Working to make what matters better, together

TESCO

Tesco PLC Annual Report and Financial Statements 2013

TESCO at a glance

Highlights*

£72.4bn
Group sales

+1.3%
Group sales growth

£2.0bn
Group profit before tax

(14.5)%
Underlying profit before tax**

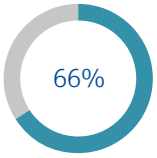
(14.0)%
Underlying diluted earnings per share**†

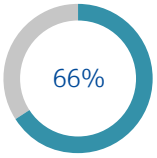
14.76p
Full year dividend per share maintained

UK

£43.6bn
Revenue±

£2,272m
Trading profit





+1.8%
Revenue growth±

(8.3)%
Trading profit growth

313,885
colleagues

1st
market positioning

3,146
stores

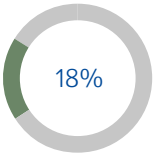
Around 16m
loyalty scheme members

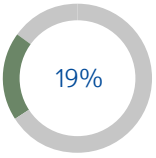
- Plan to 'Build a Better Tesco' on track with improvements made to our offer and more to come in 2013/14
- Year-on-year profit performance reflects UK reinvestment
- Strong progress in our online grocery business with sales growing by 12.8%
- Growing our portfolio of businesses by investing in WE7, Mobcast, Giraffe, Harris + Hoole and Euphorium

Asia

£11.5bn
Revenue±

£661m
Trading profit





+6.0%
Revenue growth±

(10.3)%
Trading profit growth

125,797
colleagues

1st or 2nd
in three markets

2,131
stores

Around 20m
loyalty scheme members

- Regulatory challenges in South Korea held back profit growth
- Successfully launched online grocery businesses in Thailand and Malaysia
- Expanded our convenience store business in Thailand to over 1,115 stores

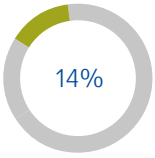
* All highlights reported on a continuing operations basis, excluding the United States and Japan which have been treated as discontinued.
** See glossary on the inside back cover for full accounting definitions.
† Calculated on a constant tax rate basis.
± Excludes the accounting impact of IFRIC 13.

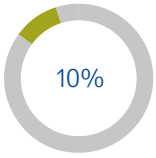
As one of the world's largest retailers, with over 530,000 colleagues, we serve millions of customers a week in our stores and online

Europe

£9.3bn
Revenue±

£329m
Trading profit





(5.5)%
Revenue growth±

(37.8)%
Trading profit growth

94,712
colleagues

1st or 2nd
in five markets

1,507
stores

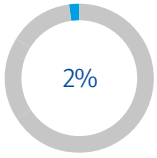
Over 7m
loyalty scheme members

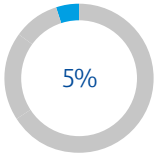
- Customers affected by severe economic conditions
- Slovakia and Hungary proved more resilient
- Successfully launched online grocery businesses, now in all of our Central European markets

Tesco Bank

£1.0bn
Revenue±

£191m
Trading profit





(2.2)%
Revenue growth±

(15.1)%
Trading profit growth

3,390
colleagues

£6.0bn
savings deposits

6.6m
customer accounts

- Successfully transferred all of our customers onto our own platforms
- Launched our first range of mortgage products in August
- Launched ISAs and Junior ISAs in November

Our year in review

Overview
1 Chairman's statement

Business review
3 Report from the Chief Executive*
10 Core Purpose and Values*
12 Vision and Strategy*
14 Business Model*

Performance review
16 Key performance indicators*
20 Financial review*

Governance
24 Board of Directors
26 Executive Committee
28 Corporate governance*
44 Directors' remuneration report
67 General information*

Financial statements

70 Statement of Directors' responsibilities
71 Independent auditors' report to the members of Tesco PLC
72 Group income statement
73 Group statement of comprehensive income
74 Group balance sheet
75 Group statement of changes in equity
76 Group cash flow statement
76 Reconciliation of net cash flow to movement in net debt note
77 Notes to the Group financial statements
126 Tesco PLC – Parent Company balance sheet
127 Notes to the Parent Company financial statements
135 Independent auditors' report to the members of Tesco PLC
136 Five year record
IBC Financial calendar
IBC Glossary

Find out more online

Go online to find out more, hear from our leadership team and explore our businesses in more detail. You'll find PDF and Excel downloads of our financial statements too. Visit www.tescoplc.com/ar2013.

* These sections form the Business Review and have been prepared pursuant to the Companies Act 2006. Together with the Board of Directors and Executive Committee sections, these sections form the Report of the Directors.

Chairman's statement

Sir Richard Broadbent Chairman

"It has been a year of addressing long-standing business issues; bedding in management and governance change; and laying the foundations for sustainable future growth. In all these areas I believe the Company has responded with energy, skill and application and we have made progress."

This time last year, I referred to the business going through a transition and said:

"We will continue in 2012/13 to address long-standing business issues in the UK and elsewhere in order to secure future prosperity as well as ensuring that our financial and human resources are developed and deployed where they are able most effectively to generate future growth and returns."

This is what has been done. It has been a year of addressing long-standing business issues; bedding in management and governance change; and laying the foundations for sustainable future growth. In all these areas I believe the Company has responded with energy, skill and application and we have made progress.

Business issues

One of the greatest challenges for a business is to face itself honestly. It is also the mark of a quality business that it can do so, since the capacity to name issues is the essential first step towards addressing them.

The decisions to seek a sale of the US business and to call an end to the UK space race in large stores reflect this. As with the decision last year to reinvest in our UK business, they reflected a long, hard look at where the business needs to devote its energy and resources to create sustainable value; and a willingness to face up to tough decisions to do this.

Some of these decisions had painful short-term consequences. The early signs are that the decision to reinvest in the UK is strengthening the business and we believe the steps we have taken in the US and in respect to UK property will similarly underpin a sustainable, profitable future, notwithstanding the accounting write-downs we have had to take this year as a consequence.

Bedding in management and governance change

The year has also seen a generational transition in management. This is not a surprise when there has been a relatively unchanged management team in place for a substantial time and we are fortunate in Tesco to have a substantial depth of talent to draw on from around the world. It is striking how many of the executives taking on new and enhanced responsibilities bring international as well as extensive UK experience to their roles, reflecting the breadth of Tesco's business.

A largely new Executive Committee has been developed under Philip Clarke's leadership. Many talented, and widely experienced, younger executives are getting to grips with new responsibilities with skill and enthusiasm. Similarly in the UK business, a substantially new leadership team with a wide diversity of experience and skills is in place under a new Managing Director.

▶ Visit www.tescoplc.com/ar2013 to hear more from Sir Richard Broadbent and other members of the leadership team.

Chairman's statement continued

The Board also has been reshaped during the year. We now have a smaller Board, of ten, with a different balance of Executives and Non-executives. Three Executive Directors – Andrew Higginson, Tim Mason and Lucy Neville-Rolfe – have left the Board since our last Annual Report and we are grateful for all that they have contributed to Tesco over many years. The Group Executive Committee rather than the Board is now the focus of operational business oversight, allowing the Board to focus on a more strategic agenda.

We have also seen Karen Cook and Ken Hydon, two long-serving Non-executives, retire after nine years on the Board and we extend our thanks to them for their contributions. Liv Garfield, Chief Executive of BT Openreach, joined the Board as a Non-executive Director on 1 April 2013.

Laying the foundations for future growth

As immediate operational business issues are addressed, our attention can turn increasingly to the strategic judgements that will determine Tesco's prosperity and value for shareholders over the next decade. Our strategic choices are defined by three parameters: the strength of the Tesco brand; the internet and all the associated developments it is driving; and the potential to leverage our skill and scale internationally.

All retailers must decide how to position their businesses relative to the rapid development of the internet which, together with social media, is changing both how consumers choose to shop and what they expect from a retailer that aspires to serve them. This creates both opportunities and challenges which Tesco needs to understand and respond to, both in terms of offering more diverse ways for customers to shop and by forging more personal, customised relationships with its customers.

Internationally, we have the potential to create value for shareholders by leveraging our skill and scale into relatively high-growth economies with less well-developed retail sectors. The key to unlocking this value is discipline in how opportunities are approached and flexibility, drawing on the lessons of experience, in how they are developed.

At the same time, and driven by many of the same factors, brand and reputation will become ever more critical points of differentiation as the internet continues to broaden access and choice for consumers, and as consumers themselves develop expectations about levels of choice, service and, increasingly, behaviours that match their own values and aspirations.

Against this background, the investment choices we make over the next few years as we develop Tesco as an international multichannel retailer with strong brands and a distinctive identity appreciated by customers, are and will continue to be critical judgements for the Board as it seeks to secure long-term returns for shareholders.

We will approach these choices within a framework of rigorous capital discipline. A company like Tesco will often appear to have multiple short-term opportunities to invest, but sustained returns depend on a rigorous judgement about both the quantum and allocation of capital over time. As we made clear in our Preliminary Results announcement in April, this is a discipline that now informs all that we do.

Financial results

The financial results for the year reflected the steps being taken to ensure that we can deliver sustainable and attractive returns and long-term growth for shareholders. Hence, while we continued to see sales growth, of 1.3%, Group trading profit was down (13.0)% on last year and underlying profit before tax down by (14.5)%, reflecting our previously announced investment in the shopping trip for customers in the UK, in addition to the impact of regulatory restrictions on opening hours in South Korea and the effects of deteriorating economic conditions, particularly in Central Europe. Statutory profit before tax fell by (51.5)%, due to the impact of a number of significant but one-off charges related to the important steps we are taking to reshape the business, including a write-down of our UK property following an in-depth review of our forward pipeline, our exit from the US and goodwill impairment of businesses in Poland, Czech Republic, and Turkey.

Return on capital employed ('ROCE') decreased during the year as expected, reflecting the impact of the decline in trading profit as described above. Prior to the impact of one-off charges, Group ROCE was 12.7%. We continued our long record of strong dividend payouts to shareholders, with the full year dividend maintained at 14.76p.

I would like to extend my thanks, on behalf of the Board, to everyone in Tesco who in an exceptional year has, as always, striven to anticipate and meet the needs of our customers while all the time retaining a sense of perspective, sometimes a sense of humour and always a sense of respect for others. They are a great group of people and we are lucky to have them.

Sir Richard Broadbent Chairman

Report from the Chief Executive

Philip Clarke Chief Executive

"I've worked in retailing for nearly 40 years but never in that time has there been a period of such profound and rapid change as I see today. The digital age is transforming not just the way people shop, but also the way they live their lives."

I am pleased to have this opportunity to report on the past year, during which we have taken some significant business decisions and laid down some important building blocks for the future.

I will share my perceptions of the year under the following headings:

- The wider context – adapting to lead the digital future
- The business in 2012/13 – a year of transition
- Setting financial disciplines for the future
- Driving future growth and returns
- Culture
- Management

The wider context – adapting to lead the digital future

It has been clear for some time that we are seeing a seismic shift in our industry and its pace is accelerating. In 2012 global e-commerce activity reached $1 trillion. I've worked in retailing for nearly 40 years but never in that time has there been a period of such profound and rapid change as I see today. The digital age is transforming not just the way people shop, but also the way they live their lives.

The opportunities this is creating are exciting. It provides the potential for Tesco to make customers' lives easier; to enable them to shop in whichever way suits them best; and it enables us to offer them new products and services.

This plays to our strengths. Since Tesco was founded, we have always been pioneers and innovators in retailing. Our central focus, our culture, is and has been to lead in understanding and delivering what customers want, in the way they want it, at the time they want it.

Uniquely among our peers, we have a profitable dotcom grocery business. From drive-through Grocery Click & Collect in the UK to our virtual shopping walls on the subway in South Korea, we are introducing exciting innovations to improve the customer shopping trip. Thanks to Clubcard and dunnhumby we have unique insights into how our customers' behaviour is changing. Our new conversation with customers – through a variety of channels – is about listening to what they want, to how they're living their lives today, and then adapting and building the business accordingly: as we have said for years, 'Every Little Helps'.

▶ Visit www.tescoplc.com/ar2013 to hear more from Philip Clarke and other members of the leadership team.

Report from the Chief Executive continued

"A truly multichannel business – one which offers customers the ability to shop anywhere, anyhow and any time – will be more likely to become a winner in the new era than one which concentrates purely on one channel or another."

So we are exceptionally well-placed to thrive in this new era of retailing. However, to grasp the opportunity we must adapt because it will require a different type of business, with a different type of relationship with our customers, and a new set of capabilities.

We have already begun this process of adaptation.

A year ago, I signalled the end of the space race and a change in focus. I indicated that our future investment would be less about new large stores, and that it would be more focused on multichannel retailing and on smaller formats.

A year on, I am even more certain that this is the right approach for us to take. The future of retailing is multichannel because, in this increasingly complex and volatile world, consumers are looking for simplicity and for brands they can trust. A truly multichannel business – one which offers customers the ability to shop anywhere, anyhow and any time – will be more likely to become a winner in the new era than one which concentrates purely on one channel or another.

Our stores are a vital part of this multichannel vision. Tesco has a superb portfolio of well-located stores in all of our markets, but adapting to a digital future means harnessing this great asset to the changing requirements of the digital age. This will require rethinking how we use the space in our stores, how we offer and deliver what we sell, how we interface with our customers and much else besides. I will return to the specifics of what we are doing in some of these areas below.

The business in 2012/13 – a year of transition

This year's performance was principally the result of three things in combination:

- the decision we took in early 2012 to reset our margin in the UK and invest £1 billion in improving our offer for customers;
- the continuing economic challenges our customers around the world are facing, particularly in and around the Eurozone; and
- the impact of legislation restricting opening hours in South Korea, our largest market outside the UK.

I have reflected on the work we have done over the first two years of my tenure as CEO and it is clear to me that much of our effort has been about removing barriers to progress. The business has delivered many years of growth and good returns, but was in danger of being inhibited from further sustainable progress by an attachment to initiatives and strategies which, while they served us well in the past, need to be adapted to deliver growth in a more economically challenged and rapidly changing world.

Consequently we have had to tackle a number of issues which needed to be addressed before we could move the business forward. This work has entailed some tough and at times painful decisions and while it is not finished, I am confident we have already tackled the biggest issues.

These changes were often difficult to face up to, complex to implement and they have required a great deal of hard work by many people, some of whom have been directly affected by the decisions. By way of reminder, in a little over 18 months we have:

1. Decided to exit markets in which we saw no prospect of acceptable investment returns in an appropriate time frame – Japan and the United States;
2. Devised and progressed the comprehensive £1 billion investment plan to 'Build a Better Tesco' in the UK, resetting our margins to fund the scale and pace of change required;
3. Put an end to the big store space race – placing a much greater emphasis on growth through both digital and convenience retailing, wherever we operate;
4. Reviewed our entire UK property pipeline to ensure it is appropriate for our future needs and valued accordingly. Going forward this will mean less capital commitment to property development and also less asset divestment;
5. Reflected the new global economic reality by reviewing and moderating the rate of expansion in some large economies such as China and sharply reduced spending in some of our European markets; and
6. Focused Tesco Bank on the smooth migration of customer accounts to our platforms, strong governance, risk management and increasingly on preparing it for its key role in our multichannel future.

These decisive actions are necessary in order to ensure sustainable longer-term growth. I am acutely aware that withdrawing from the US and writing down the value of property developments no longer appropriate for the future have had a significant impact. It is time to act and I believe this work has cleared the way for the business now to move forward.

Having tackled these issues, Tesco is a more focused business, which can apply all of its considerable resources and energies to meeting the challenges and grasping the opportunities created by the changes taking place in our industry today. These actions may have been the most visible, and therefore the most tangible, signs of change to the outside world but within Tesco we've been making other important changes to prepare the business for the future – putting it on track for sustainable growth and returns.

Setting financial disciplines for the future

Not only have we started on the journey of transforming our business to enable it to move forward as a leader in the new digital world, we are also fundamentally changing the financial profile of the Group.

The Tesco of the future will pursue more focused growth, consume less capital and generate more free cash flow. Making this transformation in all its aspects will of course not be without its challenges – and the clearest evidence of this can be seen in the first reduction in profits of the Group for two decades, which we reported on in April.

Everything we are doing reflects my determination to deliver shareholder value, an appropriate balance between investing for future growth, and delivering sustainable returns for our shareholders. I want to be very clear: if there is one lesson to be learned from the past it is the importance of capital discipline and this marks the start of a new era of capital discipline in Tesco.

We are confident we can deliver attractive and sustainable returns within a framework where capital expenditure falls to around 3.5% to 4% of sales.

For our investors, this means they can expect mid-single digit trading profit growth and return on capital employed within a range of 12% to 15%.

The fundamental change in our approach to new space I described earlier also has implications for our sale and leaseback programme. Two years ago, we reviewed the programme and announced a steady reduction in the level of divestments, in order to ensure that any property profits released were matched to the level of new profit created by development activities. Given that we have significantly reduced the amount of these activities going forward, we believe that it is appropriate to accelerate the scaling back of the sale and leaseback programme, such that it is unlikely to make a material contribution after the next few years.

The outcomes which we have laid out for investors will be achieved through disciplined investment, focused on those existing markets where we see the best opportunity for significant growth and returns.

Driving future growth and returns

For me as your CEO, driving sustainable growth within this new financial framework is about three priorities. These are not new areas for us but they each have the capacity to be the engines of growth for the Group for years to come:

(i) Continue to strengthen the UK business
(ii) Drive sustainable growth through multichannel leadership
(iii) Pursue disciplined international growth

Whilst the past year has not been without some significant challenges, we have made progress on these priorities:

"Everything we are doing reflects my determination to deliver shareholder value, an appropriate balance between investing for future growth, and delivering sustainable returns for our shareholders."

Report from the Chief Executive continued

"Having grasped the nettle and decided to reinvest in the UK business in early 2012, we have seen a pleasing response from customers – and consequently the performance of the business is now markedly better."

(i) Continue to strengthen the UK business

A year ago we announced a plan to 'Build a Better Tesco' in the UK. In last year's Annual Report I described how getting our business at home back to leading was the single most important objective for Tesco. Having grasped the nettle and decided to reinvest in the UK business in early 2012, we have seen a pleasing response from customers – and consequently the performance of the business is now markedly better. The 'Building a Better Tesco' plan is firmly on track.

I am proud of the work our teams have done to improve the look and feel of certain stores, to develop new products and to reformulate existing product ranges, whilst delivering better service and availability for customers. We want to be the best value, most convenient and integrated, most relevant and personalised retailer and we are making good progress.

We invested £200 million to have the equivalent of 8,000 more colleagues in-store and also provided customer service and specialist training for nearly 250,000 team members to help them serve customers better. Consequently, our customer ratings of service and staff helpfulness have improved and customer complaint numbers have fallen sharply. We have made a good start and there will be more progress in 2013. We refreshed 300 stores, representing almost a quarter of our space, delivering a warmer look and feel and better standards of presentation in our fresh food departments.

Our price image with customers has also improved, and we have supplemented our work on pricing with stronger, personalised Clubcard mailings and, more recently, the introduction of our Tesco Price Promise, which aims to reassure customers that they will never be disadvantaged on price when they shop with us. On ranging, the strong performance of the relaunched Everyday Value range has continued and we have put significant investment into improving 3,500 core Tesco own-label lines, with an emphasis on fresh food categories.

We have made fundamental changes to the way we communicate with our customers, with the most prominent early change being the appointment of a new lead advertising agency, Wieden + Kennedy. Our first new advertising campaign, which began last Christmas, was very well received by customers.

Our store strategy is 'Food First' which means a more targeted, less space-intensive approach to general merchandise in-store, with Tesco Direct becoming better equipped to offer customers the much greater breadth and depth of range that the online platform provides so well.

It also means other changes to our stores – such as clothing becoming more prominent and services taking more space. This means, for example, allocating more space to Click & Collect so that we are giving customers the compelling convenience of being able to order what they want online and pick up in-store.

Upgrading our in-store dining offer will also utilise more of our existing space. We aim to give customers shopping in our stores the kind of food experience they have when they visit shopping malls or high streets. We'll do this through the investments we have made in new family-friendly restaurants, coffee shops and artisan bakeries – such as Giraffe, Harris + Hoole and Euphorium. They will be increasingly available around our network of larger stores in the UK.

I've been particularly encouraged to see that the innovative spirit, that desire to be first for customers which made Tesco what it is, has also flourished in this period of rapid change. A good example of this is in our dotcom grocery business where the roll-out of our drive-through Click & Collect modules in 150 of our car parks helped our online sales grow 12.8% – which was faster than the market, in which we already have a high share. The launch of our Delivery Saver subscription service in May 2012 also contributed to our outperformance.

Our UK business is more competitive, performance relative to the market has improved and our margins have stabilised, as planned, and there is still much more to come. The scope for further improvement means that this objective remains our most important priority. I am pleased with the progress we've made, but I am equally pleased that we have the opportunity and plans for that progress to continue.

With the new UK management team now bedded in, in January this year I felt able to step back from the day-to-day running of the business, which I had assumed temporarily in March 2012. Chris Bush, who has over 30 years' experience in Tesco, has taken over the leadership as UK Managing Director.

The strategic importance of Tesco Bank to the Group is being increased by the impact of the internet on the way our customers shop – and I believe it is a key part of our multichannel future. It will provide the means for more and more of our customers to transact online using Tesco financial products. Several years of infrastructure build and the wider challenges that the whole banking sector has had to deal with – from more careful management of risk to PPI claims – have held back performance. The Bank plays an important role in driving increased loyalty for Tesco and we are giving even more focus to delivering the best possible products and prices to our Clubcard customers.

"The strategic importance of Tesco Bank to the Group is being increased by the impact of the internet on the way our customers shop – and I believe it is a key part of our multichannel future."

(ii) Drive sustainable growth through multichannel leadership

I believe establishing multichannel leadership – combining digital and online seamlessly with our existing excellent physical store network – is going to be critical for our future success. We've made good progress – we're the largest internet retailer of food in the UK and we're getting bigger and better in clothing and general merchandise – but the opportunities remain huge.

The judgements we make today about how we respond to the new digital era will profoundly affect the kind of business Tesco becomes in the years ahead. The internet and social media are rapidly changing the way people live their lives; the way they shop and what they expect from us – not just in terms of goods and services, but also what we stand for and how we contribute to society.

The speed of that change is accelerating and if we are to lead this revolution in our industry, I believe we must move faster and embrace it.

Calling an end to the big store space race and beginning a move to refocus our investment away from large stores, particularly hypermarkets, to convenience and online has been followed by an accelerating pace of change over recent months in all our businesses and geographies. For example, we are increasing our investment in technology and £500 million of our total capital spend will be devoted to technology, enabling us to create a seamless blend between our stores and online businesses.

A good example of this change in emphasis is blinkbox. We are already one of the leading retailers of films, TV series, music and books in the UK. Given the rapid pace of change in the way customers are buying entertainment products, we have been working to develop a range of new digital services. In March 2013 we launched Clubcard TV using the blinkbox platform, a free service providing family-friendly films and television series to our most loyal customers. In the next few months, we will be launching blinkboxmusic and blinkboxbooks, demonstrating our commitment to providing the very best entertainment as easily as possible for our customers.

"Given the rapid pace of change in the way customers are buying entertainment products, we have been working to develop a range of new digital services."

Going forward, we will be applying this thinking and experience to our international markets around the world.

Report from the Chief Executive continued

(iii) Pursue disciplined international growth

The single most important step we took in 2012/13 in our international business was to launch a strategic review of Fresh & Easy in the United States and in April we confirmed our decision to exit the market. This was not a decision lightly reached but in keeping with what I have said about the need to move the business forward, and to do so in a disciplined way – the US business simply did not offer the prospect of acceptable returns in an appropriate time frame.

Whilst the process of exit is ongoing, and as such the full financial effect of it is yet to be fully determined, we have written down the assets of the business and booked provisions for future liabilities – which together have impacted profit after tax by £(1) billion.

Fundamentally, we invest overseas because we have the opportunity to generate returns by using our skill and scale in high-growth economies, where retailing is less mature, to build substantial market positions and strong consumer franchises.

This opportunity is unchanged and exploiting it remains an important element of our strategy. We have had success – 32% of our sales and 29% of our profit now comes from outside the UK, and we have market-leading businesses in eight of our 11 international markets. Over two decades of international development we have learned a huge amount about what works and what doesn't – getting the pace and scale of expansion right for local conditions, getting the balance right between local front-end, global skills in sourcing and logistics and being ready to partner where appropriate. Utilising this knowledge is critical to driving future returns from our international business.

"We will stay focused for the foreseeable future on our existing markets, and on allocating significant capital only where we see very good prospects of strong investment returns."

Looking forward, these lessons will guide our approach to internationalisation. We will stay focused for the foreseeable future on our existing markets, and on allocating significant capital only where we see very good prospects of strong investment returns. And where we do invest, it will be with a clear emphasis on lower capital intensity routes to growth such as convenience and online.

I have categorised our countries into three groups to explain what this approach means in practice:

- In Thailand, South Korea and Malaysia, where we have strong market positions and economic growth remains more robust, our businesses have substantial further potential for growth. These markets continued to deliver excellent performance in 2012/13, although the headline growth was obscured by the c.£(100) million profit impact of legislation to restrict large store shopping hours in South Korea. Looking forward, the opportunities to build on our already strong positions in these fast-growing economies remain compelling and are therefore our highest international priority.
- In the European markets where we have solid, in some cases, market-leading businesses, but where the economic backdrop has been damaging to performance, our emphasis will be on holding our position, driving further benefits of skill and scale and making targeted investment in specific opportunities, such as online and convenience retailing. At present, the economic context remains unfavourable with continued recession and austerity in all of our markets – the Republic of Ireland, the Czech Republic, Hungary, Poland and Slovakia. Long term, these remain fundamentally attractive markets for Tesco both as growth markets and as markets where multichannel retailing is still in its infancy.
- In China, Turkey and India, which are exciting long-term growth opportunities, we will push on – but carefully – adopting a steadier pace of growth that is, importantly, more cautious about capital allocation. Our model in India is to work with the Tata Group, and we are unable to commit our own capital under current regulations. However, the model works, we like our partner and we are learning a lot about the market. We will commit new capital to China and Turkey, but only for those opportunities that pass our rigorous investment appraisal targets. We will be committing less capital in the coming years than we have done in the past – at least until we can demonstrate a significant step forward towards our objective of stronger returns.

Capitalising on the multichannel opportunity in all these markets will be a core part of our long-term planning. We are already moving much faster to roll out grocery home shopping – which is now in eight international markets and we plan to launch in China later this financial year.

Culture

For a consumer business above all, what you represent is critical and it is right that we should be responsive and open about our Values and what we stand for. We should actively manage them just as we manage other parts of our business.

We have completed a thorough review, looking at whether our Core Purpose and Values are all that we need in this new world and at a time of change. We have concluded that we need to encourage some changes to ensure it is clear to everyone at Tesco and beyond that we will put more back into society than we take out. You will find a lot more about this over the page and in the Tesco and Society Report.

Today, our brand must be about more than simply function. It's about the way we work, the values we live by, the legacy we leave. We can't solve the world's problems but we want Tesco to always do the right thing, to inspire and to earn trust and loyalty from all our stakeholders.

And we are putting some clear ambition into changing things for the better in areas where we can make a difference because of who and what we are:

- First, we are going to focus our attention on young people wherever we are in the world. We are a major global employer, which means we understand how to provide opportunities for people in their working lives. So we want to use that to help millions of young people who are worried about their future and are uncertain how to get a foothold in the world of work.
- Second, we're going to help and encourage our colleagues and customers to live healthier lives and through this help to tackle the global obesity crisis.
- Third, we're going to lead on the challenge of reducing food waste globally. 'Waste not, want not' is at the heart of 'Every Little Helps'. So it is natural for us to want to take a leading role in preventing the enormous quantities of food going to waste every day around the world.

I believe that by applying our skills and resources – our scale – to these areas, Tesco can make a difference and make things better.

Management

I am delighted to say that underpinning all of our drivers of growth – UK, multichannel and international – is the strength of the new management team we have created. Our new Executive Committee draws on the potential of the strongest, most experienced leaders within Tesco, complemented by some first-class external appointments in key disciplines. I am confident that the team we now have in place has the skills, experience, creativity and drive to deliver our ambitions.

All of these changes are the result of my determination to ensure that Tesco is a company that delivers shareholder value – but one that does so by delivering what matters to all our stakeholders.

Philip Clarke Chief Executive

"Today, our brand must be about more than simply function. It's about the way we work, the values we live by, the legacy we leave."

Core Purpose and Values

Our Core Purpose is a clear and simple statement of what we do and what we stand for:

We make what matters better, together

Our Core Purpose is a clear and simple statement of what we do and what we stand for. It has been the same for many years but the time has come to update it.

Our Core Purpose needs to reflect how much society has changed in recent years – more scepticism about corporations, more desire to see business demonstrate it has a purpose beyond profit, a sense that large companies should be contributing more to tackling some of the big challenges. The world has changed from a culture of 'more is better' to 'making what matters better'.

That's why we've changed our Core Purpose – this profound shift in society must be reflected in the way we think and behave as a business. Today, our brand must be about more than simply function. It's about the way we work, the values we live by, the legacy we leave. We can't solve the world's problems but we want Tesco to always do the right thing, to inspire and to earn trust and loyalty from all of our stakeholders.

Our Values help us to understand how to put this into practice:

1 No one tries harder for customers

- Understand customers
- Be first to meet their needs
- Act responsibly for our communities

Understanding people – customers, colleagues, communities – and what matters to them, and then trying to make those things better, is at the heart of Tesco. It's about listening to people and talking to them using all the tools at our disposal – from Clubcard data to social media – and then acting by changing and innovating to meet their needs.

2 We treat everyone how we like to be treated

- Work as a team
- Trust and respect each other
- Listen, support and say thank you
- Share knowledge and experience

We know that looking after our colleagues in a culture of trust and respect is essential to the success of Tesco. Where colleagues feel recognised and rewarded for the work they do together, where they have the opportunity to get on and where they are supported in their development as they move through their careers in the business – they in turn try their hardest for customers.

3 We use our scale for good

- Creating new opportunities for millions of young people around the world
- Helping and encouraging our colleagues and customers to live healthier lives and through this helping to tackle the global obesity crisis
- Leading in reducing food waste globally

Our scale means that we can provide affordable, high-quality food to people around the world and create value for customers. We want to use this scale to create greater value for society as a whole. In many ways we do this already, whether it's by creating thousands of jobs or working with thousands of farmers to provide world-class products. But now we want to scale up our efforts and make a positive contribution to some of the most pressing challenges facing the world.

Our new Core Purpose is: **We make what matters better, together**. It is true to where we came from but more relevant to today and to the kind of company we want to be.

Since we first introduced our Tesco Values more than a decade ago, they have become a vital part of our culture – and an essential underpinning of our growth and success. They ensure that every person at Tesco understands what is important – about how we work together as a team and how customers are at the centre of what we do. They are universal values, which have helped guide our people as Tesco has grown into new markets and new countries.

And as with our Core Purpose, we have had a hard look at whether the Values are all that we need in this new world and at a time of change – and we've concluded that we need a new Value, one that makes it clear to everyone at Tesco and beyond that we will put more back into society.

Our new Value is: **We use our scale for good**. Tesco is now a large company, touching millions of people's lives every day. This scale gives us an opportunity to make a positive difference to some of the biggest challenges facing the world. We've set three big ambitions in areas where we can make a real contribution and create value for society as a whole. Our new Value is also about building on the essential work we already do as a responsible corporate citizen.

Vision and Strategy

Wanted and needed around the world

We see it as essential not only to be the shop of choice for customers but also the place people want to work, a business that communities welcome and the retailer in which every shareholder wants to invest.

A growing business, full of opportunities

Whether it's food or general merchandise, books or digital entertainment, banking or eating out, our business is full of opportunities for both customers and colleagues. We want our business to offer something new every time.

Our Vision sets out what we want to be:

In any business, clear direction is vital. Our Vision guides the direction and the decisions we take as an organisation. Tesco is a company built around customers and colleagues, high-quality assets around the world and multiple opportunities for growth – and these characteristics are central to our Vision for the business.

We want Tesco to be the most highly valued business by: the customers we serve, the communities in which we operate, our loyal and committed colleagues and of course, our shareholders. For these things to be possible, our Vision for the business has five elements – each of them describes the sort of company Tesco aspires to be.

Modern, innovative and full of ideas

Tesco's success has always been based on trying to understand customers' needs better than anyone else – and then innovating to make their lives that little bit easier. This attitude, which brought online grocery shopping, extended shopping hours, Finest, Everyday Value, a range of formats from Express to Extra – and all the other things that make us who we are – is as central to our Vision now as it ever has been.

Winners locally whilst applying our skills globally

Retail is local because cultures, tastes, climates, regulations are all different. But the core skills that we have learned in one place can be applied in others. For example, setting up our grocery home shopping operations from scratch in eight international markets across the Group wouldn't have been possible without what we've learned in the UK.

Inspiring, earning trust and loyalty from customers, our colleagues and communities

We want Tesco to be a company that earns trust, not just respect, through everything we do – be it our in-store shopping trip, our Price Promise, or our determination to assure customers on food quality. We want to be a business that customers, colleagues and communities trust and are loyal to.

Our Strategy reflects our priorities as the business grows and customers' needs change:

We have a well-established and consistent seven-part strategy for growth, which reflects the way consumer needs are changing and the increasingly global nature of our business – and of course driving it forward is critical to our success over the coming years.

To grow the UK core

To grow the UK core, the largest business in the Group and a key driver of sales and profit, is a priority. Our 'Building a Better Tesco' plan has been restoring growth to the business through a comprehensive series of improvements for customers.

To be an outstanding international retailer in stores and online

We have established profitable businesses in Asian and European markets. Today, 32% of our Group sales and 29% of profits are made internationally and our goal now is to take the performance of these businesses to higher levels.

To be as strong in everything we sell as we are in food

Food is our heritage but as the business has grown and diversified over recent years, we have added an ever-wider range of products and services in-store and online, bringing Tesco value and quality to many more categories.

To grow retail services in all our markets

Consumers are increasingly spending a bigger proportion of their income on services – whether it is in telecoms, eating out or financial services. In the UK, we have built some strong, successful new businesses and our ambition now is to take that experience to all of our markets.

To put our responsibilities to the communities we serve at the heart of what we do

The changes we have made to our Core Purpose and Values to reflect Tesco's wider social purpose are clear signals that we put our responsibilities to the communities we serve at the heart of what we do.

To be a creator of highly valued brands

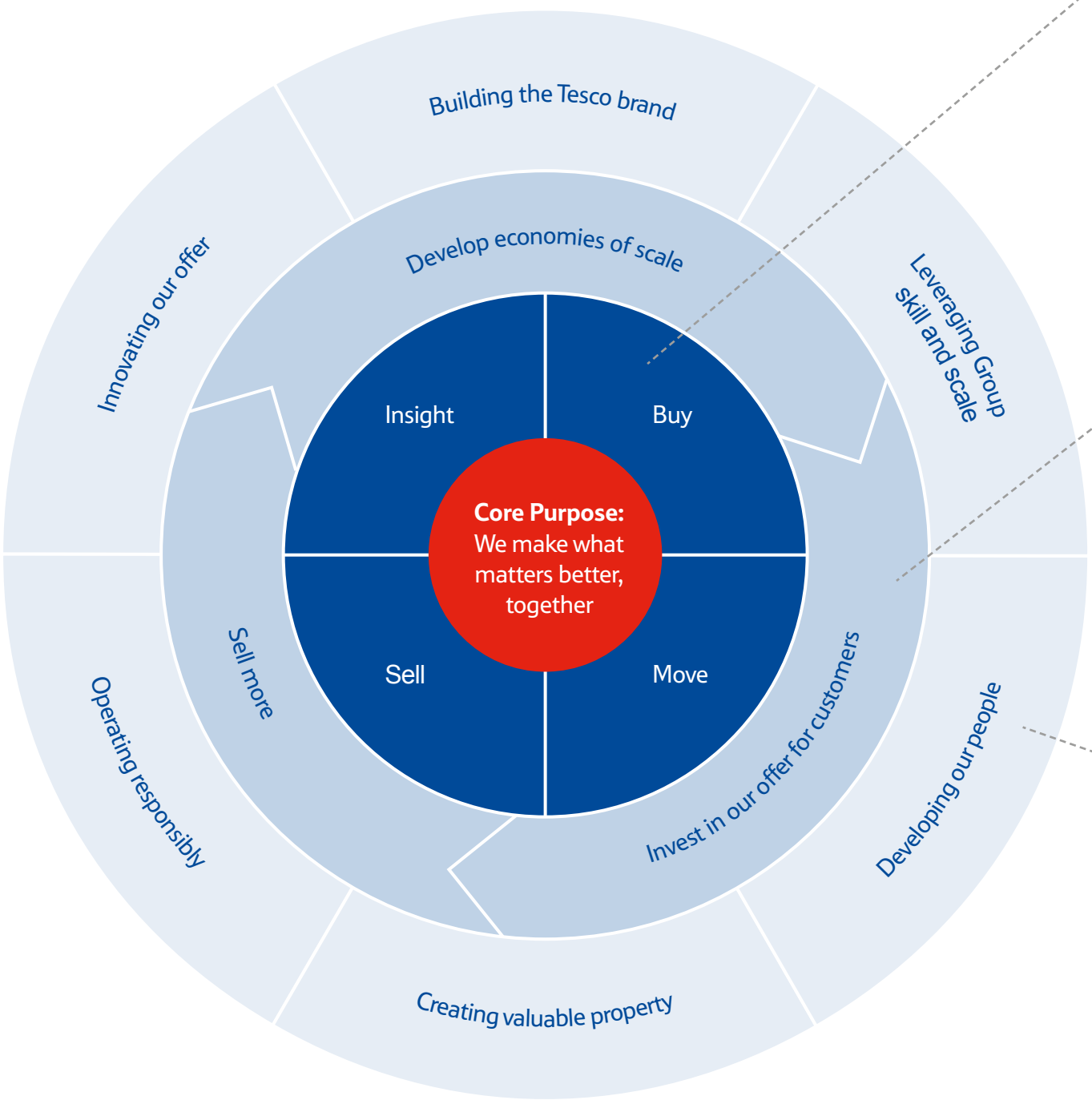
Brands are about giving customers confidence in the quality, value and reliability of the things we sell. We aim to be a creator of highly valued brands across our offer, whether it is Finest, F&F or Tesco Bank.

To build our team so that we create more value

As Tesco continues to grow and diversify we need more leaders to run the broad range of businesses, operations and support functions. We are investing in the development of more leaders and a bigger, more diverse talent pool to support the growth of the Group.

Business Model

Our Business Model is how we put our Strategy into action:



Our core activities

Like all retailers, we buy, move and sell products and services for our customers. They rely on us to do these things consistently well and we strive to do them better, more simply and more efficiently each time.

We have convenient, well-invested store and distribution networks, with a skilled and experienced team and modern systems designed to help us do this reliably – as well as growing capability and scale online. This operational effectiveness is at the core of the Tesco business model.

Winning loyalty is also about looking constantly at ways to do things differently and innovating for customers so that our offer doesn't stand still. Innovation comes from insight and insight starts with listening.

We try to work out what matters to customers by talking to them – and the conversation goes on all the time, in all our businesses, in stores and online, whether it is through our regular customer question time sessions or social media feedback. Customers tell us what's important to them – when we're doing well and, even more importantly, when we're not. Coupling that feedback with the data we get from Clubcard and the analysis we apply from dunnhumby – and then acting on the result – is what Tesco is all about.

The virtuous circle

Striving for continuous improvement in operations and in the shopping trip, as well as staying close to customers, are fundamentals but the engine of the Tesco business model has always been a combination of scale and growth.

This remains just as true today in an environment where growth across many markets is harder to come by. Tesco may only be as successful as a customer's last shopping trip but our scale and how we use it are very important to how we create value.

Buying well and selling efficiently are essential in order to be competitive for customers. When we combine these really well, we deliver a great offer and customers reward us with more of their business. The more we sell, the more we are able to work with our suppliers to achieve mutually beneficial economies of scale, which in turn creates room to invest more for customers – in products, categories and businesses.

This has served the business well over many decades – but in our business in the UK we stepped off the virtuous circle when the recession hit. We didn't put enough back in for customers at a time when they were under pressure – and our performance and reputation felt the effect. We recognised the need to change, and last year we chose to reduce and reset our own margin to fund substantial investment in improving the shopping trip for customers and to move the business towards stronger growth.

The key enablers

The core elements of the business model have six key enablers – including, for example, leveraging Group skill and scale and innovating our offer – which maximise the potential of the core activities and ensure that what we do is sustainable.

Transferring know-how, new systems and processes around the Group has become a regular part of how we do things based on the principle of 'invent once, deploy everywhere'. As our leadership group – which numbers over 500 directors – gains even more experience in multiple markets, new technologies and approaches can be introduced quickly and cost-effectively. Loyalty and own-label programmes, format expertise and online trading platforms are all current examples of Tesco leveraging Group skill and scale.

As keeping pace with changing consumer shopping patterns – what they buy, how, where and when they shop – becomes ever more demanding, staying close to our customers means that we are well-placed to see and to grasp the opportunities to innovate. For example, we spend a lot of time applying new technology in-store so that we can improve the shopping experience for customers. A good example is Scan as you Shop – now in 100 stores – which allows customers to scan products as they put them into the trolley, see how much they are spending as they go, and reduce their waiting time at the checkouts.

