annual periods beginning on or after 1 July 2009. The amendment provides clarification on how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations.
- IFRS 9 'Financial Instruments', effective for annual periods beginning on or after 1 January 2013. This is the first part of a new standard on classification and measurement of financial assets that will replace IAS 39.
- Amendment to IAS 24 'Related Party Disclosures', effective for annual periods beginning on or after 1 January 2011.
- IFRIC 17 'Distributions of Non-Cash Assets to Owners', effective for annual periods beginning on or after 1 July 2009.
- IFRIC 18 'Transfers of Assets from Customers', effective for transfers of assets from customers received on or after 1 July 2009.
- IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments', effective for annual periods beginning on or after 1 July 2010.
- IAS 19 Income Statement charge for pensions – Under IAS 19 'Employee Benefits', the cost of providing pension benefits in the future is discounted to a present value at the corporate bond yield rates applicable on the last day of the previous financial year. Corporate bond yield rates vary over time which in turn creates volatility in the Group Income Statement and Group Balance Sheet. IAS 19 also increases the charge for young pension schemes, such as Tesco's, by requiring the use of rates which do not take into account the future expected returns on the assets held in the pension scheme which will fund pension liabilities as they fall due. The sum of these two effects can make the IAS 19 charge disproportionately higher and more volatile than the cash contributions the Group is required to make in order to fund all future liabilities. Therefore, within underlying profit we have included the 'normal' cash contributions for pensions but excluded the volatile element of IAS 19 to represent what the Group believes to be a fairer measure of the cost of providing post-employment benefits.
- IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods – The amount charged to the Group Income Statement in respect of operating lease costs and incentives is expected to increase significantly as the Group expands its international business. The leases have been structured in a way to increase annual lease costs as the businesses expand. IAS 17 'Leases' requires the total cost of a lease to be recognised on a straight-line basis over the term of the lease, irrespective of the actual timing of the cost. The impact of this treatment in 2010 was a charge of £41m (2009 – £27m) to the Group Income Statement after deducting the impact of the straight-line treatment recognised as rental income within share of post-tax profits of joint ventures and associates.
- IFRS 3 Amortisation charge from intangible assets arising on acquisition – Under IFRS 3 'Business Combinations', intangible assets are separately identified and valued. The intangible assets are required to be amortised on a straight-line basis over their useful economic lives and as such is a non-cash charge that does not reflect the underlying performance of the business acquired.
- IFRIC 13 'Customer Loyalty Programmes' – This new interpretation requires the fair value of customer loyalty awards to be measured as a separate component of a sales transaction. The underlying profit measure removes this fair value allocation to present underlying business performance, and to reflect the performance of the operating segments as measured by management.
- Exceptional items – Due to their significance and special nature, certain other items which do not reflect the Group's underlying performance have been excluded from underlying profit. These gains or losses can have a significant impact on both absolute profit and profit trends; consequently, they are excluded from the underlying profit of the Group. For the year ended 27 February 2010, exceptional items are as follows:

The Group continually reviews amendments to the standards made under the IASB's annual improvements project.

### Use of non-GAAP profit measures – underlying profit before tax

The Directors believe that underlying profit before tax and underlying diluted earnings per share measures provide additional useful information for shareholders on underlying trends and performance. These measures are used for internal performance analysis. Underlying profit is not defined by IFRS and therefore may not be directly comparable with other companies' adjusted profit measures. It is not intended to be a substitute for, or superior to IFRS measurements of profit.

The adjustments made to reported profit before tax are:

- IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements – Under IAS 32 and IAS 39, the Group applies hedge accounting to its various hedge relationships when allowed under the rules of IAS 39 and when practical to do so. Sometimes the Group is unable to apply hedge accounting to the arrangements but continues to enter into these arrangements as they provide certainty or active management of the exchange rates and interest rates applicable to the Group. The Group believes these arrangements remain effective and economically and commercially viable hedges despite the inability to apply hedge accounting.
- Where hedge accounting is not applied to certain hedging arrangements, the reported results reflect the movement in fair value of related derivatives due to changes in foreign exchange and interest rates. In addition, at each period end, any gain or loss accruing on open contracts is recognised in the Group Income Statement for the period, regardless of the expected outcome of the hedging contract on termination. This may mean that the Group Income Statement charge is highly volatile, whilst the resulting cash flows may not be as volatile. The underlying profit measure removes this volatility to help better identify underlying business performance. During 2010 there was no impact (2009 – £10m) of the IAS 32 and IAS 39 charge arose in the share of post-tax profit of joint ventures and associates, with the remainder in finance income/costs.
- IAS 36 Impairment of goodwill arising on acquisitions – the carrying value of goodwill relating to Japan was not fully recoverable, resulting in an impairment charge of £131m (2009 – £nil), and as such is a non-cash charge that does not reflect the underlying performance of the business. The recoverable amount for Japan was based on value in use, calculated from cash flow projections for five years using data from the Group's latest internal forecasts, the results of which are reviewed by the Board.
- Restructuring costs – These relate to certain costs associated with the Group's restructuring activities. For the year ended 27 February 2010, the Group incurred £33m (2009 – £nil), relating to restructuring activities.

There were no exceptional items in 2009.

# Notes to the Group financial statements continued

## Note 2 Segmental reporting

IFRS 8 requires operating segments to be determined based on the Group's internal reporting to the Chief Operating Decision Maker ('CODM'). The CODM has been determined to be the Executive Committee of the Board of Directors as it is primarily responsible for the allocation of resources to segments and the assessment of performance of the segments. Previously, segments were determined and presented in accordance with IAS 14 'Segment Reporting'.

The CODM uses trading profit, as reviewed at monthly Executive Committee meetings as the key measure of the segments' results as it reflects the segments' underlying trading performance for the period under evaluation. Trading profit is a consistent measure within the Group.

Segmental trading profit is an adjusted measure of operating profit, which measures the performance of each segment before exceptional items (goodwill impairment and restructuring charges), profit arising on property-related items, impact on leases of annual uplifts in rent and rent-free periods, amortisation charges from intangible assets arising on acquisition, adjustments to fair value of customer loyalty awards and replaces the IAS 19 pension charge with the 'normal' cash contributions for pensions.

On the adoption of IFRS 8, the Group revised its operating and reporting segments. The Group's operating segments were previously defined geographically – UK, Rest of Europe, Asia and US. The Group's operations (retail and retailing services) are managed by geography, with Tesco Bank as a separate reporting segment because of its different regulatory environment. Accordingly, the segments under IFRS 8 are UK, Rest of Europe (ROE comprises Republic of Ireland, Hungary, Poland, the Czech Republic, Slovakia and Turkey), Asia (comprising Thailand, South Korea, Malaysia, China, Japan and India), US and Tesco Bank.

Comparative information has been restated to reflect these new segments.

Segment assets include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated is comprised mainly of derivative receivables, interest-bearing loan receivables and taxation-related assets.

Inter-segment turnover between the operating segments is not material.

The segment results for the year ended 27 February 2010, for the year ended 28 February 2009 and the reconciliation of the segment measures to the respective statutory items included in the consolidated financial information are as follows:

Year ended 27 February 2010 At constant exchange rates	UK £m	ROE £m	Asia £m	US £m	Tesco Bank £m	Total at constant exchange £m	Foreign exchange £m	Total at actual exchange £m
Continuing operations								
Sales inc. VAT (excluding IFRIC 13)	42,254	9,979	8,737	324	860	62,154	383	62,537
Revenue (excluding IFRIC 13)	39,104	8,704	8,148	319	860	57,135	367	57,502
Effect of IFRIC 13	(546)	(19)	(25)	–	–	(590)	(2)	(592)
Revenue	38,558	8,685	8,123	319	860	56,545	365	56,910
Trading profit/(loss)	2,413	466	422	(151)	250	3,400	12	3,412
Trading margin*	6.2%	5.4%	5.2%	(47.3%)	29.1%	5.9%	–	5.9%

Year ended 27 February 2010 At actual exchange rates	UK £m	ROE £m	Asia £m	US £m	Tesco Bank £m	Total at actual exchange £m
Continuing operations						
Sales inc. VAT (excluding IFRIC 13)	42,254	9,997	9,072	354	860	62,537
Revenue (excluding IFRIC 13)	39,104	8,724	8,465	349	860	57,502
Effect of IFRIC 13	(546)	(20)	(26)	–	–	(592)
Revenue	38,558	8,704	8,439	349	860	56,910
Trading profit/(loss)	2,413	474	440	(165)	250	3,412
Trading margin*	6.2%	5.4%	5.2%	(47.3%)	29.1%	5.9%

Year ended 28 February 2009 At constant exchange rates	UK £m	ROE £m	Asia £m	US £m	Tesco Bank £m	Total at constant exchange £m	Foreign exchange £m	Total at actual exchange £m
Continuing operations								
Sales inc. VAT (excluding IFRIC 13)	41,357	8,373	7,020	181	163	57,094	2,332	59,426
Revenue (excluding IFRIC 13)	38,028	7,335	6,552	179	163	52,257	2,070	54,327
Effect of IFRIC 13	(378)	(26)	(18)	–	–	(422)	(7)	(429)
Revenue	37,650	7,309	6,534	179	163	51,835	2,063	53,898
Trading profit/(loss)	2,309	411	345	(123)	68	3,010	76	3,086
Trading margin*	6.1%	5.6%	5.3%	(68.7%)	41.7%	5.8%	–	5.7%

\* Trading margin is based on revenue excluding IFRIC 13.

## Note 2 Segmental reporting continued

Year ended 28 February 2009 At actual exchange rates	UK £m	ROE £m	Asia £m	US £m	Tesco Bank £m	Total at actual exchange £m
Continuing operations						
Sales inc. VAT (excluding IFRIC 13)	41,357	10,120	7,578	208	163	59,426
Revenue (excluding IFRIC 13)	38,028	8,862	7,068	206	163	54,327
Effect of IFRIC 13	(378)	(31)	(20)	–	–	(429)
Revenue	37,650	8,831	7,048	206	163	53,898
Trading profit/(loss)	2,309	496	355	(142)	68	3,086
Trading margin*	6.1%	5.6%	5.0%	(68.9%)	41.7%	5.7%

\* Trading margin is based on revenue excluding IFRIC 13.

### Reconciliation of trading profit to profit before tax

	2010 £m	2009 Restated £m
Trading profit for reportable segments	3,412	3,086
Adjustments for:		
Profit arising on property-related items	377	236
IAS 19 Non-cash Group Income Statement charge for pensions	24	(52)
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	(51)	(36)
IFRS 3 'Business Combinations' – amortisation charge from intangible assets arising on acquisition	(127)	(32)
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	(14)	(33)
Exceptional items:		
IAS 36 Impairment of goodwill arising on acquisitions	(131)	–
Restructuring costs	(33)	–
<b>Operating profit</b>	<b>3,457</b>	<b>3,169</b>
Share of post-tax profit from joint ventures and associates	33	110
Finance income	265	116
Finance costs	(579)	(478)
Profit before tax	3,176	2,917
Taxation	(840)	(779)
<b>Profit for the year</b>	<b>2,336</b>	<b>2,138</b>

### Segment assets

At 27 February 2010	UK £m	ROE £m	Asia £m	US £m	Tesco Bank £m	Other/ unallocated £m	Total at actual exchange £m
Total segment non-current assets	14,741	6,588	7,115	790	3,738	1,286	34,258
Total segment non-current assets includes:							
Investments in joint ventures and associates	55	–	95	–	2	–	152

At 28 February 2009	UK £m	ROE £m	Asia £m	US £m	Tesco Bank £m	Other/ unallocated £m	Total at actual exchange £m
Total segment non-current assets	15,441	5,748	5,883	721	2,748	1,467	32,008
Restatement of acquisitions through business combinations	–	–	14	–	63	–	77
Total segment non-current assets – restated	15,441	5,748	5,897	721	2,811	1,467	32,085
Total segment non-current assets includes:							
Investments in joint ventures and associates	49	–	13	–	–	–	62

# Notes to the Group financial statements continued

## Note 2 Segmental reporting continued

### Other segment information

Year ended 27 February 2010	UK £m	ROE £m	Asia £m	US £m	Tesco Bank £m	Total at actual exchange £m
Capital expenditure (including acquisitions through business combinations):						
Property, plant and equipment	1,485	518	736	141	44	2,924
Investment property	–	8	8	–	–	16
Goodwill and other intangible assets	124	21	91	–	25	261
Depreciation:						
Property, plant and equipment	(570)	(260)	(226)	(29)	(6)	(1,091)
Investment property	–	(8)	(8)	–	–	(16)
Amortisation of intangible assets	(116)	(20)	(14)	–	(127)	(277)
Goodwill impairment losses recognised in the Group Income Statement	–	–	(131)	–	–	(131)
Impairment losses recognised in the Group Income Statement	(27)	(18)	(6)	–	–	(51)
Reversal of prior period impairment losses through the Group Income Statement	27	40	10	–	–	77

### Other segment information

Year ended 28 February 2009 – restated	UK £m	ROE £m	Asia £m	US £m	Tesco Bank £m	Total at actual exchange £m
Capital expenditure (including acquisitions through business combinations):						
Property, plant and equipment	2,392	852	1,404	305	25	4,978
Investment property	–	48	152	–	–	200
Goodwill and other intangible assets	217	15	399	–	1,060	1,691
Depreciation:						
Property, plant and equipment	(565)	(249)	(176)	(20)	(1)	(1,011)
Investment property	–	(9)	(16)	–	–	(25)
Amortisation of intangible assets	(99)	(16)	(6)	–	(32)	(153)
Goodwill impairment losses recognised in the Group Income Statement	–	–	–	–	–	–
Impairment losses recognised in the Group Income Statement	(21)	(41)	(4)	–	–	(66)
Reversal of prior period impairment losses through the Group Income Statement	21	50	17	–	–	88

## Note 3 Income and expenses

From continuing operations	2010 £m	2009 £m
Profit before tax is stated after charging/(crediting) the following:		
Profit arising on property-related items	<b>(377)</b>	(236)
Rental income, of which £351m (2009 – £304m) relates to investment properties	<b>(461)</b>	(349)
Direct operating expenses arising on rental earning investment properties	<b>103</b>	91
Costs of inventories recognised as an expense	<b>42,504</b>	40,779
Stock losses	<b>1,000</b>	870
Depreciation of property, plant and equipment and investment property	<b>1,107</b>	1,036
Net reversal of impairment of property, plant and equipment and impairment of investment property	<b>(26)</b>	(22)
Amortisation of internally-generated development intangible assets	<b>103</b>	88
Amortisation of other intangibles	<b>174</b>	65
Operating lease expenses†	<b>927</b>	738

† Operating lease expenses include £83m (2009 – £81m) for hire of plant and machinery.

### Note 3 Income and expenses continued

During the year, the Group (including its overseas subsidiaries) obtained the following services from the Group's auditor, PricewaterhouseCoopers LLP, and network firms:

	2010 £m	2009 £m
<b>Audit services</b>		
Fees payable to the Company's auditor for the audit of the Parent Company and Group financial statements	<b>0.6</b>	0.6
<b>Non-audit services</b>		
Fees payable to the Company's auditor and network firms for other services:		
The audit of the accounts of the Company's subsidiaries pursuant to legislation	<b>3.5</b>	3.1
Other services pursuant to such legislation	<b>0.1</b>	0.1
Other services relating to taxation	<b>0.4</b>	0.8
Other services relating to corporate finance transactions	<b>0.1</b>	1.3
All other services	<b>0.6</b>	0.6
<b>Total auditor remuneration</b>	<b>5.3</b>	6.5

In addition to the amounts shown above, the auditors received fees of £0.1m (2009 – £0.1m) for the audit of the main Group pension scheme.

A description of the work of the Audit Committee is set out in the Corporate Governance Report on page 46 and includes an explanation of how objectivity and independence is safeguarded when non-audit services are provided by PricewaterhouseCoopers LLP.

### Note 4 Employment costs, including Directors' remuneration

	2010 £m	2009 Restated £m
Wages and salaries	<b>5,057</b>	4,707
Social security costs	<b>435</b>	410
Post-employment benefits (note 28)	<b>403</b>	439
Share-based payments expense (note 27)	<b>300</b>	246
	<b>6,195</b>	5,802

The average number of employees by operating segment during the year was:

	Average number of employees		Average number of full-time equivalents	
	2010	Restated 2009	2010	Restated 2009
UK	<b>287,266</b>	286,092	<b>196,604</b>	194,135
Rest of Europe	<b>86,642</b>	86,760	<b>77,847</b>	78,914
Asia	<b>94,536</b>	92,773	<b>94,248</b>	88,099
US	<b>3,246</b>	2,583	<b>3,246</b>	2,583
Tesco Bank	<b>404</b>	300	<b>393</b>	284
<b>Total</b>	<b>472,094</b>	468,508	<b>372,338</b>	364,015

\* The comparatives have been restated to reflect Tesco Bank as a separate segment. In 2009, Tesco Bank employees were included in the UK reporting segment.

# Notes to the Group financial statements continued

## Note 5 Finance income and costs

	2010 £m	2009 £m
<b>Finance income</b>		
Bank interest receivable and similar income on cash and cash equivalents	114	91
Net pension finance income (note 28)	–	25
<b>Total finance income (on historical cost basis)</b>	<b>114</b>	116
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	151	–
<b>Total finance income</b>	<b>265</b>	116
<b>Finance costs</b>		
Interest payable on short-term bank loans and overdrafts repayable within five years	(135)	(152)
Finance charges payable under finance leases and hire purchase contracts	(9)	(13)
6% 125m GBP MTN 2008	–	(2)
5.25% 500m EUR MTN 2008	–	(4)
5.125% 192m GBP MTN 2009	(8)	(10)
6.625% 150m GBP MTN 2010	(10)	(10)
4.75% 750m EUR MTN 2010	(25)	(26)
3.875% 500m EUR MTN 2011	(13)	(14)
5.625% 1,500m EUR MTN 2012	(74)	(35)
5% 600m GBP MTN 2014	(30)	(1)
5.125% 600m EUR MTN 2015	(27)	(1)
4% RPI GBP MTN 2016 <sup>(a)</sup>	(12)	(23)
5.875% 1,500m EUR MTN 2016	(72)	(33)
5.5% 850m USD Bond 2017	(23)	(23)
5.5% 350m GBP MTN 2019	(19)	(20)
6.125% 900m GBP MTN 2022	(55)	(1)
5% 515m GBP MTN 2023	(26)	(21)
3.322% LPI GBP MTN 2025 <sup>(b)</sup>	(11)	(20)
6% 200m GBP MTN 2029	(12)	(12)
5.5% 200m GBP MTN 2033	(11)	(11)
1.982% RPI GBP MTN 2036 <sup>(c)</sup>	(5)	(14)
6.15% 1,150m USD Bond 2037	(34)	(35)
5% 300m GBP MTN 2042	(15)	(15)
5.125% 600m EUR MTN 2047	(21)	(21)
5.2% 500m GBP MTN 2057	(26)	(26)
Other MTNs	(13)	(9)
Capitalised interest (note 11)	155	152
<b>Total finance costs (on historical cost basis)</b>	<b>(531)</b>	(400)
Net pension finance cost (note 28)	(48)	–
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	–	(78)
<b>Total finance costs</b>	<b>(579)</b>	(478)

(a) Interest payable on the 4% RPI GBP MTN 2016 includes £1m (2009 – £13m) of Retail Price Index (RPI) related amortisation.

(b) Interest payable on the 3.322% LPI GBP MTN 2025 includes £2m (2009 – £11m) of RPI related amortisation.

(c) Interest payable on the 1.982% RPI GBP MTN 2036 includes £1m (2009 – £10m) of RPI related amortisation.

Finance income of £20m (2009 – finance costs of £30m) resulted from hedge ineffectiveness.

## Note 6 Taxation

### Recognised in the Group Income Statement

	2010 £m	2009 Restated £m
<b>Current tax expense</b>		
UK corporation tax	566	673
Foreign tax	128	88
Adjustments in respect of prior years	(91)	(164)
	<b>603</b>	597
<b>Deferred tax expense</b>		
Origination and reversal of temporary differences	110	110
Adjustments in respect of prior years	124	97
Change in tax rate	3	(25)
	<b>237</b>	182
<b>Total income tax expense</b>	<b>840</b>	779

UK corporation tax is calculated at 28.0% (2009 – 28.2%) of the estimated assessable profit for the year. Taxation in other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

### Reconciliation of effective tax charge

	2010 £m	2009 Restated £m
Profit before tax	3,176	2,917
Effective tax charge at 28.0% (2009 – 28.2%)	(889)	(823)
Effect of:		
Non-deductible expenses	(13)	(190)
Differences in overseas taxation rates	93	111
Adjustments in respect of prior years	(33)	67
Share of results of joint ventures and associates	5	31
Change in tax rate	(3)	25
Total income tax charge for the year	(840)	(779)
Effective tax rate	<b>26.4%</b>	26.7%

### Tax on items credited directly to equity

	2010 £m	2009 £m
<b>Current tax credit on:</b>		
Share-based payments	15	46
<b>Deferred tax credit on:</b>		
Share-based payments	3	14
<b>Total tax on items credited to equity</b>	<b>18</b>	60

### Tax relating to components of other comprehensive income

	2010 £m	2009 £m
<b>Current tax (charge)/credit on:</b>		
Foreign exchange movements	(33)	199
<b>Deferred tax credit on:</b>		
Pensions	87	176
<b>Total tax on items credited to other comprehensive income</b>	<b>54</b>	375

# Notes to the Group financial statements continued

## Note 6 Taxation continued

### Deferred tax

The following are the major deferred tax assets/(liabilities) recognised by the Group and movements thereon during the current and prior year:

	Accelerated tax depreciation £m	Retirement benefit obligation £m	Share-based payments £m	Short-term timing differences £m	Tax losses £m	IAS 32 and IAS 39 £m	Other pre/post tax temporary differences £m	Total £m
At 23 February 2008 (restated)	(1,068)	233	76	36	12	13	11	(687)
(Charge)/credit to the Group Income Statement	(194)	7	(46)	70	1	(8)	(12)	(182)
Credit directly to equity	–	–	14	–	–	–	–	14
Credit to other comprehensive income	–	176	–	–	–	–	–	176
Acquisition of subsidiaries	12	–	–	(14)	–	42	–	40
Foreign exchange translation	3	1	–	(2)	3	–	7	12
At 28 February 2009 (restated)	(1,247)	417	44	90	16	47	6	(627)
(Charge)/credit to the Group Income Statement	(257)	7	9	(7)	21	(11)	1	(237)
Credit directly to equity	–	–	3	–	–	–	–	3
Credit to other comprehensive income	–	87	–	–	–	–	–	87
Acquisition of subsidiaries	–	–	–	–	2	–	–	2
Foreign exchange and other movements	8	–	–	8	2	–	(3)	15
At 27 February 2010	(1,496)	511	56	91	41	36	4	(757)

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2010 £m	2009 Restated £m
Deferred tax assets	<b>38</b>	49
Deferred tax liabilities	<b>(795)</b>	(676)
	<b>(757)</b>	(627)

The impact of adopting IFRIC 13 on the 2009 opening balance sheet was an £11m reduction in deferred tax liabilities.

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries and joint ventures, because the earnings are continually reinvested by the Group and no tax is expected to be payable on them in the foreseeable future. The temporary difference unrecognised at the year end amounted to £2,766m (2009 – £1,726m). Furthermore the introduction of a dividend exemption in the UK tax legislation with effect from 1 July 2009 means that earnings can be remitted from certain subsidiary undertakings where no tax will be payable on repatriation.

### Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items (because it is not probable that future taxable profits will be available against which the Group can utilise the benefits):

	2010 £m	2009 £m
Deductible temporary differences	<b>1</b>	12
Tax losses	<b>286</b>	192
	<b>287</b>	204

As at 27 February 2010, the Group has unused trading tax losses of £1,019m (2009 – £744m) available for offset against future profits. A deferred tax asset has been recognised in respect of £142m (2009 – £58m) of such losses. No deferred tax asset has been recognised in respect of the remaining £877m (2009 – £686m) due to the unpredictability of future profit streams. Included in unrecognised tax losses are losses of £297m (2009 – £32m in 2013) that will expire in 2014 and £550m (2009 – £647m between 2014 and 2029) that will expire between 2015 and 2030. Other losses will be carried forward indefinitely.

In addition, the Group has UK capital losses of £342m (2009 – £310m) in respect of which no deferred tax asset has been recognised.

## Note 7 Non-current assets classified as held for sale

	2010 £m	2009 £m
Non-current assets classified as held for sale	<b>373</b>	398

The non-current assets classified as held for sale consist mainly of properties in the United Kingdom due to be sold within one year.

## Note 8 Dividends

	52 weeks ended 27 February 2010		53 weeks ended 28 February 2009	
	pence/share	£m	pence/share	£m
Amounts recognised as distributions to owners in the year:				
Final dividend for the prior financial year	8.39	660	7.70	603
Interim dividend for the current financial year	3.89	308	3.57	280
	<b>12.28</b>	<b>968</b>	11.27	883
Proposed final dividend for the current financial year	<b>9.16</b>	<b>731</b>	8.39	662

The proposed final dividend was approved by the Board of Directors on 19 April 2010 and is subject to the approval of shareholders at the Annual General Meeting. The proposed dividend has not been included as a liability as at 27 February 2010, in accordance with IAS 10 'Events After the Balance Sheet Date'. It will be paid on 9 July 2010 to shareholders who are on the register of members on 1 May 2010.

## Note 9 Earnings per share and diluted earnings per share

Basic earnings per share amounts are calculated by dividing the profit attributable to owners of the parent by the weighted average number of ordinary shares in issue during the year.

Diluted earnings per share amounts are calculated by dividing the profit attributable to owners of the parent by the weighted average number of ordinary shares in issue during the year (adjusted for the effects of potentially dilutive options).

The dilution effect is calculated on the full exercise of all potentially dilutive ordinary share options granted by the Group, including performance-based options which the Group considers to have been earned.

All operations are continuing for the years presented.

	52 weeks ended 27 February 2010			53 weeks ended 28 February 2009 Restated		
	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
Profit (£m)	2,327	–	2,327	2,133	–	2,133
Weighted average number of shares (millions)	7,933	39	7,972	7,859	53	7,912
Earnings per share (pence)	29.33	(0.14)	29.19	27.14	(0.18)	26.96

There have been no transactions involving ordinary shares between the reporting date and the date of approval of these financial statements which would significantly change the earnings per share calculations shown above.

## Reconciliation of non-GAAP underlying diluted earnings per share

	52 weeks ended 27 February 2010		53 weeks ended 28 February 2009 Restated	
	£m	pence/share	£m	pence/share
Profit	2,327	29.19	2,133	26.96
Adjustments for:				
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	(151)	(1.90)	88	1.11
Total IAS 19 Non-cash Group Income Statement charge for pensions	24	0.30	27	0.34
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	41	0.52	27	0.34
IFRS 3 Amortisation charge from intangible assets arising on acquisition	127	1.59	32	0.41
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	14	0.18	33	0.41
Exceptional items:				
IAS 36 Impairment of goodwill arising on acquisitions	131	1.64	–	–
Restructuring costs	33	0.41	–	–
Tax effect of adjustments at the effective rate of tax (2010 – 25.4%*; 2009 – 26.7%)	(22)	(0.27)	(56)	(0.70)
Underlying earnings from operations	<b>2,524</b>	<b>31.66</b>	2,284	28.87

\* The effective tax rate of 25.4% excludes the adjustment for goodwill impairment.

# Notes to the Group financial statements continued

## Note 10 Goodwill and other intangible assets

	Internally generated development costs £m	Pharmacy and software licences £m	Other intangible assets £m	Goodwill £m	Total £m
<b>Cost</b>					
At 28 February 2009	879	310	318	3,283	4,790
Restatement of acquisitions through business combinations	–	–	–	49	49
At 28 February 2009 (restated)	879	310	318	3,332	4,839
Foreign currency translation	9	11	14	136	170
Additions	111	50	2	98	261
Reclassification across categories	136	(1)	1	1	137
Disposals	(2)	(2)	–	(1)	(5)
<b>At 27 February 2010</b>	<b>1,133</b>	<b>368</b>	<b>335</b>	<b>3,566</b>	<b>5,402</b>
<b>Accumulated amortisation and impairment losses</b>					
At 28 February 2009	426	197	42	98	763
Foreign currency translation	3	6	3	1	13
Amortisation for the year	103	43	131	–	277
Reclassification across categories	42	(3)	4	(1)	42
Impairment charge for the year	–	–	–	131	131
Disposals	–	(1)	–	–	(1)
<b>At 27 February 2010</b>	<b>574</b>	<b>242</b>	<b>180</b>	<b>229</b>	<b>1,225</b>
<b>Net carrying value</b>					
At 27 February 2010	559	126	155	3,337	4,177
At 28 February 2009 (restated)	453	113	276	3,234	4,076
<b>Cost</b>					
At 23 February 2008	691	278	48	1,927	2,944
Foreign currency translation	6	7	(4)	205	214
Additions	192	26	2	–	220
Acquisitions through business combinations – restated	–	–	270	1,201	1,471
Reclassification across categories	(2)	–	2	–	–
Disposals	(8)	(1)	–	(1)	(10)
<b>At 28 February 2009 (restated)</b>	<b>879</b>	<b>310</b>	<b>318</b>	<b>3,332</b>	<b>4,839</b>
<b>Accumulated amortisation and impairment losses</b>					
At 23 February 2008	340	163	7	98	608
Foreign currency translation	–	4	–	–	4
Amortisation for the year	88	31	34	–	153
Reclassification across categories	(1)	–	1	–	–
Disposals	(1)	(1)	–	–	(2)
<b>At 28 February 2009 (restated)</b>	<b>426</b>	<b>197</b>	<b>42</b>	<b>98</b>	<b>763</b>
<b>Net carrying value</b>					
At 28 February 2009 (restated)	453	113	276	3,234	4,076
At 23 February 2008	351	115	41	1,829	2,336

There are no intangible assets, other than goodwill, with indefinite useful lives.

## Note 10 Goodwill and other intangible assets continued

### Impairment of goodwill

Goodwill arising on business combinations is not amortised but is reviewed for impairment on an annual basis or more frequently if there are indications that goodwill may be impaired. Goodwill acquired in a business combination is allocated to groups of cash-generating units according to the level at which management monitor that goodwill.

Recoverable amounts for cash-generating units are based on the higher of value in use and fair value less costs to sell. In 2010, recoverable amounts are based on value in use. Value in use is calculated from cash flow projections for generally five years using data from the Group's latest internal forecasts, the results of which are reviewed by the Board. The key assumptions for the value in use calculations are those regarding discount rates, growth rates and expected changes in margins. Management estimate discount rates using pre-tax rates that reflect the current market assessment of the time value of money and the risks specific to the cash-generating units. Changes in selling prices and direct costs are based on past experience and expectations of future changes in the market. Given the current economic climate, a sensitivity analysis has been performed in assessing the recoverable amounts of goodwill.

The carrying amount for Japan has been reduced to its recoverable amount through the recognition of an impairment loss of £131m against goodwill. This has been included in cost of sales in the Group Income Statement. The key assumptions for Japan include a long-term growth rate of 1.1% (2009 – 1.5%) and a pre-tax discount rate of 6.1% (2009 – 7.3%).

The forecasts are extrapolated beyond five years based on estimated long-term average growth rates of generally 1% to 4% (2009 – 2% to 10%).

In the case of Poland, it is reasonably possible that a change in key assumptions would cause the goodwill to exceed its value in use. With headroom of £46m (2009 – £84m) and assuming a 10.6% pre-tax discount rate (2009 – 11.3%), a 0.3% (2009 – 0.4%) increase in the discount rate would cause goodwill to exceed its value in use.

The pre-tax discount rates used to calculate value in use range from 6%-14% (2009 – 7% to 24%). On a post-tax basis, the discount rates ranged from 4% to 13% (2009 – 5% to 19%). These discount rates are derived from the Group's post-tax weighted average cost of capital as adjusted for the specific risks relating to each geographical region.

In February 2010 and 2009 impairment reviews were performed by comparing the carrying value of goodwill with the recoverable amount of the cash-generating units to which goodwill has been allocated.

The components of goodwill are as follows:

	2010 £m	2009 Restated £m
UK	645	616
Tesco Bank	802	802
Thailand	157	153
South Korea	489	392
Japan	55	196
China	594	540
Malaysia	77	76
Poland	424	354
Czech Republic	35	47
Turkey	54	53
Other	5	5
	<b>3,337</b>	<b>3,234</b>

# Notes to the Group financial statements continued

## Note 11 Property, plant and equipment

	Land and buildings £m	Other <sup>(a)</sup> £m	Total £m
<b>Cost</b>			
At 28 February 2009	22,349	7,495	29,844
Foreign currency translation	793	234	1,027
Additions <sup>(b)</sup>	2,189	735	2,924
Transfers	(279)	71	(208)
Classified as held for sale	2	4	6
Disposals	(1,669)	(141)	(1,810)
At 27 February 2010	23,385	8,398	31,783
<b>Accumulated depreciation and impairment losses</b>			
At 28 February 2009	2,540	4,152	6,692
Foreign currency translation	80	121	201
Charge for the year	354	737	1,091
Transfers	(34)	(48)	(82)
Classified as held for sale	(39)	1	(38)
Disposals	(178)	(83)	(261)
Impairment losses	51	–	51
Reversal of impairment losses	(74)	–	(74)
At 27 February 2010	2,700	4,880	7,580
<b>Net carrying value<sup>(c)(d)(e)</sup></b>			
At 27 February 2010	20,685	3,518	24,203
At 28 February 2009	19,809	3,343	23,152
<b>Capital work in progress included above<sup>(f)</sup></b>			
At 27 February 2010	1,652	193	1,845

(a) Other assets consist of plant, equipment, fixtures and fittings and motor vehicles.

(b) Includes £155m (2009 – £152m) in respect of interest capitalised, principally relating to land and building assets. The capitalisation rate used to determine the amount of finance costs capitalised during the year was 5.1% (2009 – 5.1%). Interest capitalised is deducted in determining taxable profit in the year in which it is incurred.

(c) Net carrying value includes:

(i) Capitalised interest at 27 February 2010 of £805m (2009 – £910m).

(ii) Assets held under finance leases which are analysed below:

	2010		2009	
	Land and buildings £m	Other <sup>(a)</sup> £m	Land and buildings £m	Other <sup>(a)</sup> £m
Cost	139	582	121	578
Accumulated depreciation and impairment losses	(36)	(430)	(22)	(390)
Net carrying value	103	152	99	188

These assets are pledged as security for the finance lease liabilities.

(d) The net carrying value of land and buildings comprises:

	2010 £m	2009 £m
Freehold	17,855	17,332
Long leasehold – 50 years or more	971	1,450
Short leasehold – less than 50 years	1,859	1,027
Net carrying value	20,685	19,809

(e) Carrying value of land and buildings includes £3m (2009 – £4m) relating to the prepayment of lease premiums.

(f) Capital work in progress does not include land.

**Note 11 Property, plant and equipment** continued

	Land and buildings £m	Other <sup>(a)</sup> £m	Total £m
<b>Cost</b>			
At 23 February 2008	19,210	6,340	25,550
Foreign currency translation	434	191	625
Additions <sup>(b)</sup>	3,345	1,013	4,358
Acquisitions through business combinations	586	34	620
Reclassification across categories	(305)	45	(260)
Classified as held for sale	(74)	(8)	(82)
Disposals	(847)	(120)	(967)
<b>At 28 February 2009</b>	<b>22,349</b>	<b>7,495</b>	<b>29,844</b>
<b>Accumulated depreciation and impairment losses</b>			
At 23 February 2008	2,280	3,483	5,763
Foreign currency translation	55	103	158
Charge for the year	352	659	1,011
Reclassification across categories	(5)	–	(5)
Classified as held for sale	18	(3)	15
Disposals	(128)	(90)	(218)
Impairment losses	56	–	56
Reversal of impairment losses	(88)	–	(88)
<b>At 28 February 2009</b>	<b>2,540</b>	<b>4,152</b>	<b>6,692</b>
<b>Net carrying value<sup>(c)(d)(e)</sup></b>			
<b>At 28 February 2009</b>	<b>19,809</b>	<b>3,343</b>	<b>23,152</b>
At 23 February 2008	16,930	2,857	19,787
<b>Capital work in progress included above<sup>(f)</sup></b>			
<b>At 28 February 2009</b>	<b>1,375</b>	<b>159</b>	<b>1,534</b>

**Impairment of property, plant and equipment**

The Group has determined that for the purposes of impairment testing, each store is a cash-generating unit. Cash-generating units are tested for impairment if there are indications of impairment at the balance sheet date.