Key performance indicators

Group performance

Growth in underlying profit before tax

(14.5)%

09/10	10/11	11/12	12/13
8.7%	12.3%	2.1%†	**(14.5)%**

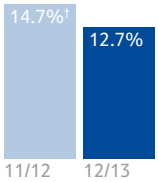
Definition
Our underlying profit provides information on the underlying trend and performance of the business. It is adjusted for a number of (non-cash) accounting adjustments and one-off costs.

Performance
Our year-on-year performance in underlying profit before tax reflects a number of factors – mainly our planned investment into the UK business, the regulatory changes in South Korea and the impact of challenging economic conditions in Europe.

† The 2011/12 figure including the US was 1.6%.

Return on capital employed ('ROCE')

12.7%



Definition
ROCE is a relative profit measurement that demonstrates the return the business is generating from its gross assets.

Performance
ROCE decreased during the year, reflecting our trading profit performance.

† The 2011/12 figure including the US was 13.3%.

Growth in underlying diluted earnings per share (at a constant tax rate)

(14.0)%

09/10	10/11	11/12	12/13
7.7%	10.8%	2.6%†	**(14.0)%**

Definition
Underlying diluted earnings per share ('EPS') is the amount of underlying profit, adjusted for the number of shares in issue.

Performance
The fall in underlying diluted EPS reflects the reduction of earnings this year. We have maintained the proposed full year dividend per share despite this, demonstrating our confidence that the steps we have taken in 2012/13 will set the Group on track to resume growth.

† The 2011/12 figure including the US was 2.1%.

Group financial ratios

Total shareholder return ('TSR')

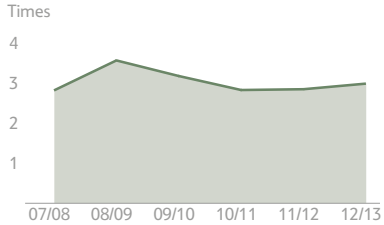
22.5% 1 year **2.1%** 5 year

	09/10	10/11	11/12	12/13
1 year	30.4%	(0.2)%	(18.7%)	**22.5%**
5 year	9.5%	6.7%	(3.0%)	**2.1%**

Definition
TSR is the notional annualised return from a share: the percentage change in the share price, plus the dividends paid and reinvested. For example, five-year TSR for 2012/13 is the annualised growth in the share price from 2007/08 and dividends paid and reinvested in Tesco shares, as a percentage of the 2007/08 share price.

Performance
TSR increased this year, reflecting the effect on our share price of increased investor confidence since last year's decision to invest significantly in our customer offer in the UK.

Net indebtedness



Definition
Net indebtedness shows debt in relation to operating cash flow ('EBITDAR'). Debt is adjusted net debt, calculated as net debt, the pension deficit and the net present value of lease obligations.

Performance
Net indebtedness has risen despite a reduction in net debt, due mainly to the decline in EBITDAR driven by our investment in the UK, the regulatory impact in South Korea and challenging economic conditions, particularly in Central Europe.

Gearing

39.6%

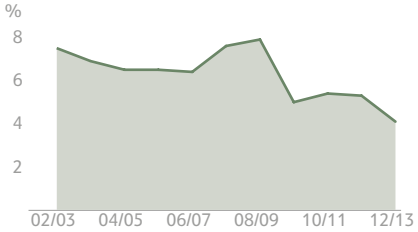
09/10	10/11	11/12	12/13
54.0%	40.8%	38.4%	**39.6%**

Definition
The proportion of net assets financed through debt rather than equity, calculated as net debt divided by total equity.

Performance
Our gearing remained relatively flat reflecting our stable debt position and our growing investment in assets.

Capital expenditure ('capex') as % of sales

4.1%

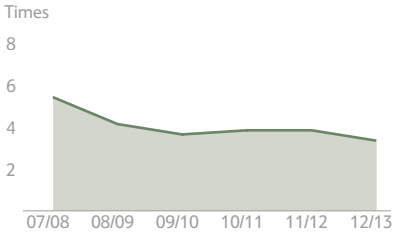


Definition
Capex is the investment in property, plant and equipment, investment property and intangible assets. This is divided by Group sales (inc. VAT, inc. petrol) to show a relative investment to sales.

Performance
This year we continued to reduce our rate of capital investment, focusing on less capital-intensive investments with higher returns, most notably online and convenience.

This year our capex was £3 billion or 4.1% of sales and fell year-on-year in every one of our reporting segments. Going forward, we intend to carefully and appropriately allocate capital within a range of 3.5% to 4% of sales.

Fixed charge cover



Definition
The number of times that our operating cash flow ('EBITDAR') covers our debt obligations (largely rent and interest payments).

Performance
Our fixed charge cover decreased slightly due to the decline in EBITDAR and rent increases.

More detailed definitions for our Group performance and Group financial KPIs can be found in the glossary on the inside back cover. All KPIs on pages 16 to 19 (apart from Gearing and TSR where it is not appropriate) exclude the results from our operations in Japan and the United States for 2011/12 and 2012/13, with the exception of Supplier Viewpoint, Donation of pre-tax profits to charities and good causes, and our Greenhouse gas ('GHG') emission reporting.

Group strategy

1. To grow the UK core

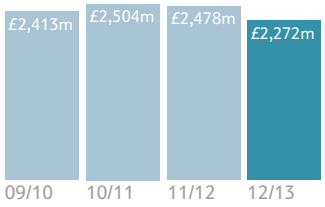
UK like-for-like (inc. VAT, exc. petrol)

09/10	10/11	11/12	12/13
2.6%	1.0%	0.0%	**(0.3)%**

Definition
The growth in sales from stores that have been open for at least a year.

Performance
We aim to continue improving like-for-like sales in 2013/14 through our 'Building a Better Tesco' plan. We expect the plan to continue delivering stronger like-for-like sales in 2013/14.

UK trading profit



Definition
The profit generated from the UK business in its retail operations.

Performance
UK profits declined, reflecting the £1 billion investment into the UK business to improve the shopping trip for customers.

Customer rating of overall shopping experience as excellent or good

79%
3% improvement on last year

Source: Marketing Sciences.

Definition
Percentage of customer ratings, measured in exit interviews.

Performance
79% of customers find their shopping experience excellent or good, and 98% find it reasonable, good or excellent. Through our UK Plan we have been improving customers' shopping experiences and this focus will continue in 2013/14.

Growth in UK online sales

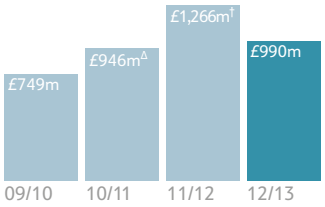
+10%

Definition
The year-on-year sales growth from total tesco.com and online telecoms.

Performance
Our online businesses are performing well and we are pleased with the UK sales growth. Our largest online business, grocery home shopping, saw increased sales growth of 12.8%, driven in part by the success of our Grocery Click & Collect roll-out and the launch of our Delivery Saver subscription scheme.

2. To be an outstanding international retailer in stores and online

International trading profit



Definition
The profit generated from our international businesses in their retail operations.

Performance
International trading profits declined, due to the c.£(100) million impact of regulatory restrictions in South Korea and challenging economic conditions, particularly in Europe.

Δ Re-presented to exclude Japan.
† The 2011/12 figure including the US was £1,113 million.

Proportion of customers pleased with their shopping trip

≥95%
in 6 markets

Definition
The number of markets where at least 95% of customers asked were very or fairly satisfied with their overall shopping experience – the top two ratings.

Performance
In six of our markets at least 95% of customers are very or fairly satisfied with their overall shopping experience, compared to eight* markets last year. We have seen a dip in some of our Central European markets and we have customer plans in place to improve the shopping trip in all markets.

* Re-presented to exclude the US.

Source: Country customer satisfaction tracker and Country image tracker.

Growth in international online sales

+46.5%

Definition
The year-on-year sales growth from our international online businesses.

Performance
We are pleased with the growth in online sales across the Group. We now have online grocery businesses in eight of our international markets, so would expect to see sizeable growth. We generated over £3 billion sales online for the Group as a whole for the first time.

Key performance indicators continued

3. To be as strong in everything we sell as we are in food

UK general merchandise, clothing and electricals range image

1st supermarket

Source: Marketing Sciences.

Definition
Our relative position among competitors, as rated by customers.

Performance
We have maintained our leading position amongst our supermarket peers, reflecting our efforts to create a compelling general merchandise range in-store, combined with the strengths of our online platform, Tesco Direct.

Proportion of UK customers buying general merchandise, clothing and electricals

36%

Definition
The average weekly proportion of UK Clubcard customers who bought a general merchandise, clothing or electricals item.

Performance
The proportion of customers buying general merchandise, clothing and electricals has remained broadly similar to last year. We continue to see subdued demand for discretionary items.

International general merchandise, clothing and electricals range image

9 markets – 1st or 2nd place

Source: Country image tracker.

Definition
The number of international markets where we are ranked first or second by customers for our general merchandise range.

Performance
We are ranked first, or joint first, for our general merchandise range image in eight of these nine markets. This is an improvement on 2011/12 when customers ranked us first, or equal first, in six markets, and reflects the strength of our clothing and general merchandise offers.

Proportion of general merchandise, clothing and electricals sourced as a Group

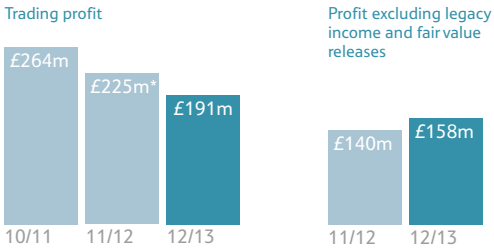
26%

Definition
The proportion, by sales, of general merchandise, clothing and electricals we buy together, through our Group Commercial function.

Performance
Our performance on this measure is similar to last year, despite challenging economic conditions holding back general merchandise and electricals sales.

4. To grow retail services in all our markets

Bank profit



* Re-presented to exclude PPI provision.

Definition
Trading profit measures the profit generated by Tesco Bank in its operations. It excludes the one-off impact of an increasing provision for customer redress payments including Payment Protection Insurance ('PPI').

Performance
Trading profit fell by (15)% impacted by the unwinding of the fair value provision – an accounting adjustment made at the time of acquisition in 2008 – and the run-off in legacy income from the Bank's insurance distribution arrangement with Direct Line Group, which terminated last year. Before these items, profits grew well and are up 13%, with a particularly pleasing performance in customer lending.

5. To put our responsibilities to the communities we serve at the heart of what we do

Reduction in CO_2e emissions from existing stores

09/10	10/11	11/12	12/13
8.5%†	4.6%†	3.9%†	**4.9%**

Definition
The year-on-year reduction in greenhouse gas emissions per square foot of sales area from existing stores built before 2006/07.

Performance
We reduced the CO_2e emissions from our stores built before March 2006 by 4.9% compared to last year, exceeding our target of 3.5%, helped by our continued focus across the Group on reducing refrigerant gas leakage. Last year, this KPI included distribution centres ('DCs') in addition to existing stores[Δ]. Using this definition, our performance this year is a 4.5% reduction. From next year, we will be measuring the cumulative reduction in CO_2e across all of our stores and DCs against a 2006/07 baseline – no matter when they were built. This will simplify our target and is consistent with our 2020 goal to achieve a 50% reduction in emissions per square foot. At the end of 2012/13, we had achieved a reduction of 32.5% towards this goal.

† These figures have been restated to exclude emissions from existing DCs and from our US operations.

Δ This change was set out in the 2011/12 CR report and the previous year's figures are adjusted accordingly. Additional information can be found at www.tescoplc.com/society.

Greenhouse gas ('GHG') emission reporting

This is a new addition to our Annual Report ahead of the upcoming UK legislation on mandatory greenhouse gas ('GHG') emission reporting that we expect to come into force later this year. This year our carbon footprint was 5.75 million tonnes of CO_2e. Our overall carbon intensity has decreased by 30% since 2006/07. For more information on our carbon targets, see the Tesco and Society Report, available online at www.tescoplc.com/society/report2013.

GHG emissions data for period 25 February 2012 to 23 February 2013

	Global tonnes of CO_2e		
	Base year 2006/07	2011/12	2012/13
Scope 1	1,390,756	1,465,494	1,418,798
Scope 2	2,790,259	3,587,747	3,764,068
Scope 1 and 2 carbon intensity (kg CO_2e/sq ft of stores and DCs)	51.66	36.47	35.12
Scope 3	320,510	524,639	566,941
Total gross emissions	4,501,525	5,577,880	5,749,807
Renewable energy exported to the grid	–	–	829
Total net emissions	4,501,525	5,577,880	5,748,978
Overall net carbon intensity (total net emissions kg CO_2e/sq ft of stores and DCs)	55.62	40.25	38.96

We have calculated our carbon footprint according to the WRI/WBCSD Greenhouse Gas ('GHG') Protocol. We follow the operational control approach and use emission factors from Defra/DECC's GHG Conversion Factors for Company Reporting 2012. For more information on our carbon targets and how we calculate our carbon footprint, including reporting standards, the definition of Scope 1, 2 and 3 emissions, and ERM's independent carbon assurance statement, see www.tescoplc.com/society/resources.

Supplier Viewpoint

71%

Definition
The percentage of positive scores from our annual survey of suppliers, Supplier Viewpoint, when we ask whether Tesco treats them with respect.

Performance
We were just behind our stretching target of 74% and we are confident that we have good plans in place to improve our performance in 2013/14 and beyond. We know that we will only succeed if we have strong relationships with our suppliers. We are launching a new Commercial Food Support Office and simplifying our systems to make it easier for suppliers to do business with us. We will work more closely with suppliers to develop joint business plans and recognise success through our Supplier Values Awards.

Donation of pre-tax profits to charities and good causes

£78.1m

Definition
Our contribution to charities and good causes through direct donations, cause-related marketing, gifts-in-kind, staff time and management costs.

Performance
We have donated £78.1 million to charities and good causes this year, compared to £74.6 million in 2011/12.

As a proportion of statutory profit before tax our donations represent 4.0% – an increase on last year's figure of 1.9% reflecting the decline in profits this year. This equates to 2.2% of underlying profit before tax, similar to 1.9% on the same basis last year. We expect to maintain a broadly similar level of contributions going forward with the percentage proportion returning to our usual historical levels in the coming years.

Total cash donations for 2012/13 were £22.2 million.

6. To be a creator of highly valued brands

Customer loyalty

8
markets – 1st or 2nd place

Source: Market research (GFK, Ipsos, Kantar).

Definition
The number of markets where we are placed first or second for the proportion of customers who do over 50% of their shopping with a single retailer.

Performance
Building customer loyalty is at the heart of Tesco and we are already ranked first in seven of our markets. This is an important indicator of the strength of the Tesco brand. We earn our customers' loyalty by delivering a great shopping experience and rewarding them for their custom. We now have loyalty schemes in each of our markets.

Group-wide own-label participation

38%
Tesco own-label brands

Definition
Own-label sales as a proportion of total Group sales. Own-label sales include Tesco brands (such as F&F, Finest or Venture brands) and unbranded products, such as produce. Tesco Bank and Tesco Mobile are not included.

Performance
Group own-label participation was stable in the year. Improving the range and quality of our own-label products is an important part of our plan to improve the shopping trip for customers in the UK. We built on the Everyday Value relaunch early in 2012/13 with range additions in September and made significant improvements in the core Tesco own-label range of products throughout the year. The strategy of improving our Tesco brands will continue in 2013/14.

7. To build our team so that we create more value

Colleague retention

91%
in the UK

Definition
The proportion of colleagues with over one year's service who have worked for Tesco in the UK throughout the year.

Performance
Our retention rate in the UK remains strong, up from 90% in 2011/12. This reflects our focus on creating good jobs and long-term careers, with excellent benefits and career development opportunities. It is also a reflection of our determined and ongoing efforts to make what matters to our colleagues better. For example, through our UK Plan we have made significant investments in training and equipment for our colleagues, supporting them to do their jobs.

Colleagues being trained for their next role

5.8%
across the Group

Definition
The proportion of colleagues who are on development programmes training for their next role.

Performance
Giving our colleagues the opportunity to get on at Tesco is very important to us and we are proud of our commitment to this area. This KPI measures the number of colleagues being trained for their next job through our dedicated 'Options' programme and we narrowly missed this year's increased target of 6% of colleagues. This measure doesn't include other development activities such as apprenticeships, A-level Entry Programmes and our Advanced Leadership Programme. Including these opportunities, almost 7% of colleagues across the Group benefited this year. In addition, we have also heavily invested in our colleagues in the UK this year through our 'Building a Better Tesco' plan. More than 250,000 colleagues in-store have received customer service training, with additional technical training for 36,000 colleagues.

Financial review

Laurie McIlwee Chief Financial Officer

£72.4bn
Group sales

£3.5bn
Group trading profit

35.97p
Underlying diluted earnings per share

14.76p
Full year dividend per share maintained

▶ Visit www.tescoplc.com/ar2013 to hear more from Laurie McIlwee and other members of the leadership team.

"As we adapt to ensure we deliver on our objective to be the best multichannel retailer for our customers, we are realistic in our approach to growth and returns. We can therefore offer clarity to shareholders about how we intend to deliver an appropriate balance of growth and returns in the years ahead."

Group results 2012/13 (on a continuing operations basis)

52 weeks ended 23 February 2013	2012/13	Growth (actual exchange rates)	Growth (constant exchange rates)
Group sales (inc. VAT)*	£72,363m	1.3%	2.5%
Sales growth exc. petrol		1.8%	3.1%
Group revenue (exc. VAT, inc. IFRIC 13)	£64,826m	1.4%	2.5%
Group trading profit	£3,453m	(13.0)%	(12.3)%
– UK	£2,272m	(8.3)%	(8.3)%
– Asia	£661m	(10.3)%	(9.8)%
– Europe	£329m	(37.8)%	(33.3)%
– Tesco Bank	£191m	(15.1)%	(15.1)%
Underlying profit before tax	£3,549m	(14.5)%	(14.0)%
Underlying diluted earnings per share	35.97p	(14.0)%**	n/a
ROCE (adjusted for one-off items)	12.7%	(200)bp	n/a
Capex	£3.0bn	down 19.0%	down 18.1%
Statutory profit before tax includes the following one-off items:			
– UK property write-down			£(804)m
– Goodwill impairment (Poland, Czech Republic, Turkey)			£(495)m
– Increased provision for PPI (Tesco Bank) (inc. H1 £(30)m)			£(115)m
Statutory profit before tax	£1,960m	(51.5)%	n/a

United States treated as discontinued, with restructuring and other one-off costs of £(1.0) billion.

* Group sales (inc. VAT) exclude the accounting impact of IFRIC 13.
** Underlying diluted EPS growth calculated on a constant tax rate basis; (10.8)% at actual tax rates.

Group results and strategic update

It has been a year in which we have taken decisive action to focus our efforts on those markets where we can have a leadership position. We exited Japan and launched our strategic review of the United States, while at the same time taking a more measured approach to our growth in China. We also set an appropriate pace of migration for the Bank, keeping it focused on the needs of our most loyal customers. Most importantly, we have begun the essential process of getting the UK business back on track, making sure we protect and build on one of the most important leadership positions we have.

Group trading profit declined by (13.0)%, reflecting our investment in the UK, the impact of regulatory changes in South Korea and the challenging economic conditions in Europe. This trading performance coupled with reduced JV income and higher net finance costs led to a decline in Group underlying profit before tax of (14.5)%.

Group statutory profit before tax declined by (51.5)% to £1,960 million due to the impact of three main one-off charges:

- UK property write-down of £(804) million, following an in-depth review of our property pipeline in the context of our fundamentally different approach to new space and our announcement in April 2012 that we would be reducing the level of new space growth in the UK going forward;
- Goodwill impairment of £(495) million, reflecting the impact of differing growth prospects in today's environment for the businesses we acquired in Poland, the Czech Republic and Turkey in the mid 1990s to early 2000s; and
- Increase of £(115) million in our provision for potential Payment Protection Insurance claims against Tesco Bank.

Based on our progress so far with our strategic review of Fresh & Easy, we have confirmed that the outcome of the review will be an exit from the United States. The results of our business there, in addition to those of our business in Japan, have been classified as discontinued operations in these results.

Segmental results

UK

It is a year since we unveiled our six-part plan to get the UK business back on top form. The UK is absolutely fundamental to the success of the Group, which is why this was our number one priority for the year, and I'm pleased to say the plan is very much on track.

We have made the investment as planned and it has led to a clear improvement in performance, both in absolute terms and relative to the market. Total sales rose by 2.6% excluding petrol, and like-for-like performance improved during the course of the year, with a particularly encouraging result at Christmas.

UK results 2012/13

	£m	% growth
UK sales	£48,216m	1.8%
UK revenue (exc. VAT, exc. impact of IFRIC 13)	£43,579m	1.8%
UK revenue (exc. petrol, exc. VAT, exc. impact of IFRIC 13)		2.6%
UK trading profit	£2,272m	(8.3)%
Trading margin (trading profit/revenue)	5.21%	(58)bp

When we laid out our plans last year, we described the impact of the investment in terms of a rebasing of our trading margin to 5.2% and the progress we have made in the UK has been achieved whilst delivering a margin absolutely in line with these expectations.

The most important judge of progress is the customer and we introduced a new way of measuring customer perceptions back in July – our 'customer viewpoint'. This measures real customer feedback in all of our stores on a regular and frequent basis, across 12 aspects of their shopping trip. Pleasingly, every one of these aspects improved throughout the second half of the year. This underpins our confidence that the underlying improvement we have seen in our trading performance is driven by the changes we have made for customers.

While there are a number of drivers that could enable us to improve overall UK margins, we believe the new base of 5.2% is appropriate for the foreseeable future and any outperformance will be reinvested in driving additional improvements in our customer offer.

Asia

Our Asia performance was in line with expectations and was dominated by the South Korean regulatory changes concerning trading hours. These changes held back headline numbers, and the impact on trading profit was broadly in line with our £(100) million guidance, with significant levels of Sunday store closures throughout the second half and considerable uncertainty in the market about exactly which stores would be closed and when, impacting operations even when stores were able to open. Following the passing of the legislation in January this year, the situation seems more certain, with more consistent store closures expected on alternate Sundays. As such, we expect the full-year effect of the regulations, combined with the extension of 24-hour trading restrictions to between midnight and 10am, to lead to an incremental impact of around £(40) million in 2013/14.

Asia results* 2012/13

		Actual rates	Constant rates
	£m	% growth	% growth
Asia sales	£12,317m	5.9%	6.1%
Asia revenue (exc. VAT, exc. impact of IFRIC 13)	£11,479m	6.0%	6.2%
Asia trading profit	£661m	(10.3)%	(9.8)%
Trading margin (trading profit/revenue)	5.76%	(105)bp	(102)bp

* Exc. Japan.

In Thailand, like-for-like sales grew by 3.1% and we continued to gain market share. We benefited from a strong opening programme, including almost 300 Express stores and we launched our first dotcom grocery operation in Bangkok in February.

We have adopted a more cautious stance in China. We still see an excess amount of new space being opened in the market – ahead of customer demand – and we have moderated our pace of development accordingly, opening just 12 new stores this year and closing five underperforming stores as part of our increased focus on our three strongest regions.

Europe

Whilst our markets in Europe remain fundamentally attractive, our performance this year was disappointing.

Clearly, we faced significant headwinds throughout the year, as macroeconomic uncertainties continued to impact businesses. This had a particularly marked impact on our general merchandise businesses across the region, holding back our overall like-for-like sales performance.

Europe results 2012/13

		Actual rates	Constant rates
	£m	% growth	% growth
Europe sales	£10,809m	(4.9)%	2.1%
Europe revenue (exc. VAT, exc. impact of IFRIC 13)	£9,319m	(5.5)%	1.4%
Europe trading profit	£329m	(37.8)%	(33.3)%
Trading margin (trading profit/revenue)	3.53%	(183)bp	(183)bp

Financial review continued

Our performance in Hungary and Slovakia, where we enjoy two of our strongest positions, has proved more resilient to the economic headwinds. While our profits in Hungary continued to be held back by the crisis tax this year, this will no longer be applied from the start of our new financial year.

In some markets such as the Czech Republic and Poland, we saw increased competitive activity, with those retailers focused on discount small formats faring much better than those – like us – with a greater proportion of larger stores. Our own smaller format stores have performed better than the business as a whole, and our dotcom operations – now in 13 cities in these markets alone – have grown strongly since launch.

We have faced particularly intense competition in Turkey, in a year in which we have retrenched from our strategy of pursuing large store expansion to the east of our existing business. Like many other businesses in the country, we faced intense cost-price inflation and the impact of this was exacerbated by a number of one-off, historic issues. The resulting losses contributed to our shortfall versus expectations for European performance.

All of our businesses undertake a value in use test each year to justify the carrying value of goodwill. Those businesses acquired in Europe in the 1990s and early 2000s unfortunately face a more difficult market today and different growth prospects as a result. This led to a write-down in the value of acquired goodwill for our businesses in Poland, the Czech Republic and Turkey.

Our priority in all of these markets is to get the businesses focused on driving underlying performance and it is for this reason that we will only open 400,000 sq ft of net new selling space in the year ahead.

Tesco Bank

We were pleased to complete the final stages of migration of Tesco Bank early in the financial year and to be able to get back to focusing on marketing our existing products. Our programme of new products resumed in August with mortgages and more recently, our ISA range.

We made progress through the year in banking products, with good growth in both customer accounts and balances. Our insurance business was held back by a very challenging market, with strong downward price pressure in motor insurance. Throughout this period, we focused on ensuring we offer the best products and prices to our loyal Clubcard customers.

Tesco Bank results 2012/13

	£m	% growth
Tesco Bank revenue (exc. VAT, exc. impact of IFRIC 13)	£1,021m	(2.2)%
Tesco Bank trading profit	£191m	(15.1)%
Trading margin (trading profit/revenue)	18.71%	(284)bp

In recent years, the Bank's profit has been impacted by a couple of non-trading factors – the first, fair value releases and the second, the run-off of our legacy insurance agreement with Direct Line Group. Before these, profits grew well and are up 13% with a particularly pleasing performance in customer lending.

In line with the rest of the industry, we have been proactively consulting more widely with our customers on PPI. In light of this contact, it has become necessary to increase our provision for compensation by £(85) million in the second half. In addition to the £(30) million provision in the first half, this takes us to a £(115) million one-off charge.

Group balance sheet

Net debt reduced by £0.2 billion year-on-year, despite the trading profit impact and increased working capital, mainly due to significantly reduced capital expenditure and a small increase in property proceeds. The working capital increase was largely as a result of regulatory impacts in a number of markets and the shortening of order lead times for general merchandise which reduced our creditor days.

Our return on capital employed, on a continuing operations basis and prior to the impact of one-off charges, is 12.7%. This is a (200) basis point decline on returns calculated on a similar basis for last year, mainly reflecting the trading profit performance.

We continued to see strong investor demand for our property during the year. We launched the Tesco Lotus Retail Growth Freehold and Leasehold Property Fund along with a number of transactions in the UK and South Korea, contributing to profits arising on property-related items of £370 million. The market value of our property across the Group currently exceeds £38 billion.

Since becoming Chief Financial Officer I have made it a priority to improve our debt metrics. Resetting the UK margin, regulatory challenges in South Korea and a disappointing profit performance in Europe have stalled the improvements we have made to date.

It is a high priority for the Group to maintain a strong investment grade credit rating. Our target on net indebtedness remains unchanged and it should be achieved within the next couple of years.

Fixed charge cover is more challenging because our gross debt has long maturity periods. We have £2 billion of debt that we can potentially retire over the next three years. Our lower level of sale and leasebacks will help slow down the rising rent bill. Both of these will benefit fixed charge cover. Our improved cash flow growth will help improve retained cash flow to adjusted net debt, a key credit rating measure, underpinning our commitment to maintain a strong investment grade rating.

Looking forward – our approach to growth and returns

The actions we have taken over the last two years have removed a number of significant barriers to progress and underpin our more disciplined approach to capital allocation.

As we adapt to ensure we deliver on our objective to be the best multichannel retailer for our customers, we are realistic in our approach to growth and returns. We can therefore offer clarity to shareholders about how we intend to deliver an appropriate balance of growth and returns in the years ahead.

We are managing the business in order to:

- Generate positive free cash flow
- Ensure a disciplined allocation of capital within a range of 3.5% to 4% of sales
- Maintain a strong investment grade credit rating

We are therefore allocating our capital to achieve three clear priorities:

1. Continuing to invest in a strong UK business
2. Establishing multichannel leadership in all of our markets
3. Pursuing disciplined international growth

This means that, in the current economic environment, investors can expect us to deliver:

- Mid-single digit trading profit growth
- Return on capital employed within a range of 12% to 15%
- Dividend growth, broadly in line with underlying earnings, with a target cover of more than 2 times

Our approach to growth and returns

Financial disciplines	Guiderails
Generate positive free cash flow	Trading profit growth • Mid-single digit
Allocate capital within range of 4% down to 3.5% of sales	Sustainable ROCE • 12% to 15% range
Maintain a strong investment grade credit rating	Dividend growth • In line with underlying EPS • Target cover of more than 2 times

We will update on our progress in the context of these objectives as part of our future results announcements.

As we described earlier, the fundamental change in our approach to new space also has implications for our sale and leaseback programme. Two years ago, we reviewed the programme and announced a steady reduction in the level of divestments, in order to ensure that any property profits released were matched to the level of new profit created by development activities. Given that we have significantly reduced the amount of these activities going forward, we believe that it is appropriate to accelerate the scaling back of the sale and leaseback programme, such that it is unlikely to make a material contribution after the next few years.

Our reported underlying profit measure currently includes these property profits and related items, and therefore its growth over the next few years would be held back by this accelerated reduction. We will therefore disclose and adjust for this impact when using underlying earnings per share as the basis for our dividend policy. In doing so, we will better align dividend growth to the key targeted profit performance measure for the business.

Growth has always been a central part of the investment case for Tesco. To be clear, it is still at the core of the investment case, but it is now a sustainable level of growth – a growth that enables us to deliver improving returns and a much stronger level of cash generation.

The guidance we are sharing is for mid-single digit trading profit growth. This takes into account the structurally changing retailing environment and the lower growth outlook for economies and consumer spending around the world.

We are determined to achieve this growth in a balanced way and we see the application of our financial disciplines as an important part of ensuring it is delivered in a way that supports strong, sustainable and attractive returns going forward.

We will tightly control our capex. There will likely be a very small increase in 2013/14, as we push on at pace with our refresh plans in the UK. Following this, we will move quickly into and then down through the range we have set out of 4% down to 3.5% of sales. Importantly this will enable us to move to a position where we can produce free cash flow without the historic requirement for property proceeds.

This is clearly a significant change from our historic cash flow shape. For a number of years, we relied on property proceeds to fund our investment, as capex exceeded available cash. We are getting close to a position where capex is broadly equivalent to available cash, removing our reliance on these proceeds. From then on, available cash grows and exceeds capex, giving us much greater flexibility from a cash point of view.

Protecting our strong position in the UK is still one of our highest priorities. The best returns now are from refreshing our existing stores and investing in the broader multichannel opportunities of convenience and online. We will not invest in those large-store schemes where we see unacceptable returns. We will, of course, continue our process of making our existing large stores even more compelling destinations with the repurposing of space.

Our next priority is Asia where modern retail is still very underdeveloped. We will continue to strengthen our positions in Thailand, Malaysia and South Korea. In China, we still see a huge opportunity, although our approach going forward is more measured, focused on stand-alone retail sites in the three regions where we have critical mass and good margins. We will build out the remaining 13 Lifespace malls, but are not committing capital to any new freehold investments beyond these.

Finally, in Europe, our large-store networks are largely complete and we are effectively at a maintenance level of capex. Specific capital investments will be considered, but these will be about improving the assets we have and expanding in low capital formats such as the internet and convenience.

More of our capital will be going into already high-returning businesses and into driving forward returns in our immature businesses.

This allocation will enable us to produce a steady improvement in return on capital employed from the current base, within a range of 12% to 15%.

The approach I have laid out above provides appropriate and realistic objectives for the business. As we deliver our objective of being the leading multichannel retailer, we are determined to do even better – for customers and for shareholders.

Laurie McIlwee Chief Financial Officer

Board of Directors

1 Sir Richard Broadbent ▲ ● ✚
Non-executive Chairman
Sir Richard Broadbent joined the Board of Tesco PLC on 2 July 2011 and was appointed Chairman on 30 November 2011. He started his career at HM Treasury before joining Schroders in 1986. In 2000, Sir Richard was appointed Executive Chairman of HM Customs and Excise. He also joined the Management Board of the UK Civil Service, serving in both roles until 2003. In 2003 he was appointed to the Board of Barclays plc, becoming Senior Independent Director in September 2004 and Deputy Chairman in 2010. He stepped down from the Board of Barclays on 30 September 2011. Sir Richard joined the Board of Arriva plc in July 2004 and served as Chairman from November 2004 until 2010. He is also a trustee of the charity Relate.

Committee membership (from 23 February 2013)
▲ = Nominations Committee
■ = Audit Committee
● = Remuneration Committee
✚ = Corporate Responsibility Committee

2 Philip Clarke
Group Chief Executive
Philip Clarke was appointed to the Board on 16 November 1998. Prior to his appointment as CEO in March 2011 he was Asia, Europe & IT Director. Philip began his career with Tesco in-store during 1974 and continued to work part-time through school and university. After graduating with a degree in Economic History, he joined the Tesco Management Training Programme and then spent nine years in store management before holding a number of roles in commercial and marketing. In 1994 he was appointed Stores Director and a year later promoted to Regional Managing Director, before joining the Tesco PLC Board as Supply Chain Director and a year later adding Information Technology to his responsibilities.

3 Laurie McIlwee
Chief Financial Officer
Laurie McIlwee was appointed to the Board on 27 January 2009 as Chief Financial Officer. He began his career with Tesco in 2000 as UK Finance Director and after four years, became Distribution Director. Prior to Tesco, Laurie worked for PepsiCo in a variety of roles including Vice President of Business Planning at Frito-Lay International, Chief Financial Officer and Business Change Director at Frito-Lay Europe, Chief Financial Officer of Walkers Snack Foods and Finance Director of PepsiCo Eastern Europe. Laurie is a Fellow of the Chartered Institute of Management Accountants and a member of The Hundred Group of Finance Directors.

4 Patrick Cescau ▲ ■ ✚
Senior Independent Director
Patrick Cescau was appointed a Non-executive Director on 1 February 2009 and became Senior Independent Director in July 2010; he is also a member of the Audit, Nominations and Corporate Responsibility Committees. Patrick was Group Chief Executive of Unilever from 2005 to 2008, and prior to this he was Chairman of Unilever plc, Vice Chairman of Unilever NV and Foods Director. He was also a Non-executive Director of Pearson plc from 2002 until 2012 and became Senior Independent Director in 2010. Patrick was appointed Non-executive Chairman of InterContinental Hotels Group on 1 January 2013 and is also a Non-executive Director of International Airlines Group. He was appointed a Chevalier de la Légion d'honneur in 2005. He is a trustee of the Leverhulme Trust and Chairman of the St Jude India Children's Charity, and was formerly a Director at INSEAD.

5 Gareth Bullock ■
Non-executive Director
Gareth Bullock was appointed a Non-executive Director on 3 July 2010 and was appointed to the Board of Tesco Bank as a Non-executive Director effective from 17 July 2012. He is also a member of the Audit Committee. Gareth was Group Executive Director of Standard Chartered plc until his retirement in April 2010 and was also responsible for the Group's risk and special asset management function. He is Senior Independent Director and Chairman of the Remuneration Committee of Spirax-Sarco Engineering plc, a Non-executive Director of Global Market Group Ltd and a member of the Advisory Council of Good Governance Group (G3). Gareth has been a trustee of the British Council since October 2012.

6 Stuart Chambers ▲ ●
Non-executive Director
Stuart Chambers was appointed a Non-executive Director and Chairman of the Remuneration Committee on 3 July 2010 and was appointed to the Board of Tesco Bank as a Non-executive Director effective from 17 July 2012. He is also a member of the Nominations Committee. He was Group Chief Executive of NSG Group from 2008 to 2009. Prior to NSG's acquisition of Pilkington plc in 2006, Stuart was Group Chief Executive of Pilkington plc. Previously he held a number of senior roles at Pilkington plc, the Mars Corporation and Royal Dutch Shell. From 2006 to 2013 he was a Non-executive Director of Smiths Group plc and from 2010 to 2013 a Non-executive Director of Manchester Airport Group plc. Stuart was appointed a Non-executive Director of Rexam plc on 1 February 2012 and Non-executive Chairman effective from 22 February 2012.

7 Olivia Garfield
Non-executive Director
Olivia Garfield (Liv) was appointed a Non-executive Director on 1 April 2013. She has worked for BT since 2002 and has been CEO of Openreach since 2011. Prior to that she carried out a range of senior strategic and operational roles, including Group Director Strategy, Portfolio and Regulation, Managing Director Commercial and Brands, Global Services and Vice President UK Customer Services, Global Services. From 1998 to 2002 Liv worked for Accenture as a consultant in the Communications and High Tech Market Unit, designing and implementing business change solutions across a number of industry sectors.

8 Ken Hanna ▲ ■ ●
Non-executive Director
Ken Hanna was appointed a Non-executive Director on 1 April 2009. He is a member of the Nominations and Remuneration Committees and became Audit Committee Chairman on 5 October 2012. Ken was previously Chief Financial Officer of Cadbury plc from 2004 until 2009 and prior to that an Operating Partner of Compass Partners and CFO and then CEO of Dalgety plc. Ken has also been CFO of United Distillers and Avis Europe plc. He is currently Chairman of Inchcape plc, Aggreko plc and Shooting Star CHASE. Ken is a fellow of the Institute of Chartered Accountants.

9 Deanna Oppenheimer ✚
Non-executive Director
Deanna Oppenheimer was appointed a Non-executive Director on 1 March 2012 and was appointed to the Board of Tesco Bank as a Non-executive Director effective from 17 July 2012. She is also a member of the Corporate Responsibility Committee. Deanna held various senior roles between 2005 and 2011 at Barclays, initially as Chief Executive of UK Retail and Business Banking, Vice Chair of Global Retail Banking and also as Chief Executive of Europe Retail and Business Banking. Prior to this, she was Marketing Director and later President of Consumer Banking of Washington Mutual. She has also served as a Non-executive Director of Catellus and Plum Creek Timber. Deanna is currently CEO of CameoWorks LLC and a Non-executive Director at NCR Corporation and at AXA.

10 Jacqueline Tammenoms Bakker ● ✚
Non-executive Director
Jacqueline Tammenoms Bakker was appointed a Non-executive Director on 1 January 2009 and is also a member of the Corporate Responsibility and Remuneration Committees. She was a Director General at the Ministry of Transport in the Netherlands from 2001 to 2007 and a Non-executive Director of the Dutch Land Registry and Ordnance Survey from 2008 to 2012. Prior to this, she held senior positions at Quest International and McKinsey & Co. Jacqueline is a trustee of the Van Leer Group Foundation and the Vice Chair of the Advisory Board to the Rotterdam School of Management and was appointed a Chevalier de la Légion d'honneur in 2006. Jacqueline is also a Non-executive Director of Vivendi and Fiat Industrial.

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

Executive Committee

Our Executive Committee oversees the implementation of the strategy set by the Board. Over the past year we have strengthened the Committee, building a team with extensive UK, international and digital experience.

1

2

3

4

5

6

7

8

1 Philip Clarke
Group Chief Executive
See page 24 for biography.

2 Laurie McIlwee
Chief Financial Officer
See page 24 for biography.

3 Matt Atkinson
Chief Marketing Officer
Matt joined Tesco in 2011 as Group Marketing and Chief Digital Officer. Before joining Tesco, Matt was the Global CEO of Havas's digital and data businesses. Prior to this, Matt had a diverse background in marketing, brand and agency management.

4 Chris Bush
Managing Director – UK
Chris joined Tesco in 1982 and has held various positions including Store Manager, Store Director and International Support Office Director. In 2004 he relocated to South Korea as COO of Tesco Homeplus and later became CEO of Tesco Malaysia. In June 2010, Chris was appointed CEO of Thailand and returned to the UK in March 2012 to take up the role of Chief Operating Officer UK. Chris was appointed UK Managing Director in January 2013.

5 Jill Easterbrook
Managing Director – Developing Businesses
Jill joined Tesco in 2001 and has held leadership roles across a range of business areas including Retail Operations, Group Strategy, Corporate Affairs and Clothing (stores and online). In January 2013 she took up her current position as Managing Director – Developing Businesses.

6 Gordon Fryett
Group Property Director
Gordon joined Tesco in 1969 and has held a number of roles including Operations Director, International Support Director, CEO of Republic of Ireland and UK Property Director. He is a Non-executive Director of Severn Trent PLC.

7 Kevin Grace
Group Commercial Director
Kevin joined Tesco in 1982 and has held a number of roles including Support Office Director, COO of South Korea, CEO of Poland and UK Property Director. Kevin joined the Executive Committee in 2011 and has responsibility for commercial practice across our markets and sourcing from over 80 countries worldwide.