Recoverable amounts for cash-generating units are mainly based on value in use, which is generally calculated from cash flow projections for five to twenty years using data from the Group's latest internal forecasts, the results of which are reviewed by the Board. The key assumptions for the value in use calculations are those regarding discount rates, growth rates and expected changes in margins. Management estimate discount rates using pre-tax rates that reflect the current market assessment of the time value of money and the risks specific to the cash-generating units. Changes in selling prices and direct costs are based on past experience and expectations of future changes in the market.

The forecasts are extrapolated beyond five years based on estimated long-term growth rates of generally 1% to 4% (2009 – 2% to 10%).

The pre-tax discount rates used to calculate value in use range from 6% to 14% (2009 – 7% to 24%) depending on the specific conditions in which each store operates. These discount rates are derived from the Group's post-tax weighted average cost of capital.

# Notes to the Group financial statements continued

## Note 11 Property, plant and equipment continued

The following amounts have been (charged)/credited to cost of sales in the Group Income Statement:

	2010 £m	2009 £m
<b>Impairment losses</b>		
UK	(27)	(21)
Rest of Europe	(18)	(31)
Asia	(6)	(4)
	<b>(51)</b>	<b>(56)</b>
<b>Reversal of impairment losses</b>		
UK	27	21
Rest of Europe	37	50
Asia	10	17
	<b>74</b>	<b>88</b>
<b>Net reversal of impairment losses</b>	<b>23</b>	<b>32</b>

The impairment losses relate to stores whose recoverable amounts do not exceed the asset carrying values. In all cases, impairment losses arose due to stores performing below forecasted trading levels.

The reversal of previous impairment losses arose principally due to improvements in stores' performances over the last year which increased the net present value of future cash flows.

## Note 12 Investment property

	2010 £m	2009 £m
<b>Cost</b>		
At beginning of year	1,660	1,190
Foreign currency translation	172	24
Additions	16	114
Acquisitions through business combinations	–	86
Transfers	71	260
Classified as held for sale	–	(10)
Disposals	–	(4)
<b>At end of year</b>	<b>1,919</b>	<b>1,660</b>
<b>Accumulated depreciation and impairment losses</b>		
At beginning of year	121	78
Foreign currency translation	14	3
Charge for the period	16	25
Transfers	40	5
Impairment losses	–	10
Reversal of impairment losses	(3)	–
<b>At end of year</b>	<b>188</b>	<b>121</b>
<b>Net carrying value</b>	<b>1,731</b>	<b>1,539</b>

The net carrying value at 23 February 2008 was £1,112m.

## Note 12 Investment property continued

The following amounts have been credited/(charged) to operating costs in the Group Income Statement:

	2010 £m	2009 £m
Impairment losses		
Rest of Europe	–	(10)
Impairment losses	–	(10)
	2010 £m	2009 £m
Reversal of impairment losses		
Rest of Europe	3	–
Reversal of impairment losses	3	–
Net reversal of impairment losses/(impairment charge)	3	(10)

The impairment losses relate to malls whose recoverable amounts do not exceed the asset carrying values. In all cases, impairment losses arose due to the malls performing below forecasted trading levels.

The reversal of previous impairment losses arose principally due to improvements in the performance of malls over the last year, which increased the net present value of cash flows.

The estimated fair value of the Group's investment property is £2.8bn (2009 – £3.2bn). This fair value has been determined by applying an appropriate rental yield to the rentals earned by the investment property. A valuation has not been performed by an independent valuer.

## Note 13 Group entities

### Principal subsidiaries

The Group consolidates its subsidiary undertakings and its principal subsidiaries are:

	Business activity	Share of issued ordinary share capital and voting rights	Country of incorporation and principal country of operation
Tesco Stores Limited	Retail	100%	England
One Stop Stores Limited <sup>(a)</sup>	Retail	100%	England
Tesco Ireland Limited	Retail	100%	Republic of Ireland
Tesco-Global Stores Privately Held Co. Limited	Retail	99%	Hungary
Tesco Polska Sp. z o.o.	Retail	100%	Poland
Tesco Stores Č R a.s.	Retail	100%	Czech Republic
Tesco Stores S R a.s.	Retail	100%	Slovakia
Tesco Kipa Kitle Paza rlama Ticaret ve Gide Sanai A.Ş. <sup>(a)</sup>	Retail	93%	Turkey
Samsung Tesco Co. Limited	Retail	94%	South Korea
Homever Tesco Co. Limited	Retail	100%	South Korea
Ek-Chai Distribution System Co. Limited	Retail	86% <sup>(b)</sup>	Thailand
Tesco Stores Malaysia Sdn Bhd	Retail	70%	Malaysia
Tesco Japan Co. Limited	Retail	100%	Japan
Shanghai Kancheng Storage Co. Limited	Retail	100%	People's Republic of China
Dobbies Garden Centres PLC	Retail	100%	Scotland
Fresh & Easy Neighborhood Market Inc	Retail	100%	USA
Tesco Personal Finance Group Limited <sup>(a)</sup> (trading as Tesco Bank)	Financial Services	100%	Scotland
Tesco Distribution Limited	Distribution	100%	England
Tesco Property Holdings Limited	Property	100%	England
Tesco International Sourcing Limited	Purchasing	100%	Hong Kong
dunnhumby Limited	Data Analysis	90%	England
ELH Insurance Limited (formerly Tesco Insurance Limited)	Self-insurance	100%	Guernsey
Valiant Insurance Company Limited	Self-insurance	100%	Republic of Ireland

(a) Held by the Parent Company (all other principal subsidiaries are held by an intermediate subsidiary).

(b) The Group has 86% of voting rights and 39% of issued ordinary share capital in Ek-Chai Distribution System Co. Limited.

The accounting period ends of the subsidiary undertakings consolidated in these financial statements are on or around 27 February 2010. A full list of the Group's subsidiary undertakings will be annexed to the next Annual Return filed at Companies House. There are no significant restrictions on the ability of subsidiary undertakings to transfer funds to the parent, other than those imposed by the Companies Act 2006.

# Notes to the Group financial statements continued

## Note 13 Group entities continued

### Interests in joint ventures and associates

The Group uses the equity method of accounting for joint ventures and associates. The following table shows the aggregate movement in the Group's investment in joint ventures and associates:

	Joint ventures £m	Associates £m	Total £m
At 24 February 2008	295	10	305
Foreign currency translation	4	–	4
Share of profit of joint ventures and associates	106	4	110
Income received from joint ventures and associates	(68)	(1)	(69)
Transferred to amounts owed by subsidiary undertakings	(37)	–	(37)
Transferred to investment in subsidiary undertakings	(251)	–	(251)
At 28 February 2009	49	13	62
Additions	83	–	83
Foreign currency translation	9	–	9
Share of profit of joint ventures and associates	29	4	33
Income received from joint ventures and associates	(34)	(1)	(35)
At 27 February 2010	136	16	152

### Transferred to investment in subsidiary undertakings

During the year ended 28 February 2009, the Group acquired the remaining 50% of the share capital of Tesco Personal Finance Group Limited (trading as Tesco Bank), previously a joint venture, making the company a wholly-owned subsidiary entity which has been consolidated within the Group results from the date of acquisition onwards.

### Significant joint ventures

The Group's principal joint ventures are:

Business activity	Share of issued share capital, loan capital and debt securities	Country of incorporation and principal country of operation
Tesco Mobile Limited	50%	England
Shopping Centres Limited <sup>(a)</sup>	50%	England
BLT Properties Limited <sup>(a)</sup>	50%	England
Tesco British Land Property Partnership	50%	England
Tesco Red Limited Partnership	50%	England
Tesco Aqua Limited Partnership	50%	England
Tesco Jade Limited Partnership	50%	England
Tesco Coral Limited Partnership	50%	England
Tesco Blue Limited Partnership	50%	England
Tesco Atrato Limited Partnership	50%	England
Fushun Jinxiu Real Estate Development Co Limited	50%	People's Republic of China
Anshan Real Estate Development Co Limited	50%	People's Republic of China
Tesco Qinhuangdo Property Limited	50%	People's Republic of China
Arena (Jersey) Management Limited	50%	Jersey
The Tesco Property Limited Partnership	50%	England
The Tesco Property (No. 2) Limited Partnership	50%	Jersey

(a) Held by the Parent Company (all other principal subsidiaries are held by an intermediate subsidiary).

The accounting period ends of the joint ventures consolidated in these financial statements range from 31 December 2009 to 28 February 2010. Accounting period end dates different from those of the Group arise for commercial reasons and depend upon the requirements of the joint venture partner as well as those of the Group.

### Note 13 Group entities continued

The share of the assets, liabilities, revenue and profit of the joint ventures, which are included in the consolidated financial statements, are as follows:

	2010 £m	2009 £m
Non-current assets	2,216	1,637
Current assets	359	281
Current liabilities	(411)	(426)
Non-current liabilities	(2,041)	(1,458)
Goodwill	1	1
Cumulative unrecognised losses	12	14
	136	49
Revenue	355	549
Expenses	(326)	(443)
Profit for the year	29	106

The unrecognised share of losses made by joint ventures during the year ended 27 February 2010 was £3m (2009 – £7m).

#### Associates

The Group's principal associate is:

	Business activity	Share of issued share capital, loan capital and debt securities	Country of incorporation and principal country of operation
Greenery International Limited†	Fuel Supplier	21%	England

† Held by an intermediate subsidiary.

Although the Group only holds a 21.3% non-voting shareholding in Greenery International Limited it is treated as an associate as the Board of Greenery International Limited requires the consent of the Group on certain reserve matters as specified in the company's Articles of Association.

The share of the assets, liabilities, revenue and profit of the Group's associates, which are included in the consolidated financial statements, are as follows:

	2010 £m	2009 £m
Assets	156	163
Liabilities	(142)	(152)
Goodwill	2	2
	16	13
Revenue	473	540
Profit for the year	4	4

The accounting period ends of the associates consolidated in these financial statements range from 31 December 2009 to 31 January 2010. The accounting period end dates of the associates are different from those of the Group as they also depend upon the requirements of the parent companies of those entities.

There are no significant restrictions on the ability of associated undertakings to transfer funds to the parent, other than those imposed by the Companies Act 2006.

### Note 14 Other investments

	2010 £m	2009 £m
Loan receivable	259	259
Available-for-sale financial assets	604	–
	863	259

The loan receivable comprises an interest-free subordinated loan made by Tesco Bank to Direct Line Group Limited. This loan has no interest receivable and no fixed repayment date.

No impairment charge was recognised on the loan during the year (2009 – £nil).

Included in available-for-sale financial assets is £224m, which is current.

# Notes to the Group financial statements continued

## Note 14 Other investments continued

The following table shows the aggregate movement in the Group's other investments during the year:

	2010 £m	2009 £m
At beginning of year	259	4
Additions	603	–
Acquisitions through business combinations	–	259
IAS 32 and IAS 39 'Financial Instruments' – Fair value remeasurements	1	(4)
At end of year	863	259

## Note 15 Inventories

	2010 £m	2009 £m
Goods held for resale	2,726	2,656
Development properties	3	13
	2,729	2,669

## Note 16 Trade and other receivables

	2010 £m	2009 Restated £m
Prepayments and accrued income	337	419
Other receivables	1,236	1,125
Amounts owed by joint ventures and associates (note 30)	315	276
	1,888	1,820

Included within trade and other receivables are the following amounts receivable after more than one year:

	2010 £m	2009 £m
Prepayments and accrued income	31	14
Other receivables	346	275
Amounts owed by joint ventures and associates (note 30)	309	262
	686	551

Trade and other receivables are generally non-interest bearing. Credit terms vary by country and the nature of the debt and can be from 7 to 60 days.

Trade receivables are recorded at amortised cost, reduced by estimated allowances for doubtful debts.

### Provision for impairment of receivables

	£m
At 23 February 2008	(29)
Foreign currency translation	(2)
Charge for the year	(21)
Uncollectible amounts written off	3
Recoveries of amounts previously written off	5
At 28 February 2009	(44)
Foreign currency translation	(5)
Charge for the year	(3)
Uncollectible amounts written off	–
Recoveries of amounts previously written off	5
At 27 February 2010	(47)

## Note 16 Trade and other receivables continued

As at 27 February 2010, trade and other receivables of £49m (2009 – £45m) were past due and impaired. The amount of the provision was £47m (2009 – £44m). The ageing analysis of these receivables is as follows:

	2010 £m	2009 £m
Up to three months past due	8	3
Three to six months past due	4	3
Over six months past due	37	39
	<b>49</b>	<b>45</b>

As at 27 February 2010, trade and other receivables of £115m (2009 – £97m) were past due but not impaired. The ageing analysis of these receivables is as follows:

	2010 £m	2009 £m
Up to three months past due	97	71
Three to six months past due	10	15
Over six months past due	8	11
	<b>115</b>	<b>97</b>

No receivables have been renegotiated in the current or prior year.

## Note 17 Loans and advances to customers

Tesco Bank has loans and advances to customers.

	2010 £m	2009 £m
Current	2,268	1,918
Non-current	1,844	1,470
	<b>4,112</b>	<b>3,388</b>

The maturity of these loans and advances is as follows:

	2010 £m	2009 £m
Repayable on demand or at short notice	1	1
Within three months	2,370	2,021
Greater than three months but less than one year	70	38
Greater than one year but less than five years	1,504	1,061
After five years	481	517
	<b>4,426</b>	<b>3,638</b>
Provision for impairment of loans and advances	<b>(314)</b>	<b>(250)</b>
	<b>4,112</b>	<b>3,388</b>

Loans and advances include amounts subject to securitisation of £1,459m (2009 – £1,468m). During 2009 the Group entered into a securitisation transaction and issued debt securities which the Group subsequently purchased. The purpose of the transaction was to allow the Group to enter into the Special Liquidity Scheme whereby it would enter into a sale and repurchase agreement acquiring Treasury Bills issued by the UK Government and using the debt securities as security. As at 27 February 2010 the Group held £500m (2009 – £588m) in respect of this transaction. The Treasury Bills do not meet the recognition criteria of IAS 39 and are not recognised on the Group Balance Sheet.

### Provision for impairment of loans and advances

	£m
Acquisition through business combination*	(229)
Charge for the period	(130)
Uncollectible amounts written off	109
Recoveries of amounts previously written off	(7)
Unwind of discount	7
<b>At 28 February 2009</b>	<b>(250)</b>
Charge for the period	(177)
Uncollectible amounts written off	119
Recoveries of amounts previously written off	(10)
Unwind of discount	4
<b>At 27 February 2010</b>	<b>(314)</b>

\* Tesco Personal Finance Group Limited (trading as Tesco Bank) was acquired on 19 December 2008.

# Notes to the Group financial statements continued

## Note 17 Loans and advances to customers continued

At 27 February 2010, Tesco Bank's non-interest bearing loans were £373m (2009 – £291m). Loan impairment provisions of £314m (2009 – £250m) were held against these loans. During the year ended 27 February 2010, the gross income not recognised but which would have been recognised under the original terms of non-interest bearing loans was £29m (2009 – £25m).

At 27 February 2010, loans and advances to customers of £75m (2009 – £82m) were past due but not impaired. The ageing analysis of these loans and advances is as follows:

	2010 £m	2009 £m
Up to one month past due	55	58
One to three months past due	13	15
Over three months past due	7	9
	<b>75</b>	<b>82</b>

## Note 18 Loans and advances to banks and other financial assets

Tesco Bank has loans and advances to banks and other financial assets with the following maturity:

	2010 £m	2009 Restated £m
Within three months	144	1,509
Greater than three months but less than one year	–	3
Greater than one year but less than five years	–	29
	<b>144</b>	<b>1,541</b>

There are no loans and advances to banks and other financial assets which are past due and impaired.

## Note 19 Cash and cash equivalents

	2010 £m	2009 £m
Cash at bank and in hand	2,062	2,112
Short-term deposits	757	1,397
	<b>2,819</b>	<b>3,509</b>

Cash of £1,314m (2009 – £1,233m) held on money market funds is classed as short-term investments.

## Note 20 Trade and other payables

	2010 £m	2009 Restated £m
Trade payables	5,084	4,748
Other taxation and social security	487	334
Other payables	2,014	2,054
Amounts payable to joint ventures and associates (note 30)	42	162
Accruals and deferred income	1,815	1,367
	<b>9,442</b>	<b>8,665</b>

Included in other payables are amounts of £160m (2009 – £68m) which are non-current.

The impact of adopting IFRIC 13 on the 2009 opening balance sheet was to increase other payables by £38m and accruals and deferred income by £2m. Overall trade and other payables increased to £7,359m.

## Note 21 Borrowings

### Current

	Par value	Maturity year	2010 £m	2009 Restated £m
Bank loans and overdrafts	–	–	575	3,014
Loan from joint ventures (note 30)	–	–	23	20
5.125% MTN	£192m	2009	–	198
6.625% MTN	£150m	2010	158	–
4.75% MTN	€750m	2010	704	–
Other MTNs	–	–	24	192
Finance leases (note 35)	–	–	45	47
			<b>1,529</b>	<b>3,471</b>

### Non-current

	Par value	Maturity year	2010 £m	2009 £m
Finance leases (note 35)	–	–	164	196
6.625% MTN	£150m	2010	–	154
4.75% MTN	€750m	2010	–	689
3.875% MTN	€500m	2011	479	476
5.625% MTN	€1,500m	2012	1,375	1,362
LIBOR + 1.33% Bond – Tesco Bank	£225m	2012	224	225
5% MTN	£600m	2014	604	592
5.125% MTN	€600m	2015	539	522
4% RPI MTN <sup>(a)</sup>	£263m	2016	270	268
5.875% MTN	€1,500m	2016	1,520	1,488
5.5% USD Bond	\$850m	2017	621	678
5.5% MTN	£350m	2019	351	351
6.125% MTN	£900m	2022	890	901
5% MTN	£515m	2023	520	515
3.322% LPI MTN <sup>(b)</sup>	£265m	2025	269	267
6% MTN	£200m	2029	212	216
5.5% MTN	£200m	2033	210	216
1.982% RPI MTN <sup>(c)</sup>	£221m	2036	222	221
6.15% USD Bond	\$1,150m	2037	834	977
5% MTN	£300m	2042	306	306
5.125% MTN	€600m	2047	587	628
5.2% MTN	£500m	2057	500	500
Other MTNs	–	–	267	285
Other loans	–	–	780	358
			<b>11,744</b>	<b>12,391</b>

(a) The 4% RPI MTN is redeemable at par, indexed for increases in the Retail Price Index (RPI) over the life of the MTN.

(b) The 3.322% LPI MTN is redeemable at par, indexed for increases in the RPI over the life of the MTN. The maximum indexation of the principal in any one year is 5%, with a minimum of 0%.

(c) The 1.982% RPI MTN is redeemable at par, indexed for increases in the RPI over the life of the MTN.