8 Benny Higgins
CEO Tesco Bank
Before joining Tesco Bank, Benny served as Chief Executive Officer of Retail Business at HBOS PLC. Between 1997 and 2005 Benny was Chief Executive of Retail Banking at the Royal Bank of Scotland. He has been Chief Executive of Tesco Bank since 2008.

9 Alison Horner
Group Personnel Director
Alison joined Tesco in 1999 as a Personnel Manager and was later promoted to Personnel Director for Tesco's UK operations. After eight years in stores and general management roles she joined the Executive Committee in 2011 as Group Personnel Director.

10 Trevor Masters
CEO Asia
Trevor joined Tesco in 1979 and has held a number of roles including Store Manager, Store Director, Operations Director for Extras, and CEO of Central Europe. He became CEO of Asia in 2011.

9

10

11

12

13

14

15

16

17

11 Mike McNamara
Chief Information Officer
Mike has been with Tesco since 1998, having previously worked at Accenture and BT. He was on the Board of tesco.com from its inception in 1999 through to 2006, during which time he led the transition of tesco.com onto a fully online platform, as well as the national roll-out of the service.

12 Adrian Morris
Group General Counsel
Adrian joined Tesco in September 2012 as Group General Counsel. Prior to Tesco, Adrian worked at BP plc as Associate General Counsel for Refining and Marketing. From 2002 to 2009, Adrian was with Centrica PLC, initially as European General Counsel and then as General Counsel for British Gas.

13 Bob Robbins
Group Business Improvement Director
Bob joined Tesco in 1975 and has held a number of roles including CEO of Asia, CEO of Central Europe, Strategy and Development Director Asia and various retail, marketing and general management roles. Prior to taking up his current position as Group Business Improvement Director, Bob held the role of Chief Operating Officer UK.

14 Rebecca Shelley
Group Corporate Affairs Director
Rebecca joined Tesco on 1 May 2012 as Group Corporate Affairs Director. Before joining Tesco, Rebecca was a partner at Brunswick LLP, where she advised a wide range of companies on financial and corporate reputation issues. From 2000 to 2007, Rebecca worked at Prudential, most recently as Group Communications Director and before that as Group Investor Relations Director.

15 Robin Terrell
Group Multichannel Director
Robin joined Tesco in February 2013 as Group Multichannel Director, having worked in online retailing nearly since its inception. From 1999 Robin worked at Amazon, ultimately as VP & Managing Director, with responsibility for Amazon's UK and French businesses. After leaving Amazon, Robin held senior e-commerce and multichannel roles at Figleaves.com, John Lewis and House of Fraser.

16 Ken Towle
Managing Director – Central Europe and Turkey
Ken joined Tesco in 1985 and has held a number of roles including various UK operations roles and CEO of Tesco China. Ken joined the Executive Committee as Internet Retailing Director in 2011, before taking up his current role as Managing Director of Central Europe and Turkey in February 2013.

17 Jonathan Lloyd
Company Secretary
See page 25 for biography.

Corporate governance

Sir Richard Broadbent Chairman

In this section

28 Introduction from the Chairman
29 Compliance with the UK Corporate Governance Code

The Board

29 Role and responsibilities of the Board
30 Governance structures
31 Board roles
31 Board composition and independence
32 Conflicts of interest
32 Appointments and succession
32 Board induction
32 Information and support
32 Training and development
33 Board attendance
33 Board evaluation

Committee information

34 Audit Committee
36 Corporate Responsibility Committee
37 Nominations Committee

Risk management and internal controls

38 Effectiveness of risk management and internal controls
38 Risk management
38 Principal risks and uncertainties
42 Financial risks review
42 Internal controls
43 Internal Audit
43 External Audit

Engagement

43 Engagement

Introduction from the Chairman

This section of our report sets out how we manage Tesco to ensure as far as possible that the values you would expect us to operate by are in place and adhered to, that commercial and operational risks are identified and controlled, that we have strategies and plans in place to optimise shareholder value over an appropriate time period and that a proper system of checks and balances is in place without inhibiting the efficient running of the Company.

Our approach to governance remains unchanged from last year. It begins with the recognition that it is not a set of rules but the framework supporting the core values which defines what is and what is not acceptable. It is an expression of the way we want to conduct ourselves which informs actions and decisions whether or not there is a specific rule for the situation, and which supports the culture and behaviours that we wish to foster.

The main governance challenges of the past year have been:

- to bed in the substantially new governance framework we put in place in February 2012;
- to manage a significant transition in balance and size of the Board, increasing its Non-executive representation relative to Executive within an absolutely smaller Board; and
- to judge and oversee the execution of a number of significant business initiatives.

The governance framework, and perhaps more importantly the corporate culture and human relationships that underpin all governance frameworks, are operating as we hoped and we do not judge that any further material changes are needed.

The Board now comprises ten Directors, seven of whom (excluding the Chairman) are Non-executive. This change in both size and balance is supporting the Board to bring a substantial focus on strategic and longer-term issues. We do not anticipate further substantial changes in size in the foreseeable future although the exact number of Directors may rise or fall slightly in line with the normal process of Board development and succession planning.

Sir Richard Broadbent Chairman

Compliance with the UK Corporate Governance Code
The UK Corporate Governance Code (the 'Code') sets out principles and specific provisions on how a company should be directed and controlled to achieve standards of good corporate governance. The Code was revised in September 2012, with minor changes including a greater focus on a company's approach to diversity. For the 2012/13 financial year, the Company is required to report against the 2010 version of the Code. A copy of the Code is available at www.frc.org.uk.

The Board considers that Tesco PLC has complied in all material respects with the 2010 version of the Code for the whole of the financial year ended 23 February 2013.

Role and responsibilities of the Board
The Board is the custodian of the Company's Values and of its long-term vision, and provides strategic direction and guidance for the Company. There are certain matters which are deemed significant enough to be reserved for only the Board's decision. These are set out in a schedule of Matters Reserved to the Board, which was updated in February 2012, as part of a number of changes to our governance framework, to ensure that it remained in line with best practice.

The Board's agenda is determined against a pre-planned template to ensure that, in addition to day-to-day matters requiring its attention, all relevant issues come to the Board for review at appropriate intervals. The Board also receives regular updates, including between meetings if necessary, on a range of matters including business, financial, legal and corporate affairs.

During the year ended 23 February 2013, the Board considered a wide range of matters, including:

- the Group's strategy and key priorities;
- the strategy and performance of key businesses and functions within the Group;
- the financial position of the Group and various businesses within the Group;
- the budget and long-term plans for the Group;
- the interim and full-year results;
- corporate and social responsibility;
- shareholder feedback and reports from brokers and analysts;
- opportunities for business development;
- risk management and controls within the Group, including a detailed review of the Key Risk Register;
- reports from the Audit Committee, Corporate Responsibility Committee, Nominations Committee, and Remuneration Committee; and
- a review of the effectiveness of the Board, the Matters Reserved to the Board and the Terms of Reference of Board Committees.

These matters are in addition to the work of the Committees, reported to the Board, which covered in detail a range of important matters such as remuneration, succession planning, talent development, audit and social responsibility.

In addition to its regular programme of activities, the Board made a number of key strategic decisions in the year, including to dispose of our business in Japan, to exit the US, to acquire Mobcast and a stake in WE7 as part of an online media strategy and to carry out the IPO of a property fund in Thailand.

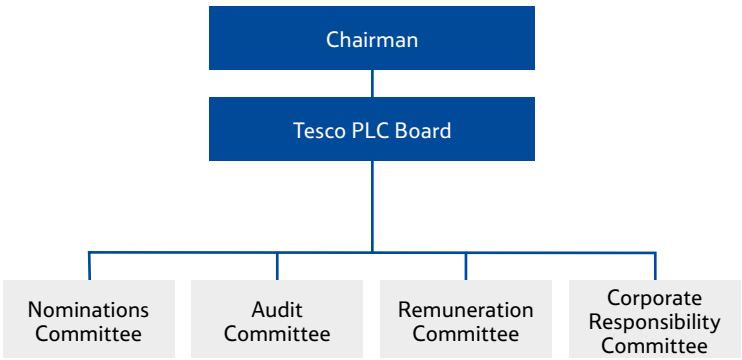
The Board delegates to the Group Chief Executive ('CEO') the management of the day-to-day operation of the business, in accordance with appropriate risk parameters. The Board monitors compliance with policies and achievements against objectives by holding management accountable for its activities through regular updates. In addition, each business unit within the Group is required to update the Board on a regular basis, giving the Board the opportunity to understand and explore issues in-depth as appropriate.

In a constantly evolving and challenging business environment, the Board recognises that our corporate governance framework needs to continue to adapt so that it remains fit for purpose. The Board will therefore continue to review structures and processes across the Group to ensure they remain effective and to make timely changes when needed to enhance the way the Group operates.

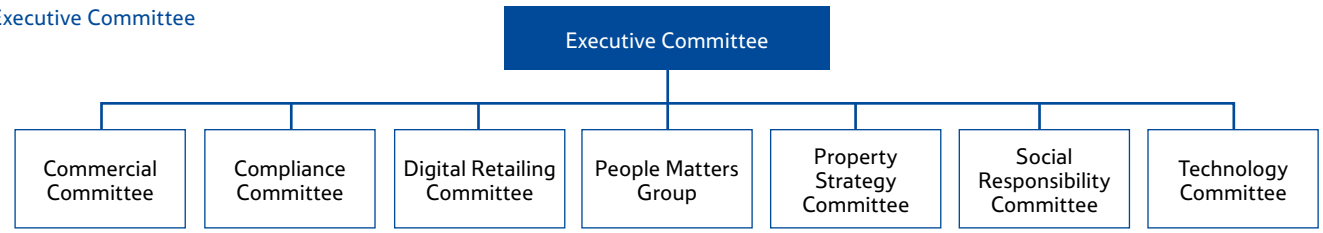
Corporate governance continued

Governance structures

Board



Executive Committee



The Board is supported in its work by the following key committees:

- Nominations Committee;
- Audit Committee;
- Remuneration Committee; and
- Corporate Responsibility Committee.

The work of the Committees is essential to the effective operation of the Board. The Committees consider in greater depth and detail, on behalf of the Board, issues relevant to their Terms of Reference, and report to the Board after every meeting.

Details of the remit and activities of the Nominations Committee can be found on page 37; the Audit Committee on pages 34 to 35; the Remuneration Committee on pages 57 to 58; and the Corporate Responsibility Committee on page 36. Copies of the Terms of Reference of the above committees are available on the Company's website at www.tescoplc.com.

The Board delegates responsibility for formulating and, after approval, implementing the Group's strategic plan and for management of the day-to-day operation of the Group to the CEO. The Group Executive Committee, which the CEO chairs, supports the CEO in carrying out his role and manages the day-to-day operation of the Group's businesses. The Group Executive Committee comprises the Executive Directors and a number of senior executives. Biographies of the members of the Group Executive Committee can be found on pages 26 to 27.

The Group Executive Committee has established a number of sub-committees which assist it in its work and ensure:

- strategic choices are properly considered;
- new growth opportunities are fully discussed; and
- progress against the Group's priorities is reviewed.

The membership of each of the sub-committees comprises an appropriate mix of Group Executive Committee members and senior management from relevant functions. The CEO chairs all of these committees. The sub-committees report to the Group Executive Committee after each of their meetings on their work and issues are escalated for discussion and/or decision to the Group Executive Committee or the Board as appropriate. The key committees are:

- Commercial Committee;
- Compliance Committee;
- Digital Retailing Committee;
- People Matters Group;
- Property Strategy Committee;
- Social Responsibility Committee; and
- Technology Committee.

The Board is kept up to date with developments in the business, including the work of the Group Executive Committee and its sub-committees, through the CEO's monthly report, which is also discussed in detail at each Board meeting. Group Executive Committee members regularly attend Board meetings to present items and they also regularly meet with the Chairman to discuss matters which are specific to their area on a less formal basis.

To support the governance structure there are a number of Group policies and processes in place.

Code of Business Conduct

The Code of Business Conduct explains to colleagues their most important individual responsibilities and obligations while working for Tesco, and all colleagues must comply with it. The code provides guidance on key issues which may arise for colleagues and indicates who they should contact if they think that they, or another colleague, may have breached those rules. All colleagues are required to provide an annual statement of compliance with the terms of the code. Disciplinary action may result from breaches of the code.

Whistleblowing

The Group operates a Whistleblowing policy which is reviewed annually. In every business we operate a confidential telephone and email service which enables concerned colleagues to report, anonymously if they choose, any instances of inappropriate behaviour or malpractice within the business. Such issues include unethical or illegal behaviour such as bribery and corruption, fraud, dishonesty and any practices which may prejudice or endanger our colleagues, customers or the environment.

All complaints made are treated as confidential and are investigated by the relevant department and where the individual provides their identity, they are kept updated. Where there is a serious issue, it will be escalated to the CEO of the relevant business. This policy is monitored by the compliance committees in each business, as well as by the Group Compliance Committee and the Group Audit Committee annually.

Anti-corruption

We seek to maintain the highest standards of ethics and integrity in the way we do business around the world. Bribery and corruption in all forms are illegal and unacceptable. Any act of fraud, bribery or corruption would be treated with extreme seriousness by Tesco and our Group CEO has communicated our zero-tolerance approach to all forms of bribery and corruption to all colleagues. We expect our business partners to adopt the same approach. In accordance with our anti-bribery and corruption policy, the CEO of each business is responsible for ensuring compliance with all local legislation and Company policies and for reporting on this area to the Group Compliance Committee, which is chaired by the Group CEO. To ensure the implementation of our bribery and corruption policy, key colleagues across the business have completed anti-bribery training, using an e-learning tool which includes training on the UK Bribery Act, as well as our policy, and requires them to pass an assessment. Annual refresher training is also provided.

Board roles

The Chairman and CEO

There is a clear delineation between the roles of the Chairman and CEO. Their role descriptions were updated and agreed by the Board in 2012 and are summarised below.

The Chairman was independent upon his appointment to the Board. He leads the Board, ensuring its effectiveness while taking account of the interests of the Group's various stakeholders, and promoting high standards of corporate governance. The Chairman has regular one-to-one meetings with the CEO and other members of the Group Executive Committee. He also has one-to-one and group meetings with the Non-executive Directors. The CEO leads the development of strategy and manages all aspects of the performance and management of the Group. The main responsibilities of the Chairman and CEO include:

Chairman's responsibilities
Ensuring the Directors receive accurate, timely and clear information
Facilitating the effective contribution of Non-executive Directors and the engagement between Executive and Non-executive Directors
Ensuring an annual evaluation of the Board is conducted and leading the performance evaluation of the CEO and Non-executive Directors and ensuring that Committee Chairmen conduct evaluations of their Committees
Building an effective Board
The induction of new Directors and further training for all Directors as appropriate
Communicating effectively with shareholders and other stakeholders and ensuring that the Board develops an understanding of the view of stakeholders

Group CEO's responsibilities
Leading the development of the Company's strategic direction and implementing the agreed strategy
Identifying and executing new business opportunities
Managing the Group's risk profile and implementing and maintaining an effective framework of internal controls
Building and maintaining an effective top management team
Ensuring effective communication with shareholders and key stakeholders and regularly updating institutional investors on the business strategy and performance

Senior Independent Director

Patrick Cescau was the Senior Independent Director ('SID') throughout the year. Patrick was selected in July 2010 for the role because of his experience and expertise, both as an Executive and as a Non-executive Director. A biography is available on page 24. In his role as SID, Patrick Cescau is available to assist in resolving shareholder concerns should alternative channels be exhausted. The SID's role includes responsibility for the Chairman's appraisal and succession; and to hold at least one meeting each year with the Non-executive Directors without the Chairman present. Those responsibilities were fulfilled during the past year.

Non-executive Directors

Our Non-executive Directors have the wide range of skills and experience necessary to enable them to provide constructive challenge, scrutinise performance and help to develop our strategy. Biographies are available on pages 24 to 25.

Company Secretary

The Group Company Secretary is responsible for developing, implementing and sustaining high standards of corporate governance. Key responsibilities include:

- keeping abreast of legislation, regulation and corporate governance developments which impact the business and advising the Board accordingly;
- supporting the Chairman and other Board members as necessary, including the management of Board and Committee meetings and their evaluation, advising on Directors' duties and facilitating information flows;
- when appropriate, providing a discreet but challenging voice to the Board;
- communicating with shareholders and other stakeholders and ensuring that the Board is kept informed of their opinions; and
- ensuring that the Company is compliant with statutory and regulatory governance requirements.

Board composition and independence

During the year, the Board was intentionally managed to a smaller size and, within that, proportionally greater Non-executive representation relative to Executive. These changes were designed to support the Board in focusing more of its attention on the strategic and longer-term opportunities and challenges facing the business, and to underpin the trust and respect necessary to create a collegiate, unitary Board within which debate can be robust, open and transparent.

In light of the changed balance of the Board, a series of steps have been taken to ensure that Non-executive Directors maintain line of sight into business operations; share thinking and views on business issues among each other and with management; and have the opportunity to form first-hand relationships with senior management, especially the Group Executive Committee and those below identified as having leadership potential.

As at 23 February 2013, the Board of Tesco PLC comprised the Non-executive Chairman, Sir Richard Broadbent, two Executive Directors and six Non-executive Directors, all of whom are considered to be independent under the criteria set out in the Code. On 1 April 2013, a further Non-executive Director, Olivia Garfield, was appointed bringing the total Board size up to ten. We do not anticipate further substantial changes in size in the foreseeable future, although the exact number of Directors may rise or fall slightly in line with the normal process of Board development and succession planning.

Corporate governance continued

The following changes to the Board took place during the year ended 23 February 2013 and between that date and the date of publication of this document:

Changes to the Board since 23 February 2012		
Deanna Oppenheimer	Non-executive Director	Appointed to the Board with effect from 1 March 2012
Richard Brasher	Executive Director	Stepped down from the Board on 15 March 2012
Andrew Higginson	Executive Director	Retired from the Board on 1 September 2012
Tim Mason	Executive Director	Stepped down from the Board on 5 December 2012
Lucy Neville-Rolfe	Executive Director	Retired from the Board on 2 January 2013
Karen Cook	Non-executive Director	Retired from the Board on 23 February 2013
Ken Hydon	Non-executive Director	Retired from the Board on 23 February 2013

Changes to the Board since 23 February 2013		
Olivia Garfield	Non-executive Director	Appointed to the Board with effect from 1 April 2013

Our Non-executive Directors are appointed for an initial period of three years, subject to (a) remaining independent; and (b) provision B.7.1 of the Code, which requires all directors to be re-elected by shareholders annually at the Company's Annual General Meeting ('AGM'); and may be reappointed for further periods of three years. The Board makes a careful assessment of the time commitment required from the Chairman and Non-executive Directors to discharge their roles properly. This is discussed with potential candidates as part of the recruitment process and a commitment to the appropriate time requirement is included in their engagement letters. The independence of each Non-executive Director is reviewed annually by the Chairman as part of the performance review process.

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

Length of service of each Non-executive Director

Non-executive Director	Date of appointment	Years in post at 2013 AGM
Sir Richard Broadbent	2 July 2011	2
Jacqueline Tammenoms Bakker	1 January 2009	4
Patrick Cescau	1 February 2009	4
Ken Hanna	1 April 2009	4
Gareth Bullock	3 July 2010	3
Stuart Chambers	3 July 2010	3
Deanna Oppenheimer	1 March 2012	1
Olivia Garfield	1 April 2013	–

Executive Directors are permitted to hold one FTSE 100 external Non-executive Directorship, although none of the Executive Directors do.

Biographies of the Board are available on pages 24 to 25.

Conflicts of interest

The Company has comprehensive procedures in place to deal with any situation where a Director has an actual or potential conflict of interest. Under these procedures the Board is required to:

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

Appointments and succession

Board development is a continuous process. We are constantly assessing what the appropriate mix of skills and experience should be for the Board, given the diverse markets the Group operates in and the breadth of operations and services offered. We also ensure plans are in place to support succession for all key Board roles. Further details of the Board appointment process can be found in the Nominations Committee section on page 37 and biographies of our Directors can be found on pages 24 to 25.

Board induction

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 over time to take into account feedback from new Directors and the development of best practice, and includes a wide-ranging programme of meetings with senior management from across the Group, attending results and broker briefings, comprehensive briefing materials and opportunities to visit the Group's operations across the world including spending time in-store and in our distribution network. The Chairman agrees the personalised induction plan with each new Director and ensures that it meets the individual needs of that Director.

Information and support

During the year we reviewed the information provided to the Board, with a view to creating a suite of information which covers the right ground in a focused way to support the Board's pattern of meetings, as well as ensuring that Directors receive appropriate information in the periods between meetings in a form consistent with the information provided for Board meetings.

Board papers are circulated a week before each meeting to give the Directors and Committee members sufficient time to fully consider the information.

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.

Training and development

The Chairman reviews the Directors' development needs as part of the annual performance evaluation process and puts appropriate arrangements in place for specific training. The Nominations Committee reviews the Directors' skills and experience as a group against those needed to continue to enable the Board to oversee and support the Group's diverse operations in the future, and identifies any gaps. This informs the approach to ongoing refreshing of the Board as well as the training plan for the current members of the Board. Training is arranged to help develop the knowledge and skills of the Directors in a variety of areas relevant to the Group's business, including social, environmental and ethical issues. In the last year the Board received training focusing, among other things, on the global macroeconomic outlook and social trends. Further training in a number of key areas is planned for Directors in the coming year, including developments and opportunities in relation to digital and their obligations as directors of a listed company.

The Board holds at least one in-depth session a year focusing on one of the Group's key areas of business, with the aim of broadening and deepening the Directors' understanding of that business. In March 2012 the Board carried out an in-depth review of our UK business. Board trips allow the Directors to view first-hand the progress, development, challenges and direction of our businesses, as well as meeting our teams in those businesses.

Board attendance

The Board held eight scheduled meetings in the year ended 23 February 2013, including the AGM, and ad hoc meetings were also arranged to deal with matters between scheduled meetings as appropriate.

It is expected that all Directors attend scheduled 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, they receive the papers scheduled for discussion in the relevant meetings, giving them the opportunity to raise any issues and give any comments to the Chairman in advance of the meeting.

Following each meeting the Chairman briefs any member not present on the discussions and any decisions taken at the meeting. Directors leave the meeting where matters relating to them, or which may constitute a conflict of interest for them, are being discussed.

The table below records attendance at the meetings of the Board:

Board attendance

	Number of possible meetings attended	Actual meetings attended
Non-executive Directors		
Sir Richard Broadbent	8	8
Gareth Bullock	8	8
Patrick Cescau	8	8
Stuart Chambers	8	8
Ken Hanna	8	8
Deanna Oppenheimer	8	8
Jacqueline Tammenoms Bakker	8	8
Executive Directors		
Philip Clarke	8	8
Laurie McIlwee	8	8
Past Non-executive Directors		
Karen Cook	8	6
Ken Hydon	8	7
Past Executive Directors		
Andrew Higginson	4	–
Tim Mason	6	6
Lucy Neville-Rolfe	7	7

In the current year, the Board will move to a pattern of six formal meetings annually, plus a strategy meeting. Board meetings will be preceded by a day of Committee meetings and by a dinner the previous evening. Board meetings themselves will last substantially the whole day. This pattern of meetings is intended to support the Board's focus on the strategic and long-term while ensuring it can discharge its monitoring and oversight role effectively through intensive high-quality meetings and high-quality information flows. This pattern of meetings also serves to broaden the pool of international talent and working executives able to take up a non-executive role.

The effectiveness of this approach will be reviewed at the end of the year.

Board evaluation

The Board conducted an external evaluation in 2011/12 with the support of Egon Zehnder, which has no other connection with the Company. In 2012/13 we conducted an internal Board evaluation. The evaluation considered a range of factors relevant to the effectiveness of the Board, including: the balance of skills, experience, independence and knowledge of the Board, its diversity and how the Board works together as a unit. The review was led by the SID, supported by the Company Secretary and combined in-depth interviews with each Director and a questionnaire completed by members of the Board. The results of the review were considered in detail by the Board, which recognised that a number of improvements had taken place during the year, while also noting an appetite for continuing to push the agenda towards more strategic discussion. The Board agreed a number of actions to be taken in the coming year.

Annual reviews of the performance of the Remuneration and Audit Committees have been carried out, led by each Committee's Chairman. These reviews have confirmed that each Committee continues to operate effectively and in each case a number of actions were agreed to further improve the effectiveness of the relevant committee. Reviews of the effectiveness of the Nominations Committee and Corporate Responsibility Committee will be held in the 2013/14 year.

Our CEO reviewed the performance of the CFO and the Chairman has reviewed the performance of the CEO and each Non-executive Director. The Non-executive Directors led by the SID have reviewed the performance of the Chairman. Having completed these evaluations, the CEO, Chairman, Non-executive Directors and SID have confirmed that each individual whose performance they have assessed continues to be effective and committed to their role.

During the year, the Chairman met with the Non-executive Directors, without the Executive Directors present, to discuss a number of matters.

Corporate governance continued

Audit Committee

Ken Hanna Audit Committee Chairman

Audit Committee attendance

	Number of possible meetings attended	Actual meetings attended
Members		
Ken Hanna (Chairman since 5 October 2012)	5	5
Gareth Bullock	5	5
Patrick Cescau	5	4
Past members		
Ken Hydon (Chairman until 5 October 2012)	3	3

Introduction from the Committee Chairman
Our business operates in an increasingly challenging environment, particularly with regard to economic, reputational, political and regulatory factors. Consequently we have seen a trend towards increasing risks in the business. The role of the Audit Committee is now more important than ever in reviewing the effectiveness of the Group's internal controls, providing assurance on the Group risk management processes and assessing and acting upon information received by external auditors and Internal Audit. We keep the current risk management and internal controls framework under review, to ensure that it adapts to the changing environment and remains as robust as it can be.

Ken Hanna Audit Committee Chairman

Audit Committee responsibilities
The Committee's Terms of Reference can be found at www.tescoplc.com. The Committee Chairman, Ken Hanna, and Gareth Bullock, a member of the Committee, both have recent and relevant financial experience.

The key responsibilities of the Committee are to:

- consider the appointment of the external auditors, their reports to the Committee and their independence, including an assessment of their appropriateness to conduct any non-audit work;
- review the financial statements and announcements relating to the financial performance of the Company;
- review the internal audit programme and ensure that the Internal Audit function is adequately resourced and has appropriate standing within the Company;
- discuss with the external auditors the nature and scope of the audit;
- review, and challenge where necessary, the actions and judgements of management, in relation to the interim and annual financial statements before submission to the Board;
- formally review the effectiveness of the external and internal audit processes;
- consider management's response to any major External or Internal Audit recommendations;
- review the Company's plans for business continuity;
- review the Company's plans for the prevention and detection of fraud, bribery and corruption; and
- report to the Board on how it has discharged its responsibilities.

During the year the Committee received update reports from a number of businesses, including the Bank and from Internal Audit on its work, including findings from its internal audit programme. The Committee also considered a variety of matters including the Group Finance Risk Register, the arrangements for IT governance and business continuity, the Grocery Supply Chain Compliance Code and Whistleblowing arrangements.

In relation to the financial statements the Committee: reviewed and recommended approval of the quarterly, and half-yearly results and annual financial statements; conducted impairment reviews; reviewed and recommended dividend levels; reviewed corporate governance disclosures; and monitored the statutory audit.

The Committee continually assesses the need for training and the annual agenda provides substantial time for technical updates which are generally provided by external experts. During the year training was provided on: UK Financial Reporting Council's guidance of listed companies; developments in corporate governance; the outputs from the Financial Reporting Review Panel; and regulatory updates including: the Competition Commission's issues statement; the European Commission's proposals for audit reform; IASB updates on reporting; direct and indirect tax; pensions; capital markets; sustainability; assurance and remuneration. Training is also provided on an ongoing basis to meet the specific needs of individual committee members.

PricewaterhouseCoopers LLP ('PwC') has served as the Company's auditors since 1983. The partner engaged on the audit is changed regularly. The services provided by PwC have been reviewed periodically and the Audit Committee is satisfied that they remain appropriately independent and are best placed to conduct the Company's audit for 2013/14. The Committee therefore recommended PwC be reappointed as the Company's auditors.

It is essential for the Committee to be able to have an honest and open relationship with both its external and internal auditors. This relationship is developed and maintained through regular private meetings with both PwC and the Head of Internal Audit. Further information on the role of the external auditors and our Non-audit Service Policy can be found on page 43.

The Committee assessed the effectiveness of the external audit process by means of a detailed questionnaire completed by key stakeholders including the Board, the Executive Committee, members of senior management and Internal Audit. The questionnaire assesses the external audit in the following areas: qualification; expertise and resources; operational effectiveness; independence and leadership. The results are rated against an ideal standard and compared to prior years to assess the consistency of performance.

The effectiveness of the Internal Audit function was assessed by means of a detailed questionnaire completed by key stakeholders including members of senior management and the external auditors. The assessment covers the Internal Audit function's understanding of its role and responsibility, its charter, the quality of its communications, its performance and the skills and experience of the function.

The Committee carried out a review of its effectiveness during the year, by the Committee Chairman conducting interviews with key stakeholders and the use of a questionnaire. The Committee concluded that it continued to be effective and has sufficient resources to carry out its duties.

Corporate governance continued

Corporate Responsibility Committee

Sir Richard Broadbent Corporate Responsibility Committee Chairman

Corporate Responsibility Committee attendance

	Number of possible meetings attended	Actual meetings attended
Members		
Sir Richard Broadbent (Chairman)	4	4
Patrick Cescau	4	3
Deanna Oppenheimer	4	4
Jacqueline Tammenoms Bakker	4	4

Introduction from the Chairman

Corporate responsibility is not new or optional. It reflects the inescapable reality that if the values of a business fail to resonate with the values of society, it is endangering its long-term prosperity. For the Board therefore, whose role it is to define and uphold the values of the business, corporate responsibility is not just an ethical issue. It is a strategic issue. It is central to defining Tesco's identity, and defining it in a way that integrates our customers' values with our own. The establishment of the Corporate Responsibility Committee reflects Tesco's commitment to identifying and living by values which are important to our colleagues and customers.

The Corporate Responsibility Committee was created by the Board to ensure, reflecting this reality, that the Board gives adequate attention to this subject. The full ambit of the Committee's work can be gauged by reading the Tesco and Society Report 2013 being published today to accompany our Annual Report and Financial Statements. This sets out our thinking and our ambitions as they relate to our responsibility in society and how we discharge it. I commend it to you.

Sir Richard Broadbent Corporate Responsibility Committee Chairman

Corporate Responsibility Committee responsibilities

The Corporate Responsibility Committee was established in 2012 to ensure that the Board maintains an adequate focus on corporate responsibility in its widest sense. The Committee's Terms of Reference are available at www.tescoplc.com.

The key responsibilities of the Committee are to:

- define the Group's corporate and social obligations as a responsible corporate citizen and oversee its conduct in the context of those obligations;
- approve a strategy for discharging the Group's corporate and social responsibilities in such a way as to command respect and confidence;
- identify and monitor those external developments which are likely to have a significant influence on the Group's reputation and/or its ability to conduct its business appropriately as a good corporate citizen and review how best to protect that reputation or that ability;
- oversee the creation of appropriate policies and supporting measures;
- monitor the Group's engagement with external stakeholders and other interested parties; and
- ensure that appropriate communications policies are in place and working effectively to build and protect the Group's reputation both internally and externally.

During the year we introduced a new Core Purpose: We make what matters better, together. Millions of customers come to us for the food and products they need for their lives. What matters to them is that we make the little things better, providing millions of great value products, safely and conveniently every day. Today, we have hundreds of thousands of colleagues, tens of thousands of suppliers and distributors, and we are significant in thousands of communities around the world. We have also articulated a new Value to help us achieve our Core Purpose: We use our scale for good. Our scale gives us an opportunity to make a positive difference to some of the biggest challenges facing the world.

The Committee spent time during the year considering reputational research and giving thought to where we are most relevant and where we have an authentic contribution to make. The output was establishing our three big ambitions:

- to create new opportunities for millions of young people around the world;
- to help and encourage our colleagues and customers to live healthier lives and through this help to tackle the global obesity crisis; and
- to lead in reducing food waste globally.

The Committee has regularly been updated on the work in these areas and discussed the proposed approach to developing targets to measure progress against these ambitions.

Further information is available in our Tesco and Society Report 2013, which is available on our website at www.tescoplc.com.

Nominations Committee

Nominations Committee attendance

	Number of possible meetings attended	Actual meetings attended
Members		
Sir Richard Broadbent (Chairman)	5	5
Patrick Cescau	5	5
Stuart Chambers	5	5
Ken Hanna	5	5

Introduction from the Chairman
The Nominations Committee has developed its role over the past year in line with the broader terms of reference that were put in place at the beginning of the year. In a year of planned but rapid change in both executive management and on the Board, the Committee has been very conscious of the need to assess and manage the risks that such change brings and to ensure that where risk is taken on, it is because it offers the optimal way forward.

In relation to executive management, an exceptionally long period of stability inevitably meant that change, when it came, would be broadly based. The Committee supported the CEO in developing his executive team through the year, a process which is now substantially complete.

In relation to the Board, the Committee oversaw a substantial change in its composition, to an overall smaller size, and its balance, with a proportionally greater representation of Non-executive Directors than Executive Directors.

Aside from these changes, the Committee, supported by the CEO, has instituted a cycle of reviews of bench strength, succession and talent development to ensure that Tesco maximises the considerable value of its human capital which has a breadth of skill and experience not commonly available.

Sir Richard Broadbent Nominations Committee Chairman

Nominations Committee responsibilities
The Committee's Terms of Reference are available at www.tescoplc.com. Where matters discussed relate to the Chairman, the Senior Independent Non-executive Director chairs the meeting.

The key responsibilities of the Committee include:

- reviewing the Board's structure, size and composition;
- identifying, nominating and reviewing candidates for appointment to the Board;
- putting in place plans for succession;
- reviewing the leadership needs of the organisation, both Executive and Non-executive;
- reviewing the Group's talent planning programmes;
- reviewing Board succession over the longer term, in order to maintain an appropriate balance of skills and experience and to ensure progressive refresh of the Board; and
- monitoring the Group's compliance with corporate governance guidelines.

During the year consideration was given to finding a new Non-executive Director ahead of the retirement of Ken Hydon and Karen Cook from the Board on 23 February 2013. Olivia Garfield joined the Board as a Non-executive Director on 1 April 2013. A biography is available on page 25.

The Committee considers a number of factors when making new appointments, including what the new Director will add to the balance of skills and experience on the Board; and whether the Director will be able to allocate sufficient time to the Company to discharge his or her responsibilities. We work with a number of independent external executive search companies, as well as using our own networks to identify candidates with the right skills and experience to fulfil our needs.

The Committee also discussed the challenges and actions relating to succession and leadership and reviewed the management's development and succession plans to ensure the business has the right capabilities and capacities for the future, with a focus on areas such as increasing the number of women in senior roles, the under 35s and increasing the number of local nationals in senior roles.

Diversity
Tesco approaches diversity in its broadest sense, recognising that successful world-class businesses flourish through embracing intellectual, experiential, geographical and skills diversity as well as other factors such as age, disability, gender, race and sexual orientation. With regard to gender diversity, which is the focus of significant current attention, we accept the spirit and aspirations of the Davies Report, including the representation of women at the highest levels in the organisation.

There are currently three women on our Board (30%), three women on the Executive Committee (19%) and women in senior management positions across the Group account for 31% as a whole. We believe that the focus must remain firmly on understanding what it takes to develop women and to retain them in senior positions. Senior roles are very demanding for all – regardless of gender – and we are determined to develop a culture and an environment where our people can advance whilst having the time to be good partners, parents and active members of their local community.

Our policy is to find, develop and keep a diverse workforce at all levels within our Company and we are committed to increasing the percentage of female leaders. We set a target in September 2011 for women to represent 32% of senior managers and 20% of business leaders and Directors. We are close to achieving this target with 31% of senior managers and 19% of business leaders and Directors being women.

Corporate governance continued

Effectiveness of risk management and internal controls
A successful risk management process balances risks and rewards and relies on sound judgement of their likelihood and impact. Accepting that risk is an inherent part of doing business, our risk management processes are designed to encourage entrepreneurial spirit and also provide assurance that risk is fully understood and managed.

A key part of an effective risk management process is ensuring that our colleagues have a good understanding of the Group's strategy and our policies, procedures, values and expected performance. We have a structured communications programme that provides colleagues with clarity on these matters. This ensures that all our colleagues understand what is expected of them and that decision-making takes place at the appropriate level.

The Board has overall responsibility for ensuring the Group has appropriate risk management and internal controls in place and that they continue to work effectively. The key arrangements put in place to enable the Board to discharge its responsibility and for all the members of the Board to satisfy themselves with the integrity of the Group's financial information, financial controls and risk management systems are detailed below.

Risk management
There is a comprehensive process for the review and consideration of risk at Tesco. Risk Registers are in place for all businesses and some key Group functions also maintain a specific Risk Register. Risk Registers are considered regularly by the management of relevant businesses.

The Group also maintains a Group Key Risk Register which describes the key risks faced by the Group and assesses their likelihood and impact, as well as the controls and procedures implemented to mitigate them. The Group risks are determined by discussion with senior management and are reviewed by the Group Executive Committee and then agreed by the Board. In addition to reviewing the Group Risk Register, the Board carries out in-depth reviews of key risk areas each year.

Principal risks and uncertainties
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.

The table below sets out the principal risks faced by the Group, and examples of relevant key controls and mitigating factors. The Board considers these to be the most significant risks faced by the Group. They do not comprise all the risks associated with the Group and they are not set out in any order of priority. Additional risks not presently known to management, or currently deemed to be less material, may also have an adverse effect on the business.

There has been a trend towards increasing net risk during the year, and in particular the likelihood of risks occuring, driven in the majority of cases by the global economic and regulatory environment in which the business operates. Political, regulatory and economic risks have therefore seen an increase in net risk rating, whilst the risks relating to business strategy and property are considered to have decreased as a result of the Group's strategic changes during the year.

Principal risks	Key controls and mitigating factors
Business strategy	
If our strategy follows the wrong direction or is not effectively communicated or implemented, the business may suffer	• Diversification and pursuit of growth in emerging markets under our strategy continues to reduce reliance on limited business areas • Regular review of strategic matters by Board and Executive Committee; Board dedicates two full days a year to Group strategy. Decisive action is taken on strategy as appropriate, including recent decisions regarding operations in Japan and the US – see the Report from the Chief Executive for more details • New structure of Executive sub-committees is designed to focus on key risks through the work of the Group Commercial, Compliance, Digital Retailing, Technology, People Matters Group, Property Strategy and Social Responsibility Committees • Significant resource invested to communicate strategy effectively to those delivering it • Consistent Operational Plans developed throughout the Group to ensure delivery • Steering Wheel balanced scorecard system helps monitor delivery • Structured stakeholder engagement programmes
Financial strategy	
Risks relate to an incorrect or unclear financial strategy and the failure to achieve financial plans	• Regular review of strategy, risks and financial performance by Board and Executive Committee, with external advice as required • Balance Sheet Committee regularly reviews gearing and net debt management • Consistent Operational Plans and Budgets developed throughout the Group to ensure delivery • Steering Wheel balanced scorecard system helps monitor delivery • Structured stakeholder engagement programmes
Competition and consolidation	
Failure to compete on areas including price, product range, quality and service in increasingly competitive UK and overseas retail markets could impact our market share and adversely affect the Group's financial results The consolidation of competitors, key geographical areas or markets through mergers or trade agreements could also adversely impact our market share	• Strategy to have broad appeal on price, range and store format to allow us to compete in different markets • Regular review of markets, trading opportunities and competitor activities, including online, by Executive Committee, Digital Committee and Trading Groups • Increased global marketing effort to maximise the impact of our brand and intellectual property • Performance tracked against relevant KPIs and measures that customers tell us are critical to their shopping experience • Constant monitoring of customer perceptions of Tesco and competitors to ensure we can respond quickly as appropriate • Monitoring of legislative changes, legal framework and compliance

Principal risks	Key controls and mitigating factors
Reputational risk	
Failure to protect the Group's reputation and brand in the face of ethical, legal or moral challenges could lead to a loss of trust and confidence, a decline in customer base and affect our ability to recruit and retain good people	• Tesco Values embedded in how we do business at every level • Our embedded Group Code of Business Conduct and Bribery Act Guidelines guide our behaviour in dealing with customers, employees and suppliers • Stakeholder communication and engagement to understand their views and reflect them in our strategy • Commitment to tackling societal and environmental issues through our Community Plan and activities. Our new Value – We use our scale for good – aims to tackle some of the most important issues for society – see our Tesco and Society Report 2013 for more details • Comprehensive supplier auditing and product surveillance programmes in place to minimise risks associated with labour standards and product integrity • Governance committees, including Executive, Group Commercial, Corporate Responsibility, Social Responsibility, Compliance and Information Security Committees, guide and monitor policies
Performance risk in the business	
Risk that business units (including the UK) underperform against plan and against competitors and our business fails to meet the stated strategy in full	• Board, Executive Committee and various operational committees, including the UK Operating Board, meet regularly to review performance risks • All business units have stretching targets based on the Steering Wheel balanced scorecard system; performance against budgets and KPIs are monitored continually and reported regularly to Board • Clear budgets, goals and objectives set for subsidiary CEOs, with a high proportion of reward based on achievement • Diversification strategy minimises impact of changes in economic climate
Property	
Continuing acquisition and development of property sites carries inherent risk; targets to deliver new space may not be achieved; challenges may arise in relation to finding suitable sites, obtaining planning or other consents and compliance with varying country design and construction standards	• Group Property Strategy, Property Acquisition and related committees regularly review, and closely control, all aspects of property acquisition, planning and construction processes to ensure standards are met and risks are minimised • Group Property blueprints adopted to ensure consistency of approach • Group and country Compliance Committees monitor legal and regulatory compliance in property activities • Mall management systems in place to assist tenant management
Economic risks	
In each country where we operate, we are impacted by the underlying economic environment and the fiscal measures that apply to the retail sector	• External economic outlook is carefully considered when developing strategy and continuously monitored through the Executive Committee's review of performance • A central Euro Disaster Committee monitors developments in the Eurozone • Ongoing monitoring of country developments through local CEOs • We try to anticipate and contribute to important changes in public policy wherever we operate
Political and regulatory risks	
In each country where we operate, we may be impacted by legal and regulatory changes, increased scrutiny by competition authorities and political developments relevant to domestic trade and the retail sector	• Engagement with governmental and non-governmental organisations to represent views of our customers and employees • Ongoing monitoring of country developments through local CEOs • Group and country Compliance Committees monitor legal and regulatory compliance • The Tesco Bank Executive and Treating Customers Fairly Board oversee Tesco Bank's compliance with regulatory requirements • Compliance with the UK Groceries Supply Code of Practice ('Code') is carefully monitored by our Code Compliance Officer • We try to anticipate and contribute to important changes in public policy wherever we operate • Business development follows thorough due diligence work

Corporate governance continued

Principal risks	Key controls and mitigating factors
Product safety	
Failures could damage customer trust and confidence, impacting our customer base and therefore financial results	• Group Product Policy adopted, implemented and monitored across the business by our technical teams • Controls in place around key risks including product integrity; approval and management of supplier sites; standards in store and distribution centres; competency of our people; management of crises, emerging issues and changes in regulatory standards • Detailed, established procedures, operating globally, to ensure product integrity • Product surveillance programmes in place including our new DNA traceability programme • Regular reporting to local and Group Compliance Committees on management of risks associated with products, suppliers and operations
IT systems and infrastructure	
Any significant failure in the IT processes of our retail operations would impact our ability to trade. Failure to invest appropriately in IT could increase our vulnerability to attack, constrain the growth of the business and fail to safeguard personnel, supplier or customer data	• IT strategy is approved and reviewed by the Executive Committee to ensure that investments in IT systems and innovations improve business efficiency and customers' shopping experience • Group Technology Committee monitors controls to maintain integrity and efficiency of IT infrastructure and data • Information Security Committee meets regularly to review the development and implementation of policies • Rigorous governance processes for new and modified systems implementations • Processes to deal with significant IT security incidents • Sharing of systems across international operations to ensure consistency of delivery
People	
Failure to attract, retain, develop and motivate the best people with the right capabilities at all levels could limit our ability to succeed	• People Matters Group ('PMG') regularly meets to review and monitor all people policies, procedures and risks • Clear processes to understand and respond to employees' needs through our PMG, colleague surveys, regular performance reviews, involvement of trade unions in relevant markets and regular communication of business developments • Talent planning and people development is a key objective for each member of the Executive Committee • Significant investment in training, development and incentives, including Executive Committee Talent Cycle, Talent Planning, Leadership Development and succession planning for future needs of the business • Pay, pension and share plan arrangements help us to attract and retain good people
Group Treasury	
Failure to ensure the availability of funds to meet the needs of the business or to manage interest or exchange rate fluctuations could limit our ability to trade profitably. Further detail on the management of financial risks can be found in the 'Financial risks review' table on page 42 and in Note 22 of the financial statements	• An annual Finance Plan and General Board Authority set out the controls and authority limits for all Treasury matters • The Balance Sheet Committee meets regularly to monitor Treasury risks and manage the liquidity needs of the business • An annual Treasury Review is carried out by the Executive Committee • Comprehensive Treasury Policies set out processes and controls around the use of financial instruments, hedging, liquidity, bank account management and the segregation of duties required between our back and front offices

Principal risks	Key controls and mitigating factors
Tesco Bank	
The impact on the Group of financial risks taken by Tesco Bank	• The Bank has a defined 'Risk Appetite', approved and regularly reviewed by both the Bank's Board and the Tesco PLC Board, which sets out the key risks, their optimum ranges, alert limits and the controls required to manage them within their approved tolerance limits • There is a comprehensive structure of governance and oversight in place to ensure the Bank complies with all applicable laws and regulations
Pensions	
Our IAS 19 deficit could increase if there is a fall in corporate bond yields which is not offset by an increase in the pension scheme's assets. There are also increasing risks of legal and regulatory changes introducing more burdensome requirements	• Diversified investment strategy with increased control and visibility through the appointment of an in-house investment team • Changes to benefits were introduced in 2012 to reduce the scheme's life expectancy and inflation risks • Appointment of a new Audit and Risk Pensions Committee to provide greater visibility and internal controls of pension and investment risks • Monthly review by Pensions and Treasury Directors • External advisors and pension fund trustees fully engaged to consider deficit and fund performance and legislative and regulatory changes and their impact
Fraud, compliance and internal controls	
As the business develops new platforms and grows in both size and geographical scope, the potential for fraud and dishonest activity by our suppliers, customers and employees increases	• Appropriate procedures and controls including Group Accounting Policy, key financial controls, IT access controls and segregation of duties are set out across the business to reduce fraud risks • Compliance Committee monitors implementation of, and compliance with, relevant policies and procedures • An annual governance return is completed by each business unit • Clear behavioural guidance given to employees through training on Tesco Values, the Group Code of Business Conduct, the UK Bribery Act and our Whistleblowing service – Protector Line • Internal Audit undertakes risk-based programmes and detailed investigations into all business areas and reports its findings to the Audit Committee • Group Loss Prevention & Security monitors fraud, bribery and business continuity across the Group and reports its findings to the Audit Committee • Store and distribution compliance and technical law and trading reviews conducted regularly to reinforce compliance across the estate • Information Security Committee regularly reviews IT incidents • External Audit rotational coverage of areas and assessment of controls
Business continuity and crisis management	
A major incident or activism could impact on colleague safety or the Group's ability to trade	• Appropriate business continuity plans and crisis management plans are in place for each business area • Disaster recovery plans are in place for key IT systems and data centres • Security systems and processes that reflect best practice are also in place to review the risks of incidents or activism across the Group including liaison with the UK National Co-ordinator for Counterterrorism

Corporate governance continued

Financial risks review

The main financial risks faced by the Group relate to the availability of funds to meet business needs, fluctuations in interest and foreign exchange rates and credit risks relating to the risk of default by parties to financial transactions. The management of these risks is set out below. Details of the main financial risks relating to Tesco Bank and the management of those risks can be found in Note 22 to the financial statements on page 108.

Financial risk	Risk management
Funding and liquidity	The Group finances its operations by a combination of retained profits, disposals of property assets, 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. The Group has a long-term rating of BBB+ (stable) from Fitch, Baa1 (stable) from Moody's and BBB+ (stable) from Standard & Poor's. New funding of £1.4 billion was raised during the year from property disposals. At the year end, net debt was £6.6 billion (2012: £6.8 billion).
Interest rate risk management	Our objective is to limit the impact to our profit and loss from rising interest rates. Forward rate agreements, interest rate swaps, caps and floors may be used to achieve the desired mix of fixed and floating rate debt. Our policy is to fix interest rates for the year on a minimum of 40% of actual and projected debt interest costs of the Group excluding Tesco Bank. At the year end, the percentage of interest bearing debt at fixed rates was 75% (2012: 90%). 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 4.8% (2012: 4.8%).
Foreign currency risk management	Our principal objective is to reduce the effect of exchange rate volatility on operating margins. Transactional currency exposures that could significantly impact the Group Income Statement are managed, typically using forward purchases or sales of foreign currencies and purchased currency options. At the year end, forward foreign currency transactions, designated as cash flow hedges, equivalent to £1,835 million were outstanding (2012: £1,944 million) as detailed in Note 21. We translate overseas profits at average foreign exchange rates. We only hedge a proportion of the investment in our international subsidiaries as well as ensuring that each subsidiary is appropriately hedged in respect of its non-functional currency assets. During the year, currency movements increased the net value, after the effects of hedging, of the Group's overseas assets by £420 million (last year decrease of £22 million).
Credit risk	The objective is to reduce the risk of loss arising from default by parties to financial transactions. The Group holds positions with an approved list of counterparties of good credit quality and these counterparties and their credit ratings are routinely monitored.
Insurance	We purchased assets, earnings and combined liability protection from the open insurance market for higher value losses only. The risk not transferred to the insurance market is retained within the business with some cover being provided by our captive insurance companies, ELH Insurance Limited in Guernsey and Valiant Insurance Company Limited in the Republic of Ireland. ELH Insurance Limited covers Assets, Earnings and Combined Liability, while Valiant Insurance Company Limited covers Combined Liability only.

Internal controls

The Board is responsible for the Company's system of internal controls and for reviewing their effectiveness. As part of the year end process, the CEOs of all international businesses, the UK core business and other relevant material businesses in the UK, are required to certify that their business has operated in compliance with applicable governance and compliance requirements, policies and legislation during the year. The details of any incidences of non-compliance must be disclosed and a report of the responses is reviewed by Internal Audit and the Group Compliance Committee.

Colleagues are required to confirm annually that they have complied with the Code of Business Conduct which sets out the individual obligations and responsibilities for anyone working at Tesco. More details on this code can be found on page 30.

Group Finance is responsible for preparing the Group financial statements, using a well-controlled consolidation process. Group Finance contains a technical accounting team, which reviews external technical accounting developments, financial reporting and accounting policy issues. It is also responsible for maintaining a mandatory Group accounting policy manual, which is in accordance with International Financial Reporting Standards. Group Finance maintains its own Risk Register and assesses its own controls systems. During the year Group Finance has taken steps to make its processes more robust by developing a key financial control framework to describe a mandatory suite of controls across key business processes. Compliance is being monitored by management by means of an annual self-assessment programme which is being rolled out across the Group.

The Internal Audit programmes covering key financial controls have been aligned with this framework to ensure consistency of approach.

There are a number of key committees which play a role in monitoring compliance with internal controls.

The Group Compliance Committee is responsible for monitoring compliance across the Group, including receiving reports from the individual business unit compliance committees. It also reviews local policies and approves changes and exceptions to those policies. During the year it met six times and covered topics on social, environmental, ethical, operational, commercial and corporate, property and financial matters.

The Audit Committee reports to the Board each year on its assessment of the effectiveness of the risk management and 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. Internal Audit and senior management also regularly provide updates to the Committee.

All systems are designed to provide reasonable, but not absolute, assurance against material statement or loss. The Board has conducted a review of the effectiveness of internal controls and is satisfied that the controls in place remain appropriate.

Internal Audit

The Internal Audit function is independent of business operations and has a Group-wide mandate. It undertakes a continuous programme to address internal control and risk management processes with particular reference to the Code. 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;
- facilitating oversight of risk and controls across the Group through risk committees in Asia, Europe and a number of our businesses and joint ventures; and
- 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.

External Audit

PwC, the Company's external auditors, 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. The engagement and independence of the external auditors is considered annually by the Audit Committee before it recommends its selection to the Board.

The Company has a Non-audit Services Policy for work carried out by PwC. This is split into three categories as explained below:

- pre-approved for the external auditors – is predominantly the audit of subsidiary undertakings' statutory accounts and is audit-related in nature;
- work for which Committee approval is specifically required – transaction work and corporate tax services, and certain advisory services; and
- work from which the external auditors are prohibited.

The Audit Committee concluded that it was in the best interests of the Company for the external auditors to provide a number of non-audit services during the year due to their experience, expertise, and knowledge of the Group's operation. Auditor objectivity and independence was achieved by ensuring that personnel involved in the non-audit work were not involved in the audit, and by ensuring that management took responsibility for all decisions made. PwC follows its own ethical guidelines and continually reviews its audit team to ensure its independence is not compromised. PwC's independence is also considered by the Audit Committee regularly.

The fees paid to the auditors in the year are disclosed in Note 3 to the Group financial statements.

Engagement

Relations with shareholders

We are committed to having a constructive dialogue with shareholders to ensure that we understand what is important to them and enable clear communication of our position. The Chairman, CEO and CFO hold regular meetings with shareholders and update the Board on the outcomes of those meetings. Investor Relations keep the Board informed of broker and analyst views and reports and present formally to the Board twice each year. In addition we carry out a survey each year of a cross section of shareholders in order to assess shareholder perceptions of the Company. The results of this survey are reviewed by the Board.

We support greater engagement with institutional shareholders as envisaged by the Stewardship Code. We are also keen to develop our engagement with private shareholders through various channels of communication, including the AGM; the Company's website; and social media.

Stakeholder engagement

We engage regularly with our colleagues to invite them to give us their thoughts on how the business is run and how they feel about working for Tesco. We also engage with unions in the UK and our other markets to discuss employee matters and business developments. During the year we also carried out over 50 high-level stakeholder interviews – including supranational organisations, NGOs, charities, leading academics, politicians and activists. They gave us valuable insight into how we are currently perceived, what they think of our ambition to use our scale for good and their future expectations of Tesco. Further information is available in our Tesco and Society Report 2013, which is available on our website at www.tescoplc.com.

Corporate governance discussions and consultations

We take an active part in the debate on corporate governance and remuneration issues and during the year we responded to a number of consultations, including those carried out by the Department of Business, Innovation and Skills in relation to Revised Remuneration Reporting Regulations and Enhanced Shareholder Voting Rights and the Financial Reporting Council consultation on revisions to the UK Corporate Governance Code and Guidance on Audit Committees.

Our Annual General Meeting

The AGM is seen as a good opportunity for the Board to communicate the Company's progress directly to shareholders. Our 2013 AGM will be held in London at 11am on 28 June 2013.

The whole Board is expected to attend the AGM and be 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 AGM all resolutions are proposed and voted upon individually by shareholders or their proxies. All votes taken during the AGM are 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 a Regulatory Information Service and the Tesco PLC website. In 2012 shareholders supported all of the resolutions put to them by the Board with votes of over 90% in favour on all resolutions. Full details of the votes are available on our website www.tescoplc.com.

Directors' remuneration report

Stuart Chambers Chairman of the Remuneration Committee

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 23 February 2013.

In this section

44 Introduction from Stuart Chambers, Chairman of the Remuneration Committee

Remuneration strategy

45 Linking executive pay with strategy
45 Remuneration arrangements throughout the Group

Remuneration policy

46 Remuneration framework
47 Remuneration policy for Executive Directors for 2013/14
48 Remuneration outcomes in different performance scenarios
48 Share ownership guidelines
49 Service contracts and leaver provisions

How remuneration policy will be applied in 2013/14

50 Fixed remuneration for 2013/14
50 Performance related remuneration for 2013/14

Remuneration outcomes for Executive Directors in 2012/13

52 Salaries for 2012/13
53 Performance related remuneration for 2012/13
55 Aligning pay with performance

Other information

56 Leaving arrangements for Executive Directors
56 Outside appointments

Non-executive Directors

56 Non-executive Director responsibilities
57 Non-executive Director fees
57 Chairman fees

Corporate governance

57 Governance including the role, membership and advisors to the Committee

Audited information

60 Data tables

Dear Shareholder

In an important year for Tesco, the Remuneration Committee has sought to ensure that the Company's remuneration arrangements continue to support the strategic direction of the business, and that the remuneration decisions we have made are fair and comprehensible to the outside world.

This report sets out in full how we have approached this and the specific decisions we have reached. I would like to highlight two areas:

- Firstly, the year just ended was a challenging one. A number of important decisions were taken during the year, such as reinvesting profits back into the UK business to improve the shopping experience for customers, and deciding to exit the US and write down the value of the Fresh & Easy business. These decisions have had financial consequences this year but were necessary to set the business on the right track to deliver realistic, sustainable and attractive returns over the long term. We also faced external challenges which impacted our performance, most notably the regulatory restrictions on opening hours in South Korea and the difficult economic conditions in Central Europe.

  As a consequence, our financial performance fell short of where we wanted it to be, which in turn resulted in no annual bonus being paid to the senior management team for 2012/13. The long-term incentives that were due to vest this year also lapsed as performance targets were not met. The Remuneration Committee believes that this demonstrates that our remuneration policy is effective in aligning pay with performance.

- Secondly, as set out in more detail in this report and at the time of our Preliminary Results announcement, we have clearly articulated our business priorities for the foreseeable future and the financial performance that shareholders can expect us to deliver in the current economic environment. We have consequently amended the management incentives for 2013/14 to align them with the new strategic priorities and financial parameters.

The changes for 2013/14 are summarised below:

Annual bonus

- The annual bonus will be less heavily weighted towards short-term profits but linked to a more balanced scorecard of financial, strategic and operational measures. However, bonuses will only be paid if profits have grown.
- The profit measure used will be based on Trading Profit rather than Underlying Profit. Trading Profit does not include property profits, which reflects our fundamentally different approach to space going forward.
- We have replaced UK ROCE with Group Working Capital. The Committee feels that ROCE is an important capital efficiency measure but is better suited to long-term incentives. Management have more line-of-sight and control of Working Capital over the short term.
- The measures for customer service and colleague engagement will reflect overall Group performance rather than just the UK as used in previous years.

Long Term Performance Share Plan

- We have amended the performance targets on the long-term Performance Share Plan to align with the new financial parameters described in this report and at our Preliminary Results announcement. To reflect the lower performance threshold at which awards may vest, we have also lowered the amount of the award that vests. This ensures incentives remain aligned with the strategy while striking a balance between creating long-term value for shareholders and rewarding management fairly.
- The calculation of underlying Earnings Per Share used to assess performance will exclude property profits to reflect our different approach to space.

Whilst it has been a difficult year, we are making progress against our plan to 'Build a Better Tesco'. The Remuneration Committee is confident that the changes above will better support the business strategy leaving the management team to get on with the job at hand and make what matters better, together.

I hope you find this report informative.

Stuart Chambers Chairman of the Remuneration Committee

Remuneration strategy

Tesco's most important asset is its people. Business success depends on the performance and contribution of each individual colleague but outstanding performance comes from teamwork. Therefore, our approach to remuneration throughout Tesco is guided by a framework of common objectives and principles which are outlined in the table below.

Reward objectives	Reward principles
Attract • Enable Tesco to recruit the right people **Motivate** • Incentivise colleagues to deliver our business goals together **Recognise** • Acknowledge individual contribution and performance **Align** • Create shareholder value by focusing colleagues on making what matters better **Retain** • Foster loyalty and pride in Tesco so that colleagues want to stay with us and strive to do their best	**Competitive** • We assess competitiveness on a total reward basis including financial and non-financial rewards • Reward reflects an individual's role, experience, performance and contribution • Reward is set with reference to external market practice and internal relativity **Simple** • Reward is simple, clear, and easy to understand • We avoid unnecessary complexity • Reward is delivered accurately

Fair
• Policies are transparent, and applied consistently and equitably
• Reward decisions are trusted and properly governed
• Reward is legal and compliant

Sustainable
• Reward is aligned to the business strategy, reflects our performance, and is affordable
• Our reward framework is flexible to meet the changing needs of the business
• We reward in a responsible way

Linking executive pay with strategy
The world has changed from a culture of 'more is better' to 'better is better'. This is why we have changed our Core Purpose this year. We can't solve the world's problems but we want to always do the right thing to earn trust and loyalty from all our stakeholders. Our new Core Purpose is a statement of what we do and what we stand for – 'We make what matters better, together'.

Our Values help us to understand how to put our Core Purpose into practice. Our Values are: No one tries harder for customers, We treat everyone how we like to be treated and We use our scale for good.

Our Vision has five elements – each of them describes the sort of company Tesco aspires to be:

- Wanted and needed around the world
- A growing business, full of opportunities
- Modern, innovative and full of ideas
- Winners locally whilst applying our skills globally
- Inspiring, earning trust and loyalty from customers, our colleagues and communities

Our seven-part long-term strategy (outlined below) aims to broaden the scope of the business to enable it to deliver strong, sustainable long-term growth for all stakeholders.

1. To grow the UK core
2. To be an outstanding international retailer in stores and online
3. To be as strong in everything we sell as we are in food
4. To grow retail services in all our markets
5. To put our responsibilities to the communities we serve at the heart of what we do
6. To be a creator of highly valued brands
7. To build our team so that we create more value

Further details of this strategy are set out on page 13.

Remuneration is one of our key tools to support the delivery of our Vision, Core Purpose, Strategy and long-term value creation.

Executive remuneration has been designed to support our strategy within the framework above. The key features are:

- Alignment with strategy – The majority of our reward is linked to the delivery of stretching performance over the short and long term and is delivered in shares. Our medium-term strategic focus is to build a stronger business that is sustainable and equipped to compete in the future. The minor changes made to remuneration arrangements this year reflect our Vision, new Core Purpose, Values and Strategy.

  Our short-term performance is measured in relation to profit growth and the delivery of other strategic financial and non-financial objectives. Our long-term performance is measured by assessing the growth in our earnings per share and the level of our return on capital. These metrics are a key measure of the success of the delivery of our long-term strategy.

- Simple, collegiate approach to remuneration – Our remuneration arrangements are designed to be simple to provide clarity to both our Executives and to shareholders. Executive Directors and other management participate in a common incentive framework to ensure teamwork in delivering our key strategic goals.

- Creating alignment with shareholders by building a shareholding in our business – We believe that it is important that our colleagues are shareholders in the business to create alignment with our other shareholders. The CEO is required to hold shares with a value of four times salary, the CFO is required to hold shares with a value of three times salary and other senior managers are required to hold shares with a value of one times salary.

Remuneration arrangements throughout the Group
Tesco is one of the largest public company employers in the world. Our colleagues come from diverse backgrounds reflecting the countries we operate in and the range of skills we need to run our various businesses (from stores to banking to telecoms).

Reward packages therefore differ taking into account appropriate factors but they are all built around the common reward objectives and principles outlined above.

- Annual bonus – Annual bonuses throughout the Group are linked to local business performance and Group success in a structure that is consistent with the Executive Directors' annual bonus with a focus on profit growth, strategic financial and strategic non-financial measures.

Directors' remuneration report continued

- **Share incentives** – Our 5,000 strong management team across the Group participates in the Performance Share Plan based on similar performance conditions to those for the Executive Directors' PSP. This management team also receives some of their bonus in Tesco shares deferred for a period of two or three years.
- **Colleagues as shareholders** – It is an important part of the Tesco Values that all colleagues, not just management, have the opportunity to become Tesco shareholders. Over 200,000 of our colleagues participate in our all-employee schemes and hold over 125 million shares in our Share Incentive Plan and over 140 million options over shares in our Save As You Earn scheme.

When determining Executive Director remuneration arrangements the Committee takes into account pay conditions throughout the Group to ensure that the structure and quantum of Executive pay remains appropriate in this context. When considering salary increases for the Executive Directors the Committee considers the general level of salary increase across the Group. Over the last four years Executive Director salary increases have been at a similar level to the general increase for colleagues across the Group.

The remuneration arrangements for the Executive Committee fall within the Remuneration Committee's remit ensuring a common approach to the design of reward and determining reward outcomes for the most senior people within the organisation.

Remuneration policy

In light of our new Strategy, the Committee reviewed our remuneration policy and concluded that it was broadly fit for purpose. In the year there has been very little change to our policy beyond adjusting certain performance measures for the annual bonus and the performance targets on the Long Term Performance Share Plan to reflect the new strategic priorities for the Company.

Remuneration framework

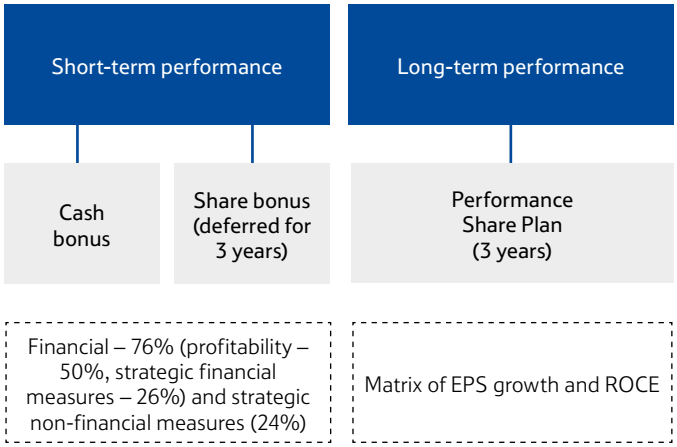
The following chart and accompanying table on page 47, provide a summary of the different elements of pay, their purpose and linkage to our strategy, and the key features of each component.

Fixed pay

Base salary + Benefits + Pension

c.20% of total reward opportunity

Performance related pay



c.80% of total reward opportunity

Remuneration policy for new hires

Tesco has a strong history of succession planning and developing internal Executive talent. In the event that the Company recruited a new Executive Director, the Committee would generally seek to align the remuneration package offered with our broader remuneration policy.

In determining appropriate remuneration arrangements, the Committee will take into consideration all relevant factors (including but not limited to quantum, the type of remuneration being offered and the jurisdiction the candidate was recruited from) to ensure that arrangements are in the best interests of both Tesco and its shareholders without paying more than is necessary to recruit an Executive of the required calibre.

The Committee may make awards on hiring an external candidate to 'buy out' remuneration arrangements forfeited on leaving a previous employer. In doing so the Committee will take account of relevant factors including any performance conditions attached to these awards, the form in which they were granted (e.g. cash or shares) and the time over which they would have vested. Generally buy-out awards will be made on a comparable basis to those forfeited.

Risk management

Risk management is an important part of business process. The Committee considers that Tesco's processes in this area provide the necessary controls to prevent inappropriate risk taking. When reviewing remuneration structures the Committee considered whether any aspect of these might encourage behaviours that are incompatible with our Tesco Values and the long-term interests of shareholders. If necessary, the Committee would take appropriate steps to address this.

Consulting with shareholders

The Committee believes that it is very important to maintain open dialogue with shareholders on remuneration matters.

During the year under review the Committee consulted with shareholders regarding some potential changes to remuneration arrangements and the views of shareholders have been instrumental in shaping the changes discussed in this report.

Going forward the Committee will continue to liaise with shareholders regarding remuneration matters more generally and Tesco arrangements as appropriate. It is the Committee's intention to consult with shareholders in advance of making any material changes to remuneration arrangements.

Remuneration policy for Executive Directors for 2013/14

At a glance

	Element	Link to strategy	Operation and opportunity: CEO	Operation and opportunity: CFO	Performance measures	Changes to the policy for 2013/14
Fixed pay	Base salary	• The role of base salary is to support the recruitment and retention of Executive Directors of the calibre required to deliver the strategy.	• £1,122,000 • When determining pay the Committee examines salary levels at the leading FTSE companies, other major retailers and gives consideration to appropriate international competitors. • Next review 1 July 2013. • For the last four years the base salary increases have been **similar to the increase awarded to other colleagues across the Group**.	• £869,040	• n/a	• No changes to the policy.
	Pension (Cash in retirement)	• To provide a market-leading retirement benefit that will foster loyalty and retain experienced Executives, which supports our culture of developing talent internally. • A key incentive and retention tool throughout the organisation.	• Current pension provision of **defined benefit** pension of up to two-thirds of base salary at retirement with a 10% employee contribution. This is provided through registered arrangements up to approved HMRC limits, with the remainder provided through secured unfunded arrangements.		• n/a	• No changes to the policy.
	Benefits	• To provide a market-competitive level of benefits for our Executive Directors.	• **Core benefits** – Benefits include car allowance, life assurance, disability and health insurance, club membership and staff discount. • **All-employee share plans** – Executives are eligible to participate in the Company's all-employee share schemes on the same terms as UK colleagues.		• n/a	• No changes to the policy.
Performance related pay	Annual bonus (One-year performance) (Cash and shares)	• The role of the annual bonus is to incentivise Executives to deliver our annual financial, strategic and operational goals. • The performance measures have been selected as they are considered to be closely aligned to the delivery of our seven-point strategy, building a stronger underlying business and long-term shareholder value creation.	• Maximum opportunity of **250%** of base salary. • 50% in **cash**. • 50% in shares which are **deferred** for three years. • **Clawback** applies to deferred shares to allow the Committee to scale back deferred share awards prior to vesting in the event that results are materially misstated.	• Maximum opportunity of **200%** of base salary.	• 76% of bonus based on financial performance: – 50% of bonus based on **Trading Profit** performance. – 26% based on **strategic financial** performance measures. • 24% of bonus based on performance against key **strategic non-financial** performance measures focused on customer, colleague and community objectives. • All objectives are specific and measurable.	• In April 2012, we set out detailed plans to 'Build a Better Tesco', which included investing in the UK business to improve the shopping experience for customers and some fundamental changes to our approach to capital allocation – focusing on improving returns through reducing space growth, improving the performance of existing stores, and investing more in the digital revolution that is shaping the future of the retailing industry. • To ensure that our incentives are aligned to our plans, the Committee has decided to expand the success factors against which annual performance is assessed to create a better balance between incentive payouts, financial results, and the strategic drivers of sustainable shareholder value.
	Performance Share Plan (Three-year performance) (Shares)	• The role of the PSP is to reward Executive Directors for achieving Tesco's long-term strategy and creating sustainable shareholder value. • To enhance shareholder value by motivating Executives to grow earnings over the long term while maintaining a sustainable level of return on capital. • To align the economic interests of Executives and shareholders. • To act as a retention tool.	• Maximum award of **275%** of base salary. • **Clawback** provisions apply to awards, allowing the Committee to scale back awards prior to vesting in the event that results are materially misstated.	• Maximum award of **225%** of base salary.	• Based on a **matrix of ROCE/EPS growth** performance.	• In light of our business priorities for the foreseeable future and the financial performance that shareholders can expect us to deliver in the current economic environment, we have amended the performance targets for the 2013 PSP award. The calculation of earnings growth performance will also exclude property profits to reflect our fundamentally different approach to space growth going forward. The revised targets are set out on page 52.

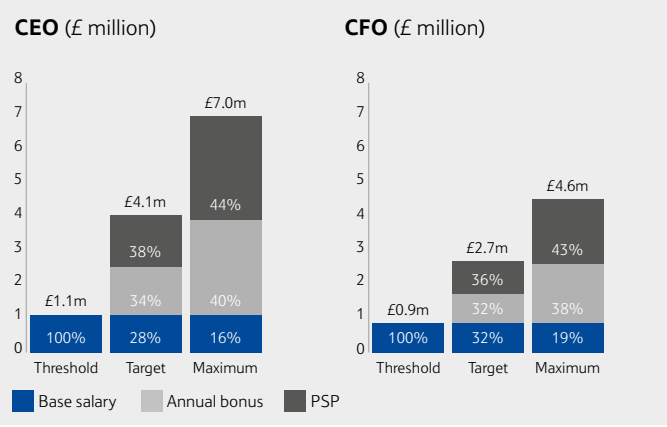
Directors' remuneration report continued

Remuneration outcomes in different performance scenarios
Tesco remuneration arrangements have been designed to ensure that a significant proportion of pay is dependent on the delivery of short-term and long-term goals that are aligned with our short-term and long-term strategic objectives and the creation of shareholder value. The Committee considers the level of remuneration that may payout in different performance scenarios to ensure that this is considered appropriate in the context of the performance delivered and the value added for shareholders.

The charts below show hypothetical values of the remuneration package for Executive Directors under three assumed performance scenarios:

Below target performance	• No bonus payout • No vesting under the Performance Share Plan
On target performance	• 50% annual bonus payout • 50% vesting under the Performance Share Plan
Maximum performance	• 100% annual bonus payout • 100% Performance Share Plan vesting

For the purposes of these illustrations, no share price growth is assumed, dividends are not included and pension and benefits are not included.



Share ownership guidelines

At a glance
• Four times base salary for the CEO
• Three times base salary for the CFO
• The purpose is to create alignment with the interests of shareholders
• This requirement is at the upper end of typical market practice for similar sized companies

The Remuneration Committee believes that a significant shareholding by Executive Directors aligns their interests with shareholders and demonstrates their ongoing commitment to the business.

Policy for calculating shareholding

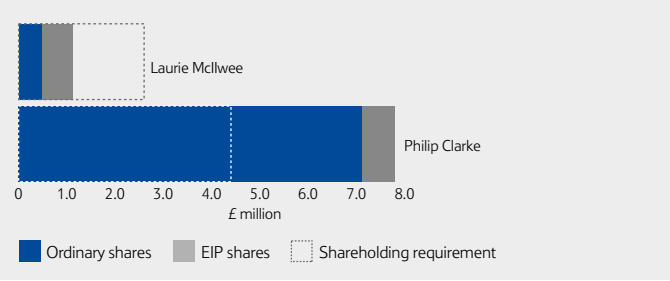
- **Shares included** – Shares held in plans which are not subject to forfeiture will be included (on a net basis) for the purposes of calculating Executive Directors' shareholdings, as will shares held by an Executive's spouse. Vested but unexercised market value share options are not included in the calculation.
- **Five years for new appointees to build shareholdings** – New appointees will be expected to achieve this minimum level of shareholding within five years of appointment.
- **PSP participation may be subject to maintaining holding** – Full participation in the long-term Performance Share Plan will generally be conditional upon maintaining the minimum shareholding.
- **Holding of 50% of vesting awards until requirement met** – Where an Executive Director does not meet the shareholding requirement they will be required to hold, and not dispose of, at least 50% of the net number of shares which vest under incentive arrangements until they meet this requirement.

Given the importance of owning shares, the Executive Committee and over 100 other senior managers are also required to build a holding of Tesco shares.

Shares held by Executive Directors at 23 February 2013

The chart below illustrates the value of Executive Directors' shareholdings, based on the three-month average share price to 23 February 2013 of 348p per share compared to the shareholding guideline.

The shareholding guideline has been shown based on the full requirement of four times salary for the CEO and three times salary for the CFO. When the shareholding guidelines were increased in 2011, Executives were given a period of five years to meet this enhanced requirement and therefore should meet the requirement by June 2016.



Share dealing policy

Tesco has a share dealing policy in place for Executive Directors and for members of the Executive Committee. This policy prevents Executive Directors and Executive Committee members and their connected persons dealing in shares at times when this would be prohibited by the UK Listing Authority's Listing Rules. At all times, Executive Directors and Executive Committee members must seek advance clearance before dealing in shares on their own behalf or in respect of their connected persons.

Service contracts

At a glance

Provision	Current service contracts
Notice period	• 12 months' notice by the Company and six months' notice by the Executive. • For new appointments 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. No Executive currently has a notice period of greater than 12 months.
Expiry date	• Philip Clarke and Laurie McIlwee entered into service agreements with Tesco PLC on 31 May 2011 and 27 January 2009 respectively. • Rolling service contract. • No fixed expiry date.
Termination payments (Does not apply if notice is provided, as per the service agreement, or for termination by reason of resignation or unacceptable performance or conduct)	• CEO – Termination payments in lieu of notice based on base salary and benefits only. • CFO – Termination payments in lieu of notice based on base salary, benefits and the average annual bonus paid for the last two years. • Our policy for new appointments is that termination payments in lieu of notice will be based on base salary and benefits only. • No account will be taken of pension. • Termination payments will be subject to mitigation and normally paid in instalments to facilitate this (other than for long-serving Executives). • If the termination occurs within one year of retirement, the termination payment will be reduced accordingly.
Other information	• The Committee may determine that an Executive Director may receive a pro rata bonus in respect of the period they remained in employment in respect of the financial year in which they ceased employment. Where an Executive leaves by reason of death, disability or ill-heath they are entitled to a pro rata bonus for the year of cessation. • In the event that an Executive Director retires from the Company they shall be entitled to retain their private medical cover in retirement. New Executive Directors will not be entitled to this benefit going forward.

The service agreements are available to shareholders to view on request from the Company Secretary.

Share plan rules – leaver provisions

The treatment of outstanding share awards in the event that an Executive Director leaves is governed by the relevant share plan rules. The following table summarises leaver provisions under the executive share plans. In specific circumstances the Committee may exercise its discretion to modify the policy outlined if the rules of the share plan allow such discretion.

	'Good leavers' as determined by the Committee	Leavers in other circumstances (other than gross misconduct)
Executive Incentive Plan	• Unvested awards vest at cessation. • 12 months to exercise (if options).	• Unvested awards vest at the normal vesting date. • 12 months to exercise (if options).
Performance Share Plan	• Awards granted in the 12 months prior to leaving lapse. • Other unvested awards continue until the normal vesting date and remain subject to performance. • 12 months to exercise (if options).	• Unvested awards lapse.
Share Option Plan	• Awards granted in the 12 months prior to leaving lapse. • Other unvested awards continue until the normal vesting date and remain subject to performance. • Three years from leaving to exercise.	• Unvested awards lapse. • 12 months from leaving to exercise vested awards.
All-employee share plans	• Leaver provisions under all-employee share plans are determined in accordance with HMRC approved provisions.	

Directors' remuneration report continued

How remuneration policy will be applied in 2013/14

Salary	
Policy	• Base salary is designed to attract and retain talented individuals. • It is set to reflect individual capability, responsibilities and market-competitive positioning.
Benchmarking group	• The Committee reviews salary levels at the leading FTSE companies, other major retailers and ensures consideration is also given to appropriate international competitors.
Relationship to all-employee pay	• The Committee also takes into account pay conditions throughout the Group in deciding executive annual salary increases. • The average increase for established Executive Directors last year was 2%. This was the same as the 2% average increase for other colleagues. • Pay levels for all Group colleagues are determined with consideration to a number of factors, including the prevailing economic environment, discussions with employee representative groups, and current market practice.
Review date	• Base salaries are typically reviewed with effect from 1 July each year. • The next salary review will be 1 July 2013 and salaries following this review will be disclosed in next year's report.

Pension	
Policy	• Pension provision is central to our ability to foster loyalty and retain experience, which is why Tesco wants to ensure that pension is a highly valued benefit. • Both current 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 (Final Salary Scheme). • This Final Salary Scheme is now closed to new entrants and has been replaced in the UK by a defined benefit scheme based on career average earnings. New Executive Directors will be automatically enrolled into this scheme. • From 1 June 2012, two changes were made in respect of the build-up of future benefits under the Pension Scheme. These changes applied to all participants in the Scheme including the Executive Directors. Firstly, whilst the Normal Pension Age remains unchanged, the age at which a full pension is paid was increased by two years from 60 to 62. This will be adjusted up or down to reflect any further unexpected changes in life expectancy. Secondly, we will increase pensions, up to 5%, by CPI instead of RPI. • Pension accrued before 1 June 2012 and drawn before age 60 will be actuarially reduced to reflect early retirement. Pension accrued from 1 June 2012 will be actuarially reduced if it is drawn before the age at which a full pension is paid (currently age 62 but subject to adjustment up or down to reflect unexpected changes in life expectancy). • Our defined benefit pension remains a key part of our total reward package for all UK colleagues.
SURBS	• Since April 2006, following implementation of the regulations contained within the Finance Act 2004, and the subsequent changes to the annual allowance in 2010, Executive Directors have been eligible to receive the maximum pension that can be provided from the registered Pension Scheme without incurring additional tax charges. The balance of any pension entitlement for Executive Directors is delivered through an unfunded retirement benefit scheme ('SURBS'). The SURBS is secured by using a fixed charge over a cash deposit in a designated account. • This SURBS is closed to new entrants.
Employee contribution	• Executive Directors who are members of the Final Salary Scheme are required to contribute 10% of salary. New Executive Directors will be required to contribute 7.75% of salary into the new career average pension scheme. Both these rates are in line with contribution levels by senior management below Board level.

Further details of the pension benefits earned by the Directors can be found on page 60.

Short-term bonus

The table below sets out a summary of the maximum opportunity under the short-term bonus for 2013/14:

At a glance

- Maximum opportunity of **250%** of salary for the CEO.
- Maximum opportunity of **200%** of salary for the CFO.
- **Half** payable in **cash** and **half** payable in **shares** which are deferred for three years.
- Clawback provisions apply to the deferred shares element prior to vesting.

During the year the Committee reviewed the performance measures used for the short-term bonus plan in light of our business priorities for the foreseeable future and the financial performance that shareholders can expect us to deliver in the current economic environment. The Committee decided to expand the success factors against which annual performance is assessed to create a better balance between incentive payouts, financial results, and the strategic drivers of sustainable shareholder value.