### Borrowing facilities

The Group has the following undrawn committed facilities available at 27 February 2010, in respect of which all conditions precedent had been met as at that date:

	2010 £m	2009 £m
Expiring within one year	–	100
Expiring between one and two years	1,000	–
Expiring in more than two years	1,600	2,600
	<b>2,600</b>	<b>2,700</b>

All facilities incur commitment fees at market rates and would provide funding at floating rates.

# Notes to the Group financial statements continued

## Note 22 Financial instruments

Derivatives are used to hedge exposure to market risks and those that are held as hedging instruments are formally designated as hedges as defined in IAS 39. Derivatives may qualify as hedges for accounting purposes and the Group's hedging policies are further described below.

Finance income of £20m (2009 – finance costs of £30m) resulted from hedge ineffectiveness.

### Fair value hedges

The Group maintains interest rate and cross-currency swap contracts as fair value hedges of the interest rate and currency risk on fixed rate debt issued by the Group. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Group Income Statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The gain or loss on the hedging instrument and hedged item is recognised in the Group Income Statement within finance income or costs. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying value of the hedged item is amortised to the Group Income Statement under the effective interest rate method.

A loss of £65m on hedging instruments was recognised during the year, offset by a gain of £85m on hedged items (2009 – a gain of £1,197m on hedging instruments was offset by a loss of £1,227m on hedged items).

### Cash flow hedges

The Group uses forward foreign currency contracts to hedge the cost of future purchases of goods for resale, where those purchases are denominated in a currency other than the functional currency of the purchasing company. Where these contracts qualify for hedge accounting, mark-to-market gains and losses are deferred in equity.

The hedging instruments are primarily used to hedge purchases in Euros and US Dollars. The cash flows hedged will occur and will affect the Group Income Statement within one year of the balance sheet date.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is recognised in the Group Income Statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the Group Income Statement.

### Net investment hedges

The Group uses forward foreign currency contracts, currency denominated borrowings and currency swaps to hedge the exposure of a proportion of its non-Sterling denominated assets against changes in value due to changes in foreign exchange rates.

The Group has a South Korean Won denominated liability relating to the future purchase of the minority shareholding of its subsidiary, Samsung Tesco Co. Limited. This liability has been designated as a net investment hedge of a proportion of the assets of Samsung Tesco Co. Limited.

Gains and losses accumulated in equity are included in the Group Income Statement on disposal of the overseas operation.

### Financial instruments not qualifying for hedge accounting

The Group's policy is not to use derivatives for trading purposes, however, some derivatives do not qualify for hedge accounting, or are specifically not designated as a hedge where gains and losses on the hedging instrument and the hedged item offset in the Group Income Statement.

These instruments include caps, interest rate swaps and forward foreign currency contracts. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the Group Income Statement within finance income or costs.

The Group has a liability relating to the future purchase of the minority shareholding of its subsidiary, dunnhumby Limited. Changes in the value of the liability are recognised immediately in the Group Income Statement within finance income or costs.

The fair value of derivative financial instruments have been disclosed in the Group Balance Sheet as follows:

	2010		2009	
	Asset £m	Liability £m	Asset £m	Liability £m
Current	224	(146)	382	(525)
Non-current	1,250	(776)	1,478	(302)
	1,474	(922)	1,860	(827)

## Note 22 Financial instruments continued

The fair value and notional amounts of derivatives analysed by hedge type are as follows:

	2010				2009			
	Asset		Liability		Asset		Liability	
	Fair value £m	Notional £m						
<b>Fair value hedges</b>								
Interest rate swaps and similar instruments	10	685	(88)	2,304	6	307	(67)	2,123
Cross currency swaps	1,130	4,513	(45)	259	1,219	3,957	(39)	825
<b>Cash flow hedges</b>								
Interest rate swaps and similar instruments	–	–	(40)	555	–	100	(66)	400
Cross currency swaps	129	315	(205)	1,064	227	357	(1)	171
Forward foreign currency contracts	19	483	(15)	600	101	1,762	(24)	348
<b>Net investment hedges</b>								
Forward foreign currency contracts	19	244	(172)	1,037	92	2,623	(194)	2,767
Cross currency swaps	–	–	(30)	124	–	–	–	–
Future purchases of minority interests	–	–	(105)	–	–	–	(167)	–
<b>Derivatives not in a formal hedge relationship</b>								
Interest rate swaps and similar instruments	140	1,140	(114)	1,350	1	774	(35)	3,740
Cross currency swaps	2	204	(25)	533	25	411	(47)	639
Forward foreign currency contracts	25	635	(42)	1,254	189	2,784	(154)	2,767
Future purchases of minority interests	–	–	(41)	–	–	–	(33)	–
<b>Total</b>	<b>1,474</b>	<b>8,219</b>	<b>(922)</b>	<b>9,080</b>	<b>1,860</b>	<b>13,075</b>	<b>(827)</b>	<b>13,780</b>

The carrying value and fair value of financial assets and liabilities are as follows:

	2010		2009	
	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	Restated £m	Restated £m
<b>Assets</b>				
Cash and cash equivalents	2,819	2,819	3,509	3,509
Loans and advances to customers – Tesco Bank	4,112	4,325	3,388	3,388
Loans and advances to banks and other financial assets – Tesco Bank	144	144	1,541	1,541
Short-term investments	1,314	1,314	1,233	1,233
Other investments – Tesco Bank	863	848	259	259
Joint venture loan receivables (note 30)	309	309	262	262
<b>Derivative financial assets:</b>				
Interest rate swaps and similar instruments	150	150	7	7
Cross currency swaps	1,261	1,261	1,471	1,471
Forward foreign currency contracts	63	63	382	382
<b>Total financial assets</b>	<b>11,035</b>	<b>11,233</b>	<b>12,052</b>	<b>12,052</b>
<b>Liabilities</b>				
<b>Short-term borrowings:</b>				
Amortised cost	(771)	(770)	(3,191)	(3,190)
Bonds in fair value hedge relationships	(713)	(683)	(233)	(223)
<b>Long-term borrowings:</b>				
Amortised cost	(5,513)	(5,617)	(5,248)	(5,028)
Bonds in fair value hedge relationships	(6,067)	(5,992)	(6,947)	(6,147)
Finance leases (Group as lessee – note 35)	(209)	(209)	(243)	(243)
Customer deposits – Tesco Bank	(4,357)	(4,357)	(4,538)	(4,538)
Deposits by banks – Tesco Bank	(30)	(30)	(24)	(24)
<b>Derivative and other financial liabilities:</b>				
Interest rate swaps and similar instruments	(242)	(242)	(168)	(168)
Cross currency swaps	(305)	(305)	(87)	(87)
Forward foreign currency contracts	(229)	(229)	(372)	(372)
Future purchases of minority interests	(146)	(146)	(200)	(200)
<b>Total financial liabilities</b>	<b>(18,582)</b>	<b>(18,580)</b>	<b>(21,251)</b>	<b>(20,220)</b>
<b>Total</b>	<b>(7,547)</b>	<b>(7,347)</b>	<b>(9,199)</b>	<b>(8,168)</b>

# Notes to the Group financial statements continued

## Note 22 Financial instruments continued

The fair values of financial instruments have been determined by reference to prices available from the markets on which the instruments are traded. The fair value of all other items have been calculated by discounting expected future cash flows at prevailing interest rates. The above table excludes other receivables/payables, which have fair values equal to their carrying values.

### Financial assets and liabilities by category

The accounting classifications of each class of financial assets and liabilities as at 27 February 2010 and 28 February 2009 are as follows:

At 27 February 2010	Available-for-sale £m	Loans and receivables/ other financial liabilities £m	Fair value through profit or loss £m	Total £m
Cash and cash equivalents	–	2,819	–	2,819
Loans and advances to customers – Tesco Bank	–	4,112	–	4,112
Loans and advances to banks and other financial assets – Tesco Bank	–	144	–	144
Short-term investments	–	1,314	–	1,314
Other investments – Tesco Bank	604	259	–	863
Joint venture loan receivables (note 30)	–	309	–	309
Customer deposits – Tesco Bank	–	(4,357)	–	(4,357)
Deposits by banks – Tesco Bank	–	(30)	–	(30)
Short-term borrowings	–	(1,484)	–	(1,484)
Long-term borrowings	–	(11,580)	–	(11,580)
Finance leases (Group as lessee – note 35)	–	(209)	–	(209)
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	–	(92)	(92)
Cross currency swaps	–	–	956	956
Forward foreign currency contracts	–	–	(166)	(166)
Future purchases of minority interests	–	–	(146)	(146)
	604	(8,703)	552	(7,547)

At 28 February 2009	Loans and receivables/ other financial liabilities Restated £m	Fair value through profit or loss Restated £m	Total Restated £m
Cash and cash equivalents	3,509	–	3,509
Loans and advances to customers – Tesco Bank	3,388	–	3,388
Loans and advances to banks and other financial assets – Tesco Bank	1,541	–	1,541
Short-term investments	1,233	–	1,233
Other investments – Tesco Bank	259	–	259
Joint venture loan receivables (note 30)	262	–	262
Customer deposits – Tesco Bank	(4,538)	–	(4,538)
Deposits by banks – Tesco Bank	(24)	–	(24)
Short-term borrowings	(3,424)	–	(3,424)
Long-term borrowings	(12,195)	–	(12,195)
Finance leases (Group as lessee – note 35)	(243)	–	(243)
Derivative financial instruments:			
Interest rate swaps and similar instruments	–	(161)	(161)
Cross currency swaps	–	1,384	1,384
Forward foreign currency contracts	–	10	10
Future purchases of minority interests	–	(200)	(200)
	(10,232)	1,033	(9,199)

### Fair value measurement

Effective from 1 March 2009, the Group adopted the amendment to IFRS 7 for financial instruments that are measured in the Group Balance Sheet at fair value. This requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2); and
- inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

## Note 22 Financial instruments continued

The following table presents the Group's financial assets and liabilities that are measured at fair value at 27 February 2010:

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Assets</b>				
Available-for-sale financial assets	–	604	–	604
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	150	–	150
Cross currency swaps	–	1,261	–	1,261
Forward foreign currency contracts	–	63	–	63
<b>Total assets</b>	<b>–</b>	<b>2,078</b>	<b>–</b>	<b>2,078</b>
<b>Liabilities</b>				
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	(242)	–	(242)
Cross currency swaps	–	(305)	–	(305)
Forward foreign currency contracts	–	(229)	–	(229)
Future purchases of minority interests	–	–	(146)	(146)
<b>Total liabilities</b>	<b>–</b>	<b>(776)</b>	<b>(146)</b>	<b>(922)</b>
<b>Total</b>	<b>–</b>	<b>1,302</b>	<b>(146)</b>	<b>(1,156)</b>

The following table presents the changes in Level 3 instruments for the year ending 27 February 2010:

	£m
Opening balance	(200)
Losses recognised in finance costs in the Group Income Statement	(26)
Losses recognised in reserves	(11)
Cash flow	91
Closing balance	(146)

## Note 23 Financial risk factors

The main financial risks faced by the Group relate to fluctuations in interest and foreign exchange rates, the risk of default by counterparties to financial transactions, and the availability of funds to meet business needs. These risks are managed as described below. The Group Balance Sheet position at 27 February 2010 is representative of the position throughout the year.

Risk management is carried out by a central treasury department under policies approved by the Board of Directors. The Board provides written principles for risk management, as described in the Business Review on pages 41 to 44.

### Interest rate risk

Interest rate risk arises from long-term borrowings. Debt issued at variable rates exposes the Group to cash flow interest rate risk. Debt issued at fixed rates exposes the Group to fair value risk. Our interest rate management policy is explained on page 44.

The Group has RPI debt where the principal is indexed to increases in the RPI index. RPI debt is treated as floating rate debt. The Group also has LPI debt, where the principal is indexed to RPI, with an annual maximum increase of 5% and a minimum of 0%. LPI debt is treated as fixed rate debt.

For interest rate risk relating to Tesco Bank please refer to the separate section on Tesco Bank financial risk factors.

# Notes to the Group financial statements continued

## Note 23 Financial risk factors continued

During 2010 and 2009, net debt was managed using derivative instruments to hedge interest rate risk as follows:

	2010			2009		
	Fixed £m	Floating £m	Total £m	Fixed Restated £m	Floating Restated £m	Total Restated £m
Cash and cash equivalents	–	2,819	2,819	–	3,509	3,509
Loans and advances to customers – Tesco Bank	1,827	2,285	4,112	3,388	–	3,388
Loans and advances to banks and other financial assets – Tesco Bank	144	–	144	–	1,541	1,541
Short-term investments	–	1,314	1,314	–	1,233	1,233
Other investments – Tesco Bank	581	282	863	259	–	259
Joint venture loan receivables	–	309	309	–	262	262
Finance leases	(83)	(126)	(209)	(84)	(159)	(243)
Bank and other borrowings	(11,806)	(1,258)	(13,064)	(11,540)	(4,079)	(15,619)
Customer deposits – Tesco Bank	–	(4,357)	(4,357)	–	(4,538)	(4,538)
Deposits by banks – Tesco Bank	(30)	–	(30)	–	(24)	(24)
Future purchases of minority interests	(146)	–	(146)	(200)	–	(200)
Derivative effect:						
Interest rate swaps	(2,215)	2,215	–	(415)	415	–
Cross currency swaps	6,677	(6,677)	–	4,524	(4,524)	–
Caps and collars	120	(120)	–	774	(774)	–
<b>Total</b>	<b>(4,931)</b>	<b>(3,314)</b>	<b>(8,245)</b>	<b>(3,294)</b>	<b>(7,138)</b>	<b>(10,432)</b>

### Credit risk

Credit risk arises from cash and cash equivalents, trade and other receivables, customer deposits, financial instruments and deposits with banks and financial institutions. The Group policy on credit risk is described on page 44.

The counterparty exposure under derivative contracts is £1,474m (2009 – £1,860m). The Group policy is to transact derivatives only with counterparties rated at least A1 by Moody's.

The Group considers its maximum credit risk to be £11.0bn (2009 – £12.1bn), being the Group's total financial assets.

For credit risk relating to Tesco Bank please refer to the separate section on Tesco Bank financial risk factors on page 109.

### Liquidity risk

Liquidity risk is managed by short-term and long-term cash flow forecasts. In addition, the Group has committed facility agreements for £2.6bn (2009 – £2.7bn), which mature between 2011 and 2014.

The Group has a European Medium Term Note programme of £15.0bn, of which £10.6bn was in issue at 27 February 2010 (2009 – £11.0bn), plus a Euro Commercial Paper programme of £2.0bn, none of which was in issue at 27 February 2010 (2009 – £1.6bn), and a US Commercial Paper programme of \$4.0bn, none of which was in issue at 27 February 2010 (2009 – £nil).

For liquidity risk relating to Tesco Bank please refer to the separate section on Tesco Bank financial risk factors on page 109.

## Note 23 Financial risk factors continued

The following is an analysis of the undiscounted contractual cash flows payable under financial liabilities and derivatives. The potential cash outflow of £15.6bn is considered acceptable as it is offset by financial assets and trade receivables of £12.9bn (2009 – £16.9bn offset by financial assets and trade receivables of £13.9bn).

The undiscounted cash flows will differ from both the carrying values and fair value. Floating rate interest is estimated using the prevailing rate at the balance sheet date. Cash flows in foreign currencies are translated using spot rates at the balance sheet date. For index-linked liabilities, inflation is estimated at 3% for the life of the liability.

At 27 February 2010	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 3 years £m	Due between 3 and 4 years £m	Due between 4 and 5 years £m	Due beyond 5 years £m
<b>Non-derivative financial liabilities</b>						
Bank and other borrowings	(1,484)	(1,078)	(1,615)	(845)	(637)	(7,267)
Interest payments on borrowings	(554)	(518)	(491)	(405)	(370)	(4,605)
Customer deposits – Tesco Bank	(4,357)	–	–	–	–	–
Deposits by banks – Tesco Bank	(30)	–	–	–	–	–
Finance leases	(49)	(47)	(33)	(11)	(10)	(178)
Trade and other payables	(9,282)	(56)	(26)	(4)	(7)	(67)
<b>Derivative and other financial liabilities</b>						
Net settled derivative contracts – receipts	71	50	50	48	21	19
Net settled derivative contracts – payments	(164)	(119)	(59)	(35)	(56)	(695)
Gross settled derivative contracts – receipts	1,966	1,747	757	867	759	5,273
Gross settled derivative contracts – payments	(1,703)	(1,362)	(689)	(866)	(653)	(3,792)
Future purchases of minority interests	–	(131)	(25)	–	–	–
<b>Total</b>	<b>(15,586)</b>	<b>(1,514)</b>	<b>(2,131)</b>	<b>(1,251)</b>	<b>(953)</b>	<b>(11,312)</b>

At 28 February 2009 (restated)	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 3 years £m	Due between 3 and 4 years £m	Due between 4 and 5 years £m	Due beyond 5 years £m
<b>Non-derivative financial liabilities</b>						
Bank and other borrowings	(3,028)	(971)	(873)	(1,931)	(225)	(7,943)
Interest payments on borrowings	(560)	(549)	(514)	(486)	(411)	(5,045)
Customer deposits – Tesco Bank	(4,538)	–	–	–	–	–
Deposits by banks – Tesco Bank	(24)	–	–	–	–	–
Finance leases	(55)	(51)	(48)	(32)	(9)	(172)
Trade and other payables	(8,522)	(34)	(5)	(2)	(4)	(23)
<b>Derivative and other financial liabilities</b>						
Net settled derivative contracts – receipts	104	17	9	5	4	1
Net settled derivative contracts – payments	(245)	(30)	(19)	(23)	(13)	(112)
Gross settled derivative contracts – receipts	4,657	1,186	1,247	404	708	5,707
Gross settled derivative contracts – payments	(4,577)	(957)	(1,053)	(313)	(671)	(4,652)
Future purchases of minority interests	(93)	–	(87)	(20)	–	–
<b>Total</b>	<b>(16,881)</b>	<b>(1,389)</b>	<b>(1,343)</b>	<b>(2,398)</b>	<b>(621)</b>	<b>(12,239)</b>

### Foreign exchange risk

The Group is exposed to foreign exchange risk principally via:

- Transactional exposure, from the cost of future purchases of goods for resale, where those purchases are denominated in a currency other than the functional currency of the purchasing company. Transactional exposures that could significantly impact the Group Income Statement are hedged. These exposures are hedged via forward foreign currency contracts which are designated as cash flow hedges. The notional and fair value of these contracts is shown in note 22.
- Net investment exposure, from the value of net investments outside the UK. The Group hedges a proportion of its investments in its international subsidiaries via foreign currency transactions and borrowings in matching currencies, which are formally designated as net investment hedges.
- Loans to non-UK subsidiaries. These are hedged via foreign currency transactions and borrowings in matching currencies, which are not formally designated as hedges, as gains and losses on hedges and hedged loans will naturally offset.

# Notes to the Group financial statements continued

## Note 23 Financial risk factors continued

The impact on Group financial statements from foreign currency volatility is shown in the sensitivity analysis below.

### Sensitivity analysis

The analysis excludes the impact of movements in market variables on the carrying value of pension and other post-employment obligations and on the retranslation of overseas net assets as required by IAS 21 'The Effects of Changes in Foreign Exchange Rates'. However, it does include the foreign exchange sensitivity resulting from all local entity non-functional currency financial instruments.

The sensitivity analysis has been prepared on the basis that the amount of net debt, the ratio of fixed to floating interest rates of the debt and derivatives portfolio, and the proportion of financial instruments in foreign currencies are all constant and on the basis of the hedge designations in place at 27 February 2010.

It should be noted that the sensitivity analysis reflects the impact on income and equity due to all financial instruments held at the balance sheet date. It does not reflect any change in sales or costs that may result from changing interest or exchange rates.

The following assumptions were made in calculating the sensitivity analysis:

- the sensitivity of interest payable to movements in interest rates is calculated on net floating rate debt, deposits and derivative instruments with no sensitivity assumed for RPI-linked debt;
- changes in the carrying value of derivative financial instruments designated as fair value hedges from movements in interest rates or foreign exchange rates have an immaterial effect on the Group Income Statement and equity due to compensating adjustments in the carrying value of debt;
- changes in the carrying value of derivative financial instruments designated as net investment hedges from movements in foreign exchange rates are recorded directly in equity;
- changes in the carrying value of derivative financial instruments not designated as hedging instruments only affect the Group Income Statement;
- all other changes in the carrying value of derivative financial instruments designated as hedging instruments are fully effective with no impact on the Group Income Statement;
- debt with a maturity below one year is floating rate for the interest payable part of the calculation; and
- the floating leg of any swap or any floating rate debt is treated as not having any interest rate already set, therefore a change in interest rates affects a full 12-month period for the interest payable portion of the sensitivity calculations.

Using the above assumptions, the following table shows the illustrative effect on the Group Income Statement and equity that would result from changes in UK interest rates, and in exchange rates:

	2010		2009	
	Income gain/(loss) £m	Equity gain/(loss) £m	Income gain/(loss) £m	Equity gain/(loss) £m
1% increase in GBP interest rates (2009 – 1%)	(38)	–	(59)	–
15% appreciation of the Euro (2009 – 25%)	(13)	(43)	(22)	(22)
10% appreciation of the South Korean Won (2009 – 20%)	–	(82)	(1)	(222)
25% appreciation of the US Dollar (2009 – 25%)	(1)	(8)	(11)	218
25% appreciation of the Thai Baht (2009 – 25%)	–	(1)	–	(1)
10% appreciation of the Czech Koruna (2009 – 25%)	–	(31)	–	(204)
5% appreciation of the Polish Zloty (2009 – 15%)	–	–	14	–

A decrease in interest rates and a depreciation of foreign currencies would have the opposite effect to the impact in the table above.

The impact on equity from changing exchange rates results principally from foreign currency deals used as net investment hedges. The impact on equity will largely be offset by the revaluation in equity of the hedged assets. For changes in the USD/GBP exchange rate, the impact on equity results principally from forward purchases of US Dollars as cash flow hedges.

### Capital risk

The Group's objectives when managing capital (defined as net debt plus equity) are to safeguard the Group's ability to continue as a going concern in order to provide returns to shareholders and benefits for other stakeholders, while maintaining a strong credit rating and headroom whilst optimising return to shareholders through an appropriate balance of debt and equity funding. The Group manages its capital structure and makes adjustments to it, in light of changes to economic conditions and the strategic objectives of the Group.

To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, buy back shares and cancel them or issue new shares. In April 2006, the Group outlined its plan to release cash from its property assets, via a sequence of property joint ventures and other transactions, and return significant value to shareholders, either through enhanced dividends or share buy-backs. The target for the value of share buy-backs was increased from £1.5bn to £3.0bn over a five-year period from April 2007. Whilst the Group continued with the policy at the beginning of 2009, it subsequently used the proceeds from property divestment to pay down debt, following the two major acquisitions in 2009 (Homever and Tesco Bank). During 2009 the Group purchased and cancelled £100m ordinary shares. In the financial year 2010 the Group continued to use the proceeds from the sale of property to pay down debt, which it expects to continue in 2011.

The policy for debt is to ensure a smooth debt maturity profile with the objective of ensuring continuity of funding. This policy continued during the current year with bonds redeemed of £390m (2009 – £524m) and new bonds issued totalling £nil (2009 – £4,901m). The Group borrows centrally and locally, using a variety of capital market issues and borrowing facilities to meet the requirements of each local business.

## Note 23 Financial risk factors continued

### Tesco Bank

#### Interest rate risk

Interest rate risk arises where assets and liabilities in Tesco Bank's banking activities have different repricing dates. Tesco Bank policy seeks to minimise the sensitivity of net interest income to changes in interest rates. Potential exposures to interest rate movements in the medium to long term are measured and controlled through position and sensitivity limits. Short-term exposures are measured and controlled in terms of net interest income sensitivity over 12 months to a 1% parallel movement in interest rates. Tesco Bank also use value at risk (VaR) for risk management purposes with a time horizon of one trading day and a confidence interval of 95%. Interest rate risk is managed using interest rate swaps as the main hedging instrument.

#### Credit risk

Credit risk is the probability of customers and counterparties failing to meet their obligations to Tesco Bank and arises principally from Tesco Bank's lending activities but also from other transactions involving on and off-balance sheet instruments. Limits have been established for all counterparties based on their respective credit ratings. The limits and proposed counterparties are reviewed and approved by the Risk Management Committee (RMC) of Tesco Bank.

Internal reporting and oversight of risk assets is principally differentiated by credit ratings. Internal ratings are used to assess the credit quality of borrowers. Customers are assigned credit ratings, based on various credit grading models that reflect the probability of default.

#### Liquidity risk

Liquidity risk is managed on a consolidated basis within Tesco Bank's banking activities and adheres to the liquidity requirements set by the Financial Services Authority (FSA) from time to time. To meet regulatory requirements a diversified portfolio of high quality liquid and marketable assets is maintained. Cash flow commitments and marketable asset holdings are measured and managed on a daily basis. Tesco Bank has credit facilities sufficient to meet all foreseeable outflow requirements as they fall due and its liquidity risk is further mitigated by its well diversified retail deposit base.

Expressed as an annual probability of default, the upper and lower boundaries and the midpoint for each of the asset quality grades are as follows:

At 27 February 2010 and 28 February 2009

Asset quality grade	Annual probability of default			S&P equivalent
	Minimum %	Midpoint %	Maximum %	
AQ1	0.00	0.10	0.20	AAA to BBB-
AQ2	0.21	0.40	0.60	BB+ to BB
AQ3	0.61	1.05	1.50	BB- to B+
AQ4	1.51	3.25	5.00	B+ to B
AQ5	5.01	52.50	100.00	B and below

At 27 February 2010	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Accruing past due £m	Non- accrual £m	Impairment provision £m	Total £m
<b>Assets:</b>									
Other investments	863	–	–	–	–	–	–	–	863
Loans and advances to customers	501	381	762	1,495	838	76	373	(314)	4,112
Loans and advances to banks and other financial assets	144	–	–	–	–	–	–	–	144
<b>Total assets</b>	<b>1,508</b>	<b>381</b>	<b>762</b>	<b>1,495</b>	<b>838</b>	<b>76</b>	<b>373</b>	<b>(314)</b>	<b>5,119</b>
Commitments (note 33)	3,926	1,329	573	452	184	–	–	–	6,464
<b>Total off balance sheet</b>	<b>3,926</b>	<b>1,329</b>	<b>573</b>	<b>452</b>	<b>184</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>6,464</b>

At 28 February 2009 (restated)	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Accruing past due £m	Non- accrual £m	Impairment provision £m	Total £m
<b>Assets:</b>									
Other investments	259	–	–	–	–	–	–	–	259
Loans and advances to customers	352	652	828	870	563	82	291	(250)	3,388
Loans and advances to banks and other financial assets	1,541	–	–	–	–	–	–	–	1,541
<b>Total assets</b>	<b>2,152</b>	<b>652</b>	<b>828</b>	<b>870</b>	<b>563</b>	<b>82</b>	<b>291</b>	<b>(250)</b>	<b>5,188</b>
Commitments (note 33)	3,103	1,451	744	305	129	–	–	–	5,732
<b>Total off balance sheet</b>	<b>3,103</b>	<b>1,451</b>	<b>744</b>	<b>305</b>	<b>129</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>5,732</b>

# Notes to the Group financial statements continued

## Note 23 Financial risk factors continued

### Insurance risk

Tesco Bank is exposed to insurance risk indirectly through its profit sharing commission arrangement with The Royal Bank of Scotland Group PLC. Insurance risk is the risk of fluctuations in the timing, frequency or severity of insured events, relative to the expectations at the time of underwriting.

The frequency and severity of claims and the sources of uncertainty for the key classes that Tesco Bank is exposed to are as follows:

#### Motor insurance

Claims experience is quite variable, due to a wide range of factors, but the principal ones are age, gender and driving experience, type and nature of vehicle, use of vehicle and area. There are many sources of uncertainty that will affect Tesco Bank's experience under motor insurance including operational risk, reserving risk, premium rates not matching claims inflation rates, the weather, the social, economic and legislative environment and reinsurance failure risk.

#### Property insurance

The major causes of claims for property insurance are theft, flood, escape of water, fire, storm, subsidence and various types of accidental damage. The major source of uncertainty is the volatility of weather.

## Note 24 Customer deposits

	2010 £m	2009 £m
Customer deposits	4,357	4,538

Customer deposits are recorded at amortised cost and are repayable on demand.

## Note 25 Deposits by banks

The Group has deposits by banks with the following maturity:

	2010 £m	2009 £m
Within three months	30	24

Deposits by banks are recorded at amortised cost.

## Note 26 Provisions

	Property provisions £m	Other provision £m	Total £m
At 23 February 2008	27	–	27
Foreign currency translation	3	–	3
Acquisitions through business combinations (restated)	93	99	192
Amount utilised in the year	(12)	–	(12)
At 28 February 2009 (restated)	111	99	210
Foreign currency translation	12	–	12
Amount provided in the year	–	1	1
Amount utilised in the year	(12)	–	(12)
At 27 February 2010	111	100	211

Property provisions comprise future rents payable net of rents receivable on onerous and vacant property leases, provisions for terminal dilapidations and provisions for future rents above market value on unprofitable stores. The majority of the provision is expected to be utilised over the period to 2020.

The other provision balance relates to a provision for customer redress in respect of potential customer complaints. This is likely to be utilised over several years.

The balances are analysed as follows:

	2010 £m	2009 Restated £m
Current	39	10
Non-current	172	200
	211	210

## Note 27 Share-based payments

The total Group Income Statement charge for the year recognised in respect of share-based payments is £300m (2009 restated – £246m), which is made up of share option schemes and share bonus payments. Of this amount £241m (2009 restated – £208m) will be equity-settled and £59m (2009 – £38m) cash-settled.

### a) Share option schemes

The Company had nine share option schemes in operation during the year, all of which are equity-settled schemes:

- i) The Savings-related Share Option Scheme (1981) permits the grant to employees of options in respect of ordinary shares linked to a building society/bank save-as-you-earn contract for a term of three or five years with contributions from employees of an amount between £5 and £250 per four-weekly period. Options are capable of being exercised at the end of the three- or five-year period at a subscription price not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceding the offer date.
- ii) The Irish Savings-related Share Option Scheme (2000) permits the grant to Irish employees of options in respect of ordinary shares linked to a building society/bank save-as-you-earn contract for a term of three or five years with contributions from employees of an amount between €12 and €320 per four-weekly period. Options are capable of being exercised at the end of the three- or five-year period at a subscription price not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceding the offer date.
- iii) The Approved Executive Share Option Scheme (1994) was adopted on 17 October 1994. The exercise of options granted under this scheme will normally be conditional upon the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the Discretionary Share Option Plan (2004). There were no discounted options granted under this scheme.
- iv) The Unapproved Executive Share Option Scheme (1996) was adopted on 7 June 1996. The exercise of options granted under this scheme will normally be conditional upon the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the Discretionary Share Option Plan (2004). There were no discounted options granted under this scheme.
- v) The International Executive Share Option Scheme (1994) was adopted on 20 May 1994. This scheme permits the grant to selected non-UK executives of options to acquire ordinary shares on substantially the same basis as their UK counterparts. The exercise of options granted under this scheme will normally be conditional on the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the Discretionary Share Option Plan (2004). There were no discounted options granted under this scheme.
- vi) The Executive Incentive Plan (2004) was adopted on 5 July 2004. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options are normally exercisable between three and ten years from the date of grant for nil consideration.
- vii) The Performance Share Plan (2004) was adopted on 5 July 2004 and amended on 29 June 2007. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options granted before 29 June 2007 are normally exercisable between four and ten years from the date of grant for nil consideration. Options granted after 29 June 2007 are normally exercisable between three and ten years from the date of grant for nil consideration. The exercise of options will normally be conditional on the achievement of specified performance targets related to the return on capital employed over a three-year period.
- viii) The Discretionary Share Option Plan (2004) was adopted on 5 July 2004. This scheme permits the grant of approved, unapproved and international options in respect of ordinary shares to selected executives. Options are normally exercisable between three and ten years from the date of grant at a price not less than the middle-market quotation or average middle-market quotations of an ordinary share for the dealing day or three dealing days preceding the date of grant. The exercise of options will normally be conditional on the achievement of a specified performance target related to the annual percentage growth in earnings per share over a three-year period. There will be no discounted options granted under this scheme.
- ix) The Group New Business Incentive Plan (2007) was adopted on 29 June 2007. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options will normally vest in four tranches: four, five, six and seven years after the date of grant and will be exercisable for up to two years from the vesting dates for nil consideration. The exercise of options will normally be conditional on the achievement of specified performance targets related to the return on capital employed over the seven-year plan.

The following tables reconcile the number of share options outstanding and the weighted average exercise price (WAEP):

#### For the year ended 27 February 2010

	Savings-related share option scheme		Irish savings-related share option scheme		Approved share option scheme		Unapproved share option scheme		International executive share option scheme		Nil cost share options	
	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 28 February 2009	142,810,097	306.21	5,418,903	315.67	15,868,920	350.56	81,299,884	339.97	43,898,205	366.61	14,323,708	0.00
Granted	38,117,516	328.00	1,752,363	328.00	2,844,857	338.40	26,542,534	338.42	19,097,981	338.82	3,093,147	0.00
Forfeited	(9,476,452)	315.43	(873,617)	314.96	(581,769)	409.75	(3,213,394)	409.29	(2,147,644)	403.74	(2,299,256)	0.00
Exercised	(33,216,641)	257.20	(842,581)	270.60	(3,581,117)	286.54	(18,721,402)	273.16	(5,967,794)	291.66	(5,932,144)	0.00
Outstanding at 27 February 2010	138,234,520	323.37	5,455,068	326.70	14,550,891	361.57	85,907,622	351.46	54,880,748	363.64	9,185,455	0.00
Exercisable as at 27 February 2010	6,287,764	266.10	369,370	282.75	5,868,560	282.29	32,430,807	280.29	15,277,598	289.05	–	–
Exercise price range (pence)		195.00 to 307.00		195.00 to 307.00		197.50 to 388.75		197.50 to 415.50		197.50 to 318.60		–
Weighted average remaining contractual life (years)		0.18		0.15		4.26		4.53		4.75		–

# Notes to the Group financial statements continued

## Note 27 Share-based payments continued

For the year ended 28 February 2009

	Savings-related share option scheme		Irish savings-related share option scheme		Approved share option scheme		Unapproved share option scheme		International executive share option scheme		Nil cost share options	
	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 23 February 2008	153,361,820	281.40	5,083,009	300.71	16,229,846	324.45	77,043,605	307.00	36,970,259	333.22	10,838,238	0.00
Granted	38,531,375	311.00	1,642,089	311.00	3,308,213	426.79	18,297,370	426.82	13,664,591	422.88	3,591,855	0.00
Forfeited	(10,351,962)	299.64	(485,512)	293.84	(901,163)	384.34	(2,768,871)	388.51	(3,268,614)	327.65	–	–
Exercised	(38,731,136)	214.48	(820,683)	226.80	(2,767,976)	277.55	(11,272,220)	243.72	(3,468,031)	269.07	(106,385)	0.00
Outstanding at 28 February 2009	142,810,097	306.21	5,418,903	315.67	15,868,920	350.56	81,299,884	339.97	43,898,205	366.61	14,323,708	0.00
Exercisable as at 28 February 2009	6,553,484	220.72	398,093	233.61	5,574,827	259.54	36,205,357	260.09	12,340,929	268.72	2,048,225	0.00
Exercise price range (pence)		159.00 to 248.00		159.00 to 248.00		197.50 to 313.50		164.00 to 313.50		176.70 to 312.75		0.00
Weighted average remaining contractual life (years)		0.18		0.15		3.99		4.63		4.76		5.83

Share options were exercised on a regular basis throughout the year. The average share price during the year ended 27 February 2010 was 380.05p (2009 – 372.06p).

The fair value of share options is estimated at the date of grant using the Black-Scholes option pricing model. The following table gives the assumptions applied to the options granted in the respective periods shown. No assumption has been made to incorporate the effects of expected early exercise.

	2010			2009		
	Savings-related share option schemes	Executive share option schemes	Nil cost option schemes	Savings-related share option schemes	Executive share option schemes	Nil cost option schemes
Expected dividend yield (%)	3.6%	3.6-3.9%	0.0%	3.3%	3.3%	0.0%
Expected volatility (%)	26-31%	25%	25%	25-30%	25%	25%
Risk-free interest rate (%)	2.0-2.8%	2.8-3.3%	2.9%	3.2-3.8%	3.2-4.9%	4.6-4.9%
Expected life of option (years)	3 or 5	6	6	3 or 5	6	6
Weighted average fair value of options granted (pence)	86.74	64.24	374.00	89.28	93.90	418.09
Probability of forfeiture (%)	14-16%	10%	0%	20-25%	10%	0%
Share price (pence)	378.00	345.23	374.00	361.00	425.20	418.09
Weighted average exercise price (pence)	328.00	338.58	0.00	311.00	425.20	0.00

Volatility is a measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in the Group's option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. In estimating the future volatility of the Company's share price, the Board considers the historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option, taking into account the remaining contractual life of the option.