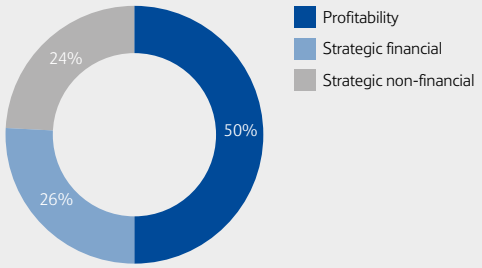
The following short-term performance measures apply for the 2013/14 bonus arrangements:

Short-term performance measures for 2013/14

Financial (76% of short-term bonus)		
Profitability (50% of short-term performance)	Strategic financial (26% of short-term performance)	Strategic non-financial (24% of short-term performance)
Measured in relation to Trading Profit performance.	Based on performance against key strategic financial measures. For 2013/14 these metrics will be: • Group internet sales – 10% • UK like-for-like – 8% • Group working capital – 8%	Based on performance against key strategic operational measures. For 2013/14 these metrics will be: • Customer – Group customer service – 8% • Colleague – Group colleague engagement – 8% • Community – Group CO_2 reduction – 8%
	The strategic financial and non-financial elements of the bonus are subject to a profit underpin. No portion that relates to strategic measures can be earned unless profit growth has been achieved.	
Link to strategy – This measure incentivises the delivery of strategy by encouraging the creation of annual shareholder value through improved bottom-line financial results. The profit measure used will be based on Trading Profit rather than Underlying Profit. Trading Profit is widely understood throughout the business but, unlike Underlying Profit, does not include property profits. This reflects our fundamentally different approach to space going forward.	**Link to strategy** – The selected strategic financial measures allow for the Company to more specifically incentivise the delivery of key elements of our strategy. 'Clicks & Bricks' is an important and exciting dimension of our strategy and a key focus for 2013/14. Another key priority for 2013/14 is delivering on our commitments to build a better business in the UK. A focus on improving like-for-like performance will support this. A working capital metric has been introduced this year to focus Executives on the effective management of stock, cash and suppliers. The Committee believes that this working capital is a measure that is better suited to the short-term bonus than ROCE which measures long-term capital efficiency.	**Link to strategy** – At Tesco we believe that a focus on the enablers of business performance will help us build a much more successful, sustainable business for the long term which will ultimately yield financial returns for all stakeholders. The Committee therefore considered that it was important the 2013/14 annual bonus framework focused on: – Improving our service to our customers. – Improving the engagement of all of our colleagues – if our colleagues smile, our customers smile too. – Being a business that puts back more into our community than we take out. Group customer service and Group colleague engagement is objectively measured through our management Steering Wheel which ensures that we manage in a balanced way across our business. We are currently developing a new reputation scorecard and envisage replacing the CO_2 metric from 2014/15 with this new metric.

The balance of measures is illustrated in the chart below:

Balance of measures for short-term bonus (%)



Given their commercial sensitivity, we do not publish the details of targets in advance. However, targets are considered to be measurable and appropriately stretching. If they are achieved the Committee considers that value will have been added for shareholders. The Committee will provide an explanation of the rationale for the level of any bonus paid in the 2013/14 Directors' Remuneration Report to ensure transparency for shareholders regarding the level of reward paid in the context of performance delivered.

Clawback applies to deferred shares to allow the Committee to scale back deferred share awards prior to vesting (potentially to zero) in the event that results are materially misstated.

Long-term incentives

At a glance

- Maximum award of **275%** of salary for the CEO.
- Maximum award of **225%** of salary for the CFO.
- Shares vest in **three years** time subject to performance targets being met.
- Clawback provisions apply to PSP awards prior to vesting.

The ultimate goal of our strategy is to provide long-term sustainable returns for all of our shareholders. Tesco believes that the best way to deliver enhanced value is to grow earnings over the long term while maintaining a sustainable level of return on capital employed – in other words to keep growing the size of the business in an efficient way.

2013 Performance Share Plan awards will continue to be subject to performance against a matrix of stretching earnings growth targets and sustainable return on capital performance. The Committee believes that this combination of EPS growth and ROCE performance is strongly aligned with our strategic objectives and also reflects the drivers of long-term shareholder value. Achieving this performance will demonstrate the successful implementation of our strategy.

The economic environment, both in the UK and internationally, continues to be challenging. In January 2012, we announced our plans to reprioritise our Group investment. We have focused our investment on the customer experience, our multichannel offering and targeted consumer offers rather than new space expansion. We are starting to see positive returns from this strategy, with encouraging sales performance being achieved, particularly in the UK, however we are still at the start of our journey to 'Build a Better Tesco'. 2013/14 will see us continuing on this journey.

Directors' remuneration report continued

In light of our fundamentally different approach to space going forward, the Committee has determined that underlying EPS performance will be measured excluding property profits. The Committee also reviewed the performance targets for the 2013 PSP awards to ensure that they remained motivational for management while still representing long-term value creation for shareholders. Having carefully reviewed targets in the context of this objective and having discussed proposals with shareholders, the Committee determined that it was appropriate to lower the EPS target range and broaden the ROCE target range. Given this it is also proposed to reduce the proportion of the award that vests for meeting threshold performance from 20% of maximum opportunity to 0% and to reduce the level of vesting in the bottom right end of the matrix from 85% to 70%.

2013/14 award
The vesting matrix and targets for the three years to 2015/16 are illustrated below:

		% of initial award vesting		
		EPS growth p.a.		
		Threshold		Stretch
	Targets	3%		10%
ROCE	15%	45%	Straight-line vesting between these points	100%
	12%	0%		70%

Performance targets for awards granted in 2011 and 2012 are set out in a footnote to the Long Term Performance Share Plan table on page 64.

The Remuneration Committee reserves the right to make adjustments to ROCE to take account of acquisitions which were not envisaged when the targets were set but will only do so when the impact is material.

Clawback provisions apply to awards, allowing the Committee to scale back awards (potentially to zero) prior to vesting in the event that results are materially misstated.

Remuneration outcomes for Executive Directors in 2012/13

Our strategy to 'Build a Better Tesco' focuses on improving returns through reducing space growth, improving the performance of existing stores, and investing more in developing different ways to reach customers, for example, digital shopping.

Over the last year we have made a significant investment in the customer shopping trip, particularly in the UK, developing warmer, friendlier and more inviting stores. The feedback so far is that customers and colleagues like this focus on service and the format of the new stores.

Good trading over Christmas and New Year offers us encouragement about progress against our new strategic plans but we are at the start of our journey to 'Build a Better Tesco'. Our customer satisfaction rating in the UK has improved following through to an improvement in UK like-for-like sales, we have delivered strong growth in internet sales, reduced CO_2 output and improved our feedback from colleagues. However, this progress has yet to flow through into profitability and we have fallen short of where we need to be.

Against this performance background, the main aspects of remuneration practice for the year were as follows:

At a glance	
Base salary	• Salaries for Executive Directors were reviewed and increased by 2% with effect from 1 July 2012, in line with the general increase for other colleagues across the Group. • Next base salary review is with effect from 1 July 2013.
Annual bonus	• Despite good progress against a number of strategic operational measures and encouraging financial performance in the latter part of the year, profitability targets were not met and therefore no bonus will be paid to Executive Directors in respect of 2012/13.
Long-term incentives	• Our long-term rewards were assessed based on Group and International ROCE and EPS delivered over the past three years. • Challenging Group and International ROCE targets were not met and therefore PSP awards granted in 2010 will lapse. EPS growth targets were not met and therefore the share options granted in 2010 will also lapse.

The following provides further detail on these decisions.

Salaries for 2012/13
The base salaries of the Executive Directors following the 2012 review were:

Salaries 2012/13	
Base salary 1 July 2012	
CEO	£1,122,000
CFO	£869,040

Salary increases for Executive Directors last year were 2%, which was broadly the same as the increase for other Executives and colleagues throughout the Group. Salary increases over the last four years have been aligned with those of other colleagues.

Short-term bonus 2012/13

Performance measures and payout

Performance measures		Maximum opportunity	2012/13 payout
70% based on profitability	Underlying profit performance	• CEO – Maximum bonus opportunity of 250% of base salary • CFO – Maximum bonus opportunity of 200% of base salary	0% payout
30% based on strategic performance	• UK like-for-like sales growth • UK ROCE • UK customer satisfaction • Group internet sales • Group employee engagement • Group CO_2 reduction		

The following illustrates performance against targets for various objectives.

Measures		Performance			
		Below	Threshold	Target	Stretch
Profitability	Underlying profit	◆			
Strategic	UK like-for-like sales growth			◆	
	UK return on capital employed	◆			
	UK customer satisfaction			◆	
	Group internet sales			◆	
	Group CO_2 reduction				◆
	Group employee engagement				◆

Despite good progress against a number of strategic operational measures and encouraging financial performance in the latter part of the year, annual profitability targets were not met. There will therefore be no bonus paid in respect of 2012/13.

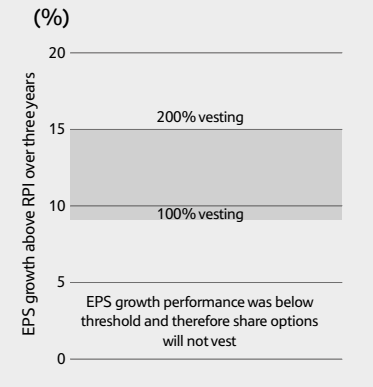
Long-term incentives

Vesting of 2010/11 to 2012/13 awards

Awards vesting in the year were made under the previous long-term incentive framework, comprising both share options and performance related shares. The performance conditions applying to these awards and achievement against these targets are summarised below:

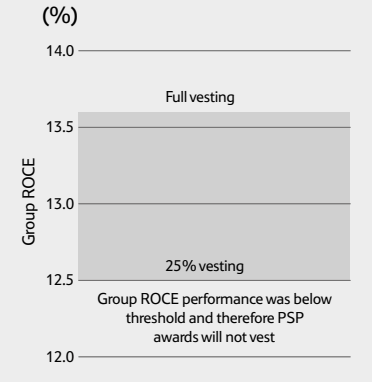
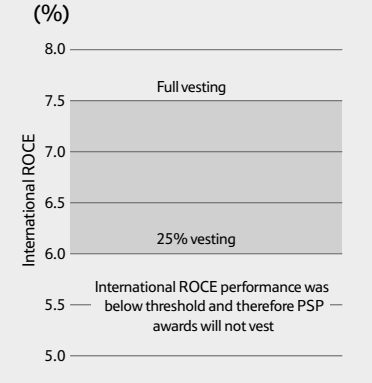
Performance measures and payout

	Maximum opportunity	2012/13 payout
Earnings per share • 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% over three years. • Granted in 2010/11. • Performance period ended 2012/13.	• Share options with a face value of 200% of salary at the date of grant.	0% of maximum opportunity vested.
• The increase in underlying diluted EPS above RPI over the three years from 2010/11 to 2012/13 was below threshold and therefore awards granted in 2010 will lapse.		



Directors' remuneration report continued

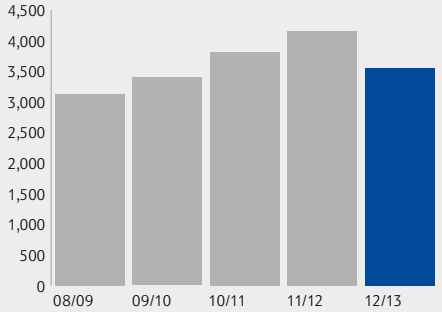
Performance measures and payout

	Maximum opportunity	2012/13 Payout	
Return on capital employed – Group • Maximum vesting for Group ROCE of 13.6% with threshold vesting (25%) for Group ROCE of 12.5%. • 75% based on performance against target with 25% based on the Committee assessment of the quality of ROCE performance. • Granted in 2010/11. • Performance period ended 2012/13.	• Maximum award of 100% of salary.	• Group reported ROCE for 2012/13 was 12.7%. This is measured on a continuing basis and excludes the US operations and one-off items in respect of the UK property write-down, goodwill impairments in Central Europe and the increased provision for PPI at Tesco Bank. The Remuneration Committee decided that underlying performance for incentive purposes should include these items and therefore adjusted ROCE performance down. This resulted in Group ROCE performance being below the threshold level of performance required and therefore 0% of the maximum the award will vest.	
Return on capital employed – International • Maximum vesting for International ROCE of 7.5% with threshold vesting for International ROCE of 6%. • 75% based on performance against target with 25% based on the Committee assessment of the quality of ROCE performance. • Granted in 2010/11. • Performance period ended 2012/13.	• Maximum award of 50% of salary.	• International ROCE for 2012/13 was below the level required for threshold levels of vesting and therefore 0% of the award will vest.	

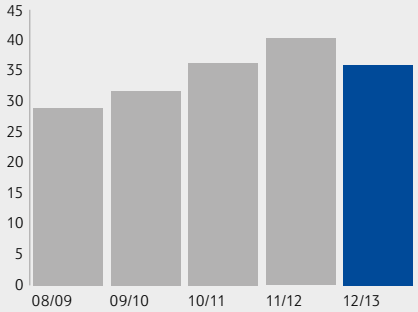
Aligning pay with performance

The following charts illustrate performance at Tesco against key performance indicators over the past five years.

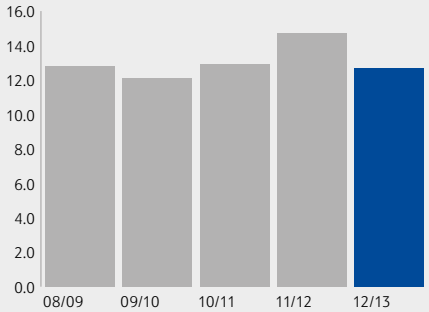
Underlying profit before tax – continuing operations
(£ million)



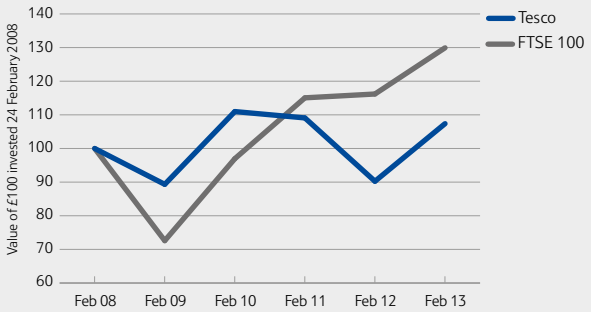
Underlying diluted earnings per share – continuing operations
(p)



Return on capital employed ('ROCE')
(%)



Total shareholder return ('TSR')
(£)

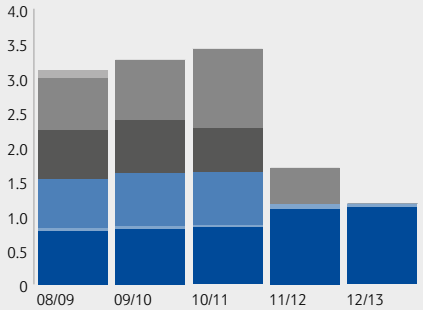


The graph above shows a comparison between TSR for the Company's shares for the five financial years to 23 February 2013, and the TSR for the companies comprising the FTSE 100 index over the same period. This index has been selected to provide an established and broad-based comparator group of retail and non-retail companies.

For further details in relation to numbers set out in the charts above please see the five year record on page 136.

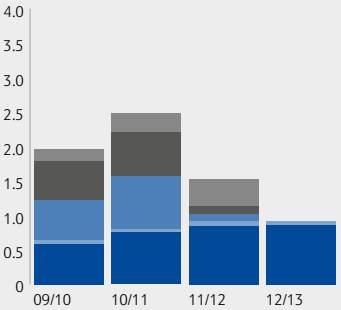
The following chart illustrates remuneration arrangements paid to Executive Directors over the last five years:

Philip Clarke
(£ million)

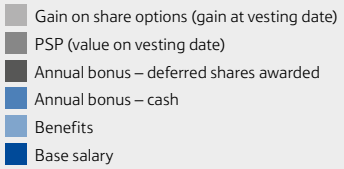


Philip Clarke was promoted to the role of CEO with effect from 1 March 2011.
He waived his entitlement to bonus for 2011/12.

Laurie McIlwee
(£ million)



Laurie McIlwee was promoted to the Board during 2008/09 and therefore the first full year shown above is for 2009/10.



Notes
1 **Base salary** – The base salary paid in the year, as reported in the emoluments table for the relevant financial year.
2 **Annual bonus (cash)** – The cash bonus in respect of annual performance in that financial year, as reported in the emoluments table for the relevant financial year.
3 **Annual bonus (deferred shares)** – The value of deferred bonus shares on award, as reported in the emoluments table for the relevant financial year.
4 **PSP** – The value of PSP awards that vested in respect of the performance period ending in the relevant financial year. Awards valued based on the share price at the date of vesting.
5 **Share options** – The 'gain' in relation to share options that vested in respect of the performance period ending in the relevant financial year. Gain calculated based on the share price at the date of vesting less the exercise price.
6 **Pension** – Pension is not included for the purpose of this analysis.

Directors' remuneration report continued

Other information

Leaving arrangements for Executive Directors
David Potts, Andrew Higginson, and Lucy Neville-Rolfe retired from the business after 68 years of combined service. Richard Brasher and Tim Mason left the business after 56 years of combined service. They are entitled to draw their accrued pension from the date of retirement. Accrued pensions are calculated based on length of service since joining the Company Pension Scheme and there has been no augmentation of pension benefits. Further details on pension benefits can be found in Table 2 (Pension) on page 60.

The liquidated damages paid to Richard Brasher and Tim Mason were determined in accordance with their contracts. Further details on these payments can be found in Table 1 (Directors' emoluments) on page 60. All unvested long-term incentive awards previously granted to Richard Brasher and Tim Mason will lapse. Further details can be found in Table 3 (Share Options) on page 61 and Table 5 (Performance Share Plan) on page 63.

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, provided that these appointments are not likely to lead to conflicts of interest, and retain the fees received. Executive Directors' biographies which include details of any outside appointments can be found on page 24 of this report.

Fees retained for any Non-executive Directorships held by individuals who were Executive Directors during the year are set out below.

Non-executive Directorships

Name	Company in which Non-executive Directorship held	Fees retained in 2012/13 £000
Andrew Higginson	BSkyB plc	79
Lucy Neville-Rolfe	The Carbon Trust plc	13
	ITV plc	49

Non-executive Directors

Non-executive Director responsibilities

	Sir Richard Broadbent	Gareth Bullock	Patrick Cescau	Stuart Chambers	Karen Cook	Ken Hanna	Ken Hydon	Deanna Oppenheimer	Jacqueline Tammenoms Bakker
Senior Independent Director			X						
Remuneration Committee	○			●	○	○			○
Nominations Committee	●		○	○		○			
Audit Committee		○	○			●	●		
Corporate Responsibility Committee	●		○					○	○

● Chairman of Committee
○ Member of Committee
X Senior Independent Director

Sir Richard Broadbent became a member of the Remuneration Committee on 5 October 2012. Ken Hanna took over from Ken Hydon as Chairman of the Audit Committee on 5 October 2012.

There were no increases to the Non-executive Director fee levels in the year. The current Non-executive Director fees are as follows:

Non-executive Director fees	
Basic fees	£70,000 p.a.
Additional fees:	
Senior Independent Director	£26,000 p.a.
Chairs of Audit and Remuneration Committees	£30,000 p.a.
Membership of Audit, Corporate Responsibility, Nominations and Remuneration Committees	£12,000 p.a. for each Committee

Gareth Bullock, Stuart Chambers and Deanna Oppenheimer were appointed to the Board of Tesco Personal Finance Group Limited in July 2012. They are paid a basic fee of £70,000 p.a. for this role and an additional fee for Committee membership of £12,000 p.a. in line with other members of the Board of Tesco Personal Finance Group Limited.

- **Letters of appointment** – 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.
- **Review of performance** – The Chairman meets with each Non-executive Director separately to review individual performance.
- **Reappointment policy** – In line with the UK Corporate Governance Code, all Non-executive Directors will submit themselves for re-election by shareholders every year at the Annual General Meeting. All Non-executive Director appointments can be terminated by either party without notice.
- **Policy for determining Non-executive Director remuneration** – The remuneration of the Non-executive Directors is determined by the Chairman and the Executive Committee after considering external market research and individual roles and responsibilities.

Chairman fees

The Remuneration Committee determines the Chairman's remuneration, having regard to time commitment of the role and remuneration arrangements for Chairmen of other companies of a similar size and complexity.

Sir Richard Broadbent's fee for his role as Non-executive Chairman is £625,000 p.a. and he has the benefit of a company car and driver. This fee was set at the time of his appointment and has not been increased since. He does not receive additional committee fees.

Corporate governance

Membership of the Remuneration Committee and attendance at meetings

	Number of possible meetings	Actual meetings attended
Stuart Chambers (Committee Chairman)	4	4
Sir Richard Broadbent	1	1
Karen Cook	4	4
Ken Hanna	4	4
Jacqueline Tammenoms Bakker	4	4

- The Committee also convenes on an ad hoc basis between formal meetings when necessary.
- The Directors' biographies can be found on pages 24 and 25 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.

Role of the Remuneration Committee

The Committee's key responsibilities are:

- To determine and recommend to the Board the remuneration policy for Executive Directors and the Chairman.
- To ensure the level and structure of remuneration is designed to attract, retain, and motivate the Executive Directors needed to run the Company while remaining appropriate in the context of the remuneration arrangements throughout the Group.
- To ensure that the structure of remuneration arrangements is aligned with the creation of sustainable returns for shareholders and that the level of reward received by Executives reflects the value delivered for shareholders.

As required by the Financial Conduct Authority ('FCA'), Tesco Bank has a separate independent remuneration committee. The Group Remuneration Committee is consulted on, and makes recommendations in relation to the remuneration arrangements for Tesco Bank colleagues, with the aim of encouraging consistency with Group remuneration policy, but it does not make decisions in relation to, or direct, how remuneration is managed within Tesco Bank.

Directors' remuneration report continued

Corporate governance continued

Remuneration Committee activities 2012/13

The following provides a summary of the Committee's activities during and shortly following the end of the financial year:

Meeting	Standing agenda items	Other agenda items
April 2012	• Review and agree payout outcomes for short-term annual bonus, long-term PSP and share option awards for 2011/12. • Approval of short-term bonus and long-term PSP targets for 2012/13 – 2014/15 awards. • Sign off 2011/12 Directors' Remuneration Report. • AGM communication plan.	• Professional development update on Department for Business, Innovation and Skills ('BIS') shareholder voting rights consultation.
June 2012	• Report from the Tesco Bank Remuneration Committee. • Update on shareholder feedback on Directors' Remuneration Report. • Review of Executive Director base salary and total compensation. • Determine base salaries with effect from 1 July 2012. • Consideration of the relationship between Executive Director and Executive Committee reward and reward at the level below this. • Benchmarking of Chairman's pay against market and agreeing his pay for 2012/13.	• Packages for new Executive Committee members. • Update on pension arrangements. • Response to BIS on shareholder rights consultation. • Confirmed leaving arrangements for Richard Brasher, Andrew Higginson and David Potts.
October 2012	• Review of remuneration trends and developments in best practice. • Review of remuneration strategy for 2013/14. • Review approach to 2012/13 Directors' Remuneration Report. • Follow-up from Committee effectiveness review. • Remuneration Committee bible.	• Response to BIS consultation. • Professional development update on Hermes discussion paper, FR lab project on single figure, Kay Review and Fidelity Principles of Ownership.
February 2013	• Review of performance against short-term annual bonus, long-term PSP and share option awards for 2012/13. • Review of remuneration strategy and policy for 2013/14 and review of shareholder feedback in relation to proposed changes. • Review of the first draft of the 2012/13 Directors' Remuneration Report. • Committee effectiveness review.	• Packages for new Executive Committee members. • Information provided on the Company's HR polices for the Committee to note. • Professional update on Association of British Insurers ('ABI'), ISS and NAPF guidelines, BIS response to the Kay Review, FR Lab project and NAPF stewardship code. • Confirmed leaving arrangements for Tim Mason and Lucy Neville-Rolfe.
April 2013 (Following year end)	• Review and agree payout outcomes for short-term annual bonus, long-term PSP and share option awards for 2012/13. • Approval of short-term bonus and long-term PSP targets for 2013/14 – 2015/16 awards. • Sign off 2012/13 Directors' Remuneration Report. • AGM communication plan.	
Number of meetings	• Normally four meetings per year. • Four meetings were held during 2012/13.	
External advisors	Deloitte LLP – Appointed by the Committee. Deloitte is one of the founding members of the Remuneration Consultants Code of Conduct and adheres to this Code in its dealings with the Committee. The Committee is satisfied that the advice provided by Deloitte is independent. Deloitte also provided unrelated advisory services in respect of corporate tax planning, technology consulting, risk management, share schemes, international taxation, corporate finance and treasury to the Group during the year.	
Internal advisors	Jonathan Lloyd, the Company Secretary, is Secretary to the Committee. Philip Clarke (Chief Executive of the Group) and Laurie McIlwee (Group CFO) attend meetings at the invitation of the Committee. They are not present when their own remuneration is being discussed. The Committee is supported by Alison Horner (Group Personnel Director), Drew Matthews (Group Remuneration Director) and Corporate Secretariat and Finance functions.	
Terms of reference	Available from the Company Secretary upon request or can be viewed at www.tescoplc.com.	

Shareholder voting
Tesco remains committed to ongoing shareholder dialogue and carefully reviews voting outcomes on remuneration matters. In the event of a substantial vote against a resolution in relation to Directors' remuneration, Tesco would seek to understand the reasons for any such vote, and would detail any actions in response to it in the Directors' Remuneration Report.

The following table sets out actual voting in respect of our last report in 2012:

% of votes	For	Against
2011/12 Directors' Remuneration Report (2012 AGM)	96.85%	3.15%

92,278,876 votes were withheld in relation to this resolution (c.1% of shareholders).

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. The current dilution usage of Executive plans is c.4% of shares in issue. Where shares are purchased in the market, these may be held by Tesco Employees Share Schemes Trustees Limited, in which case the voting rights relating to the shares are exercisable by the trustees in accordance with their fiduciary duties.

Change of control
Long-term incentive awards may vest or become exercisable before their normal vesting date in the event of a change of control of Tesco PLC subject to the rules of the applicable plans.

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 Conduct Authority derived from the UK Corporate Governance Code. The auditors' report, set out on page 71, covers the disclosures referred to in this report that are specified for audit by the Financial Conduct Authority.

The report has been drawn up in accordance with the UK Corporate Governance Code, Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the Financial Conduct Authority Listing Rules.

Details of Directors' emoluments and interests are set out on pages 60 to 66 of this report.

Approved by the Board on 1 May 2013

Stuart Chambers Chairman of the Remuneration Committee

Directors' remuneration report continued

Tables 1–9 are audited information

Table 1 Directors' emoluments

	Fixed emoluments		Performance related emoluments		Loss of office		
	Salary £000	Benefits[2] £000	Short-term cash £000	Short-term deferred shares £000	£000	Total 2012/13 £000	Total 2011/12 £000
Executive Directors							
Richard Brasher[1]	–	–	–	–	1,302	1,302	1,138
Philip Clarke	1,114	57	–	–	–	1,171	1,155
Andrew Higginson[1]	459	29	–	–		488	1,149
Tim Mason[1, 2]	691	400	–	–	1,682	2,773	1,634
Laurie McIlwee	863	54	–	–	–	917	1,137
Lucy Neville-Rolfe[1]	613	67	–	–	–	680	895
Non-executive Directors							
Sir Richard Broadbent	625	57	–	–	–	682	281
Gareth Bullock[3]	141	–	–	–	–	141	82
Patrick Cescau	132	–	–	–	–	132	120
Stuart Chambers[3]	171	–	–	–	–	171	100
Karen Cook[1]	82	–	–	–	–	82	82
Ken Hanna	112	–	–	–	–	112	94
Ken Hydon[1]	100	–	–	–	–	100	100
Deanna Oppenheimer[1, 3]	138	–	–	–	–	138	–
Jacqueline Tammenoms Bakker	94	–	–	–	–	94	82
Total	5,335	664	–	–	2,984	8,983	8,049

Appointments and leavers

1 The figures in this table are from the date of appointment or until the date that each Director ceased to be a Director of Tesco PLC, including any payments receivable in connection with the termination of qualifying services.

Sir David Reid retired from the Board in 2011/12. He continued to have the ongoing benefit of health insurance and the use of a company car and chauffeur for one year after leaving with a net value of £66,000. The gross value of these benefits is £132,000.

David Potts stepped down from the Board in 2011/12. He did not receive any payments or benefits outside his normal contractual arrangements but continued to be employed by the Group until 30 June 2012 and was paid a salary of £346,000 and received benefits of £15,000 during this period.

Richard Brasher stepped down from the Board on 15 March 2012. He did not receive any payments or benefits outside his normal contractual arrangements but continued to be employed by the Group until 31 July 2012 and was paid a salary of £386,000 and received benefits of £49,000 during this period. In line with his contract Richard Brasher was paid liquidated damages of £1,302,000 which are shown in the table above.

Andrew Higginson retired from the Board on 1 September 2012. He did not receive any payments or benefits outside his normal contractual arrangements.

Tim Mason stepped down from the Board on 5 December 2012. He did not receive any payments or benefits outside his normal contractual arrangements. In line with his contract Tim Mason was paid liquidated damages of £1,682,000 as shown in the table above.

Lucy Neville-Rolfe retired from the Board on 2 January 2013. She did not receive any payments or benefits outside her normal contractual arrangements.

Deanna Oppenheimer was appointed on 1 March 2012.

Karen Cook and Ken Hydon retired from the Board on 23 February 2013.

Benefits

2 Benefits are made up of car benefits, chauffeurs, disability and health insurance, staff discount and membership at clubs.

Tim Mason's benefits comprise a pro rata net expatriate allowance of £204,000, the gross value of which is £400,000. The Company will also pay repatriation costs up to a total value of £100,000.

NED fees

3 The figures in this table include fees paid to Gareth Bullock, Stuart Chambers and Deanna Oppenheimer in respect of their membership of the Board and Committees of Tesco Personal Finance Group Limited.

Table 2 Pension details of the Directors

	Age at 23 February 2013	Years of Company service	Total accrued pension at 23 February 2013[1, 2] £000	Increase in accrued pension during the year[3] £000	Increase in accrued pension during the year (net of inflation) (a)[4, 5] £000	Transfer value of (a) at 23 February 2013 (less Director's contributions) £000	Transfer value of total accrued pension at 25 February 2012 £000	Transfer value of total accrued pension at 23 February 2013[5] £000	Increase in transfer value (less Director's contributions) £000
Richard Brasher	51	26	421	10	6	90	6,551	6,844	293
Philip Clarke	52	38	600	28	13	182	9,727	10,738	1,011
Andrew Higginson	55	15	328	17	13	1,120	7,628	9,000	1,372
Tim Mason	55	31	379	20	11	843	9,005	10,363	1,358
Laurie McIlwee	50	12	326	33	26	351	4,464	5,217	753
Lucy Neville-Rolfe	60	15	329	24	18	373	6,811	7,796	985
David Potts	55	39	491	9	5	99	9,302	9,559	257

Notes

1 The accrued pension is that which would be paid annually on retirement at 60 based on service to 23 February 2013. Where an Executive Director has left or retired, the accrued pension is based on their pension date of leaving, or pension at retirement reduced for early retirement but before any pension is exchanged for cash respectively.

2 Some of the Executive Directors' benefits are payable from an unfunded pension arrangement. This is secured by a fixed and floating charge on a cash deposit.

3 The increase in accrued pension over the year is additional pension accrued during the year. Where Executive Directors have retired during the year, the increase in accrued pension is shown before any reduction for early retirement.

4 Inflation over the year has been allowed for using the September 2012 statutory CPI revaluation order of 2.5%. Where members retired/left during the year, a proportionate inflationary increase has been applied.

5 For members who left or retired during the year, the transfer values are calculated as at the date of leaving or retirement, using market conditions at 23 February 2013.

Table 3 Gains on share options and share options held by Directors and not exercised at 23 February 2013

Discretionary Share Option Plan (2004)

	Date of grant	Options at 25 February 2012	Options exercised in year	Options lapsed in year	Options at 23 February 2013	Exercise price (pence)	Date from which exercisable	Expiry date
Richard Brasher	08.05.2007	278,627	–	–	278,627	473.75	08.05.2010	08.05.2017
	12.05.2008	353,114	–	–	353,114	427.00	12.05.2011	12.05.2018
	06.05.2009	467,848	–	–	467,848	338.40	06.05.2012	06.05.2019
	07.05.2010	386,850	–	–	386,850	419.80	07.05.2013	07.05.2020
		1,486,439	–	–	1,486,439			
Philip Clarke	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
	08.05.2007	298,844	–	–	298,844	473.75	08.05.2010	08.05.2017
	12.05.2008	353,114	–	–	353,114	427.00	12.05.2011	12.05.2018
	06.05.2009	467,848	–	–	467,848	338.40	06.05.2012	06.05.2019
	07.05.2010	386,850	–	–	386,850	419.80	07.05.2013	07.05.2020
		2,291,408	–	–	2,291,408			
Andrew Higginson	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
	08.05.2007	298,844	–	–	298,844	473.75	08.05.2010	08.05.2017
	12.05.2008	353,114	–	–	353,114	427.00	12.05.2011	12.05.2018
	06.05.2009	467,848	–	–	467,848	338.40	06.05.2012	06.05.2019
	07.05.2010	386,850	–	–	386,850	419.80	07.05.2013	07.05.2020
		2,291,408	–	–	2,291,408			
Tim Mason	10.08.2007	333,319	–	–	333,319	424.75	10.08.2010	10.08.2017
	12.05.2008	353,114	–	–	353,114	427.00	12.05.2011	12.05.2018
	06.05.2009	467,848	–	–	467,848	338.40	06.05.2012	06.05.2019
	07.05.2010	386,850	–	386,850	–	419.80	–	–
		1,541,131	–	386,850	1,154,281			
Laurie McIlwee	08.05.2007	77,192	–	–	77,192	473.75	08.05.2010	08.05.2017
	12.05.2008	91,335	–	–	91,335	427.00	12.05.2011	12.05.2018
	06.05.2009	325,059	–	–	325,059	338.40	06.05.2012	06.05.2019
	07.05.2010	290,138	–	–	290,138	419.80	07.05.2013	07.05.2020
		783,724	–	–	783,724			
Lucy Neville-Rolfe	08.05.2007	189,973	–	–	189,973	473.75	08.05.2010	08.05.2017
	12.05.2008	231,850	–	–	231,850	427.00	12.05.2011	12.05.2018
	06.05.2009	327,494	–	–	327,494	338.40	06.05.2012	06.05.2019
	07.05.2010	290,138	–	–	290,138	419.80	07.05.2013	07.05.2020
		1,039,455	–	–	1,039,455			
Total		9,433,565	–	386,850	9,046,715			

Discretionary Share Option Plan

- Executive share options are subject to performance conditions measured over three years. The first 100% is subject to the achievement of underlying diluted EPS growth of at least RPI plus 9% over three years and the balance vests for achieving growth of at least RPI plus 15%.
- Executives have until the tenth anniversary of the date of grant to exercise their options.
- No options have been granted to Executive Directors under the Discretionary Share Option Plan since 2010. Maximum awards of up to 200% of base salary can be granted under the Discretionary Share Option Plan. However, it is not intended that this plan will be used and awards will only be granted in exceptional circumstances.

Performance against targets

- EPS growth for the period 2009/10 to 2011/12 exceeded RPI by 17.1% and therefore the share options awarded in 2009 vested in full on 6 May 2012.
- EPS growth for the period 2010/11 to 2012/13 did not meet the performance target and therefore the share options awarded in 2010 will lapse on 7 May 2013.

Market prices of Tesco PLC shares

- The share price as at 23 February 2013 was 372.25p. The share price during the 52 weeks to 23 February 2013 ranged from 297.1p to 374.4p.

Leaving provisions

- Where a Director ceased to be a Director of Tesco PLC in the year, the figures in this table are at the date on which they ceased to be a Director of Tesco PLC.
- Richard Brasher stepped down from the Board on 15 March 2012 and left the Company on 31 July 2012. His vested awards may be exercised for one year after leaving. His unvested award (2010) will lapse on 7 May 2013 as the performance conditions have not been met.
- Andrew Higginson retired from the Board on 1 September 2012. His vested awards may be exercised for three years after leaving. His unvested award (2010) will lapse on 7 May 2013 as the performance conditions have not been met.
- Tim Mason stepped down from the Board on 5 December 2012. His vested awards may be exercised for one year after leaving. His unvested award (2010) lapsed on leaving.
- Lucy Neville-Rolfe retired from the Board on 2 January 2013. Her vested awards may be exercised for three years after leaving. Her unvested award (2010) will lapse on 7 May 2013 as the performance conditions have not been met.

Directors' remuneration report continued

Table 4 Gains on share options and share options held by Directors and not exercised at 23 February 2013

Savings-related share option scheme (1981)

	Date of grant	As at 25 February 2012	Options granted in year	Options exercised in year	Options lapsed in year	As at 23 February 2013	Exercise price (pence)	Value realisable 2012/13 £000	Value realisable 2011/12 £000
Richard Brasher	07.11.2007	819	–	–	–	819	410.0	–	–
	05.11.2008	1,077	–	–	–	1,077	311.0	–	–
	11.11.2009	948	–	–	–	948	328.0	–	–
	10.11.2010	788	–	–	–	788	386.0	–	–
	16.11.2011	824	–	–	–	824	364.0	–	–
		4,456	–	–	–	4,456		–	1
Philip Clarke	07.11.2007	819	–	–	–	819	410.0	–	–
	05.11.2008	1,077	–	–	–	1,077	311.0	–	–
	11.11.2009	948	–	–	–	948	328.0	–	–
	10.11.2010	788	–	–	–	788	386.0	–	–
	16.11.2011	824	–	–	–	824	364.0	–	–
	07.11.2012	–	1,063	–	–	1,063	282.0	–	–
		4,456	1,063	–	–	5,519		–	1
Andrew Higginson	07.11.2007	819	–	–	–	819	410.0	–	–
	05.11.2008	1,077	–	–	–	1,077	311.0	–	–
	11.11.2009	948	–	–	948	–	328.0	–	–
	10.11.2010	788	–	–	788	–	386.0	–	–
		3,632	–	–	1,736	1,896		–	1
Tim Mason	07.11.2007	819	–	–	819	–	410.0	–	–
	05.11.2008	1,077	–	–	1,077	–	311.0	–	–
	11.11.2009	948	–	–	948	–	328.0	–	–
	10.11.2010	788	–	–	788	–	386.0	–	–
	16.11.2011	824	–	–	824	–	364.0	–	–
	07.11.2012	–	1,063	–	1,063	–	282.0	–	–
		4,456	1,063	–	5,519	–		–	1
Laurie McIlwee	07.11.2007	819	–	–	–	819	410.0	–	–
	05.11.2008	1,077	–	–	–	1,077	311.0	–	–
	11.11.2009	948	–	–	–	948	328.0	–	–
	10.11.2010	788	–	–	–	788	386.0	–	–
	16.11.2011	824	–	–	–	824	364.0	–	–
	07.11.2012	–	1,063	–	–	1,063	282.0	–	–
		4,456	1,063	–	–	5,519		–	–
Lucy Neville-Rolfe	07.11.2007	819	–	–	–	819	410.0	–	–
	05.11.2008	1,077	–	–	–	1,077	311.0	–	–
	11.11.2009	948	–	–	–	948	328.0	–	–
	10.11.2010	788	–	–	–	788	386.0	–	–
	16.11.2011	824	–	–	–	824	364.0	–	–
		4,456	–	–	–	4,456		–	1
Total		25,912	3,189	–	7,255	21,846			

Save As You Earn Scheme
- Save As You Earn is an HMRC approved all-employee 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.

Option exercises and lapses
- Options are not subject to performance conditions. All options are exercisable from 1 February in the year which is six years from the year of grant. All options expire six months from their exercise date (i.e. on 1 August of the relevant year).

Leaving provisions
- Where a Director ceased to be a Director of Tesco PLC in the year, the figures in this table are at the date on which they ceased to be a Director of Tesco PLC.
- Richard Brasher stepped down from the Board on 15 March 2012. His options lapsed on leaving the Company on 31 July 2012.
- Andrew Higginson retired from the Board on 1 September 2012. His options granted in 2009 and 2010 lapsed on leaving the Company on 1 September 2012. His 2007 and 2008 options may be exercised with the savings available at the point of leaving.
- Tim Mason stepped down from the Board on 5 December 2012. All his options lapsed on leaving the Company on 5 December 2012.
- Lucy Neville-Rolfe retired from the Board on 2 January 2013. Her options may be exercised with the savings available at the point of leaving.