### b) Share bonus schemes

Eligible UK employees are able to participate in Shares in Success, an all-employee profit-sharing scheme. Each year, shares are awarded as a percentage of earnings up to a statutory maximum of £3,000. Eligible Republic of Ireland employees are able to participate in a Share Bonus Scheme, an all-employee profit sharing scheme. Each year, employees receive a percentage of their earnings as either cash or shares.

Senior management also participate in performance-related bonus schemes. The amount paid to employees is based on a percentage of salary and is paid partly in cash and partly in shares. Bonuses are awarded to eligible employees who have completed a required service period and depend on the achievement of corporate targets. The accrued cash element of the bonus at the balance sheet date is £52m (2009 – £33m).

Selected senior management participate in the senior management Performance Share Plan. Awards made under this plan will normally vest three years after the date of the award for nil consideration. Vesting will normally be conditional on the achievement of specified performance targets related to the return on capital employed over a three year performance period.

Senior management in the US business also participate in the US Long-Term Incentive Plan (2007) which was adopted on 29 June 2007. The awards made under this Plan will normally vest in four tranches: four, five, six and seven years after the date of award, for nil consideration. Vesting will normally be conditional on the achievement of specified performance targets related to the return on capital employed in the US business over the seven-year plan.

## Note 27 Share-based payments continued

The Executive Directors participate in short-term and long-term bonus schemes designed to align their interests with those of shareholders. Full details of these schemes can be found in the Directors' Remuneration Report.

The fair value of shares awarded under these schemes is their market value on the date of award. Expected dividends are not incorporated into the fair value except for awards under the US Long-Term Incentive Plan.

The number and weighted average fair value (WAFV) of share bonuses awarded during the period were:

	2010		2009	
	Shares number	WAFV pence	Shares number	WAFV pence
Shares in Success	<b>28,661,004</b>	<b>349.66</b>	21,295,232	431.05
Executive Incentive Scheme	<b>13,731,567</b>	<b>355.51</b>	10,996,677	415.68
Performance Share Plan	<b>2,120,058</b>	<b>375.37</b>	2,123,237	353.76
US Long-Term Incentive Plan	<b>80,622</b>	<b>482.00</b>	673,716	403.80

## Note 28 Post-employment benefits

### Pensions

The Group operates a variety of post-employment benefit arrangements, covering both funded defined contribution and funded and unfunded defined benefit schemes. The most significant of these are the funded defined benefit pension schemes for the Group's employees in the UK and the Republic of Ireland.

### Defined contribution plans

The contributions payable for defined contribution schemes of £12m (2009 – £11m) have been fully expensed against profits in the current year.

### Defined benefit plans

#### United Kingdom

The principal plan within the Group is the Tesco PLC Pension Scheme, which is a funded defined benefit pension scheme in the UK, the assets of which are held as a segregated fund and administered by trustees. Towers Watson Limited, an independent actuary, carried out the latest triennial actuarial assessment of the scheme as at 31 March 2008, using the projected unit method.

At the date of the last actuarial valuation the actuarial deficit was £275m. The market value of the schemes' assets was £3,987m and these assets represented 94% of the benefits that had accrued to members, after allowing for expected increases in earnings and pensions in payment.

During the year, the One Stop Senior Executive Pension Scheme was merged into the Tesco PLC Pension Scheme. As the One Stop Scheme was already part of the Group there has been no impact on the overall disclosures. The One Stop Scheme had a net liability of £4.6m at 28 February 2009.

#### Overseas

The most significant overseas scheme is the funded defined benefit pension scheme which operates in the Republic of Ireland. An independent actuary, using the projected unit method, carried out the latest actuarial assessment of the scheme as at 1 April 2007.

The valuations used for IAS 19 have been based on the most recent actuarial valuations and updated by Towers Watson Limited to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 27 February 2010. The schemes' assets are stated at their market values as at 27 February 2010. Towers Watson Limited have updated the most recent Republic of Ireland valuation. The liabilities relating to retirement healthcare benefits have also been determined in accordance with IAS 19, and are incorporated in the following tables.

### Principal assumptions

The valuations used have been based on the most recent actuarial valuations and updated by Towers Watson Limited to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 27 February 2010. The major assumptions, on a weighted average basis, used by the actuaries were as follows:

	2010 %	2009 %
Rate of increase in salaries	<b>3.6</b>	3.7
Rate of increase in pensions in payment*	<b>3.4</b>	3.1
Rate of increase in deferred pensions*	<b>3.6</b>	3.2
Rate of increase in career average benefits	<b>3.6</b>	3.2
Discount rate	<b>5.9</b>	6.5
Price inflation	<b>3.6</b>	3.2

\* In excess of any Guaranteed Minimum Pension (GMP) element.

The main financial assumption is the real discount rate (the excess of the discount rate over the rate of price inflation). If this assumption increased/decreased by 0.1%, the UK defined benefit obligation would decrease/increase by approximately £140m and the annual UK current service cost would decrease/increase by approximately £17m.

# Notes to the Group financial statements continued

## Note 28 Post-employment benefits continued

### UK mortality assumptions

The Company conducts analysis of mortality trends under the Tesco PLC Pension Scheme in the UK as part of the triennial actuarial valuation of the Scheme. At the latest triennial actuarial valuation as at 31 March 2008, the following assumptions were adopted for funding purposes:

Base tables:

PMA92C00 for male members with cohort improvements to 2000 and members taken to be one year younger than actual age.

PFA92C00 for female members with cohort improvements to 2000 and members taken to be half a year older than actual age.

These assumptions were used for the calculation of the pension liability as at 27 February 2010 for the main UK scheme.

As at 27 February 2010, the mortality assumptions have been strengthened. The base tables have been updated in line with medium cohort projections with a minimum improvement of 1% per annum from 31 March 2008 to 27 February 2010. In addition, the allowance for future mortality improvements has been changed to incorporate medium cohort projections with a minimum improvement of 1% per annum.

The following table illustrates the expectation of life of an average member retiring at age 65 at the balance sheet date and a member reaching age 65 at the same date +25 years:

		2010 in years	2009 in years
Retiring at Reporting date at age 65:	Male	21.6	21.5
	Female	23.4	23.3
Retiring at Reporting date +25 years at age 65:	Male	24.0	23.9
	Female	25.9	25.8

### Rates of return on scheme assets

The assets in the defined benefit pension schemes and the expected nominal rates of return were:

	Long-term rate of return %	2010 Market value £m	Long-term rate of return %	2009 Market value £m
Equities	8.7	2,521	8.9	1,482
Bonds	5.1	1,233	5.5	1,080
Property	7.0	343	7.3	342
Other (alternative assets)	8.7	484	8.9	383
Cash	4.1	115	3.7	133
Total market value of assets		4,696		3,420

The expected rate of return on assets is a weighted average based on the actual plan assets held and the respective returns expected on the separate asset classes. The expected rate of return on equities and cash have both been set having regard to expected returns over the medium term, as calculated by the Company's independent actuary. The expected rate of return on bonds was measured directly from actual yields for gilts and corporate bond stocks. The above rate takes into account the actual mix of UK gilts, UK corporate bonds and overseas bonds held at the balance sheet date.

### Movement in pension deficit during the year

Changes in the fair value of defined benefit pension plan assets are as follows:

	2010 £m	2009 £m
Opening fair value of plan assets	3,420	4,089
Expected return	265	338
Actuarial gains/(losses)	733	(1,270)
Contributions by employer	415	376
Actual member contributions	9	8
Foreign currency translation	(2)	11
Benefits paid	(144)	(132)
Closing fair value of plan assets	4,696	3,420

## Note 28 Post-employment benefits continued

Changes in the present value of defined benefit obligations are as follows:

	2010 £m	2009 £m
Opening defined benefit obligation	<b>(4,914)</b>	(4,927)
Current service cost	<b>(391)</b>	(428)
Interest cost	<b>(313)</b>	(313)
(Loss)/gain on change of assumptions	<b>(1,052)</b>	760
Experience losses	<b>(1)</b>	(117)
Foreign currency translation	<b>–</b>	(13)
Benefits paid	<b>144</b>	132
Actual member contributions	<b>(9)</b>	(8)
Closing defined benefit obligation	<b>(6,536)</b>	(4,914)

The amounts that have been charged to the Group Income Statement and Group Statement of Comprehensive Income for the year ended 27 February 2010 are set out below:

	2010 £m	2009 £m
<b>Analysis of the amount charged to operating profit:</b>		
Current service cost	<b>(391)</b>	(428)
Total charge to operating profit	<b>(391)</b>	(428)
<b>Analysis of the amount (charged)/credited to finance (cost)/income:</b>		
Expected return on pension schemes' assets	<b>265</b>	338
Interest on pension schemes' liabilities	<b>(313)</b>	(313)
Net pension finance (cost)/income (note 5)	<b>(48)</b>	25
Total charge to the Group Income Statement	<b>(439)</b>	(403)
<b>Analysis of the amount recognised in the Group Statement of Comprehensive Income:</b>		
Actual return less expected return on pension schemes' assets	<b>733</b>	(1,270)
Experience losses arising on the schemes' liabilities	<b>(1)</b>	(117)
Foreign currency translation	<b>(2)</b>	(2)
Changes in assumptions underlying the present value of the schemes' liabilities	<b>(1,052)</b>	760
Total loss recognised in the Group Statement of Comprehensive Income	<b>(322)</b>	(629)

The cumulative losses recognised through the Group Statement of Comprehensive Income since the date of transition to IFRS are £1,323m (2009 – £1,001m).

### Summary of movements in deficit during the year

	2010 £m	2009 £m
Deficit in schemes at beginning of the year	<b>(1,494)</b>	(838)
Current service cost	<b>(391)</b>	(428)
Other finance (cost)/income	<b>(48)</b>	25
Contributions by employer	<b>415</b>	376
Foreign currency translation	<b>(2)</b>	(2)
Actuarial loss	<b>(320)</b>	(627)
Deficit in schemes at end of the year	<b>(1,840)</b>	(1,494)

### History of movements

The historical movement in defined benefit pension schemes assets and liabilities and history of experience gains and losses are as follows:

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Total market value of assets	<b>4,696</b>	3,420	4,089	4,007	3,448
Present value of liabilities relating to unfunded schemes	<b>(54)</b>	(39)	(34)	(27)	(17)
Present value of liabilities relating to partially funded schemes	<b>(6,482)</b>	(4,875)	(4,893)	(4,930)	(4,642)
Pension deficit	<b>(1,840)</b>	(1,494)	(838)	(950)	(1,211)
Experience gains/(losses) on scheme assets	<b>733</b>	(1,270)	(465)	82	309
Experience losses on plan liabilities	<b>(1)</b>	(117)	(20)	(41)	(24)

# Notes to the Group financial statements continued

## Note 28 Post-employment benefits continued

### Post-employment benefits other than pensions

The Company operates a scheme offering retirement healthcare benefits. The cost of providing these benefits has been accounted for on a similar basis to that used for defined benefit pension schemes.

The liability as at 27 February 2010 of £12m (2009 – £10m) was determined in accordance with the advice of independent actuaries. In 2010, £0.7m (2009 – £0.7m) has been charged to the Group Income Statement and £0.5m (2009 – £0.5m) of benefits were paid.

A change of 1.0% in assumed healthcare cost trend rates would have the following effect:

	2010 £m	2009 £m
Effect of a 1% increase in assumed healthcare cost trend rate on:		
Service and interest cost	0.1	0.1
Defined benefit obligation	1.5	1.6
Effect of a 1% decrease in assumed healthcare cost trend rate on:		
Service and interest cost	(0.1)	(0.1)
Defined benefit obligation	(1.5)	(1.3)

### Expected contributions

A formal actuarial valuation is carried out triennially for the scheme trustees by a professionally qualified independent actuary. The purpose of the valuation is to agree a funding plan to ensure that present and future contributions should be sufficient to meet future liabilities. The actuarial valuation of approved schemes as at 31 March 2008 has been concluded and the Group's contributions are increasing to 11.1% from 10.9%. On this basis the Group expects to make contributions of approximately £430m to defined benefit pension schemes in the year ending 27 February 2011.

## Note 29 Called up share capital

	2010		2009	
	Ordinary shares of 5p each		Ordinary shares of 5p each	
	Number	£m	Number	£m
Authorised:				
At beginning of year	10,858,000,000	543	10,858,000,000	543
Authorised during the year	2,500,000,000	125	–	–
At end of year	13,358,000,000	668	10,858,000,000	543
Allotted, called up and fully paid:				
At beginning of year	7,895,344,018	395	7,863,498,783	393
Share options	62,329,535	3	57,060,046	3
Share bonus scheme	27,370,504	1	–	–
Share buy-back	–	–	(25,214,811)	(1)
At end of year	7,985,044,057	399	7,895,344,018	395

During the financial year, 62 million (2009 – 57 million) shares of 5p each were issued in relation to share options for aggregate consideration of £166m (2009 – £130m).

During the financial year, 27 million (2009 – nil) shares of 5p each were issued in relation to share bonus awards for consideration of £1m (2009 – £nil).

During the year, the Company purchased and subsequently cancelled no shares of 5p each. During 2009, the Company purchased and subsequently cancelled 25,214,811 shares of 5p each, representing 0% of the called up share capital, at an average share price of 3.98 per share. The total consideration, including expenses, £100m. The excess of the consideration over the nominal value was charged to retained earnings.

Between 28 February 2010 and 16 April 2010 options over 3,722,750 ordinary shares have been exercised under the terms of the Savings-related Share Option Scheme (1981) and the Irish Savings-related Share Option Scheme (2000). Between 28 February 2010 and 16 April 2010, options over 5,592,493 ordinary shares have been exercised under the terms of the Executive Share Option Schemes (1994 and 1996) and the Discretionary Share Option Plan (2004).

As at 27 February 2010, the Directors were authorised to purchase up to a maximum in aggregate of 790.1 million (2009 – 784.8 million) ordinary shares.

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

### Capital redemption reserve

Upon cancellation of the shares purchased as part of the share buy-back, a capital redemption reserve is created representing the nominal value of the shares cancelled. This is a non-distributable reserve.

### Note 30 Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint ventures and associates are disclosed below:

#### i) Trading transactions

	Sales to related parties		Purchases from related parties		Amounts owed by related parties		Amounts owed to related parties	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Joint ventures	154	183	360	290	6	14	18	6
Associates	–	–	1,313	1,175	–	–	24	156

Sales to related parties consists of services/management fees and loan interest.

Purchases from related parties include £226m (2009 – £174m) of rentals payable to the Group's joint ventures, including those joint ventures formed as part of the sale and leaseback programme.

Purchases from associates include £1,312m (2009 – £1,171m) of fuel purchased from Greenergy International Limited.

#### ii) Non-trading transactions

	Sales to related parties		Loans to related parties		Loans from related parties		Injection of equity funding	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Joint ventures	87	465	309	262	23	20	83	–

Transactions between the Group and the Group's pension plans are disclosed in note 28.

A number of the Group's subsidiaries are members of one or more partnerships to whom the provisions of the Partnerships (Accounts) Regulations 2008 ('Regulations') apply. The accounts for those partnerships have been consolidated into these accounts pursuant to Regulation 7 of the Regulations.

On 25 June 2009, the Group formed a limited partnership with Tesco Pension Trustees. The limited partnerships contain twelve stores and two distribution centres which have been sold from and leased back to the Group. The Group sold assets for net proceeds of £386m to the limited partnership. The Group's share of the profit realised from this transaction is included within profit arising on property-related items.

On 23 September 2009, the Group formed a limited partnership with a third party. The limited partnerships contain fifteen stores and two distribution centres which have been sold from and leased back to the Group. The Group sold assets for net proceeds of £460m to the limited partnership. The Group's share of the profit realised from this transaction is included within profit arising on property-related items.

#### iii) Transactions with key management personnel

Only members of the Board of Directors of Tesco PLC are deemed to be key management personnel. It is the Board who have responsibility for planning, directing and controlling the activities of the Group. Key management personnel compensation is disclosed in the audited section of the Directors' Remuneration Report.

Transactions on an arm's length basis with Tesco Bank during the year were as follows:

	Credit card and personal loan balances		Saving deposit accounts	
	Number of key management personnel	£m	Number of key management personnel	£m
At 28 February 2009	2	–	2	–
At 27 February 2010	–	–	4	1

During the current and prior year, there were no other material transactions or balances between the Group and its key management personnel or their close family members.

# Notes to the Group financial statements continued

## Note 31 Reconciliation of profit before tax to cash generated from operations

	2010 £m	2009 Restated £m
Profit before tax	3,176	2,917
Net finance costs	314	362
Share of post-tax profits of joint ventures and associates	(33)	(110)
Operating profit	3,457	3,169
Depreciation and amortisation	1,384	1,189
Profit arising on property-related items	(377)	(236)
Loss arising on sale of non property-related items	5	3
Impairment of goodwill	131	–
Net reversal of impairment of property, plant and equipment	(26)	(22)
Adjustment for non-cash element of pensions charge	(24)	52
Share-based payments	241	208
Decrease/(increase) in inventories	34	(95)
Decrease in trade and other receivables	124	79
Increase in trade and other payables	453	724
Increase in trade and other receivables – Tesco Bank	(28)	–
Increase in trade and other payables – Tesco Bank	75	–
Increase in loans and advances to customers	(724)	(20)
Decrease/(increase) in loans and advances to banks, other financial assets and receivables	1,397	(1,538)
(Decrease)/increase in customer deposits, payables and other financial liabilities	(175)	1,465
Increase in working capital	1,156	619
<b>Cash generated from operations</b>	<b>5,947</b>	<b>4,978</b>

The increase in working capital includes the impact of translating foreign currency working capital movements at average exchange rates rather than period end exchange rates.