Table 5 Long Term Performance Share Plan

	Date of award/ grant	Share price on award date (pence)	As at 25 February 2012	Shares awarded/ options granted in year	Shares exercised/ released in year	Shares lapsed	As at 23 February 2013	Date of exercise/ release	Share price on exercise/ release (pence)	Value realisable £000	Date of release/date from which exercisable	Expiry date
Richard Brasher	14.11.2007	471.10	229,221	–	–	–	229,221	–	–	–	14.07.2010	14.11.2017
	08.07.2008	353.76	284,841	–	–	–	284,841	–	–	–	08.07.2011	08.07.2018
	15.10.2009	374.00	354,765	–	–	–	354,765	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	302,671	–	–	–	302,671	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	476,767	–	–	–	476,767	–	–	–	11.07.2014	11.07.2021
			1,648,265	–	–	–	1,648,265					
Philip Clarke	08.07.2008	353.76	284,841	14,998	–	–	299,839	–	–	–	08.07.2011	08.07.2018
	15.10.2009	374.00	354,765	15,420	–	196,658	173,527	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	302,671	15,936	–	–	318,607	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	752,331	39,615	–	–	791,946	–	–	–	11.07.2014	11.07.2021
	30.07.2012	317.10	–	989,162	–	–	989,162	–	–	–	30.07.2015	30.07.2022
			1,694,608	1,075,131	–	196,658	2,573,081					
Andrew Higginson	08.07.2008	353.76	284,841	10,110	–	–	294,951	–	–	–	08.07.2011	08.07.2018
	15.10.2009	374.00	354,765	12,592	–	196,658	170,699	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	302,671	10,743	–	–	313,414	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	476,767	16,924	–	–	493,691	–	–	–	11.07.2014	11.07.2021
	30.07.2012	317.10	–	604,541	–	604,541	–	–	–	–	30.07.2015	30.07.2022
			1,419,044	654,910	–	801,199	1,272,755					
Tim Mason	15.10.2009	374.00	236,511	8,395	170,699	74,207	–	16.07.12	315.475	539	–	–
	14.10.2010	433.90	201,781	7,162	–	208,943	–	–	–	–	–	–
	11.07.2011	407.19	476,767	16,924	–	493,691	–	–	–	–	–	–
	30.07.2012	317.10	–	616,632	–	616,632	–	–	–	–	–	–
			915,059	649,113	170,699	1,393,473	–					
Laurie McIlwee	15.10.2009	374.00	266,072	11,565	–	147,493	130,144	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	302,671	15,936	–	–	318,607	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	476,767	25,105	–	–	501,872	–	–	–	11.07.2014	11.07.2021
	30.07.2012	317.10	–	626,851	–	–	626,851	–	–	–	30.07.2015	30.07.2022
			1,045,510	679,457	–	147,493	1,577,474					
Lucy Neville-Rolfe	14.11.2007	471.10	150,499	7,922	–	–	158,421	–	–	–	14.07.2010	14.11.2017
	08.07.2008	353.76	199,389	10,498	–	–	209,887	–	–	–	08.07.2011	08.07.2018
	15.10.2009	374.00	266,072	11,565	–	147,493	130,144	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	227,002	11,952	–	–	238,954	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	357,575	18,829	–	–	376,404	–	–	–	11.07.2014	11.07.2021
	30.07.2012	317.10	–	470,138	–	470,138	–	–	–	–	30.07.2015	30.07.2022
			1,200,537	530,904	–	617,631	1,113,810					
Total			7,923,023	3,589,515	170,699	3,156,454	8,185,385					

Performance Share Plan

- All awards except those awarded to Tim Mason have been made in the form of nil cost options. Tim Mason's awards have been made in the form of unfunded promises to deliver shares.
- Awards are increased to reflect dividend equivalents as each dividend is paid.

Performance against targets

- Awards made before 2011 are subject to performance conditions based on ROCE targets.
- As reported in last year's report, 69.7% of the 2009 awards based on Group ROCE performance vested on 15 July 2012. The balance of the Group award and whole award subject to performance against International ROCE targets lapsed on 15 July 2012.
- For PSP awards granted on 14 October 2010 the Group ROCE target for the first 75% was 12.5% (25% vesting) to 13.6% (100% vesting). The International ROCE target for the first 75% was 6.0% (25% vesting) to 7.5% (100% vesting). The remaining 25% of each portion of the award vests subject to the Committee's assessment of the quality of ROCE performance. Group and International ROCE performance was below the level required for threshold levels of vesting and therefore no portion of these awards will vest.

Directors' remuneration report continued

Table 5 Long Term Performance Share Plan continued

PSP targets 2011 and 2012

The targets for the awards granted on 11 July 2011 and 30 July 2012 are set out below. Performance against these targets will be measured at the end of the 2013/14 and 2014/15 financial years.

		% of initial award vesting		
		EPS growth p.a.		
2011	Targets for 2011 awards	Threshold	Target	Stretch
		7%	10%	12%
ROCE	14.6%	45%	75%	100%
	13.6%	20%	60%	85%

		% of initial award vesting		
		EPS growth p.a.		
2012	Targets for 2012 awards	Threshold		Stretch
		5%		12%
ROCE	14.6%	45%	Straight-line vesting between these points	100%
	13.6%	20%		85%

Leaving provisions

- Where a Director ceased to be a Director of Tesco PLC in the year, the figures in this table are at the date on which they ceased to be a Director of Tesco PLC.
- No new awards were made to former Directors in the year. In line with the plan rules, existing awards held by former Directors will vest subject to performance in the same proportion as the other Directors' awards above.
- Richard Brasher stepped down from the Board on 15 March 2012. His last award (2011) lapsed on leaving the Company on 31 July 2012. His vested awards (2007, 2008 and 2009) may be exercised for one year after leaving. His 2010 award will lapse on 14 July 2013 as the performance targets were not met.
- Andrew Higginson retired from the Board on 1 September 2012. His last award (2012) lapsed on leaving. His vested awards may be exercised for three years after leaving. His 2010 award will lapse on 14 July 2013 as the performance targets were not met. His 2011 award will vest on 11 July 2014 subject to the achievement of performance conditions and any vesting portion will be available for exercise for one year.
- Tim Mason stepped down from the Board on 5 December 2012. All of his awards lapsed on leaving the Company on 5 December 2012.
- Lucy Neville-Rolfe retired from the Board on 2 January 2013. Her last award (2012) lapsed on leaving. Her vested awards may be exercised for three years after leaving. Her 2010 award will lapse on 14 July 2013 as the performance targets were not met. Her 2011 award will vest on 11 July 2014 subject to the achievement of performance conditions and any vesting portion will be available for exercise for one year.

Table 6 Group New Business Incentive Plan

	Date of award/ grant	As at 25 February 2012	Shares awarded in year	Options exercised/ shares released in year	As at 23 February 2013	Date from which exercisable	Expiry date
Sir Terry Leahy	14.11.2007	2,886,738	152,010	–	3,038,748	Four tranches 2011–2014	14.11.2017

Group New Business Incentive Plan

- The award 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. The former Group CEO, Sir Terry Leahy, retired on 2 March 2011 and his interest in these awards will continue until their normal vesting dates.
- Awards are increased to reflect dividends as each dividend is paid. These will vest in line with the underlying award based on performance.

Performance against targets

- The vesting of the award made to Sir Terry Leahy under this plan is conditional on achievement against Group and International ROCE performance conditions. Once performance against the Group and International targets has been determined, the extent to which the award made under this plan is capable of vesting will be conditional on the financial performance of the US business venture. The targets are set out below.
- The third tranche (2012/13) of the award was subject to testing against US Return on Capital Employed ('ROCE') and Earnings Before Interest and Tax ('EBIT') targets and the targets were not met. The 2010/11 and 2011/12 targets were also not met so no part of this award has vested to date. The next and last assessment of performance will be in respect of 2013/14. It is unlikely that any portion of the award will vest.

Targets

- The extent to which the awards will vest is conditional on the financial performance of the US business based on the achievement of stretching EBIT and ROCE targets. A percentage of the EBIT of the US business for the relevant years may be allocated to an EBIT pool which will be capped at 10% in any one year. The portion of the award which may vest will be determined by reference to the value of the EBIT pool as well as the ROCE targets.

Summary of US business performance conditions

ROCE hurdle	2010/11	2011/12	2012/13	2013/14
Maximum	6% ROCE	9% ROCE	11% ROCE	12% ROCE
Target performance	4% ROCE	6% ROCE	8% ROCE	10% ROCE
Vesting percentage (% of maximum award)				
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%

Following a strategic review, the Group has decided to dispose of its US operations. It is considered that it is highly unlikely that the final performance test for the Group New Business Incentive Plan will be met and therefore it is expected that this award will lapse in full.

Table 7 Executive Incentive Plan

	Date of award/ grant	Share price on award (pence)	As at 25 February 2012	Shares awarded/ options granted	Shares released/ options exercised	As at 23 February 2013	Share price on exercise/ release (pence)	Value realisable £000	Date of release/date from which exercisable
Richard Brasher	19.05.2009	351.16	134,584	–	–	134,584	–	–	19.05.2012
	22.06.2010	388.05	206,987	–	–	206,987	–	–	22.05.2013
	27.05.2011	411.75	155,518	–	–	155,518	–	–	13.05.2014
			497,089	–	–	497,089	–	–	
Philip Clarke	19.05.2009	351.16	134,584	4,777	139,361	–	311.125	434	19.05.2012
	22.06.2010	388.05	206,987	10,899	–	217,886	–	–	22.05.2013
	27.05.2011	411.75	155,518	8,188	–	163,706	–	–	13.05.2014
			497,089	23,864	139,361	381,592	–	–	
Andrew Higginson	19.05.2009	351.16	134,584	4,777	139,361	–	311.125	434	19.05.2012
	22.06.2010	388.05	206,987	7,347	–	214,334	–	–	22.05.2013
	27.05.2011	411.75	155,518	5,520	–	161,038	–	–	13.05.2014
	25.05.2012	308.25	–	37,424	–	37,424	–	–	25.05.2015
			497,089	55,068	139,361	412,796	–	–	
Tim Mason	19.05.2009	351.16	276,849	9,827	286,676	–	311.125	892	19.05.2012
	22.06.2010	388.05	307,367	10,910	–	318,277	–	–	22.05.2013
	27.05.2011	411.75	197,979	7,027	–	205,006	–	–	13.05.2014
	25.05.2012	308.25	–	37,424	–	37,424	–	–	25.05.2015
			782,195	65,188	286,676	560,707	–	–	
Laurie McIlwee	22.06.2010	388.05	155,240	8,174	–	163,414	–	–	22.05.2013
	27.05.2011	411.75	155,518	8,188	–	163,706	–	–	13.05.2014
	25.05.2012	308.25	–	38,044	–	38,044	–	–	25.05.2015
			310,758	54,406	–	365,164	–	–	
Lucy Neville-Rolfe	19.05.2009	351.16	94,207	3,344	97,551	–	311.125	304	19.05.2012
	22.06.2010	388.05	155,240	8,174	–	163,414	–	–	22.05.2013
	27.05.2011	411.75	116,638	6,141	–	122,779	–	–	13.05.2014
	25.05.2012	308.25	–	28,533	–	28,533	–	–	25.05.2015
			366,085	46,192	97,551	314,726	–	–	
Total			2,950,305	244,718	662,949	2,532,074			

Executive Incentive Plan

- Awards are normally made in the form of nil cost options with the exception of Tim Mason's awards which are in the form of an unfunded promise over shares. Awards made in 2009 were in the form of restricted shares.
- Awards are increased to reflect dividend equivalents as each dividend is paid.
- No options lapsed in the year.

Leaving provisions

- Where a Director ceased to be a Director of Tesco PLC in the year, the figures in this table are at the date on which they ceased to be a Director of Tesco PLC.
- As reported in last year's report, Richard Brasher and David Potts were awarded deferred share bonuses of 13.54% of salary on 25 May 2012 in respect of the performance against targets in 2011/12.
- Richard Brasher stepped down from the Board on 15 March 2012. His awards may be exercised for one year from the date that the award is due to become exercisable, three years after the date of grant.
- Andrew Higginson retired from the Board on 1 September 2012. His awards may be exercised for one year after leaving the Company on 1 September 2012.
- Tim Mason stepped down from the Board on 5 December 2012. His awards will be released at the date that the award is due to become available, three years after the date of grant.
- Lucy Neville-Rolfe retired from the Board on 2 January 2013. Her awards may be exercised for one year after leaving the Company on 2 January 2013.

Directors' remuneration report continued

Table 8 Directors' interests in the Long Term Incentive Plan

	Award date	Price on award (pence)	Number of shares as at 25 February 2012	Shares awarded	Shares released	Number of shares as at 23 February 2013	Share price on release (pence)	Value realisable £000	Release date
Laurie McIlwee	20.05.09	356.05	50,596	1,612	52,208	–	311.125	162	20.05.12

- These shares were awarded to Laurie McIlwee under the senior management bonus scheme before he joined the Board.

Table 9 Disclosable interests of the Directors, including family interests

	23 February 2013 (or at date of retirement/resignation if earlier)		25 February 2012 (or on appointment if later)	
	Ordinary shares[1]	Options to acquire ordinary shares[2]	Ordinary shares[1]	Options to acquire ordinary shares[2]
Executive Directors				
Richard Brasher[3]	1,258,619	3,501,665	1,258,585	3,501,665
Philip Clarke	1,829,467	5,251,600	1,832,007	4,352,977
Andrew Higginson[3]	572,174	3,978,855	707,081	4,076,589
Tim Mason[3]	1,082,208	1,154,281	1,975,704	1,545,587
Laurie McIlwee	76,390	2,731,881	75,506	2,144,448
Lucy Neville-Rolfe[3]	456,466	2,472,447	458,036	2,516,326
Non-executive Directors				
Sir Richard Broadbent	53,996	–	53,996	–
Gareth Bullock	–	–	–	–
Patrick Cescau	18,340	–	18,340	–
Stuart Chambers	25,000	–	5,500	–
Karen Cook[3]	–	–	–	–
Ken Hanna	25,000	–	25,000	–
Ken Hydon[3]	60,093	–	60,093	–
Deanna Oppenheimer[3]	52,500	–	–	–
Jacqueline Tammenoms Bakker	16,472	–	16,472	–
Total	5,526,725	19,090,729	6,486,320	18,137,592

Ordinary shares

1 Ordinary shares shown in this table include shares awarded to Tim Mason under the Performance Share Plan shown in Table 5 which are subject to future performance conditions, shares held by Tim Mason under the Executive Incentive Plan shown in Table 7 which are subject to a holding period, shares held under the Long Term Incentive Plan shown in Table 8 which are subject to a holding period and shares held under the all-employee Share Incentive Plan which are subject to a holding period. Deanna Oppenheimer holds 17,500 Tesco American Depositary Receipts which is equivalent to 52,500 Tesco ordinary shares of 5p.

Between 23 February 2013 and 30 April 2013, 88 shares were purchased by Executive Directors as part of the Buy As You Earn scheme. Buy As You Earn is an HMRC approved share purchase scheme under which employees invest up to a limit of £110 on a four-weekly basis to buy shares in Tesco PLC at the market value. On 25 April 2013, Olivia Garfield, a Non-executive Director appointed on 1 April 2013, purchased 4,086 ordinary shares. There have been no other changes in Directors' Interests in Tesco PLC shares at the date of the publication of this report.

Options over shares

2 Options to acquire ordinary shares shown in this table comprise options held under the Discretionary Share Option Plan shown in Table 3, Save As You Earn scheme shown in Table 4 and nil cost options held under the Performance Share Plan and Executive Incentive Plan shown in Tables 5 and 7 respectively.

Appointments and leavers

3 The figures in this table are from the date of appointment or until the date that each Director ceased to be a Director of Tesco PLC.
Richard Brasher stepped down from the Board on 15 March 2012.
Andrew Higginson retired from the Board on 1 September 2012.
Tim Mason stepped down from the Board on 5 December 2012.
Lucy Neville-Rolfe retired from the Board on 2 January 2013.
Deanna Oppenheimer was appointed on 1 March 2012.
Karen Cook and Ken Hydon retired from the Board on 23 February 2013.

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, Malaysia, Poland, Slovakia, South Korea, Thailand and Turkey. The Group also provides retail banking and insurance services through its subsidiary, Tesco Bank. Following a strategic review, the Group has decided to dispose of its US operations.

Group results Group revenue (excluding VAT) rose by £0.9 billion to £64.8 billion, representing an increase of 1.4%. Group profit before tax decreased by £2,078 million to £1,960 million. Profit for the year was £120 million, of which £124 million was attributable to equity holders of the parent company.

Dividends The Directors recommend the payment of a final dividend of 10.13p per ordinary share, to be paid on 5 July 2013 to members on the Register at the close of business on 26 April 2013. Together with the interim dividend of 4.63p per ordinary share paid in December 2012, the full year dividend will be maintained at 14.76p per ordinary share (2011/12: 14.76p).

Fixed assets Capital expenditure (excluding business combinations) amounted to £3.0 billion compared with £3.7 billion the previous year.

In the Directors' opinion, the properties of the Group have an open market value well in excess of the book value of £22.9 billion which has been included in these financial statements.

Share capital, control of the Company and significant agreements 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 27 on page 120. No shareholder holds securities carrying special rights with regards to control of the Company. There are no restrictions on voting rights or the transfer of securities in the Company and the Company is not aware of any agreements between holders of securities that result in such restrictions.

The Company was authorised by shareholders at the 2012 AGM to purchase its own shares in the market up to a maximum of approximately 10% of its issued share capital. No shares were purchased under that authority during the financial year. The Company is seeking to renew the authority 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, Tesco Ireland Share Bonus Scheme Trust and Tesco Employee Share 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.

While the Company has contractual and other arrangements with numerous third parties in support of its business activities, none of the arrangements is individually regarded as essential to the Company's business.

Company's shareholders The Company has been notified of the following significant holdings of voting rights in its shares as at 23 February 2013 and as at the date of this report:

	% of issued share capital as at 23 February 2013	% of issued share capital as at the date of this report
Berkshire Hathaway Inc.	5.08	5.08
Norges Bank	5.00	5.00
Blackrock, Inc.	4.96	4.96
Legal & General Investment Management Limited	3.99	3.99

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: Richard Brasher; Sir Richard Broadbent; Gareth Bullock; Patrick Cescau; Stuart Chambers; Philip Clarke; Karen Cook; Ken Hanna; Andrew Higginson; Ken Hydon; Tim Mason; Laurie McIlwee; Dame Lucy Neville-Rolfe CMG; Deanna Oppenheimer; David Potts; and Jacqueline Tammenoms Bakker. The biographical details of the present Directors are set out on pages 24 and 25 of this Annual Report.

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 44 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 We know that our colleagues are key to the delivery of our Core Purpose: We make what matters better, together. We regularly listen and respond to our colleagues through various channels to ensure that we know how they are feeling and they are involved in key decisions that affect them. Internal communications are designed to ensure that employees are well informed about the business of the Group.

Everyone is welcome at Tesco and this is essential to how we do business. Our Values underpin the development of fair and inclusive policies to encourage engagement and drive inspiring behaviours so that colleagues can be their best and contribute to really make a difference. We are committed to improving the skills, knowledge and well-being of our colleagues. The Group's selection, training, development and promotion policies ensure equal opportunities for all colleagues 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 of our decisions are based on merit.

Colleagues are encouraged to become involved in the financial performance of the Group through a variety of voluntary share schemes.

General information continued

Political and charitable donations Cash donations to charities in the financial year amounted to £22,185,062 (2011/12: £25,646,209). Total contributions to community projects including cash, cause-related marketing, gifts-in-kind, staff time and management costs amounted to £78,152,071 (2011/12: £74,588,818).

There were no political donations in the financial year (2011/12: £nil). During the year, the Group made contributions of £33,583 (2011/12: £28,137) in the form of sponsorship for political events: Conservative Party £11,210; Labour Party £11,452; Liberal Democrat Party £6,921; Scottish National Party £4,000.

Supplier payment policy Tesco PLC is a signatory to the Prompt Payment Code in the UK. More information about the Code can be found at www.promptpaymentcode.org.uk. Payment terms and conditions are agreed with suppliers in advance and the Group pays its creditors in accordance with those terms. Payment terms vary according to the type of product and territory in which the suppliers operate. Tesco PLC is a holding company and therefore has no trade creditors on its Balance Sheet.

Compliance with the Groceries (Supply Chain Practices) Market Investigation Order 2009 and the Groceries Supply Code of Practice ('Code') The Code places obligations on grocery retailers with a turnover greater than £1 billion to maintain a Code compliance programme, which includes training staff and providing information to the Office of Fair Trading. In addition, the Code sets out a number of provisions which relate to different aspects of the relationship between a retailer and supplier.

We are committed to treating our suppliers fairly and work in collaboration with them wherever possible. It is in our nature to treat compliance with the Code very seriously.

We have in place a Code Compliance Officer ('CCO') supported by a compliance team including a dedicated Code auditor. We have an audit plan and our approach enables us to identify any gaps in our processes so they can be quickly fixed.

We also have in place an ongoing compliance training programme for our buying teams, and a comprehensive training course is provided for relevant new starters. We identified some non-compliance with the Code this year relating to the training of some new starters within the period mandated by the Code. We responded immediately by ensuring that all relevant personnel were trained by year end and further strengthened internal processes to ensure that all starters are trained within Code timelines. Annual refresher training is provided via a bespoke e-learning programme and our training processes in this regard were fully Code-compliant.

All alleged breaches of the Code raised by suppliers this year have been dealt with internally. We have had one instance of a supplier initiating the Dispute Resolution Procedure set out in the Code. This dispute was resolved quickly.

The CCO regularly reports to the Audit Committee, which considers that it retains effective oversight of our compliance with the Code.

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.

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

Auditors A resolution to reappoint PricewaterhouseCoopers LLP as auditors of the Company and the Group will be proposed at the 2013 AGM.

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.

By order of the Board

Jonathan Lloyd Company Secretary
1 May 2013

Financial statements

This section contains our financial statements, as well as our five year record, financial calendar and glossary of financial KPI definitions.

70 Statement of Directors' responsibilities
71 Independent auditors' report to the members of Tesco PLC
72 Group income statement
73 Group statement of comprehensive income
74 Group balance sheet
75 Group statement of changes in equity
76 Group cash flow statement
76 Reconciliation of net cash flow to movement in net debt note
77 Notes to the Group financial statements
126 Tesco PLC – Parent Company balance sheet
127 Notes to the Parent Company financial statements
135 Independent auditors' report to the members of Tesco PLC
136 Five year record
IBC Financial calendar
IBC Glossary

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 Group and the Company 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 ('IFRS') 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, whose names and functions are set out on pages 24 and 25 confirm that, to the best of their knowledge:

- the Group financial statements, which have been prepared in accordance with IFRS, as endorsed by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
- the Business Review contained within this document includes a fair review of the development and performance of the business and the position of the Group, as well as a description of the principal risks and uncertainties that it faces.

The Directors are responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Group and the Company 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 Directors are responsible for the maintenance and integrity of the Company's 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 financial year ended 23 February 2013 which comprise the Group income statement, the Group statement of comprehensive income, the Group balance sheet, the Group statement of changes in equity, the Group cash flow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRS') 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 70, 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 and express an opinion on 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. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 23 February 2013 and of its profit and cash flows for the financial year then ended;
- have been properly prepared in accordance with IFRS 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 matter prescribed by the Companies Act 2006
In our opinion the information given in the Report of the Directors for the financial year ended 23 February 2013 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.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 68, in relation to going concern;
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

Other matter
We have reported separately on the Parent Company financial statements of Tesco PLC for the financial year ended 23 February 2013 and on the information in the Directors' Remuneration Report that is described as having been audited.

Mark Gill (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
1 May 2013

Group income statement

Year ended 23 February 2013	notes	52 weeks 2013 £m	52 weeks 2012 £m
Continuing operations			
Revenue	2	64,826	63,916
Cost of sales		(60,737)	(58,519)
Gross profit		4,089	5,397
Administrative expenses		(1,562)	(1,612)
Profits/losses arising on property-related items		(339)	397
Operating profit		2,188	4,182
Share of post-tax profits of joint ventures and associates	13	54	91
Finance income	5	177	176
Finance costs	5	(459)	(411)
Profit before tax	3	1,960	4,038
Taxation	6	(574)	(874)
Profit for the year from continuing operations		1,386	3,164
Discontinued operations			
Loss for the year from discontinued operations	7	(1,266)	(350)
Profit for the year		120	2,814
Attributable to:			
Owners of the parent		124	2,806
Non-controlling interests		(4)	8
		120	2,814
Earnings per share from continuing and discontinued operations			
Basic	9	1.54p	34.98p
Diluted	9	1.54p	34.88p
Earnings per share from continuing operations			
Basic	9	17.30p	39.35p
Diluted	9	17.30p	39.23p

Non-GAAP measure: underlying profit before tax

	notes	52 weeks 2013 £m	52 weeks 2012 £m
Profit before tax from continuing operations		1,960	4,038
Adjustments for:			
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	1/5	14	(44)
IAS 19 'Employee Benefits' – non-cash Group Income Statement charge for pensions	1	(56)	17
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	1	28	31
IFRS 3 'Business Combinations' – intangible asset amortisation charges and costs arising from acquisitions	1	19	22
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	1	28	17
Restructuring and other one-off costs	1		
Impairment of PPE and onerous lease provisions		895	–
Impairment of goodwill		495	–
Provision for customer redress		115	57
Other restructuring and one-off costs		51	11
Underlying profit before tax from continuing operations	1	3,549	4,149

The notes on pages 77 to 125 form part of these financial statements.

Group statement of comprehensive income

Year ended 23 February 2013	notes	52 weeks 2013 £m	52 weeks 2012 £m
Change in fair value of available-for-sale financial assets and investments		(11)	13
Currency translation differences		420	(22)
Reclassification adjustment for movements in foreign exchange reserve and net investment hedging on subsidiary disposed		20	–
Actuarial losses on defined benefit pension schemes	26	(735)	(498)
Gains/(losses) on cash flow hedges:			
Net fair value gains		84	241
Reclassified and reported in the Group Income Statement		(63)	(142)
Tax relating to components of other comprehensive income for the year	6	104	73
Total other comprehensive income for the year		(181)	(335)
Profit for the year		120	2,814
Total comprehensive income for the year		(61)	2,479
Attributable to:			
Owners of the parent		(57)	2,466
Non-controlling interests		(4)	13
		(61)	2,479
Total comprehensive income attributable to equity shareholders arises from:			
Continuing operations		1,209	2,816
Discontinued operations		(1,266)	(350)
		(57)	2,466

The notes on pages 77 to 125 form part of these financial statements.

Group balance sheet

	notes	23 February 2013 £m	25 February 2012 £m
Non-current assets			
Goodwill and other intangible assets	10	4,362	4,618
Property, plant and equipment	11	24,870	25,710
Investment property	12	2,001	1,991
Investments in joint ventures and associates	13	494	423
Other investments	14	818	1,526
Loans and advances to customers	17	2,465	1,901
Derivative financial instruments	21	1,965	1,726
Deferred tax assets	6	58	23
		37,033	37,918
Current assets			
Inventories	15	3,744	3,598
Trade and other receivables	16	2,525	2,657
Loans and advances to customers	17	3,094	2,502
Derivative financial instruments	21	58	41
Current tax assets		10	7
Short-term investments		522	1,243
Cash and cash equivalents	18	2,512	2,305
		12,465	12,353
Assets of the disposal group and non-current assets classified as held for sale	7	631	510
		13,096	12,863
Current liabilities			
Trade and other payables	19	(11,094)	(11,234)
Financial liabilities:			
Borrowings	20	(766)	(1,838)
Derivative financial instruments and other liabilities	21	(121)	(128)
Customer deposits and deposits by banks	23	(6,015)	(5,465)
Current tax liabilities		(519)	(416)
Provisions	24	(188)	(99)
		(18,703)	(19,180)
Liabilities of the disposal group classified as held for sale	7	(282)	(69)
Net current liabilities		(5,889)	(6,386)
Non-current liabilities			
Financial liabilities:			
Borrowings	20	(10,068)	(9,911)
Derivative financial instruments and other liabilities	21	(759)	(688)
Post-employment benefit obligations	26	(2,378)	(1,872)
Deferred tax liabilities	6	(1,006)	(1,160)
Provisions	24	(272)	(100)
		(14,483)	(13,731)
Net assets		16,661	17,801
Equity			
Share capital	27	403	402
Share premium		5,020	4,964
All other reserves		685	245
Retained earnings		10,535	12,164
Equity attributable to owners of the parent		16,643	17,775
Non-controlling interests		18	26
Total equity		16,661	17,801

The notes on pages 77 to 125 form part of these financial statements.

Philip Clarke
Laurie McIlwee

Directors
The financial statements on pages 72 to 125 were authorised for issue by the Directors on 1 May 2013 and are subject to the approval of the shareholders at the Annual General Meeting on 28 June 2013.

Group statement of changes in equity

	Issued share capital £m	Share premium £m	All other reserves: Other reserves £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Treasury shares £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 25 February 2012	402	4,964	40	16	73	134	(18)	12,164	17,775	26	17,801
Profit for the year	–	–	–	–	–	–	–	124	124	(4)	120
Other comprehensive income											
Change in fair value of available-for-sale financial assets and investments	–	–	–	–	–	–	–	(11)	(11)	–	(11)
Currency translation differences	–	–	–	–	–	420	–	–	420	–	420
Reclassification adjustment on subsidiaries disposed	–	–	–	–	–	20	–	–	20	–	20
Actuarial losses on defined benefit pension schemes	–	–	–	–	–	–	–	(735)	(735)	–	(735)
Gains on cash flow hedges	–	–	–	–	21	–	–	–	21	–	21
Tax relating to components of other comprehensive income	–	–	–	–	(3)	(27)	–	134	104	–	104
Total other comprehensive income	–	–	–	–	18	413	–	(612)	(181)	–	(181)
Total comprehensive income	–	–	–	–	18	413	–	(488)	(57)	(4)	(61)
Transactions with owners											
Share-based payments	–	–	–	–	–	–	9	44	53	–	53
Issue of shares	1	56	–	–	–	–	–	–	57	–	57
Purchase of non-controlling interests	–	–	–	–	–	–	–	4	4	(4)	–
Dividends authorised in the year	–	–	–	–	–	–	–	(1,184)	(1,184)	–	(1,184)
Tax on items charged to equity	–	–	–	–	–	–	–	(5)	(5)	–	(5)
Total transactions with owners	1	56	–	–	–	–	9	(1,141)	(1,075)	(4)	(1,079)
At 23 February 2013	403	5,020	40	16	91	547	(9)	10,535	16,643	18	16,661

	Issued share capital £m	Share premium £m	All other reserves: Other reserves £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Treasury shares £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 26 February 2011	402	4,896	40	13	(1)	155	(141)	11,171	16,535	88	16,623
Profit for the year	–	–	–	–	–	–	–	2,806	2,806	8	2,814
Other comprehensive income											
Change in fair value of available-for-sale financial assets and investments	–	–	–	–	–	–	–	13	13	–	13
Currency translation differences	–	–	–	–	–	(27)	–	–	(27)	5	(22)
Actuarial losses on defined benefit pension schemes	–	–	–	–	–	–	–	(498)	(498)	–	(498)
Gains on cash flow hedges	–	–	–	–	99	–	–	–	99	–	99
Tax relating to components of other comprehensive income	–	–	–	–	(25)	6	–	92	73	–	73
Total other comprehensive income	–	–	–	–	74	(21)	–	(393)	(340)	5	(335)
Total comprehensive income	–	–	–	–	74	(21)	–	2,413	2,466	13	2,479
Transactions with owners											
Purchase of treasury shares	–	–	–	–	–	–	(13)	–	(13)	–	(13)
Shares purchased for cancellation	(3)	–	–	3	–	–	–	(290)	(290)	–	(290)
Share-based payments	2	–	–	–	–	–	136	(13)	125	–	125
Issue of shares	1	68	–	–	–	–	–	–	69	–	69
Purchase of non-controlling interests	–	–	–	–	–	–	–	72	72	(72)	–
Future purchase of non-controlling interests	–	–	–	–	–	–	–	(3)	(3)	–	(3)
Dividends paid to non-controlling interests	–	–	–	–	–	–	–	–	–	(3)	(3)
Dividends authorised in the year	–	–	–	–	–	–	–	(1,180)	(1,180)	–	(1,180)
Tax on items charged to equity	–	–	–	–	–	–	–	(6)	(6)	–	(6)
Total transactions with owners	–	68	–	3	–	–	123	(1,420)	(1,226)	(75)	(1,301)
At 25 February 2012	402	4,964	40	16	73	134	(18)	12,164	17,775	26	17,801

The notes on pages 77 to 125 form part of these financial statements.

Group cash flow statement

Year ended 23 February 2013	notes	52 weeks 2013 £m	52 weeks 2012 £m
Cash flows from operating activities			
Cash generated from operations	29	3,873	5,688
Interest paid		(457)	(531)
Corporation tax paid		(579)	(749)
Net cash generated from operating activities		2,837	4,408
Cash flows from investing activities			
Acquisition/disposal of subsidiaries, net of cash acquired/disposed		(72)	(65)
Proceeds from sale of joint ventures and associates		68	–
Proceeds from sale of property, plant and equipment, investment property and non-current assets classified as held for sale		1,351	1,141
Purchase of property, plant and equipment, investment property and non-current assets classified as held for sale		(2,619)	(3,374)
Purchase of intangible assets		(368)	(334)
Net (increase)/decrease in loans to joint ventures and associates		(43)	122
Investments in joint ventures and associates		(158)	(49)
Net proceeds from sale of/(investments in) short-term and other investments		1,427	(767)
Dividends received from joint ventures and associates		51	40
Interest received		85	103
Net cash used in investing activities		(278)	(3,183)
Cash flows from financing activities			
Proceeds from issue of ordinary share capital	27	57	69
Increase in borrowings		1,820	2,905
Repayment of borrowings		(3,022)	(2,720)
Repayment of obligations under finance leases		(32)	(45)
Purchase of non-controlling interests		(4)	(89)
Dividends paid to equity owners	8	(1,184)	(1,180)
Dividends paid to non-controlling interests		–	(3)
Own shares purchased		–	(303)
Net cash used in financing activities		(2,365)	(1,366)
Net increase/(decrease) in cash and cash equivalents		194	(141)
Cash and cash equivalents at beginning of the year		2,311	2,428
Effect of foreign exchange rate changes		26	24
Cash and cash equivalents including cash held in disposal group at the end of the year		2,531	2,311
Cash held in disposal group	7	(19)	(6)
Cash and cash equivalents at the end of the year	18	2,512	2,305

Reconciliation of net cash flow to movement in net debt note

Year ended 23 February 2013	note	52 weeks 2013 £m	52 weeks 2012 £m
Net increase/(decrease) in cash and cash equivalents		194	(141)
Elimination of net (increase)/decrease in Tesco Bank cash and cash equivalents		(475)	126
Investment in Tesco Bank		(45)	(112)
Debt acquired on acquisition		(1)	(98)
Net cash outflow to repay debt and lease financing		1,589	262
Dividend received from Tesco Bank		105	100
(Decrease)/increase in Retail short-term investments		(721)	221
Increase/(decrease) in Retail joint venture loan receivables		36	(122)
Other non-cash movements		(430)	(330)
Elimination of other Tesco Bank non-cash movements		(11)	46
Decrease/(increase) in net debt for the year		241	(48)
Opening net debt	30	(6,838)	(6,790)
Closing net debt	30	(6,597)	(6,838)

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 but forms part of the notes to the financial statements.

The notes on pages 77 to 125 form part of these financial statements.

Notes to the Group financial statements

Note 1 Accounting policies

General information
Tesco PLC ('the Company') 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 23 February 2013 (prior financial year 52 weeks ended 25 February 2012). For the UK, the Republic of Ireland and the US, the results are for the 52 weeks ended 23 February 2013 (prior financial year 52 weeks ended 25 February 2012). For all other operations, the results are for the calendar year ended 28 February 2013 (prior financial year ended 29 February 2012).

The main activities of the Company and its subsidiaries (together, 'the Group') are those of retailing and retail banking.

Basis of preparation
The consolidated Group financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') and IFRS Interpretations Committee ('IFRIC') interpretations as endorsed by the European Union, and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The consolidated Group 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.

Discontinued operations
During the financial year, the Board approved a plan to dispose of its operations in the US which is consistent with the Group's long-term strategic priority to drive growth and improve returns. The exit of the Japan operations successfully completed on 1 January 2013. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', the net results for the year are presented within discontinued operations in the Group Income Statement (for which the comparatives have been reclassified) and the assets and liabilities of the businesses are presented separately in the Group Balance Sheet. See Note 7 for further details.

Presentation change to cash flow statement
The Group has reported the investment in and proceeds from the sale of short-term investments on a net basis for the year to reflect the strategic management of such investments. The previous year's gross presentation (investment cash flow £1,972m and proceeds of £1,205m) have been netted.

Presentation change to reserves
'All other reserves' in the Group Balance Sheet and Group Statement of Changes in Equity includes several items of reserves including 'Other reserves'. In the previous year, 'Other reserves' was shown separately.

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

Basis of consolidation
The consolidated 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.

Subsidiaries
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
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 Group 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. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis.

Critical estimates and assumptions that are applied in the preparation of the consolidated financial statements include:

Depreciation and amortisation
The Group exercises judgement to determine useful lives and residual values of intangibles, property, plant and equipment and investment property. The assets are depreciated down to their residual values over their estimated useful lives.

Impairment
i) Impairment of goodwill
The Group tests annually whether goodwill has suffered any impairment. The recoverable amount of the cash-generating units has been determined based on value in use calculations. These calculations require the use of estimates as set out in Note 10.

ii) Impairment of assets
The Group has determined each store as a separate cash-generating unit for impairment testing. Where there are indicators for impairment, the Group performs an impairment test.

Recoverable amounts for cash-generating units are based on the higher of value in use and fair value less costs to sell. Value in use is calculated from cash flow projections for five years using data from the Group's latest internal forecasts. These calculations require the use of estimates as set out in Note 11.

iii) Impairment of loans and advances to customers and banks
The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. These calculations require the use of estimates as set out in the accounting policy note for Financial instruments.

Provisions
Provisions have been made for onerous leases, dilapidations, restructuring, pensions, customer redress and claims. These provisions are estimates and the actual costs and timing of future cash flows are dependent on future events. The difference between expectations and the actual future liability will be accounted for in the period when such determination is made.

The Group has provisions for potential customer redress. In 2010/11, the Financial Conduct Authority ('FCA') (previously the Financial Services Authority) formally issued Policy Statement 10/12 ('PS 10/12'), which introduced new guidance in respect of Payment Protection Insurance

Notes to the Group financial statements

Note 1 Accounting policies continued

('PPI') customer redress and evidential provisions to the FCA Handbook with an implementation date of 1 December 2010. The Group continues to handle complaints and redress customers in accordance with PS 10/12. This will include ongoing analysis of historical claims experience in accordance with the guidance.

The calculation of these provisions involves estimating a number of variables, principally the level of customer complaints which may be received and the level of any compensation which may be payable to customers. The number of cases on which compensation is ultimately payable may also be influenced by the outcome of the analysis of historical claims referred to above. A change in the estimate of any of the key variables in this calculation could have the potential to significantly impact the provisions recognised.

Insurance reserves
Until October 2010 all Tesco Bank branded products were underwritten through the RBS Insurance partner. From November 2011 all general insurance policies sold under this arrangement had expired. A final termination settlement agreement executed on 26 September 2012 provided a final claims reserve determination and resulted in the full and final agreement of a concluding commission statement. The consideration received by the Group fully satisfied any and all liabilities of RBS Insurance (subsidiaries, affiliates and agents) to the Group. Insurance reserves in relation to motor and insurance products sold by the Group since October 2010 are held predominantly within Tesco Underwriting Limited.

Post-employment benefit obligations
The present value of the post-employment benefit obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of post-employment benefit obligations.

Key assumptions for post-employment benefit obligations are disclosed in Note 26.

Adoption of amended International Financial Reporting Standards
The Group has adopted the following amended standards as of 26 February 2012.

- IFRS 7 (amended) 'Financial instruments: disclosures'
- IAS 12 (amended) 'Income Taxes'.

The adoption of the above amendments has not had any significant impact on the amounts reported in the Group financial statements but may impact the disclosure for future transactions and arrangements.

Revenue
Revenue comprises the fair value of consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities.

Sale of goods
Revenue is recognised when the significant risks and rewards of ownership of the goods have transferred to the buyer and the amount of revenue can be measured reliably.

Revenue is recorded net of returns, discounts/offers and value added taxes.

Provision of services
Revenue from the provision of services is recognised when the service is provided and the revenue can be measured reliably, based on the terms of the contract.

Where the Group acts as an agent selling goods or services, only the commission income is included within revenue.

Financial services
Revenue consists of interest, fees and income from the provision of insurance.

Interest income on financial assets that are classified as loans and receivables is determined using the effective interest rate method.

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 (credit card interchange fees, late payment and ATM revenue) are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered.

The Group generates commission from the sale and service of Motor and Home insurance policies underwritten by Tesco Underwriting Limited, or in a minority of cases by a third party underwriter. This is based on commission rates which are independent of the profitability of underlying insurance policies. Similar commission income is also generated from the sale of white label insurance products underwritten by other third party providers.

The Group continues to receive insurance commission arising from the sale of insurance policies sold under the Tesco brand through the legacy arrangement with RBS. This commission income is variable and dependent upon the profitability of the underlying insurance policies.

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

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 and redemption rate.

Tesco for Schools & Clubs 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.

Rental income
Rental income is recognised in the period in which it is earned, in accordance with the terms of the lease.

Finance income
Finance income, excluding income arising from financial services, is recognised in the period to which it relates using the effective interest rate method.

Finance costs
Finance 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.

Note 1 Accounting policies continued

Business combinations and goodwill
The Group accounts for all business combinations by applying the purchase method. All acquisition-related costs are expensed.

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

Goodwill arising on consolidation represents the excess of the consideration transferred over the net fair value of the Group's share of the net assets, liabilities and contingent liabilities of the acquired subsidiary, joint venture or associate and the fair value of the non-controlling interest in the acquiree. If the consideration is less than the fair value of the Group's share of the net assets, liabilities and contingent liabilities of the acquired entity (i.e. a discount on acquisition), 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.

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.

Intangible assets
Acquired intangible assets
Separately acquired intangible assets, such as software, pharmacy licences, customer relationships, contracts and brands are measured initially at cost. Intangible assets acquired in a business combination are recognised at fair value at the acquisition date. Intangible assets with finite useful lives are carried 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 capitalised only if specific criteria are met including that the asset created will probably generate future economic benefits.

Following the initial recognition of development expenditure, the cost is amortised over the asset's estimated useful life at 10%–25% of cost per annum.

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

Property, plant and equipment is depreciated on a straight-line basis to its residual value over its anticipated useful economic life. 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.

Impairment of non-financial assets
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.

For all other non-financial assets (including intangible assets and property, plant and equipment) the Group performs impairment testing where there are indicators of impairment. If such an indicator exists, the recoverable 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 immediately in the Group Income Statement.

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 immediately as a credit to the Group Income Statement.

Investment property
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.

Short-term and other investments
Short-term and other investments in the Group Balance Sheet comprise receivables, loan receivables and available-for-sale financial assets.

Receivables and loan receivables are recognised at amortised cost. Available-for-sale financial assets are recognised at fair value.

Refer to the financial instruments accounting policy for further detail.

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

Cash and cash equivalents
Cash and cash equivalents in the Group Balance Sheet consist of cash at bank, in hand, demand deposits with banks, loans and advances to banks, certificate of deposits and other receivables 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. 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.

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.

Notes to the Group financial statements

Note 1 Accounting policies continued

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 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 a 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 lease.

Sale and leaseback
A sale and leaseback transaction is one where the Group sells an asset and immediately reacquires the use of the 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 profit 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.

Post-employment and similar obligations
For 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
The fair value of employee share option plans is calculated at the grant date using the Black-Scholes model. 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 expense is recognised in the Group Income Statement except to the extent that it relates to items recognised in the Group Statement of Comprehensive Income or directly in the Group Statement of Changes in Equity, in which case it is recognised in the Group Statement of Comprehensive Income or directly in the Group Statement of Changes in 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 assets 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.

The assets and liabilities of overseas subsidiaries denominated in foreign currencies are translated into Pound Sterling at exchange rates prevailing at the date of the Group Balance Sheet; profits and losses are translated at average exchange rates for the relevant accounting periods. Exchange differences arising are recognised in the Group Statement of Comprehensive Income and are included in the Group's translation reserve. Such translation differences are recognised as income or expenses in the period in which the operation is disposed of.

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 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, less provision for impairment.

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. For available-for-sale investments, gains and losses arising from changes in fair value are recognised directly in the other comprehensive income, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in other comprehensive income is included in the Group Income Statement 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 to customers
Loans and advances to customers are not classified as held for trading nor 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.

Note 1 Accounting policies continued

Impairment of loans and advances to customers

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.

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 is 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 these provisions are the expected loss rates. 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.

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 proceeds 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 recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

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. 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.

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.

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 the other comprehensive income.

The associated cumulative gain or loss is reclassified from the other comprehensive income 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.

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 the Group Statement of Changes 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 the Group Statement of Changes in Equity is reclassified 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 other comprehensive income. Any ineffective element is recognised immediately in the Group Income Statement. Gains and losses accumulated in other comprehensive income are included in the Group Income Statement when the foreign operation is disposed of.

Treatment of agreements to acquire non-controlling interests

The Group has entered into a number of agreements to purchase the remaining shares of subsidiaries with non-controlling interests.

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.

Notes to the Group financial statements

Note 1 Accounting policies continued

Provisions
Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

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. Provisions for dilapidation costs are recognised on a lease by lease basis.

Non-current assets held for sale and discontinued operations
Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell.

Standards issued but not yet effective
As of the date of authorisation of these financial statements, the following standards were in issue but not yet effective. The Group has not applied these standards in the preparation of the financial statements:

- IAS 1 (Amended) 'Financial statement presentation' regarding other comprehensive income 'Presentation of financial statements' is effective from periods commencing on or after 1 July 2012. The main change from this amendment is to require entities to group items presented in 'other comprehensive income' ('OCI') on the basis of whether they are potentially reclassifiable to the Group Income Statement subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI.
- IAS 19 (Amended) 'Employee benefits' is effective from periods commencing on or after 1 January 2013. It eliminates the corridor approach and requires immediate recognition of all actuarial gains and losses in other comprehensive income, immediate recognition of all past service costs and the replacement of interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability/asset. If this standard had been applied to the year ended 23 February 2013, it is estimated that interest income would have been reduced by approximately £125m.
- IFRS 9 'Financial instruments' is effective from periods commencing on or after 1 January 2015. It is the first standard issued as part of a wider project to replace IAS 39. It retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: i) amortised cost; and ii) fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset.
- IFRS 10 'Consolidated financial statements' is effective from periods commencing on or after 1 January 2014. It builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. It also provides additional guidance to assist in the determination of control where this is difficult to assess.
- IFRS 11 'Joint arrangements' is effective from periods commencing on or after 1 January 2014. It is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are now only two types of joint arrangement: joint operations; and joint ventures.
- IFRS 12 'Disclosures of interests in other entities' is effective from periods commencing on or after 1 January 2014. It includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles.
- IFRS 13 'Fair value measurement' is effective from periods commencing on or after 1 January 2013. It aims to improve consistency and reduce complexity by providing precise definition of fair value and single source of fair value measurement and disclosure requirements for use across IFRSs.
- IAS 27 (Amended) 'Separate financial statements' is effective from periods commencing on or after 1 January 2014. It includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10.
- IAS 28 (Amended) 'Associates and joint ventures' is effective from periods commencing on or after 1 January 2014. It includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. This requirement will not affect the Group because equity accounting is currently adopted under the existing requirements of IAS 31.
- IFRS 7 (Amended) 'Financial instruments: Disclosures' and IAS 32 (Amended) 'Financial instruments: Presentation' are effective from 1 January 2013 and 2014 respectively. The IAS 32 amendment clarifies some of the requirements for offsetting financial assets and financial liabilities on the Group Balance Sheet while the IFRS 7 amendment will require more extensive disclosures than are required under IFRS.
- Annual Improvements 2011 is effective from periods commencing on or after 1 January 2013. It addresses six issues in the 2009–2011 reporting cycle. It includes changes to IAS 1 ('Financial statement presentation'), IAS 16 ('Property, plant and equipment'), IAS 32 ('Financial instruments: presentation') and IAS 34 ('Interim financial reporting').

The impact on the Group's financial statements of the future adoption of these standards is still under review.

Use of non-GAAP profit measure – 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 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 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 year end, any gain or loss accruing on open contracts is recognised in the Group Income Statement for the financial year, 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 performance of the Group.

Note 1 Accounting policies continued

- IAS 19 'Employee Benefits' – non-cash Group Income Statement charge for pensions. Under IAS 19, 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 the Group'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 the Group has 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 requires the total expected 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. This adjustment also impacts the Group's operating profit and rental income within the share of post-tax profits of joint ventures and associates.
- IFRS 3 (Revised) 'Business Combinations' – intangible asset amortisation charges and costs arising from acquisitions. Under IFRS 3 intangible assets are separately identified and fair valued. The intangible assets are required to be amortised on a straight-line basis over their useful lives and as such is a non-cash charge that does not reflect the underlying performance of the business acquired. Similarly, the standard requires all acquisition costs to be expensed in the Group Income Statement. Due to their nature, these costs have been excluded from underlying profit as they do not reflect the underlying performance of the Group.
- IFRIC 13 'Customer Loyalty Programmes' – fair value of awards. The 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.
- Restructuring and other one-off costs. These relate to certain costs associated with the Group's restructuring activities and certain one-off costs including costs relating to fair valuing the assets of a disposal group. These have been excluded from underlying profit as they do not reflect the underlying performance of the Group.

Notes to the Group financial statements

Note 2 Segmental reporting

The Group's reporting segments are 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 as it is primarily responsible for the allocation of resources to segments and the assessment of performance of the segments.

During the year, the Group completed the exit of Japan operations (previously reported as part of the Asia segment). The Group made its decision to sell Fresh and Easy in the US on 12 February 2013 (previously reported in the US segment). Accordingly, these operations have been treated as discontinued as described in more detail in notes 1 and 7. The segment results do not include any amounts for these discontinued operations. The segment assets and other segment information sets out continuing operations separately from discontinued operations.

The CODM now considers the principal activities of the Group to be:

- Retailing and associated activities in:
  - the UK;
  - Asia – China, India, Malaysia, South Korea, Thailand; and
  - Europe – Czech Republic, Hungary, Poland, Republic of Ireland, Slovakia, Turkey
- Retail banking and insurance services through Tesco Bank in the UK.

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 financial year under evaluation. Trading profit is a consistent measure within the Group.

Segment trading profit is an adjusted measure of operating profit and measures the performance of each segment before profits/losses arising on property-related items, the impact on leases of annual uplifts in rent and rent-free periods, intangible asset amortisation charges and costs arising from acquisitions, and goodwill impairment and restructuring and other one-off costs. The IAS 19 pension charge is replaced with the 'normal' cash contributions for pensions. An adjustment is also made for the fair value of customer loyalty awards.

Inter-segment revenue between the operating segments is not material.

The segment results, the reconciliation of the segment measures to the respective statutory items included in the Group Income Statement, the segment assets and other segment information are as follows:

Year ended 23 February 2013 At constant exchange rates*	UK £m	Asia £m	Europe £m	Tesco Bank £m	Total at constant exchange £m	Foreign exchange £m	Total at actual exchange £m
Continuing operations							
Sales including VAT (excluding IFRIC 13)	48,216	12,334	11,609	1,021	73,180	(817)	72,363
Revenue (excluding IFRIC 13)	43,579	11,498	10,005	1,021	66,103	(705)	65,398
Effect of IFRIC 13	(491)	(36)	(48)	–	(575)	3	(572)
Revenue	43,088	11,462	9,957	1,021	65,528	(702)	64,826
Trading profit	2,272	665	353	191	3,481	(28)	3,453
Trading margin†	5.2%	5.8%	3.5%	18.7%	5.3%	–	5.3%

Year ended 23 February 2013 At actual exchange rates**	UK £m	Asia £m	Europe £m	Tesco Bank £m	Total at actual exchange £m
Continuing operations					
Sales including VAT (excluding IFRIC 13)	48,216	12,317	10,809	1,021	72,363
Revenue (excluding IFRIC 13)	43,579	11,479	9,319	1,021	65,398
Effect of IFRIC 13	(491)	(36)	(45)	–	(572)
Revenue	43,088	11,443	9,274	1,021	64,826
Trading profit	2,272	661	329	191	3,453
Trading margin†	5.2%	5.8%	3.5%	18.7%	5.3%

* Constant exchange rates are the average actual periodic exchange rates for the previous financial year.
** Actual exchange rates are the average actual periodic exchange rates for that financial year.
† Trading margin is based on revenue excluding the accounting impact of IFRIC 13.

Note 2 Segmental reporting continued

Year ended 25 February 2012 At actual exchange rates**	UK £m	Asia £m	Europe £m	Tesco Bank £m	Total at actual exchange £m
Continuing operations					
Sales including VAT (excluding IFRIC 13)	47,360	11,627	11,371	1,044	71,402
Revenue (excluding IFRIC 13)	42,803	10,828	9,866	1,044	64,541
Effect of IFRIC 13	(550)	(35)	(40)	–	(625)
Revenue	42,253	10,793	9,826	1,044	63,916
Trading profit	2,478	737	529	225	3,969
Trading margin†	5.8%	6.8%	5.4%	21.6%	6.1%

Reconciliation of trading profit to profit before tax

	2013 £m	2012 £m
Trading profit	3,453	3,969
Adjustments:		
Profits/losses arising on property-related items:		
– Included in underlying profit	370	397
– Excluded from underlying profit	(709)	–
IAS 19 'Employee Benefits' – non-cash Group Income Statement charge for pensions	4	(35)
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	(36)	(42)
IFRS 3 'Business Combinations' – intangible asset amortisation charges and costs arising from acquisitions	(19)	(22)
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	(28)	(17)
Other restructuring and one-off costs		
Other property charges	(186)	–
Impairment of goodwill	(495)	–
Provisions for customer redress	(115)	(57)
Other restructuring and one-off items	(51)	(11)
Operating profit	2,188	4,182
Share of post-tax profits from joint ventures and associates	54	91
Finance income	177	176
Finance costs	(459)	(411)
Profit before tax	1,960	4,038
Taxation	(574)	(874)
Profit for the year from continuing operations	1,386	3,164

Segment assets

At 23 February 2013	UK £m	Asia £m	Europe £m	Tesco Bank £m	Other/ unallocated £m	Total continuing operations £m	Discontinued operations £m	Total £m
Total segment non-current assets	14,532	9,298	6,471	4,709	2,023	37,033	–	37,033
Total segment non-current assets includes:								
Investments in joint ventures and associates	104	294	1	95	–	494	–	494

At 25 February 2012	UK £m	Asia £m	Europe £m	Tesco Bank £m	Other/ unallocated £m	Total continuing operations £m	Discontinued operations* £m	Total £m
Total segment non-current assets	14,995	8,471	6,835	4,799	1,749	36,849	1,069	37,918
Total segment non-current assets includes:								
Investments in joint ventures and associates	134	217	–	72	–	423	–	423

* US is included in discontinued operations for comparison purposes.
** Actual exchange rates are the average actual periodic exchange rates for that financial year.
† Trading margin is based on revenue excluding the accounting impact of IFRIC 13.

Notes to the Group financial statements

Note 2 Segmental reporting continued

Other segment information

Year ended 23 February 2013	UK £m	Asia £m	Europe £m	Tesco Bank £m	Total continuing operations £m	Discontinued operations £m	Total £m
Capital expenditure (including acquisitions through business combinations):							
Property, plant and equipment	1,207	925	434	13	2,579	60	2,639
Investment property	–	40	3	–	43	–	43
Goodwill and other intangible assets	207	29	39	97	372	–	372
Depreciation:							
Property, plant and equipment	(630)	(334)	(288)	(16)	(1,268)	(54)	(1,322)
Investment property	–	(21)	(15)	–	(36)	–	(36)
Amortisation of intangible assets	(131)	(18)	(22)	(61)	(232)	–	(232)
Goodwill impairment losses	-	–	(495)	–	(495)	–	(495)
Impairment losses	(654)	(88)	(92)	–	(834)	(16)	(850)
Reversal of prior year impairment losses	1	3	2	–	6	–	6

Year ended 25 February 2012	UK £m	Asia £m	Europe £m	Tesco Bank £m	Total continuing operations £m	Discontinued operations* £m	Total £m
Capital expenditure (including acquisitions through business combinations):							
Property, plant and equipment	1,495	1,140	663	22	3,320	147	3,467
Investment property	–	8	102	–	110	–	110
Goodwill and other intangible assets	201	29	68	143	441	–	441
Depreciation:							
Property, plant and equipment	(617)	(306)	(277)	(16)	(1,216)	(49)	(1,265)
Investment property	–	(15)	(24)	–	(39)	–	(39)
Amortisation of intangible assets	(113)	(12)	(22)	(44)	(191)	(3)	(194)
Impairment losses	(27)	(5)	(3)	–	(35)	(86)	(121)
Reversal of prior year impairment losses	27	1	8	–	36	–	36

* US is included in discontinued operations for comparison purposes.

Note 3 Income and expenses

Continuing operations	2013 £m	2012 £m
Profit before tax is stated after charging/(crediting) the following:		
Rental income, of which £493m (2012: £499m) relates to investment properties	(620)	(604)
Direct operating expenses arising on rental earning investment properties	165	157
Costs of inventories recognised as an expense	48,671	48,422
Stock losses	1,193	1,118
Depreciation, amortisation and impairment charged	2,364	1,445
Impairment of goodwill	495	–
Operating lease expense, of which £127m (2012: £133m) relates to hire of plant and machinery	1,400	1,206

Note 3 Income and expenses continued

During the financial year the Group obtained the following services from the Group's auditor, PricewaterhouseCoopers LLP, and network firms:

	2013 £m	2012 £m
Audit services		
Fees payable to the Company's auditor and its associates for the audit of the Company and Group financial statements	0.8	0.7
The audit of the accounts of the Company's subsidiaries	3.8	3.9
	4.6	4.6
Non-audit services		
Fees payable to the Company's auditor and its associates for other services:		
Taxation compliance services	0.1	0.2
Taxation advisory services	0.4	0.4
All other non-audit services	2.4	1.9
Total auditor remuneration	7.5	7.1

In addition to the amounts shown above, the auditors received fees of £0.1m (2012: £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 34 and includes how objectivity and independence is safeguarded when non-audit services are provided by PricewaterhouseCoopers LLP.

Note 4 Employment costs, including Directors' remuneration

Continuing operations	2013 £m	2012 £m
Wages and salaries	5,980	5,594
Social security costs	480	459
Post-employment defined benefits (Note 26)	482	492
Post-employment defined contributions (Note 26)	19	20
Share-based payments expense (Note 25)	89	151
	7,050	6,716

The average number of employees by operating segment during the financial year was:

	Average number of employees		Average number of full-time equivalents	
	2013	2012	2013	2012
UK	313,885	300,373	213,304	205,852
Asia	125,797	117,015	115,499	108,149
Europe	94,712	94,409	84,469	85,071
Tesco Bank	3,390	2,818	3,169	2,719
Total	537,784	514,615	416,441	401,791

Notes to the Group financial statements

Note 5 Finance income and costs

Continuing operations	2013 £m	2012 £m
Finance income		
Bank interest receivable and similar income on cash and cash equivalents	125	114
Net pension finance income (Note 26)	52	18
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	–	44
Total finance income	177	176
Finance costs		
Interest payable on short-term bank loans and overdrafts repayable within five years	(88)	(57)
Finance charges payable under finance leases and hire purchase contracts	(10)	(10)
GBP MTN	(219)	(226)
EUR MTN	(157)	(180)
USD MTN	(88)	(67)
Other MTNs	(6)	(11)
Capitalised Interest (Note 11)	123	140
IAS 32 & IAS 39 'Financial Instruments' – fair value remeasurements	(14)	–
Total finance costs	(459)	(411)

GBP MTNs
Interest payable on the 4% RPI GBP MTN 2016 includes £8m (2012: £13m) of Retail Price Index ('RPI') related amortisation.
Interest payable on the 3.322% LPI GBP MTN 2025 includes £9m (2012: £13m) of RPI related amortisation.
Interest payable on the 1.982% RPI GBP MTN 2036 includes £7m (2012: £11m) of RPI related amortisation.

Note 6 Taxation

Recognised in the Group Income Statement

Continuing operations	2013 £m	2012 £m
Current tax expense		
UK corporation tax	507	579
Foreign tax	279	195
Adjustments in respect of prior years	(99)	(42)
	687	732
Deferred tax expense		
Origination and reversal of temporary differences	(6)	226
Adjustments in respect of prior years	(5)	(12)
Change in tax rate	(102)	(72)
	(113)	142
Total income tax expense	574	874

The Finance Act 2012 included legislation to reduce the main rate of corporation tax from 26% to 24% from 1 April 2012 and to 23% from 1 April 2013. The reduction from 24% to 23% was substantively enacted at the balance sheet date and has therefore been reflected in these Group financial statements.

In addition to the changes in the rates of corporation tax disclosed above, it was announced in the December 2012 Budget Statement that the rate would be reduced from 23% to 21% from 1 April 2014 and in the March 2013 Budget Statement it was announced that the rate would be further reduced to 20% from 1 April 2015. These further rate reductions had not been substantively enacted at the balance sheet date and are therefore not reflected in these Group financial statements.

The proposed reductions to the main rate of corporation tax of 2% (to 21%) by 1 April 2014 and a further 1% (to 20%) by 1 April 2015 are expected to be enacted in 2013. The overall effect of these changes, if applied to the deferred tax balance at the balance sheet date, would be to reduce the deferred tax liability by £96m (£162m increase in profit and £66m decrease in other comprehensive income).

Note 6 Taxation continued

Reconciliation of effective tax charge

	2013 £m	2012 £m
Profit before tax	1,960	4,038
Tax charge at 24.2% (2012: 26.2%)	(474)	(1,058)
Effect of:		
Non-deductible expenses	(357)	1
Differences in overseas taxation rates	38	43
Adjustments in respect of prior years	104	54
Share of profits of joint ventures and associates	13	14
Change in tax rate	102	72
Total income tax charge for the year	(574)	(874)
Effective tax rate	29.3%	21.6%

Tax on items credited directly to the Group Statement of Changes in Equity

	2013 £m	2012 £m
Current tax charge on:		
Share-based payments	(6)	(1)
Deferred tax credit/(charge) on:		
Share-based payments	1	(5)
Total tax on items charged to Group Statement of Changes in Equity	(5)	(6)

Tax relating to components of the Group Statement of Comprehensive Income

	2013 £m	2012 £m
Current tax credit/(charge) on:		
Pensions	43	–
Foreign exchange movements	(27)	6
Fair value of movement on available-for-sale investments	6	(2)
Deferred tax credit/(charge) on:		
Pensions	85	94
Fair value movements on cash flow hedges	(3)	(25)
Total tax on items credited to Group Statement of Comprehensive Income	104	73

Deferred tax

The following are the major deferred tax (liabilities)/assets recognised by the Group and movements thereon during the current and prior financial years:

	Property-related items* £m	Retirement benefit obligation £m	Share-based payments £m	Short-term timing differences £m	Tax losses £m	Financial Instruments £m	Other pre/post tax temporary differences £m	Total £m
At 26 February 2011	(1,592)	362	47	94	32	4	7	(1,046)
(Charge)/credit to the Group Income Statement	(93)	9	(31)	(33)	3	(1)	–	(146)
Charge to Group Statement of Changes in Equity	–	–	(5)	–	–	–	–	(5)
Credit/(charge) to Group Statement of Comprehensive Income	–	94	–	–	–	(25)	–	69
Discontinued operations	–	–	–	–	(14)	–	–	(14)
Business combinations	(1)	–	–	3	1	–	1	4
Foreign exchange and other movements	(3)	–	–	–	2	–	2	1
At 25 February 2012	(1,689)	465	11	64	24	(22)	10	(1,137)
Credit/(charge) to the Group Income Statement	87	(12)	9	14	13	1	1	113
Credit to Group Statement of Changes in Equity	–	–	1	–	–	–	–	1
Credit/(charge) to Group Statement of Comprehensive Income	–	85	–	–	–	(3)	–	82
Discontinued operations	–	–	–	–	–	–	(3)	(3)
Business combinations	–	–	–	1	1	–	(2)	–
Foreign exchange and other movements**	(20)	1	–	4	2	–	1	(12)
At 23 February 2013	(1,622)	539	21	83	40	(24)	7	(956)

* Property-related items include deferred tax liability on rolled over gains of £340m (2012: £361m) and deferred tax assets on capital losses of £71m (2012: £71m). The remaining balance relates to accelerated tax depreciation.

** The deferred tax charge for foreign exchange and other movements of £12m (2012: £1m credit) relating to the retranslation of deferred tax balances at the balance sheet date is included within the Group Statement of Comprehensive Income under the heading currency translation differences.

Notes to the Group financial statements

Note 6 Taxation continued

Certain deferred tax assets and liabilities have been offset and analysed as follows:

	2013 £m	2012 £m
Deferred tax assets	58	23
Deferred tax liabilities	(1,006)	(1,160)
Deferred tax liabilities relating to disposal group	(8)	–
	(956)	(1,137)

No deferred tax liability is recognised on temporary differences of £3.6bn (2012: £3.4bn) relating to the unremitted earnings of overseas subsidiaries and joint ventures as the Group is able to control the timing of the reversal of these temporary differences and it is probable that they will not reverse in the foreseeable future. The deferred tax on unremitted earnings at 23 February 2013 is estimated to be £159m (2012: £161m) which relates to taxes payable on repatriation and dividend withholding taxes levied by overseas tax jurisdictions. UK tax legislation relating to company distributions provides for exemption from tax for most repatriated profits, subject to certain exceptions.

Unrecognised deferred tax assets

Deferred tax assets in relation to continuing operations 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):

	2013 £m	2012 £m
Deductible temporary differences	11	29
Tax losses	170	141
	181	170

As at 23 February 2013, the Group has unused trading tax losses from continuing operations of £858m (2012: £666m) available for offset against future profits. A deferred tax asset has been recognised in respect of £169m (2012: £110m) of such losses. No deferred tax asset has been recognised in respect of the remaining £689m (2012: £556m) due to the unpredictability of future profit streams. Included in unrecognised tax losses are losses of £544m that will expire in 2017 (2012: £479m in 2016) and £37m that will expire between 2018 and 2033 (2012: £21m between 2017 and 2032). Other losses will be carried forward indefinitely.

Note 7 Discontinued operations and non-current assets classified as held for sale

	2013 £m	2012 £m
Assets of disposal groups*	307	65
Non-current assets classified as held for sale	324	445
Total assets of the disposal group and non-current assets classified as held for sale	631	510
Total liabilities of the disposal group*	(282)	(69)
Total net assets classified as held for sale	349	441

* The year ending 23 February 2013 represents the US, while the year ending 25 February 2012 represents Japan.

The non-current assets held for sale consist mainly of properties in the UK and China due to be sold within one year.

Note 7 Discontinued operations and non-current assets classified as held for sale continued

Discontinued operations

The decision to sell the Group's operations in the US was taken in February 2013. An active programme to locate a buyer has been initiated and the sale is expected to be completed by February 2014.

The exit of the Japan operations was successfully completed on 1 January 2013.

The tables below show the results of the discontinued operations in relation to the US and Japan which are included in the Group Income Statement, Group Balance Sheet and Group Cash Flow Statement respectively.

	US		Japan		Total	
	2013 £m	2012 £m	2013* £m	2012 £m	2013 £m	2012 £m
Revenue	697	623	329	436	1,026	1,059
Cost of sales**	(1,567)	(759)	(360)	(539)	(1,927)	(1,298)
Administrative expenses	(50)	(40)	(20)	(23)	(70)	(63)
Loss arising on property related items	(286)	(21)	–	(1)	(286)	(22)
Finance costs	(4)	(6)	–	(1)	(4)	(7)
Loss before tax on discontinued operations	(1,210)	(203)	(51)	(128)	(1,261)	(331)
Taxation	(5)	(5)	–	(14)	(5)	(19)
Loss for the year from discontinued operations	(1,215)	(208)	(51)	(142)	(1,266)	(350)
Loss per share impact from discontinued operations						
Basic	(15.13p)	(2.60p)	(0.63p)	(1.77p)	(15.76p)	(4.37p)
Diluted	(15.13p)	(2.59p)	(0.63p)	(1.76p)	(15.76p)	(4.35p)

* The results of Japan are for the 44 weeks ended 1 January 2013, when there was an exit from the operations.
** Including operating lease expense of £60m (2012: £68m).

	US		Japan		Total	
	2013 £m	2012 £m	2013* £m	2012 £m	2013 £m	2012 £m
Non-GAAP measure: underlying loss before tax						
Loss before tax on discontinued operations	(1,210)	(203)	(51)	(128)	(1,261)	(331)
Adjustments for:						
Restructuring and other one-off costs						
Impairment of PPE and onerous lease provisions	812	9	–	57	812	66
Impairment of goodwill	80	–	–	–	80	–
Other restructuring and one-off costs	113	10	(5)	43	108	53
	1,005	19	(5)	100	1,000	119
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	5	7	–	–	5	7
Loss on disposal of Japan	–	–	35	–	35	–
Underlying loss before tax on discontinued operations	(200)	(177)	(21)	(28)	(221)	(205)

* The results of Japan are for the 44 weeks ended 1 January 2013, when there was an exit from the operations.

Notes to the Group financial statements

Note 7 Discontinued operations and non-current assets classified as held for sale continued

Balance sheet

As the Group's operations in Japan were disposed of during the year, assets and liabilities of the disposal group at 23 February 2013 comprise only those of the US.

	Total US 2013 £m
Assets of the disposal group	
Property, plant and equipment	241
Inventories	32
Trade and other receivables	15
Cash and cash equivalents	19
Total assets of the disposal group	307
Liabilities of the disposal group	
Trade and other payables	(192)
Borrowings	(7)
Other current liabilities	(83)
Total liabilities of the disposal group	(282)
Total net assets of the disposal group	25

Future minimum rentals payable under non-cancellable operating leases associated with operations in the US amount to £684m.

At 25 February 2012, the Group's US operations had not yet been classified as held for sale. Assets and liabilities of the disposal group at this date comprise only those of Japan.

	Total Japan 2012 £m
Assets of the disposal group	
Inventories	16
Trade and other receivables	43
Cash and cash equivalents	6
Total assets of the disposal group	65
Liabilities of the disposal group	
Trade and other payables	(68)
Borrowings	(1)
Total liabilities of the disposal group	(69)
Total net liabilities of the disposal group	(4)

Future minimum rentals payable under non-cancellable operating leases associated with operations in Japan at 25 February 2012 amounted to £113m.

Cash flow statement

	US		Japan		Total	
	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m
Net cash flows from operating activities	(145)	(116)	2	(53)	(143)	(169)
Net cash flows from investing activities	123	95	(48)	6	75	101
Net cash flows from financing activities	29	17	41	46	70	63
Net cash flows from discontinued operations	7	(4)	(5)	(1)	2	(5)

Note 8 Dividends

	2013		2012	
	pence/share	£m	pence/share	£m
Amounts recognised as distributions to owners in the financial year:				
Prior financial year final dividend	10.13	813	10.09	811
Current financial year interim dividend	4.63	371	4.63	369
Dividends paid to equity owners in the financial year	14.76	1,184	14.72	1,180
Current financial year proposed final dividend	10.13	815	10.13	815

The proposed final dividend was approved by the Board of Directors on 16 April 2013 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 23 February 2013, in accordance with IAS 10 'Events After the Balance Sheet Date'. It will be paid on 5 July 2013 to shareholders who are on the Register of members at close of business on 26 April 2013.

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 financial 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 financial year adjusted for the effects of potentially dilutive options. The dilutive 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.

	2013			2012		
	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
Profit/(loss) (£m)						
Continuing operations	1,390	–	1,390	3,156	–	3,156
Discontinued operations	(1,266)	–	(1,266)	(350)	–	(350)
Weighted average number of shares (millions)	8,033	4	8,037	8,021	24	8,045
Earnings per share (pence)						
Continuing operations	17.30	–	17.30	39.35	(0.12)	39.23
Discontinued operations	(15.76)	–	(15.76)	(4.37)	0.02	(4.35)
Total	1.54	–	1.54	34.98	(0.10)	34.88

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

	2013		2012	
	£m	pence/share	£m	pence/share
Profit from continuing operations (Diluted)	1,390	17.30	3,156	39.23
Adjustments for:				
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	14	0.17	(44)	(0.55)
IAS 19 'Employee Benefits' – non-cash Group Income Statement charge for pensions	(56)	(0.70)	17	0.21
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	28	0.35	31	0.39
IFRS 3 'Business Combinations' – intangible asset amortisation charges and costs arising from acquisitions	19	0.24	22	0.27
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	28	0.35	17	0.21
Restructuring and other one-off costs				
Impairment of PPE and onerous lease provisions	895	11.14	–	–
Impairment of goodwill	495	6.16	–	–
Provision for customer redress	115	1.43	57	0.71
Other restructuring and one-off items	51	0.63	11	0.14
Tax effect of adjustments at the effective rate of tax* (2013: 18.6%, 2012: 21.6%)	(88)	(1.10)	(24)	(0.30)
Underlying earnings from continuing operations	2,891	35.97	3,243	40.31

* The effective tax rate of 18.6% (2012: 21.6%) excludes certain permanent differences on which tax relief is not available.

Notes to the Group financial statements

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
Cost					
At 25 February 2012	1,454	726	347	3,548	6,075
Foreign currency translation	1	16	4	84	105
Additions	161	170	13	28	372
Reclassification	40	97	2	–	139
Disposals	(1)	(5)	–	–	(6)
Transfer to disposal group classified as held for sale	–	–	–	(80)	(80)
At 23 February 2013	1,655	1,004	366	3,580	6,605
Accumulated amortisation and impairment losses					
At 25 February 2012	777	340	241	99	1,457
Foreign currency translation	2	9	–	32	43
Amortisation for the year	121	91	20	–	232
Impairment losses for the year	16	–	–	495	511
At 23 February 2013	916	440	261	626	2,243
Net carrying value					
At 23 February 2013	739	564	105	2,954	4,362
At 25 February 2012	677	386	106	3,449	4,618

	Internally generated development costs £m	Pharmacy and software licences £m	Other intangible assets £m	Goodwill £m	Total £m
Cost					
At 26 February 2011	1,300	563	342	3,600	5,805
Foreign currency translation	(2)	2	–	34	34
Additions	261	77	3	100	441
Reclassification	(104)	120	3	–	19
Disposals	–	(4)	(1)	–	(5)
Transfer to disposal group classified as held for sale	(1)	(32)	–	(186)	(219)
At 25 February 2012	1,454	726	347	3,548	6,075
Accumulated amortisation and impairment losses					
At 26 February 2011	672	288	223	284	1,467
Foreign currency translation	(1)	–	–	1	–
Amortisation for the year	106	69	19	–	194
Impairment losses for the year	1	19	–	–	20
Disposals	–	(4)	(1)	–	(5)
Transfer to disposal group classified as held for sale	(1)	(32)	–	(186)	(219)
At 25 February 2012	777	340	241	99	1,457

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. 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 estimates 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 pre-tax discount rates used to calculate value in use range from 7% to 12% (2012: 6% to 17%). On a post-tax basis, the discount rates range from 5% to 10% (2012: 5% to 13%). 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.

The forecasts are extrapolated beyond five years based on estimated long-term average growth rates of 1% to 5% (2012: 1% to 5%).

In February 2013 and 2012 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:

	2013 £m	2012 £m
China	649	622
Czech Republic	–	73
Malaysia	86	86
Poland	–	388
South Korea	514	479
Tesco Bank	802	802
Thailand	173	165
Turkey	–	46
UK	701	681
US	–	102
Other	29	5
	2,954	3,449

An impairment charge of £495m (2012: £nil) arose in the year in Poland (£373m), Czech Republic (£69m) and Turkey (£53m) CGUs (all included in the European operating segment) following a period of difficult economic and trading conditions. This loss has been recognised in the cost of sales line in the Group Income Statement. The pre-tax discount rates used to calculate the value in use for Poland, Czech Republic and Turkey CGUs were 9% (2012: 11%), 7% (2012: 9%) and 12% (2012: 16%) respectively.

Notes to the Group financial statements

Note 11 Property, plant and equipment

	Land and buildings £m	Other[a] £m	Total £m
Cost			
At 25 February 2012	24,761	10,011	34,772
Foreign currency translation	428	173	601
Additions[b]	1,525	1,109	2,634
Acquired through business combinations	4	1	5
Reclassification	(104)	(28)	(132)
Classified as held for sale	(125)	(4)	(129)
Disposals	(734)	(116)	(850)
Transfer to disposal group classified as held for sale	(938)	(320)	(1,258)
At 23 February 2013	24,817	10,826	35,643
Accumulated depreciation and impairment losses			
At 25 February 2012	2,951	6,111	9,062
Foreign currency translation	64	98	162
Charge for the year	448	874	1,322
Impairment losses for the year	831	2	833
Reversal of impairment losses for the year	(5)	(1)	(6)
Reclassification	(6)	1	(5)
Classified as held for sale	(25)	(2)	(27)
Disposals	(182)	(98)	(280)
Transfer to disposal group classified as held for sale	(115)	(173)	(288)
At 23 February 2013	3,961	6,812	10,773
Net carrying value[c][d]			
At 23 February 2013	20,856	4,014	24,870
At 25 February 2012	21,810	3,900	25,710
Construction in progress included above[e]			
At 23 February 2013	584	96	680
At 25 February 2012	1,246	44	1,290

(a) Other assets consist of plant, equipment, fixtures and fittings and motor vehicles.

(b) Includes £123m (2012: £140m) 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 financial year was 5.1% (2012: 5.1%). Interest capitalised is deducted in determining taxable profit in the financial year in which it is incurred.

(c) Net carrying value includes:
(i) Capitalised interest at 23 February 2013 of £1,195m (2012: £1,185m).
(ii) Assets held under finance leases which are analysed below:

	2013		2012	
	Land and buildings £m	Other[a] £m	Land and buildings £m	Other[a] £m
Cost	157	559	149	574
Accumulated depreciation and impairment losses	(45)	(514)	(37)	(495)
Net carrying value	112	45	112	79

These assets are pledged as security for the finance lease liabilities.

(d) The net carrying value of land and buildings comprises:

	2013 £m	2012 £m
Freehold	18,335	19,016
Long leasehold – 50 years or more	623	676
Short leasehold – less than 50 years	1,898	2,118
Net carrying value	20,856	21,810

(e) Construction in progress does not include land.

Note 11 Property, plant and equipment continued

	Land and buildings £m	Other[a] £m	Total £m
Cost			
At 26 February 2011	23,479	9,091	32,570
Foreign currency translation	(14)	(11)	(25)
Additions[b]	2,286	1,172	3,458
Acquisitions through business combinations	3	6	9
Reclassification	(63)	–	(63)
Classified as held for sale	(53)	(11)	(64)
Disposals	(843)	(198)	(1,041)
Transfer to disposal group classified as held for sale	(34)	(38)	(72)
At 25 February 2012	24,761	10,011	34,772
Accumulated depreciation and impairment losses			
At 26 February 2011	2,705	5,467	8,172
Foreign currency translation	(10)	(11)	(21)
Charge for the year	429	836	1,265
Impairment losses for the year	74	25	99
Reversal of impairment losses for the year	(36)	–	(36)
Reclassification	5	–	5
Classified as held for sale	(5)	(7)	(12)
Disposals	(177)	(161)	(338)
Transfer to disposal group classified as held for sale	(34)	(38)	(72)
At 25 February 2012	2,951	6,111	9,062

(a) (b) See page 96 for footnotes.

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 estimates 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 1% to 5% (2012: 1% to 5%).

The pre-tax discount rates used to calculate value in use range from 7% to 12% (2012: 6% to 17%) depending on the specific conditions in which each store operates. On a post-tax basis, the discount rates range from 5% to 10% (2012: 5% to 13%). 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.

The impairment losses relate to stores, distribution centres and work-in-progress sites. The losses mainly arose following a review of work-in-progress sites which focused on ensuring sites achieve an appropriate return on capital and which resulted in some sites no longer being planned for development.

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.

Notes to the Group financial statements

Note 12 Investment property

	2013 £m	2012 £m
Cost		
At beginning of the year	2,253	2,092
Foreign currency translation	80	(9)
Additions	43	14
Acquisitions through business combinations	–	96
Reclassification	7	44
Classified as held for sale	(21)	23
Disposals	(45)	(7)
At end of the year	2,317	2,253
Accumulated depreciation and impairment losses		
At beginning of the year	262	229
Foreign currency translation	10	(2)
Charge for the year	36	39
Impairment losses for the year	1	2
Reclassification	18	(6)
Classified as held for sale	(6)	–
Disposals	(5)	–
At end of the year	316	262
Net carrying value at end of the year	2,001	1,991

The estimated fair value of the Group's investment property is £4.1bn (2012: £4.3bn). 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*	Retail	100%	England
Tesco Ireland Limited	Retail	100%	Republic of Ireland
Tesco-Global Stores Privately Held Co. Limited	Retail	100%	Hungary
Tesco Polska Sp. z o.o.	Retail	100%	Poland
Tesco Stores C R a.s.	Retail	100%	Czech Republic
Tesco Stores S R a.s.	Retail	100%	Slovakia
Tesco Kipa Kitle Pazarlama Ticaret ve Gida Sanayi A Ş.*	Retail	95%	Turkey
Homeplus Co., Limited	Retail	100%	South Korea
Homeplus Tesco Co., Limited	Retail	100%	South Korea
Ek-Chai Distribution System Co. Limited	Retail	86%**	Thailand
Tesco Stores (Malaysia) Sdn Bhn	Retail	70%	Malaysia
Tesco Holdings (China) Co. Limited	Retail	100%	People's Republic of China
Dobbies Garden Centres Limited	Retail	100%	Scotland
Fresh & Easy Neighborhood Market Inc.	Retail	100%	US
Tesco Personal Finance Group Limited* (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	100%	England
ELH Insurance Limited	Self-insurance	100%	Guernsey
Valiant Insurance Company Limited	Self-insurance	100%	Republic of Ireland

* Held by the Parent Company (all other principal subsidiaries are held by an intermediate subsidiary).
** 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 23 February 2013. A 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.