## Note 32 Analysis of changes in net debt

	At 28 February 2009 £m	Tesco Bank at 28 February 2009 Restated £m	Cash flow £m	Other non-cash movements £m	Elimination of Tesco Bank £m	At 27 February 2010 £m
Cash and cash equivalents	3,472	37	(739)	49	(204)	2,615
Short-term investments	1,233	–	81	–	–	1,314
Joint venture loan and other receivables	262	–	45	13	–	320
Derivative financial instruments and other financial assets	1,858	2	(78)	(308)	(2)	1,472
Cash and receivables	6,825	39	(691)	(246)	(206)	5,721
Bank and other borrowings	(3,424)	–	2,909	(969)	256	(1,228)
Finance lease payables	(47)	–	41	(39)	–	(45)
Derivative financial instruments and other liabilities	(483)	(42)	(51)	430	14	(132)
Debt due within one year	(3,954)	(42)	2,899	(578)	270	(1,405)
Bank and other borrowings	(11,973)	(222)	(392)	1,007	224	(11,356)
Finance lease payables	(196)	–	–	32	–	(164)
Derivative financial instruments and other liabilities	(302)	–	(10)	(464)	51	(725)
Debt due after one year	(12,471)	(222)	(402)	575	275	(12,245)
	(9,600)	(225)	1,806	(249)	339	(7,929)

## Note 33 Commitments and contingencies

### Capital commitments

At 27 February 2010 there were commitments for capital expenditure contracted for, but not provided, of £1,835m (2009 – £1,551m), principally relating to the store development programme.

### Note 33 Commitments and contingencies continued

#### Contingent liabilities

The Company has irrevocably guaranteed the liabilities, as defined in Section 5(c) of the Republic of Ireland (Amendment Act) 1986, of various subsidiary undertakings incorporated in the Republic of Ireland.

For details of assets held under finance leases, which are pledged as security for the finance lease liabilities, see note 11.

There are a number of contingent liabilities that arise in the normal course of business which if realised are not expected to result in a material liability to the Group. The Group recognises provisions for liabilities when it is more likely than not a settlement will be required and the value of such a payment can be reliably estimated.

In September 2007, the Office of Fair Trading issued its provisional findings in its Statement of Objections relating to the alleged collusion between certain large supermarkets and dairy processors. On 30 April 2010, the Office of Fair Trading announced that it had decided to drop the allegations against the Group in relation to milk and butter in the dairy investigation. The Office of Fair Trading agreed a discretionary penalty discount of 10% for the Group not contesting the two remaining allegations which related to cheese. The Group has however made no admission of wrongdoing. The discounted fine will become payable after the OFT issues its decision later this year and is immaterial to the Group and therefore no provision has been recognised in the Group's financial statements.

#### Tesco Bank

At 27 February 2010, Tesco Bank has commitments of formal standby facilities, credit lines and other commitments to lend, totalling £6.5bn (2009 – £5.7bn). The amount is intended to provide an indication of the potential volume of business and not of the underlying credit or other risks.

The Financial Services Compensation Scheme (FSCS) is the UK statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowed from HM Treasury to fund these compensation costs associated with institutions that failed in 2008 and will receive receipts from asset sales, surplus cash flow and other recoveries from these institutions in the future.

The FSCS meets its obligations by raising management expense levies. These include amounts to cover the interest on its borrowings and compensation levies on the industry. Each deposit-taking institution contributes in proportion to its share of total protected deposits. The levy is calculated based on deposit balances held as at 31 December in each year and as such, this is seen as the 'trigger event' under accounting rules.

If the FSCS does not receive sufficient funds from the failed institutions to repay HM Treasury in full it will raise compensation levies. At this time it is not possible to estimate the amount or timing of any shortfall resulting from the cash flows received from the failed institutions and, accordingly, no provision for compensation levies has been made in these financial statements.

### Note 34 Capital resources

The following table shows the composition of regulatory capital resources of Tesco Personal Finance PLC (being the regulated entity) at the balance sheet date:

	2010 £m	2009 £m
<b>Tier 1 capital:</b>		
Shareholders' funds and minority interests	<b>576</b>	521
<b>Tier 2 capital:</b>		
Qualifying subordinated debt	<b>235</b>	205
Other interests in tier 2 capital	<b>21</b>	19
Supervisory deductions	<b>(263)</b>	(259)
<b>Total regulatory capital</b>	<b>569</b>	486

The movement of tier 1 capital during the year is analysed as follows:

	2010 £m	2009* £m
Beginning of the year	<b>521</b>	514
Share capital and share premium	<b>230</b>	–
Profit attributable to shareholders	<b>37</b>	7
Ordinary dividends	<b>(153)</b>	–
Increase in intangible assets	<b>(59)</b>	–
<b>End of the year</b>	<b>576</b>	521

\* Tesco Personal Finance PLC was acquired as part of Tesco Personal Finance Group Limited on 19 December 2008.

It is Tesco Personal Finance PLC's (TPF) policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, TPF has regard to the supervisory requirements of the Financial Services Authority ('FSA'). The FSA uses Risk Asset Ratio ('RAR') as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement the RAR should be not less than 8% with a Tier 1 component of not less than 4%. TPF has complied with the FSA's capital requirements throughout the year.

# Notes to the Group financial statements continued

## Note 35 Leasing commitments

### Finance lease commitments – Group as lessee

The Group has finance leases for various items of plant, equipment, fixtures and fittings. There are also a small number of buildings which are held under finance leases. The fair value of the Group's lease obligations approximate to their carrying value.

Future minimum lease payments under finance leases and hire purchase contracts, together with the present value of the net minimum lease payments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2010 £m	2009 £m	2010 £m	2009 £m
Within one year	49	55	45	47
Greater than one year but less than five years	101	140	90	114
After five years	178	172	74	82
Total minimum lease payments	328	367	209	243
Less future finance charges	(119)	(124)		
Present value of minimum lease payments	209	243		
Analysed as:				
Current finance lease payables	45	47		
Non-current finance lease payables	164	196		
	209	243		

### Operating lease commitments – Group as lessee

Future minimum rentals payable under non-cancellable operating leases are as follows:

	2010 £m	2009 £m
Within one year	1,043	754
Greater than one year but less than five years	3,702	3,069
After five years	10,004	9,170
Total minimum lease payments	14,749	12,993

Operating lease payments represent rentals payable by the Group for certain of its retail, distribution and office properties and other assets such as motor vehicles. The leases have varying terms, purchase options, escalation clauses and renewal rights.

The Group has lease break options on certain sale and leaseback transactions, which are exercisable if an existing option to buy back leased assets at market value at a specified date is also exercised, no commitment has been included in respect of the buy-back option as the option is at the Group's discretion. The Group is not obliged to pay lease rentals after that date and so minimum lease payments exclude those falling after the buy-back date.

### Operating lease commitments with joint ventures

Since 1988, the Group has entered into several joint ventures and sold and leased back properties to and from these joint ventures. The terms of these sale and leasebacks vary, however, common factors include: the sale of the properties to the joint venture at market value, options within the lease for the Group to repurchase the properties at market value, market rent reviews and 20-30 year lease terms. The Group reviews the substance as well as the form of the arrangements when making the judgement as to whether these leases are operating or finance leases; all of the leases under these arrangements are operating leases.

### Operating lease receivables – Group as lessor

The Group both rents out its properties and also sublets various leased buildings under operating leases. At the balance sheet date, the following future minimum lease payments are contractually receivable from tenants:

	2010 £m	2009 £m
Within one year	259	201
Greater than one year but less than five years	566	445
After five years	348	335
Total minimum lease payments	1,173	981

# Five year record

	2006 <sup>1</sup>	2007	2008	2009 Restated	2010
<b>Financial statistics</b>					
Group sales (including VAT) (£m)	43,137	46,611	51,773	59,426	<b>62,537</b>
Revenue (excluding VAT) (£m)					
UK	29,990	32,665	34,858 <sup>6</sup>	37,650 <sup>3</sup>	<b>38,558</b>
Rest of Europe	5,095	5,559	6,872	8,831 <sup>5</sup>	<b>8,704</b>
Asia	4,369	4,417	5,552	7,048 <sup>3</sup>	<b>8,439</b>
US	–	–	16 <sup>6</sup>	206	<b>349</b>
Tesco Bank	–	–	–	163 <sup>6</sup>	<b>860</b>
<b>Total Group</b>	<b>39,454</b>	<b>42,641</b>	<b>47,298</b>	<b>53,898</b>	<b>56,910</b>
Group operating profit <sup>2</sup> (£m)	2,280	2,648	2,791	3,169 <sup>3</sup>	<b>3,457</b>
Group operating profit margin <sup>2</sup>	5.8%	6.2%	5.9%	5.9%	<b>6.1%</b>
Share of results of joint ventures and associates (£m)	82	106	75	110	<b>33</b>
Profit on sale of investment in associates (£m)	–	25	–	–	<b>–</b>
Net finance costs (£m)	(127)	(126)	(63)	(362)	<b>(314)</b>
Profit before tax (£m)	2,235	2,653	2,803	2,917 <sup>3</sup>	<b>3,176</b>
Taxation (£m)	(649)	(772)	(673)	(779)	<b>(840)</b>
Minority interests (£m)	(6)	(7)	(6)	(5)	<b>(9)</b>
(Loss)/profit for the period from discontinued operation <sup>4,5</sup> (£m)	(10)	18	–	–	<b>–</b>
<b>Profit for the financial year attributable to owners of the parent (£m)</b>	<b>1,570</b>	<b>1,892</b>	<b>2,124</b>	<b>2,133<sup>3</sup></b>	<b>2,327</b>
<b>Underlying profit before tax<sup>5</sup> (£m)</b>	<b>2,277</b>	<b>2,545</b>	<b>2,846</b>	<b>3,124</b>	<b>3,395</b>
Enterprise value <sup>7</sup> (£m)	30,841	40,469	37,656	35,907	<b>41,442</b>
Basic earnings per share <sup>8</sup>	20.20p	23.61p	26.95p	27.14p <sup>3</sup>	<b>29.33p</b>
Diluted earnings per share <sup>8</sup>	19.92p	23.31p	26.61p	26.96p <sup>3</sup>	<b>29.19p</b>
Dividend per share <sup>9</sup>	8.63p	9.64p	10.90p	11.96p	<b>13.05p</b>
Return on shareholders' funds <sup>10</sup>	24.9%	26.7%	25.1%	23.5% <sup>3</sup>	<b>23.0%</b>
Return on capital employed <sup>11</sup>	12.7%	12.6% <sup>16</sup>	12.7% <sup>17</sup>	12.8% <sup>20</sup>	<b>12.1%</b>
<b>Group statistics</b>					
Number of stores	2,672	3,263	3,751	4,332	<b>4,811</b>
Total sales area – 000 sq ft <sup>12</sup>	55,215	68,189	76,338	88,451	<b>93,985</b>
Average employees	368,213	413,061	444,127	468,508	<b>472,094</b>
Average full-time equivalent employees	273,024	318,283	345,737	364,015	<b>372,338</b>
<b>UK retail statistics</b>					
Number of stores <sup>18</sup>	1,898	1,988	2,115	2,282	<b>2,482</b>
Total sales area – 000 sq ft <sup>12,18</sup>	25,919	27,785	29,549	31,285	<b>32,991</b>
Average store size (sales area – sq ft) <sup>13,18</sup>	32,816	34,209	35,055	35,215	<b>35,485</b>
Average full-time equivalent employees	175,459	184,461	193,917	194,420	<b>196,604</b>
<b>UK retail productivity (£)</b>					
Revenue per employee <sup>14</sup>	170,923	177,084	179,840	196,436 <sup>3</sup>	<b>196,120</b>
Profit per employee <sup>14</sup>	10,190	11,292	10,814 <sup>19</sup>	13,065 <sup>3</sup>	<b>14,303</b>
Weekly sales per sq ft <sup>15</sup>	25.06	25.48	25.43	25.34 <sup>3</sup>	<b>25.22</b>

- 1 Results for the year ended 25 February 2006 include 52 weeks for the UK and ROI and 14 months for the majority of the remaining international businesses.
- 2 Operating profit includes integration costs and profit/(loss) arising on sale of fixed assets. Operating margin is based upon revenue excluding VAT.
- 3 The Group adopted IFRIC 13 'Customer Loyalty Programmes' and the amendments to IFRS 2 'Share-Based Payment' from 24 February 2008. Periods before this date have not been restated.
- 4 Consists of the net result of the Taiwanese business which was sold during 2007.
- 5 IFRS underlying profit excludes IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements, the IAS 19 Group Income Statement charge, which is replaced by the 'normal' cash contributions for pensions, IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods, IFRS 3 Amortisation charge from intangible assets arising on acquisition, IFRIC 13 'Customer Loyalty Programmes' – fair value of awards and exceptional items.
- For further details of this measure, see page 81.
- 6 Results have been restated to reflect the US and Tesco Bank as separate segments.
- 7 Market capitalisation plus net debt.
- 8 Basic and diluted earnings per share are on a continuing operations basis.
- 9 Dividend per share relating to the interim and proposed final dividend.
- 10 Profit before tax divided by average shareholders' funds.
- 11 The numerator is profit before interest, less tax. The denominator is the calculated average of net assets plus net debt plus dividend creditor less net assets held for sale.
- 12 Store sizes exclude lobby and restaurant areas.
- 13 Average store size excludes Express and One Stop stores.
- 14 Based on average number of full-time equivalent employees in the UK, revenue exclusive of VAT and operating profit.
- 15 Based on weighted average sales area and sales excluding property development.
- 16 Excludes one-off gain from 'Pensions A-Day', with this one-off gain ROCE was 13.6%.
- 17 Using a 'normalised' tax rate before start-up costs in the US and Tesco Direct and excluding the impact of foreign exchange in equity and our acquisition of a majority share of Dobbies.
- 18 Excluding Dobbies stores.
- 19 Excluding start-up costs in the US and Tesco Direct and adjusting average number of full-time equivalent employees in the UK to exclude US and Tesco Direct employees – profit per employee would be £11,317.
- 20 Excluding acquisition of Tesco Bank and Homever, and India start-up costs, and after adjusting for assets held for sale. Calculated on a 52-week basis, ROCE for 2009 is 12.8%.

# Tesco PLC – Parent Company balance sheet

27 February 2010	notes	2010 £m	2009 £m
<b>Non-current assets</b>			
Investments	5	<b>11,716</b>	10,975
Derivative financial instruments	10	<b>1,250</b>	1,473
		<b>12,966</b>	12,448
<b>Current assets</b>			
Derivative financial instruments	10	<b>208</b>	291
Debtors	6	<b>14,184</b>	8,815
Current asset investments	7	<b>1,997</b>	2,970
		<b>16,389</b>	12,076
<b>Creditors – amounts falling due within one year</b>			
Borrowings	9	<b>(932)</b>	(1,981)
Derivative financial instruments	10	<b>(116)</b>	(373)
Other creditors	8	<b>(8,950)</b>	(2,569)
		<b>(9,998)</b>	(4,923)
<b>Net current assets</b>		<b>6,391</b>	7,153
<b>Total assets less current liabilities</b>		<b>19,357</b>	19,601
<b>Creditors – amounts falling due after more than one year</b>			
Borrowings	9	<b>(10,805)</b>	(11,750)
Derivative financial instruments	10	<b>(621)</b>	(194)
		<b>(11,426)</b>	(11,944)
<b>Net assets</b>		<b>7,931</b>	7,657
<b>Capital and reserves</b>			
Called up share capital	13	<b>399</b>	395
Share premium account	14	<b>4,801</b>	4,638
Profit and loss reserve	14	<b>2,731</b>	2,624
<b>Total equity</b>		<b>7,931</b>	7,657

Accounting policies and notes forming part of these financial statements are on pages 123 to 130.

**Sir Terry Leahy**  
**Laurie McIlwee**

#### Directors

The Parent Company financial statements on pages 122 to 130 were authorised for issue by the Directors on 5 May 2010 and are subject to the approval of the shareholders at the Annual General Meeting on 2 July 2010.

Tesco PLC  
Registered number 00445790

# Notes to the Parent Company financial statements

## Note 1 Accounting policies

### Basis of preparation

These financial statements have been prepared under UK GAAP using the historical cost convention modified for the revaluation of certain financial instruments and in accordance with applicable accounting standards and the Companies Act 2006.

The financial year represents the 52 weeks ended 27 February 2010 (prior financial year 53 weeks ended 28 February 2009).

A summary of the Company's significant accounting policies are set out below.

### Exemptions

The Directors have taken advantage of the exemption available under Section 408 of the Companies Act 2006 and not presented a Profit and Loss Account for the Company alone.

The Company has also taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 'Cash Flow Statement'. The cash flows of the Company are included in the Tesco PLC Group financial statements.

The Company is also exempt under the terms of FRS 8 'Related Parties' from disclosing related party transactions with entities that are part of the Tesco PLC Group.

### Changes in accounting policies

The Company has adopted the following new and amended standards and interpretations as of 1 March 2009:

- Amendments to FRS 20 'Share-Based Payment' – Vesting Conditions and Cancellations, effective for annual periods beginning on or after 1 January 2009 (early adoption is permitted), clarifies that only service and performance conditions are vesting conditions. Any other conditions are non-vesting conditions which have to be taken into account to determine the fair value of the equity instrument granted. This award must be treated as a cancellation where the award does not vest as a result of a failure to meet a non-vesting condition that is within the control of either the Company or the counterparty. Cancellations are treated as accelerated vestings and all remaining future charges are immediately recognised in the Parent Company Profit and Loss Account with the credit recognised directly in equity. The results for the year ended 28 February 2009 have been restated accordingly. The impact on the Parent Company's Profit and Loss Account and Balance Sheet is immaterial for both years.
- Amendments to FRS 29 'Financial Instruments – Disclosures', effective for annual periods beginning on or after 1 January 2009 required enhanced disclosures about fair value measurement and liquidity risk.

### Current asset investments

These relate to money market deposits which are stated at cost. All income from these investments is included in the Parent Company Profit and Loss Account as interest receivable and similar income.

### Investments in subsidiaries and joint ventures

Investments in subsidiaries and joint ventures are stated at cost less, where appropriate, provisions for impairment.

### Foreign currencies

Assets and liabilities in foreign currencies are translated into Pounds Sterling at the exchange rates at the end of the financial year.

### Share-based payments

Employees of the Company receive part of their remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions) or in exchange for entitlements to cash payments based on the value of the shares (cash-settled transactions).

The fair value of employee share option plans is calculated at the grant date using the Black-Scholes model. In accordance with FRS 20 'Share-Based Payment' the resulting cost is charged to the Parent Company Profit and Loss Account over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

Where the Company awards options to employees of subsidiary entities, this is treated as a capital contribution.

### Financial instruments

Financial assets and financial liabilities are recognised on the Parent Company's Balance Sheet when the Company becomes a party to the contractual provisions of the instrument.

### Debtors

Debtors are non interest-bearing and are recognised initially at fair value and subsequently at amortised cost using the effective interest rate method, reduced by appropriate allowances for estimated irrecoverable amounts.

### Investments

Investments are classified as either held for trading or available-for-sale and are measured at subsequent reporting dates at fair value. There are no investments classified as held for trading. Gains and losses arising from changes in fair value for available-for-sale investments are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net result for the period.

### Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that gives a residual interest in the assets of the Company after deducting all of its liabilities.

### Interest-bearing borrowings

Interest-bearing bank loans and overdrafts are initially recorded at the value of the amount received, net of attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the Parent Company Profit and Loss Account over the period of the borrowings on an effective interest basis.

### Creditors

Creditors are non interest-bearing and are stated at amortised cost.

### Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

# Notes to the Parent Company financial statements continued

## Note 1 Accounting policies continued

### Derivative financial instruments and hedge accounting

The Company uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operating, financing and investing activities. The Company does not hold or issue derivative financial instruments for trading purposes, however if derivatives do not qualify for hedge accounting they are accounted for as such.

Derivative financial instruments are recognised and stated at fair value. The fair value of derivative financial instruments is determined by reference to market values for similar financial instruments, by discounted cash flows or by the use of option valuation models. Where derivatives do not qualify for hedge accounting, any gains or losses on remeasurement are immediately recognised in the Parent Company Profit and Loss Account. Where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the hedge relationship and the item being hedged.

In order to qualify for hedge accounting, the Company is required to document from inception the relationship between the item being hedged and the hedging instrument. The Company is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is performed at each period end to ensure that the hedge has remained highly effective.

Derivative financial instruments with maturity dates of more than one year from the balance sheet date are disclosed as falling due after more than one year.

### Fair value hedging

Derivative financial instruments are classified as fair value hedges when they hedge the Company's exposure to changes in the fair value of a recognised asset or liability. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Parent Company Profit and Loss Account, together with any changes in the fair value of the hedged item that is attributable to the hedged risk.

Derivative financial instruments qualifying for fair value hedge accounting are principally interest rate swaps and cross currency swaps.

### Cash flow hedging

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

The effective element of any gain or loss from remeasuring the derivative instrument is recognised directly in equity.

The associated cumulative gain or loss is removed from equity and recognised in the Parent Company Profit and Loss Account in the same period or periods during which the hedged transaction affects the Parent Company Profit and Loss Account. The classification of the effective portion when recognised in the Parent Company Profit and Loss Account is the same as the classification of the hedged transaction. Any element of the remeasurement of the derivative instrument which does not meet the criteria for an effective hedge is recognised immediately in the Parent Company Profit and Loss Account.

Derivative instruments qualifying for cash flow hedging are principally forward foreign exchange transactions and cross currency options.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs or the original hedged item affects the Parent Company Profit and Loss Account. If a forecasted hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the Parent Company Profit and Loss Account.

### Net investment hedging

Derivative financial instruments are classified as net investment hedges when they hedge the Company's net investment in an overseas operation. The effective element of any foreign exchange gain or loss from remeasuring the derivative instrument is recognised directly in equity. Any ineffective element is recognised immediately in the Parent Company Profit and Loss Account. Gains and losses accumulated in equity are included in the Parent Company Profit and Loss Account when the foreign operation is disposed of.

Derivative instruments qualifying for net investment hedging are principally forward foreign exchange transactions and cross currency options.

### Pensions

The Company participates in the Tesco PLC Pension Scheme which is a multi-employer scheme within the Tesco Group and cannot identify its share of the underlying assets and liabilities of the scheme. Accordingly, as permitted by FRS 17 'Retirement Benefits', the Company has accounted for the scheme as a defined contribution scheme, and the charge for the period is based upon the cash contributions payable.

### Taxation

Corporation tax payable is provided on the taxable profit for the year, using tax rates enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date and would give rise to an obligation to pay more or less taxation in the future.

Deferred tax assets are recognised to the extent that they are recoverable. They are regarded as recoverable to the extent that on the basis of all available evidence, it is regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on a non-discounted basis at the tax rates that are expected to apply in the periods in which the timing differences reverse, based on tax rates and laws that have been substantively enacted by the balance sheet date.

### Recent accounting developments

Standards, amendments and interpretations adopted, following new amendments to FRS interpretations. These have not had a significant impact on the results or net assets of the Company:

- amendments to UITF Abstract 42 and FRS 26 – Embedded derivatives, effective for periods beginning on or after 1 January 2009.

Standards, amendments and interpretations not yet effective, but not expected to have a significant impact on the Company:

- amendment to FRS 25 'Financial Instruments: Presentation' on 'Puttable Financial Instruments and Obligations Arising on Liquidation', effective for periods beginning on or after 1 January 2010.
- amendment to FRS 25 'Financial Instruments: Presentation' – Presentation on Classification of Rights Issues, effective for annual periods beginning on or after 1 February 2010; and
- amendment to FRS 26 'Financial Instruments: Recognition and Measurement' on Eligible Hedged Items, effective for periods beginning on or after 1 July 2009.

## Note 2 Auditor remuneration

	2010 £m	2009 £m
Fees payable to the Company's auditor for the audit of the Parent Company and Group financial statements	0.6	0.6

## Note 3 Employment costs, including Directors' remuneration

	2010 £m	2009 £m
Wages and salaries	18	15
Social security costs	2	1
Pension costs	1	1
Share-based payment expense	30	18
	51	35

The average number of employees (all Directors of the Company) during the year was 17 (2009 – 14).

The Schedule VI requirements for Directors' remuneration are included within the Directors' Remuneration Report on pages 52 to 66.

## Note 4 Dividends

For details of equity dividends see note 8 in the Group financial statements.

## Note 5 Investments

	Shares in Group undertakings £m	Shares in joint ventures £m	Total £m
<b>Cost</b>			
At 28 February 2009	11,186	16	11,202
Additions	1,118	–	1,118
At 27 February 2010	12,304	16	12,320
<b>Impairment</b>			
At 28 February 2009	227	–	227
Charge for the year	377	–	377
At 27 February 2010	604	–	604
<b>Net carrying value</b>			
At 27 February 2010	11,700	16	11,716
At 28 February 2009	10,959	16	10,975

For a list of the Company's principal operating subsidiary undertakings and joint ventures see note 13 in the Group financial statements.

The impairment charge for the year relates to a subsidiary whose net assets have been reduced below its carrying amount in the Parent Company Balance Sheet resulting from a dividend payment.

# Notes to the Parent Company financial statements continued

## Note 6 Debtors

	2010 £m	2009 £m
Amounts owed by Group undertakings	<b>13,948</b>	8,587
Amounts owed by joint ventures and associates <sup>(a)</sup>	<b>128</b>	106
Other debtors	<b>100</b>	112
Deferred tax asset <sup>(b)</sup>	<b>8</b>	10
<b>Total</b>	<b>14,184</b>	8,815

(a) The amounts due from joint ventures and associates of £128m (2009 – £106m) are due after more than one year.

(b) The deferred tax asset recognised by the Company, and the movements thereon, during the year are as follows:

	FRS 25 and FRS 26 £m	Other timing differences £m	Total £m
At 28 February 2009	11	(1)	10
Charge to profit and loss account for the year	(1)	(1)	(2)
At 27 February 2010	10	(2)	8

## Note 7 Current asset investments

	2010 £m	2009 £m
Bonds and deposits	<b>1,997</b>	2,970

## Note 8 Other creditors

	2010 £m	2009 £m
Amounts falling due within one year:		
Other tax and social security	<b>1</b>	–
Amounts owed to Group undertakings	<b>8,639</b>	2,141
Other liabilities	<b>310</b>	421
Accruals and deferred income	<b>–</b>	7
<b>Total</b>	<b>8,950</b>	2,569

## Note 9 Borrowings

	Par value	Maturity year	2010 £m	2009 £m
Bank loans and overdrafts	–	–	27	1,494
Loans from joint ventures	–	–	17	9
5.125% MTN	£192m	2009	–	198
6.625% MTN	£150m	2010	158	154
4.75% MTN	€750m	2010	704	689
3.875% MTN	€500m	2011	479	476
5.625% MTN	€1,500m	2012	1,375	1,362
5% MTN	€600m	2014	604	592
5.125% MTN	€600m	2015	539	522
4% RPI MTN <sup>(a)</sup>	£263m	2016	270	268
5.875% MTN	€1,500m	2016	1,520	1,488
5.5% USD Bond	\$850m	2017	621	678
5.5% MTN	£350m	2019	351	351
6.125% MTN	£900m	2022	890	901
5% MTN	£515m	2023	520	515
3.322% LPI MTN <sup>(b)</sup>	£265m	2025	269	267
6% MTN	£200m	2029	212	216
5.5% MTN	£200m	2033	210	216
1.982% RPI MTN <sup>(c)</sup>	£221m	2036	222	221
6.15% USD Bond	\$1,150m	2037	834	977
5% MTN	£300m	2042	306	306
5.125% MTN	€600m	2047	587	628
5.2% MTN	£500m	2057	500	500
Other MTNs	–	–	291	477
Other loans	–	–	231	226
			<b>11,737</b>	<b>13,731</b>

(a) The 4% RPI MTN is redeemable at par, indexed for increases in the Retail Price Index (RPI) over the life of the MTN.

(b) The 3.322% LPI MTN is redeemable at par, indexed for increases in the RPI over the life of the MTN. The maximum indexation of the principal in any one year is 5%, with a minimum of 0%.

(c) The 1.982% RPI MTN is redeemable at par, indexed for increases in the RPI over the life of the MTN.

	2010 £m	2009 £m
<b>Repayment analysis:</b>		
Amounts falling due within one year	932	1,981
	932	1,981
<b>Amounts falling due after more than one year:</b>		
Amounts falling due between one and two years	699	867
Amounts falling due between two and five years	2,795	2,784
Amounts falling due after more than five years	7,311	8,099
	10,805	11,750
	<b>11,737</b>	<b>13,731</b>

# Notes to the Parent Company financial statements continued

## Note 10 Derivative financial instruments

The fair value of derivative financial instruments has been disclosed in the Company's Balance Sheet as:

	2010		2009	
	Asset £m	Liability £m	Asset £m	Liability £m
Current	208	(116)	291	(373)
Non-current	1,250	(621)	1,473	(194)
<b>Total</b>	<b>1,458</b>	<b>(737)</b>	1,764	(567)

	2010				2009			
	Asset		Liability		Asset		Liability	
	Fair value £m	Notional £m						
<b>Fair value hedges</b>								
Interest rate swaps and similar instruments	10	665	(32)	400	6	257	(31)	1,000
Cross currency swaps	1,131	4,513	(44)	258	1,218	3,957	(40)	825
<b>Cash flow hedges</b>								
Interest rate swaps and similar instruments	–	–	(39)	400	–	–	(66)	400
Cross currency swaps	129	315	(206)	1,042	226	336	(1)	171
Forward foreign currency contracts	9	218	–	1	19	656	(23)	283
<b>Net investment hedges</b>								
Cross currency swaps	–	–	(30)	124	–	–	–	–
Forward foreign currency contracts	19	244	(172)	1,037	92	2,623	(194)	2,767
<b>Derivatives not in a formal hedge relationship</b>								
Interest rate swaps and similar instruments	140	1,115	(112)	1,025	1	774	(30)	3,280
Cross currency swaps	1	173	(22)	457	20	219	(47)	639
Future purchases of minority interest	–	–	(41)	–	–	–	–	–
Forward foreign currency contracts	19	376	(39)	1,070	182	2,632	(135)	2,561
<b>Total</b>	<b>1,458</b>	<b>7,619</b>	<b>(737)</b>	<b>5,814</b>	1,764	11,454	(567)	11,926

## Note 11 Share-based payments

Tesco PLC's equity-settled share-based payment schemes comprise various share schemes designed to reward Executive Directors. For further information on these schemes, including the valuation models and assumptions used, see note 27 to the Group financial statements.

### a) Share option schemes

The number of options and weighted average exercise price (WAEP) of share option schemes relating to Tesco PLC employees are:

For the year ended 27 February 2010	Savings-related share option scheme		Approved share option scheme		Unapproved share option scheme		Nil cost share options	
	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 28 February 2009	37,066	294.06	53,381	280.99	14,681,115	326.92	14,430,093	0.00
Granted	7,584	328.00	–	–	3,804,440	338.40	3,093,147	0.00
Forfeited	–	–	–	–	–	–	(2,299,256)	0.00
Exercised	(8,544)	232.00	–	–	(3,936,026)	261.41	(6,038,529)	0.00
<b>Outstanding at 27 February 2010</b>	<b>36,106</b>	<b>315.87</b>	<b>53,381</b>	<b>280.99</b>	<b>14,549,529</b>	<b>347.65</b>	<b>9,185,455</b>	<b>0.00</b>
Exercisable as at 27 February 2010	–	–	53,381	280.99	6,240,433	281.85	–	–
Exercise price range (pence)	–	–	–	197.50 to 318.60	–	197.50 to 318.60	–	–
Weighted average remaining contractual life (years)	–	–	–	4.77	–	4.40	–	–

## Note 11 Share-based payments continued

For the year ended 28 February 2009	Savings-related share option scheme		Approved share option scheme		Unapproved share option scheme		Nil cost share options	
	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 23 February 2008	37,652	269.29	53,381	280.99	12,191,979	303.75	10,838,238	0.00
Granted	7,539	311.00	–	–	2,615,968	427.00	3,591,855	0.00
Exercised	(8,125)	195.00	–	–	(126,832)	164.00	–	–
Outstanding at 28 February 2009	37,066	294.06	53,381	280.99	14,681,115	326.92	14,430,093	0.00
Exercisable as at 28 February 2009	–	–	43,965	272.93	7,511,677	258.10	2,050,588	0.00
Exercise price range (pence)	–	–	–	197.50 to 312.75	–	173.00 to 312.75	–	0.00
Weighted average remaining contractual life (years)	–	–	–	5.47	–	4.29	–	5.82

### b) Share bonus schemes

The number and weighted average fair value (WAFV) of share bonuses awarded during the period relating to Tesco PLC employees are:

	2010		2009	
	Shares number	WAFV pence	Shares number	WAFV pence
Shares in Success	6,684	349.66	5,568	431.05
Executive Incentive Scheme	1,660,771	351.16	304,713	424.65
Performance Share Plan	243,129	374.00	238,024	356.05
US Long-Term Incentive Plan	80,622	482.00	63,514	482.00

## Note 12 Pensions

The total cost of the pension scheme to the Group was £439m (2009 – £403m). Further disclosure relating to the Tesco PLC Pension Scheme can be found in note 28 of the Group financial statements.

## Note 13 Called up share capital

	2010		2009	
	Ordinary shares of 5p each		Ordinary shares of 5p each	
	Number	£m	Number	£m
Authorised:				
At beginning of year	10,858,000,000	543	10,858,000,000	543
Authorised during the year	2,500,000,000	125	–	–
At end of year	13,358,000,000	668	10,858,000,000	543
Allotted, called up and fully paid:				
At beginning of year	7,895,344,018	395	7,863,498,783	393
Share options	62,329,535	3	57,060,046	3
Share awards	27,370,504	1	–	–
Share buy-back	–	–	(25,214,811)	(1)
At end of year	7,985,044,057	399	7,895,344,018	395

During the financial year, 62 million (2009 – 57 million) shares of 5p each were issued in relation to share options for aggregate consideration of £166m (2009 – £130m).

During the financial year, 27 million (2009 – nil) shares of 5p each were issued in relation to share bonus awards for consideration of £1m (2009 – £nil).

During the year, the Company purchased and subsequently cancelled no shares of 5p each (2009 – 25,214,811), representing 0% (2009 – 0%) of the called up share capital, at an average price of £nil (2009 – £3.98) per share. The total consideration, including expenses, was £nil (2009 – £100m). The excess of the consideration over the nominal value has been charged to retained earnings.

# Notes to the Parent Company financial statements continued

## Note 13 Called up share capital continued

Between 28 February 2010 and 16 April 2010, options over 3,722,750 ordinary shares have been exercised under the terms of the Savings-related Share Option Scheme (1981) and the Irish Savings-related Share Option Scheme (2000). Between 28 February 2010 and 16 April 2010, options over 5,592,493 ordinary shares have been exercised under the terms of the Executive Share Option Schemes (1994 and 1996) and the Discretionary Share Option Plan (2004).

As at 27 February 2010, the Directors were authorised to purchase up to a maximum in aggregate of 790.1 million (2009 – 784.8 million) ordinary shares.

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

### Capital redemption reserve

Upon cancellation of the shares purchased as part of the share buy-back, a capital redemption reserve is created representing the nominal value of the shares cancelled. This is a non-distributable reserve.

## Note 14 Reserves

	2010 £m	2009 £m
<b>Share premium account</b>		
At beginning of year	<b>4,638</b>	4,511
Premium on issue of shares less costs	<b>163</b>	127
<b>At end of year</b>	<b>4,801</b>	4,638
<b>Profit and loss reserve</b>		
At beginning of year	<b>2,624</b>	2,181
Share-based payments	<b>234</b>	204
Purchase of treasury shares	<b>–</b>	(165)
Dividend	<b>(968)</b>	(883)
Change in fair value of available-for-sale financial assets	<b>–</b>	3
Share buy-back (capital redemption)	<b>–</b>	1
(Losses)/gains on cash flow hedges	<b>(82)</b>	105
Profit after tax for the year	<b>923</b>	1,178
<b>At end of year</b>	<b>2,731</b>	2,624

## Note 15 Contingent liabilities

The Company has irrevocably guaranteed the liabilities, as defined by Section 5 (c) of the Republic of Ireland (Amendment Act) 1986, of various subsidiary undertakings incorporated in the Republic of Ireland.

# Independent auditors' report to the members of Tesco PLC

We have audited the Parent Company financial statements of Tesco PLC for the 52 weeks ended 27 February 2010 which comprise the Parent Company Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

## Respective responsibilities of Directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 68, the Directors are responsible for the preparation of the Parent Company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

## Opinion on financial statements

In our opinion the Parent Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 27 February 2010;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the 52 weeks ended 27 February 2010 for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

## Other matter

We have reported separately on the Group financial statements of Tesco PLC for the 52 weeks ended 27 February 2010.

## Richard Winter (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
5 May 2010

# Financial calendar

Financial year end 2009/10	27 February 2010
Final ex-dividend date	28 April 2010
Record date	30 April 2010
Q1 Interim Management Statement	June 2010
Annual General Meeting	2 July 2010
Final dividend payment date	9 July 2010
Half year end 2010/11	28 August 2010
Interim Results	October 2010
Q3 Interim Management Statement	December 2010
Christmas and New Year Trading Statement	January 2011
Financial year end 2010/11	26 February 2011

Please note that dates are provisional and may be liable to change.



**Tesco PLC**  
Tesco House  
Delamare Road  
Cheshunt  
Hertfordshire EN8 9SL

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