Note 13 Group entities continued

Interests in joint ventures and associates

The Group uses the equity method of accounting for its interest in 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 26 February 2011	224	92	316
Additions	49	–	49
Disposals	(8)	–	(8)
Foreign currency translation	12	–	12
Share of post-tax profits of joint ventures and associates	71	20	91
Other movements in reserves	–	3	3
Dividends received from joint ventures and associates	(40)	–	(40)
At 25 February 2012	308	115	423
Additions	11	87	98
Disposals	(1)	(43)	(44)
Foreign currency translation	10	6	16
Share of post-tax profits of joint ventures and associates	35	19	54
Other movements in reserves	–	(2)	(2)
Dividends received from joint ventures and associates	(46)	(5)	(51)
At 23 February 2013	317	177	494

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
Shopping Centres Limited*	Property Investment	50%	England
BLT Properties Limited*	Property Investment	50%	England
The Tesco British Land Property Partnership	Property Investment	50%	England
The Tesco Red Limited Partnership	Property Investment	50%	England
The Tesco Aqua Limited Partnership	Property Investment	50%	England
The Tesco Coral Limited Partnership	Property Investment	50%	England
The Tesco Blue Limited Partnership	Property Investment	50%	England
The Tesco Atrato Limited Partnership	Property Investment	50%	England
The Tesco Property Limited Partnership	Property Investment	50%	England
The Tesco Passaic Limited Partnership	Property Investment	50%	England
The Tesco Navona Limited Partnership	Property Investment	50%	England
The Tesco Sarum Limited Partnership	Property Investment	50%	England
The Tesco Dorney Limited Partnership	Property Investment	50%	England
Tesco BL Properties Limited	Property Investment	50%	England
Fushun Splendor Real Estate Development Co. Limited	Property Investment	50%	People's Republic of China
Anshan Tesco Real Estate Development Co. Limited	Property Investment	50%	People's Republic of China
Tesco Qinhuangdo Property Limited	Property Investment	50%	People's Republic of China
Xiamen Hete Property Co. Limited	Property Investment	50%	People's Republic of China
Tesco Fujian Property Limited	Property Investment	50%	People's Republic of China
Tesco (Fujian) Industry Limited	Property Investment	50%	People's Republic of China
Tesco Shenyang Property Co. Limited	Property Investment	50%	People's Republic of China
Tesco Nanjing Zhongshan Real Estate Development Co. Limited	Property Investment	50%	People's Republic of China
Arena (Jersey) Management Limited	Property Investment	50%	Jersey
The Tesco Property (No. 2) Limited Partnership	Property Investment	50%	Jersey
Aeon Every Co., Ltd	Retail	50%	Japan
Tesco Mobile Limited	Telecommunications	50%	England

* Held by the Parent Company (all other significant joint ventures are held by an intermediate subsidiary).

The accounting period ends of the joint ventures consolidated in these financial statements range from 31 December 2012 to 28 February 2013. The accounting period end dates differ from those of the Group for commercial reasons and depend upon the requirements of the joint venture partner as well as those of the Group. There are no significant restrictions on the ability of joint ventures to transfer funds to the parent, other than those imposed by the Companies Act 2006.

Notes to the Group financial statements

Note 13 Group entities continued

The share of the assets, liabilities, revenue and profit of the joint ventures, which are included in the Group financial statements, are as follows:

	2013 £m	2012 £m
Non-current assets	3,384	3,173
Current assets	821	868
Current liabilities	(2,233)	(2,180)
Non-current liabilities	(1,837)	(1,678)
Goodwill	7	7
Net assets	142	190
Cumulative unrecognised losses	175	118
Interests in joint ventures	317	308
Revenue	551	492
Profit for the year	35	71

Associates
The Group's principal associates are:

	Business activity	Share of issued share capital, loan capital and debt securities	Country of incorporation and principal country of operation
Tesco Underwriting Limited*	Insurance	49.9%	England
Tesco Lotus Retail Growth Freehold and Leasehold Property Fund*	Property Investment	25%	Thailand

* Held by an intermediate subsidiary.

In August 2012, the Group disposed of its interest in Greenergy International Limited.

The share of the assets, liabilities, revenue and profit of the Group's associates, which are included in the Group financial statements, are as follows:

	2013 £m	2012 £m
Assets	568	782
Liabilities	(397)	(673)
Goodwill	6	6
Interests in associates	177	115
Revenue	2,370	3,791
Profit for the year	19	20

The accounting period ends of the associates consolidated in these financial statements range from 31 December 2012 to 28 February 2013. The accounting period end dates of the associates are different from those of the Group as they 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

	2013 £m	2012 £m
Loan receivable	–	259
Available-for-sale financial assets	818	1,267
	818	1,526

Available-for-sale financial assets comprise investments in bonds with varied maturities of which £57m (2012: £158m) is current.

Note 15 Inventories

	2013 £m	2012 £m
Goods held for resale	3,643	3,537
Development properties	101	61
	3,744	3,598

Note 16 Trade and other receivables

	2013 £m	2012 £m
Prepayments and accrued income	417	420
Other receivables	1,636	1,848
Amounts owed by joint ventures and associates (Note 28)	472	389
	2,525	2,657

Included within trade and other receivables are the following amounts receivable after more than one year:

	2013 £m	2012 £m
Prepayments and accrued income	22	36
Other receivables	472	377
Amounts owed by joint ventures and associates	335	269
	829	682

Trade and other receivables are generally non interest-bearing. Credit terms vary by country and the nature of the debt, ranging from seven to sixty days.

As at 23 February 2013, trade and other receivables of £33m (2012: £30m) were past due and impaired. The amount of the provision was £51m (2012: £50m). The ageing analysis of these receivables is as follows:

	2013 £m	2012 £m
Up to three months past due	6	5
Three to six months past due	3	3
Over six months past due	24	22
	33	30

As at 23 February 2013, trade and other receivables of £153m (2012: £415m) were past due but not impaired. The ageing analysis of these receivables is as follows:

	2013 £m	2012 £m
Up to three months past due	107	194
Three to six months past due	15	114
Over six months past due	31	107
	153	415

No receivables have been renegotiated in the current or prior financial years.

Note 17 Loans and advances to customers

Tesco Bank has loans and advances to customers.

	2013 £m	2012 £m
Non-current	2,465	1,901
Current	3,094	2,502
	5,559	4,403

The maturity of these loans and advances is as follows:

At 23 February 2013	2013 £m	2012 £m
Repayable on demand or at short notice	3	1
Within three months	3,019	2,557
Greater than three months but less than one year	175	46
Greater than one year but less than five years	1,803	1,396
After five years	731	588
	5,731	4,588
Provision for impairment of loans and advances	(172)	(185)
	5,559	4,403

At 23 February 2013, £1.2bn of the credit card portfolio had its beneficial interest assigned to a special purpose entity for use as collateral in securitisation transactions (2012: £1.2bn). Included within the unsecured lending balance is £1.3bn (2012: £nil) that has been prepositioned with the Bank of England for the purposes of contingent liquidity via the discount window facility and consequently is eligible for future participation in the Funding for Lending Scheme.

Notes to the Group financial statements

Note 17 Loans and advances to customers continued

Provision for impairment of loans and advances

	£m
At 26 February 2011	(182)
Charge for the year	(119)
Amounts written off	120
Recoveries of amounts previously written off	(8)
Unwind of discount	4
At 25 February 2012	(185)
Charge for the year	(73)
Amounts written off	94
Recoveries of amounts previously written off	(11)
Unwind of discount	3
At 23 February 2013	(172)

At 23 February 2013, Tesco Bank's non-accrual loans were £185m (2012: £194m). During the financial year ended 23 February 2013, the gross income not recognised but which would have been recognised under the original terms of non-accrual loans was £12m (2012: £13m).

Note 18 Cash and cash equivalents

	2013 £m	2012 £m
Cash at bank and in hand	2,309	1,995
Short-term deposits	63	182
Certificates of deposit	140	35
Loans and advances to banks	–	93
Cash and cash equivalents	2,512	2,305

Cash of £522m (2012: £1,243m) held on money market funds is classed as short-term investments.

Note 19 Trade and other payables

	2013 £m	2012 £m
Trade payables	6,036	5,971
Other taxation and social security	440	462
Other payables	2,750	2,651
Amounts payable to joint ventures and associates (Note 28)	33	404
Accruals and deferred income	1,835	1,746
	11,094	11,234

Included in other payables are amounts of £262m (2012: £223m) which are non-current.

Note 20 Borrowings

Current

	Par value	Maturity year	2013 £m	2012 £m
Bank loans and overdrafts	–	–	730	399
Loan from joint ventures (Note 28)	–	–	16	16
5.625% MTN	€1,500m	2012	–	1,304
Other MTNs	–	–	14	87
Finance leases (Note 34)	–	–	6	32
			766	1,838

Non-current

	Par value	Maturity year	2013 £m	2012 £m
5% MTN	£600m	2014	642	619
2% USD Bond	$500m	2014	328	317
5.125% MTN	€600m	2015	566	526
4% RPI MTN*	£290m	2016	295	288
5.875% MTN	€1,039m	2016	1,071	1,042
2.7% USD Bond	$500m	2017	328	318
5.5% USD Bond	$850m	2017	674	659
5.2% Tesco Bank Retail Bond	£125m	2018	141	138
3.375% MTN	€750m	2018	653	638
5.5% MTN	£350m	2019	352	352
1% RPI Tesco Bank Retail Bond**	£60m	2019	60	59
5% Tesco Bank Retail Bond	£200m	2020	206	–
6.125% MTN	£900m	2022	948	892
5% MTN	£389m	2023	404	401
3.322% LPI MTN†	£296m	2025	299	290
6% MTN	£200m	2029	255	251
5.5% MTN	£200m	2033	251	249
1.982% RPI MTN±	£247m	2036	248	242
6.15% USD Bond	$1,150m	2037	911	897
4.875% MTN	£173m	2042	174	174
5.125% MTN	€600m	2047	641	635
5.2% MTN	£279m	2057	274	274
Other MTNs	–	–	146	162
Other loans	–	–	79	354
Finance leases (Note 34)	–	–	122	134
			10,068	9,911

* The 4% RPI MTN is redeemable at par, including indexation for increases in the Retail Price Index ('RPI') over the life of the MTN.
** The 1% RPI Tesco Bank Retail Bond is redeemable at par, including indexation for increases in the RPI over the life of the Bond.
† The 3.322% Limited Price Inflation ('LPI') MTN is redeemable at par, including indexation 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%.
± The 1.982% RPI MTN is redeemable at par, including indexation for increases in the RPI over the life of the MTN.

Borrowing facilities

The Group has the following undrawn committed facilities available at 23 February 2013, in respect of which all conditions precedent had been met as at that date:

	2013 £m	2012 £m
Expiring between one and two years	1,600	–
Expiring in more than two years	1,225	2,825
	2,825	2,825

All facilities incur commitment fees at market rates and would provide funding at floating rates.

Notes to the Group financial statements

Note 21 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.

Net finance cost of £19m (2012: Net finance income of £3m) 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 gain of £52m on hedging instruments was recognised during the year, offset by a loss of £65m on hedged items (2012: a gain of £263m on hedging instruments was offset by a loss of £260m 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. These 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.

The Group also uses index-linked swaps to hedge cash flows on index-linked debt, interest rate swaps to hedge interest cash flows on debt and cross currency swaps to hedge intercompany loan cash flows denominated in foreign currencies.

Net investment hedges

The Group uses forward foreign currency contracts, currency denominated borrowings and currency swaps to hedge the exposure of a portion of its non-Sterling denominated assets against changes in value due to changes in foreign exchange rates. A net finance cost of £6m (2012: £nil) was recorded resulting from net investment ineffectiveness.

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 naturally offset in the Group Income Statement.

These instruments include cross currency 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 fair value of derivative financial instruments have been disclosed in the Group Balance Sheet as follows:

	2013		2012	
	Asset £m	Liability £m	Asset £m	Liability £m
Current	58	(121)	41	(128)
Non-current	1,965	(759)	1,726	(688)
	2,023	(880)	1,767	(816)

Note 21 Financial instruments continued

The fair value and notional amounts of derivatives analysed by hedge type are as follows:

	2013				2012			
	Asset		Liability		Asset		Liability	
	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m
Fair value hedges								
Interest rate swaps and similar instruments	125	1,601	(59)	1,924	96	1,751	(68)	2,031
Cross currency swaps	890	2,749	(34)	249	818	2,686	(8)	269
Cash flow hedges								
Interest rate swaps and similar instruments	5	60	(126)	480	–	–	(132)	400
Cross currency swaps	237	642	(32)	531	233	304	(41)	988
Index-linked swaps	80	833	–	–	30	809	–	–
Forward foreign currency contracts	43	1,138	(19)	697	23	733	(21)	1,211
Net investment hedges								
Forward foreign currency contracts	–	–	–	–	–	–	(7)	969
Cash flow hedges and net investment hedges								
Cross currency swaps	–	–	(10)	325	–	–	(1)	318
Derivatives not in a formal hedge relationship								
Interest rate swaps and similar instruments	–	–	–	–	3	25	(1)	25
Cross currency swaps	2	49	(3)	89	3	146	(4)	56
Index-linked swaps	627	3,604	(539)	3,589	539	3,149	(468)	3,149
Forward foreign currency contracts	14	397	(58)	1,121	22	923	(62)	1,282
Future purchases of non-controlling interests	–	–	–	–	–	–	(3)	–
Total	2,023	11,073	(880)	9,005	1,767	10,526	(816)	10,698

The carrying value and fair value of financial assets and liabilities are as follows:

	2013		2012	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Assets				
Cash and cash equivalents	2,512	2,512	2,305	2,305
Loans and advances to customers – Tesco Bank	5,559	5,581	4,403	4,440
Short-term investments	522	522	1,243	1,243
Other investments – Tesco Bank	818	818	1,526	1,524
Joint venture and associates loan receivables (Note 28)	459	459	384	384
Other receivables	17	17	10	10
Derivative financial assets:				
Interest rate swaps and similar instruments	130	130	99	99
Cross currency swaps	1,129	1,129	1,054	1,054
Index-linked swaps	707	707	569	569
Forward foreign currency contracts	57	57	45	45
Total financial assets	11,910	11,932	11,638	11,673
Liabilities				
Short-term borrowings:				
Amortised cost	(535)	(535)	(1,806)	(1,841)
Bonds in fair value hedge relationships	(225)	(221)	–	–
Long-term borrowings:				
Amortised cost	(4,450)	(4,899)	(4,575)	(4,966)
Bonds in fair value hedge relationships	(5,496)	(5,114)	(5,202)	(5,140)
Finance leases (Note 34)	(128)	(128)	(166)	(166)
Customer deposits – Tesco Bank	(6,000)	(5,997)	(5,387)	(5,410)
Deposits by banks – Tesco Bank	(15)	(15)	(78)	(78)
Derivative and other financial liabilities:				
Interest rate swaps and similar instruments	(185)	(185)	(201)	(201)
Cross currency swaps	(79)	(79)	(54)	(54)
Index-linked swaps	(539)	(539)	(468)	(468)
Forward foreign currency contracts	(77)	(77)	(90)	(90)
Future purchases of non-controlling interests	–	–	(3)	(3)
Total financial liabilities	(17,729)	(17,789)	(18,030)	(18,417)
Total	(5,819)	(5,857)	(6,392)	(6,744)

Notes to the Group financial statements

Note 21 Financial instruments continued

The fair values of financial instruments and derivatives have been determined by reference to prices available from the markets on which the instruments are traded, where they are available. Where market prices are not available, the fair value has 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 23 February 2013 and 25 February 2012 are as follows:

At 23 February 2013	Available-for-sale £m	Loans and receivables/ other financial liabilities £m	Fair value through profit or loss £m	Total £m
Cash and cash equivalents	140	2,372	–	2,512
Loans and advances to customers – Tesco Bank	–	5,559	–	5,559
Short-term investments	–	522	–	522
Other investments – Tesco Bank	818	–	–	818
Joint venture and associates loan receivables (Note 28)	–	459	–	459
Other receivables	–	17	–	17
Customer deposits – Tesco Bank	–	(6,000)	–	(6,000)
Deposits by banks – Tesco Bank	–	(15)	–	(15)
Short-term borrowings	–	(760)	–	(760)
Long-term borrowings	–	(9,946)	–	(9,946)
Finance leases (Note 34)	–	(128)	–	(128)
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	–	(55)	(55)
Cross currency swaps	–	–	1,050	1,050
Index-linked swaps	–	–	168	168
Forward foreign currency contracts	–	–	(20)	(20)
	958	(7,920)	1,143	(5,819)

At 25 February 2012	Available-for-sale £m	Loans and receivables/ other financial liabilities £m	Fair value through profit or loss £m	Total £m
Cash and cash equivalents	35	2,270	–	2,305
Loans and advances to customers – Tesco Bank	–	4,403	–	4,403
Short-term investments	–	1,243	–	1,243
Other investments – Tesco Bank	1,267	259	–	1,526
Joint venture and associates loan receivables (Note 28)	–	384	–	384
Other receivables	–	10	–	10
Customer deposits – Tesco Bank	–	(5,387)	–	(5,387)
Deposits by banks – Tesco Bank	–	(78)	–	(78)
Short-term borrowings	–	(1,806)	–	(1,806)
Long-term borrowings	–	(9,777)	–	(9,777)
Finance leases (Note 34)	–	(166)	–	(166)
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	–	(102)	(102)
Cross currency swaps	–	–	1,000	1,000
Index-linked swaps	–	–	101	101
Forward foreign currency contracts	–	–	(45)	(45)
Future purchases of non-controlling interests	–	–	(3)	(3)
	1,302	(8,645)	951	(6,392)

Note 21 Financial instruments continued

Fair value measurement

The following table presents the Group's financial assets and liabilities that are measured at fair value at 23 February 2013, by level of fair value 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).

At 23 February 2013	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Available-for-sale financial assets	808	150	–	958
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	130	–	130
Cross currency swaps	–	1,129	–	1,129
Index-linked swaps	–	707	–	707
Forward foreign currency contracts	–	57	–	57
Total assets	808	2,173	–	2,981
Liabilities				
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	(185)	–	(185)
Cross currency swaps	–	(79)	–	(79)
Index-linked swaps	–	(539)	–	(539)
Forward foreign currency contracts	–	(77)	–	(77)
Total liabilities	–	(880)	–	(880)
Total	808	1,293	–	2,101

At 25 February 2012	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Available-for-sale financial assets	542	760	–	1,302
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	99	–	99
Cross currency swaps	–	1,054	–	1,054
Index-linked swaps	–	569	–	569
Forward foreign currency contracts	–	45	–	45
Total assets	542	2,527	–	3,069
Liabilities				
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	(201)	–	(201)
Cross currency swaps	–	(54)	–	(54)
Index-linked swaps	–	(468)	–	(468)
Forward foreign currency contracts	–	(90)	–	(90)
Future purchases of non-controlling interests	–	–	(3)	(3)
Total liabilities	–	(813)	(3)	(816)
Total	542	1,714	(3)	2,253

The following table presents the changes in Level 3 instruments for the year ending 23 February 2013:

	2013 £m	2012 £m
At beginning of the year	(3)	(106)
Gains/(losses) recognised in finance costs in the Group Income Statement	–	33
Gains/(losses) recognised in the Group Statement of Changes in Equity	–	(3)
Purchase of non-controlling interests	3	73
At end of the year	–	(3)

During the financial year, £431m (2012: £nil) of Level 2 assets were transferred to Level 1 due to improved valuation systems, and there were no transfers into or out of Level 3 fair value measurements. At the start of the year the Group had a liability (classified as Level 3) relating to the future purchase of the minority shareholding of its subsidiary blinkbox entertainment limited. This option was exercised during the year.

Notes to the Group financial statements

Note 22 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. The management of these risks is set out below.

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 Principal risks and uncertainties on pages 38 to 42.

Interest rate risk
Interest rate risk arises from long-term borrowings. Debt issued at variable rates as well as cash deposits and short-term investments 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 42.

The Group has Retail Price Index ('RPI') debt where the principal is indexed to increases in the RPI. RPI debt is treated as floating rate debt. The Group also has Limited Price Inflation ('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, refer to the separate section on Tesco Bank financial risk factors below.

During 2013 and 2012, net debt was managed using derivative instruments to hedge interest rate risk as follows:

	2013			2012		
	Fixed £m	Floating £m	Total £m	Fixed £m	Floating £m	Total £m
Cash and cash equivalents	140	2,372	2,512	35	2,270	2,305
Loans and advances to customers – Tesco Bank	2,739	2,820	5,559	1,956	2,447	4,403
Short-term investments	–	522	522	–	1,243	1,243
Other investments	707	111	818	1,335	191	1,526
Joint venture and associate, loan receivables (Note 28)	–	459	459	–	384	384
Other receivables	–	17	17	–	10	10
Finance leases (Note 34)	(104)	(24)	(128)	(111)	(55)	(166)
Bank and other borrowings	(9,569)	(1,137)	(10,706)	(10,729)	(854)	(11,583)
Customer deposits – Tesco Bank	(2,399)	(3,601)	(6,000)	(1,470)	(3,917)	(5,387)
Deposits by banks – Tesco Bank	(15)	–	(15)	(78)	–	(78)
Future purchases of non-controlling interests	–	–	–	(3)	–	(3)
Derivative effect:						
Interest rate swaps	(1,156)	1,156	–	(1,402)	1,402	–
Cross currency swaps	2,436	(2,436)	–	2,635	(2,635)	–
Index-linked swaps	(537)	537	–	(522)	522	–
Caps and collars	–	–	–	(1)	1	–
Total	(7,758)	796	(6,962)	(8,355)	1,009	(7,346)

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 42.

The counterparty exposure under derivative contracts is £2.0bn (2012: £1.8bn). The Group considers its maximum credit risk to be £11.9bn (2012: £11.6bn), being the Group's total financial assets.

For credit risk relating to Tesco Bank, refer to the separate section on Tesco Bank financial risk factors below.

Liquidity risk
Liquidity risk is managed by short-term and long-term cash flow forecasts. In addition, the Group has committed facility agreements for £2.8bn (2012: £2.8bn), which mature between 2014 and 2015.

The Group has a European Medium Term Note programme of £15.0bn, of which £6.2bn was in issue at 23 February 2013 (2012: £7.4bn), plus a Euro Commercial Paper programme of £2.0bn, of which £0.1bn was in issue at 23 February 2013 (2012: £nil), and a US Commercial Paper programme of $4.0bn, of which £0.1bn was in issue at 23 February 2013 (2012: £nil).

On 12 September 2012 the Group repaid €1.5bn of long-term debt.

For liquidity risk relating to Tesco Bank, refer to the separate section on Tesco Bank financial risk factors below.

Note 22 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 £17.4bn is considered acceptable as it is offset by financial assets and trade receivables of £14.4bn (2012: £18.6bn offset by financial assets and trade receivables of £14.3bn).

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 23 February 2013	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
Non-derivative financial liabilities						
Bank and other borrowings	(711)	(1,081)	(553)	(1,550)	(575)	(5,805)
Interest payments on borrowings	(451)	(441)	(402)	(375)	(301)	(3,511)
Customer deposits – Tesco Bank	(5,323)	(577)	(100)	–	–	–
Deposits by banks – Tesco Bank	(9)	(6)	–	–	–	–
Finance leases	(13)	(13)	(13)	(13)	(13)	(212)
Trade and other payables	(10,865)	(93)	(31)	(19)	(12)	(74)
Derivative and other financial liabilities						
Net settled derivative contracts – receipts	63	62	27	71	20	608
Net settled derivative contracts – payments	(106)	(78)	(71)	(50)	(47)	(362)
Gross settled derivative contracts – receipts	3,610	1,588	157	1,057	1,369	1,008
Gross settled derivative contracts – payments	(3,564)	(1,485)	(57)	(916)	(1,000)	(531)
Total	(17,369)	(2,124)	(1,043)	(1,795)	(559)	(8,879)

At 25 February 2012	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
Non-derivative financial liabilities						
Bank and other borrowings	(1,734)	(867)	(1,005)	(5)	(1,524)	(6,124)
Interest payments on borrowings	(557)	(431)	(395)	(359)	(359)	(3,716)
Customer deposits – Tesco Bank	(5,087)	(249)	(51)	–	–	–
Deposits by banks – Tesco Bank	(78)	–	–	–	–	–
Finance leases	(39)	(17)	(15)	(13)	(13)	(222)
Trade and other payables	(11,011)	(105)	(22)	(35)	(9)	(52)
Derivative and other financial liabilities						
Net settled derivative contracts – receipts	67	54	56	21	60	470
Net settled derivative contracts – payments	(122)	(80)	(69)	(61)	(43)	(342)
Gross settled derivative contracts – receipts	3,905	735	1,416	166	1,047	3,757
Gross settled derivative contracts – payments	(3,900)	(652)	(1,328)	(77)	(935)	(2,685)
Future purchases of non-controlling interests	(3)	–	–	–	–	–
Total	(18,559)	(1,612)	(1,413)	(363)	(1,776)	(8,914)

Foreign exchange risk

The Group is exposed to foreign exchange risk principally via:

- Transactional exposure arises 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 21.
- Net investment exposure arises from changes in the value of net investments denominated in currencies other than Pounds Sterling. The Group hedges a part 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 are hedged via foreign currency transactions and borrowings in matching currencies. These are not formally designated as hedges as gains and losses on hedges and hedged loans will naturally offset.

Notes to the Group financial statements

Note 22 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 23 February 2013. 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 exposures on debt, deposits and derivative instruments with no sensitivity assumed for RPI-linked debt which has been swapped to fixed rates;
- 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 the Group Statement of Comprehensive Income;
- 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; 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:

	2013		2012	
	Income gain/(loss) £m	Equity gain/(loss) £m	Income gain/(loss) £m	Equity gain/(loss) £m
1% increase in GBP interest rates (2012: 1%)	8	–	(3)	–
5% appreciation of the Euro (2012: 5%)	(12)	(43)	(1)	(40)
5% appreciation of the South Korean Won (2012: 5%)	–	56	–	59
5% appreciation of the US Dollar (2012: 5%)	(13)	52	10	50
5% appreciation of the Czech Koruna (2012: 5%)	(1)	21	1	17

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 the Group Statement of Comprehensive Income from changing exchange rates results from the revaluation of financial liabilities used as net investment hedges. The impact on the Group Statement of Comprehensive Income will largely be offset by the revaluation in equity of the hedged assets.

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. During 2013, the Group purchased and cancelled £nil of ordinary shares (2012: £290m).

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 financial year with bonds redeemed of £1,285m (2012: £521m) and no new bonds were issued (2012: £1,358m) except those issued by Tesco Bank. The Group borrows centrally and locally, using a variety of capital market instruments and borrowing facilities to meet the Group's business requirements of each local business.

Note 22 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 Economic Value Equity ('EVE') for risk management purposes with focus on the value of Tesco Bank in today's interest rate environment and its sensitivity to changes in interest rates. Interest rate risk is managed using interest rate swaps as the main hedging instrument.

Liquidity risk
Liquidity risk is the risk that Tesco Bank is unable to meet its payment obligations as they fall due. Liquidity risk is managed within Tesco Bank's banking activities and adheres to the liquidity requirements set by the Prudential Regulation Authority ('PRA'). Tesco Bank's Board has set a defined liquidity risk policy and contingency funding which is prudent and in excess of the minimum requirements as set out by the PRA and by Tesco Bank. 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 sufficient liquidity to meet all foreseeable outflow requirements as they fall due and its liquidity risk is further mitigated by its well diversified retail deposit base and a pool of surplus cash resources that are invested in a range of marketable assets.

Credit risk
Credit risk is the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. Credit risk principally arises from the Bank's retail lending activities but also from the placement of surplus funds with other banks and money market funds, investments in transferable securities and interest rate and foreign exchange derivatives. In addition, credit risk arises from contractual arrangements with third parties where payments and commissions are due to the Bank for short periods of time.

Retail credit policy is managed through the credit risk policy framework with standards and limits defined at all stages of the customer lifecycle, including new account sanctioning, customer management and collections and recovery activity. Customer lending decisions are managed principally through the deployment of bespoke credit scorecard models and credit policy rules, which exclude specific areas of lending, and an affordability assessment which determines a customer's ability to repay an outstanding credit amount. Wholesale credit risk is managed using a limit-based framework, with limits determined by counterparty credit worthiness, instrument type and remaining tenor. A limits framework is also in place for the management of third party credit exposures.

Ineffective management and controls over the emerging asset quality of the Group's lending portfolios could expose the Group to unacceptable levels of bad debt. The Group's asset quality is reflected through the level of its impairment by lending type. Asset quality profiles are regularly monitored and reported to the appropriate senior management team and risk committees.

The table below presents an analysis of credit exposure by impairment status across the different exposure classes. The table predominantly relates to banking assets; the retail instalment lending applies to credit agreements in the insurance business.

Credit quality of loans and advances

As at 23 February 2013	Retail unsecured lending £m	Retail mortgage lending £m	Retail instalment lending £m	Total £m
Past due and defaulted				
Less than 90 days past due	30	–	–	30
90–179 days past due	42	–	–	42
180 days plus past due	76	–	–	76
Past due but not defaulted				
0–29 days past due	41	–	1	42
30–59 days past due	11	–	–	11
60–119 days past due	9	–	–	9
Neither past due nor defaulted				
Low risk*	4,935	258	202	5,395
High risk**	126	–	–	126
Total	5,270	258	203	5,731

* Low risk is defined as an asset with a probability of default of less than 10%.
** High risk is defined as an asset with a probability of default of 10% or more.

Notes to the Group financial statements

Note 22 Financial risk factors continued

Credit quality of loans and advances As at 25 February 2012	Retail unsecured lending £m	Retail mortgage lending £m	Retail instalment lending† £m	Total £m
Past due and defaulted				
Less than 90 days past due	27	–	–	27
90–179 days past due	45	–	–	45
180 days plus past due	81	–	–	81
Past due but not defaulted				
0–29 days past due	50	–	1	51
30–59 days past due	14	–	–	14
60–119 days past due	10	–	–	10
Neither past due nor defaulted				
Low risk*	4,202	–	247	4,449
High risk**	159	–	–	159
Total	4,588	–	248	4,836

* Low risk is defined as an asset with a probability of default of less than 10%.
** High risk is defined as an asset with a probability of default of 10% or more.
† Prior year retail instalment lending of £248m was classified as trade and other receivables.

During the year ended 28 February 2013 there was a change to the methodology by which the Group measures credit risk in relation to outstanding loan balances. The new methodology is considered to provide a more appropriate disclosure for reporting and monitoring purposes. The Group has prepared a prior year comparator using this new methodology.

The credit risk exposure from off balance sheet items, mainly undrawn credit card facilities and mortgage offers, was £8.5bn (2012: £7.4bn).

Insurance risk
Tesco Bank is indirectly exposed to insurance risks through its ownership of 49.9% of Tesco Underwriting Limited ('TU'), an authorised insurance company. Since late 2010 the majority of new business policies for Home and Motor Insurance products sold by Tesco Bank have been underwritten by TU. The key insurance risks within TU relate to Underwriting Risk and specifically the potential for a major weather event to generate significant claims on Home insurance or on Motor insurance the cost of settling bodily injury claims. Exposure to this risk is actively managed within TU with close monitoring of performance metrics and the use of reinsurance to limit TU's exposure above predetermined limits.

During the year the relationship with RBS Insurance was terminated and the Group has no exposure to insurance risk arising from this historic relationship.

Note 23 Customer deposits and deposits by banks

	2013 £m	2012 £m
Customer deposits	6,000	5,387
Deposits by banks	15	78
	6,015	5,465

Included above is £677m (2012: £300m) non-current customer deposits and £6m (2012: £nil) non-current deposits by banks.

Note 24 Provisions

	Property provisions £m	Other provisions £m	Total £m
At 26 February 2011	138	39	177
Foreign currency translation	2	–	2
Amount released in the year	(45)	–	(45)
Amount provided in the year	28	61	89
Amount utilised in the year	(4)	(22)	(26)
Others	2	–	2
At 25 February 2012	121	78	199
Foreign currency translation	6	–	6
Amount released in the year	(12)	–	(12)
Amount provided in the year	254	116	370
Amount utilised in the year	(11)	(92)	(103)
At 23 February 2013	358	102	460

The balances are analysed as follows:

	2013 £m	2012 £m
Current	188	99
Non-current	272	100
	460	199

Property provisions comprise obligations for future rents payable net of rents receivable on onerous leases including on vacant property and unprofitable stores, terminal dilapidations and other onerous contracts relating to property. The majority of these provisions are expected to be utilised over the period to 2020.

The other provisions balance relates mainly to a provision for Tesco Bank customer redress in respect of potential complaints arising from the historic sales of Payment Protection Insurance ('PPI'). During the year, a full-scale proactive customer contact programme was initiated for customers who were sold PPI over a specific time period. As a result of this activity and the contact received directly from customers, an increase in the provision was made. The PPI provision may be used over several years although the timing of utilisation is uncertain. The balance is classified as current at the year end.

Notes to the Group financial statements

Note 25 Share-based payments

For continuing operations, the Group Income Statement charge for the year recognised in respect of share-based payments is £89m (2012: £151m), which is made up of share option schemes and share bonus payments. Of this amount, £65m (2012: £124m) will be settled in equity and £24m (2012: £27m) in cash.

Share option schemes
The Company had ten share option schemes in operation during the financial 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 of 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 €500 per four-weekly period. Options are capable of being exercised at the end of the three- or five-year period at a subscription price of 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 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.

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 senior executives. Options are normally exercisable between three and ten years from the date of grant for nil consideration. Full details of this plan can be found in the Directors' Remuneration Report.

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 upon the achievement of specified performance targets related to the return on capital employed over a three-year period. No further options will be granted under this scheme and it has been replaced by the Performance Share Plan (2011).

viii) The Performance Share Plan (2011) was adopted on 1 July 2011 and amended on 4 July 2011. 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. The exercise of options will normally be conditional upon the achievement of specified performance targets related to the return on capital employed and earnings per share over a three-year period.

Note 25 Share-based payments continued

ix) 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 upon the achievement of a specified performance target related to the annual percentage growth in earnings per share over a three-year period. There were no discounted options granted under this scheme.

x) 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 upon 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 23 February 2013

	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 option schemes	
	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 25 February 2012	131,921,033	350.28	4,975,203	352.95	13,668,564	395.47	87,418,835	377.80	59,751,420	385.37	17,801,914	0.00
Granted	32,771,389	282.00	1,407,939	282.00	–	–	–	–	–	–	7,369,204	0.00
Forfeited	(25,049,015)	333.25	(1,055,775)	336.01	(604,143)	410.43	(3,130,086)	401.30	(4,379,756)	397.07	(3,064,780)	0.00
Exercised	(12,430,856)	321.54	(440,533)	323.97	(472,092)	281.87	(3,849,729)	257.90	(1,706,557)	284.22	(2,327,513)	0.00
Outstanding at 23 February 2013	127,212,551	338.85	4,886,834	338.78	12,592,329	399.01	80,439,020	382.62	53,665,107	387.64	19,778,825	0.00
Exercisable as at 23 February 2013	16,192,212	381.09	709,010	360.40	9,319,436	391.70	61,754,447	371.37	39,218,022	375.74	5,630,056	0.00
Exercise price range (pence)		328.00 to 410.00		328.00 to 410.00		197.50 to 473.75		197.50 to 473.75		197.50 to 473.75		0.00
Weighted average remaining contractual life (years)		0.43		0.43		4.59		4.71		4.90		5.24

For the year ended 25 February 2012

	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 option schemes	
	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 26 February 2011	141,225,710	345.41	5,720,602	348.84	14,847,597	389.21	92,512,818	374.29	65,066,054	382.06	12,399,127	0.00
Granted	28,566,015	364.00	1,133,139	364.00	7,448	402.75	2,555	402.75	40,000	402.75	6,513,912	0.00
Forfeited	(21,030,145)	376.08	(1,255,918)	367.98	(439,466)	385.94	(1,897,884)	384.93	(3,314,141)	380.28	(603,508)	0.00
Exercised	(16,840,547)	300.49	(622,620)	304.96	(747,015)	276.82	(3,198,654)	272.20	(2,040,493)	288.26	(507,617)	0.00
Outstanding at 25 February 2012	131,921,033	350.28	4,975,203	352.95	13,668,564	395.47	87,418,835	377.80	59,751,420	385.37	17,801,914	0.00
Exercisable as at 25 February 2012	16,757,641	309.18	557,813	309.91	7,887,688	402.06	44,131,269	380.11	27,530,779	393.35	5,216,671*	0.00
Exercise price range (pence)		248.00 to 410.00		307.00 to 410.00		197.50 to 473.75		197.50 to 473.75		197.50 to 473.75		0.00
Weighted average remaining contractual life (years)		0.43		0.43		4.94		4.65		5.01		6.17

* Previously, 2012 included options granted within the year.

Share options were exercised on a regular basis throughout the financial year. The average share price during the financial year ended 23 February 2013 was 328.39p (2012: 385.43p).

Notes to the Group financial statements

Note 25 Share-based payments continued

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.

	2013			2012		
	Savings-related share option schemes	Executive share option schemes	Nil cost option schemes	Savings-related share option schemes	Executive share option schemes	Nil cost share option schemes
Expected dividend yield (%)	5.0%	–	0.0%	4.1%	4.1%	0.0%
Expected volatility (%)	21 – 28%	–	27%	23 – 27%	26%	26%
Risk-free interest rate (%)	0.7 – 1.0%	–	1.3%	1.5 – 1.8%	2.0%	2.6%
Expected life of option (years)	3 or 5	–	6	3 or 5	6	6
Weighted average fair value of options granted (pence)	43.45	–	317.72	69.85	62.91	408.14
Probability of forfeiture (%)	14 – 16%	–	0%	14 – 16%	10%	0%
Share price (pence)	312.00	–	317.72	404.00	402.75	408.14
Weighted average exercise price (pence)	282.00	–	0.00	364.00	402.75	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.

Share bonus schemes

Eligible UK employees are able to participate in Shares in Success, an all-employee profit-sharing scheme which permits the award of shares to employees, usually awarded as a percentage of earnings, up to a statutory maximum of £3,000 per annum. No award was made under this scheme in the financial year. Eligible Republic of Ireland employees are able to participate in a Share Bonus Scheme, an all-employee profit-sharing scheme. Each year, employees receive an award of either cash or shares based on a percentage of their earnings.

Selected executives participate in the Group Bonus Plan, a performance-related bonus scheme. 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 selected executives who have completed a required service period and depend on the achievement of corporate targets.

Selected senior executives participate in the 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. No further awards will be granted under this scheme and it has been replaced by the Performance Share Plan (2011).

Selected executives participate in the Performance Share Plan (2011). 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 and earnings per share 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.

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 financial year were:

	2013		2012	
	Number of shares	WAFV pence	Number of shares	WAFV pence
Shares in Success	–	–	26,597,598	416.26
Irish Share Bonus Scheme	110,234	301.08	156,313	419.50
Executive Incentive Scheme	4,591,717	301.13	9,482,746	415.89
Performance Share Plan	27,025,617	317.34	21,075,604	389.13
US Long-Term Incentive Plan	178,914	314.91	132,786	405.63

Note 26 Post-employment benefits

Pensions
The Group operates a variety of post-employment benefit arrangements, covering both funded and unfunded defined benefit schemes and funded defined contribution schemes. The most significant of these are the funded defined benefit pension schemes for the Group's employees in the UK, Republic of Ireland and South Korea.

Defined contribution plans
The contributions payable for defined contribution schemes of £19m (2012: £20m) have been recognised in the Group Income Statement.

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 2011, using the projected unit method.

At 31 March 2011, the actuarial deficit was £934m. The market value of the schemes' assets was £5,587m and these assets represented 86% of the benefits that had accrued to members, after allowing for expected increases in earnings and pensions in payment.

Overseas
The most significant overseas schemes are the funded defined benefit schemes which operate in the Republic of Ireland and South Korea. An independent actuary, using the projected unit method, carried out the latest actuarial assessment of the Republic of Ireland scheme as at 1 April 2010 and South Korea as at 23 February 2013.

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 23 February 2013. The schemes' assets are stated at their market values as at 23 February 2013. Towers Watson Limited have updated the most recent Republic of Ireland and South Korea valuations. 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 major assumptions, on a weighted average basis, used by the actuaries were as follows:

	2013 %	2012 %
Discount rate	5.1	5.2
Price inflation	3.3	3.1
Rate of increase in deferred pensions*	2.3	2.1
Rate of increase in salaries	3.4	3.2
Rate of increase in pensions in payment*		
Benefits accrued before 1 June 2012	3.1	2.9
Benefits accrued after 1 June 2012	2.3	–
Rate of increase in career average benefits		
Benefits accrued before 1 June 2012	3.3	3.1
Benefits accrued after 1 June 2012	2.3	–

* In excess of any Guaranteed Minimum Pension ('GMP') element.

Changes were made in the year relating to any pension earned after 1 June 2012:

- the age at which a full pension is paid increased by two years and will be adjusted in the future if there are unexpected changes to life expectancy; and
- the basis for calculating the rate of increase in pensions in payment was changed to CPI (previously RPI).

The main financial assumption is the real discount rate (i.e. 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 £210m and the annual UK current service cost would decrease/increase by approximately £13m.

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 2011 the following assumptions were adopted for funding purposes:

Base tables:
90% of the SAPS normal male pensioners for male staff and 80% of the SAPS all male pensioners light for male senior managers.
105% of the SAPS normal female pensioners for female staff and 90% for female senior managers.

These assumptions were used for the calculation of the pension liability as at 23 February 2013 for the main UK scheme.

Notes to the Group financial statements

Note 26 Post-employment benefits continued

The mortality assumptions used are based on tables that have been projected to 2009 with long cohort improvements. In addition, the allowance for future mortality improvements from 2009 is in line with medium cohort projections with a minimum annual improvement of 1% per annum.

The following table illustrates the expectation of life of an average member retiring at age 65 at the reporting date and a member reaching age 65 at reporting date +25 years.

		2013 years	2012 years
Retiring at reporting date at age 65:	Male	22.8	21.8
	Female	24.3	23.6
Retiring at reporting date +25 years at age 65:	Male	25.2	24.2
	Female	26.5	26.1

Rates of return on scheme assets

The assets in the defined benefit pension schemes and the expected nominal rates of return are as follows:

	2013		2012	
	Long-term rate of return %	Market value £m	Long-term rate of return %	Market value £m
Equities	8.0	4,005	8.1	3,377
Bonds	3.9	1,533	4.9	1,365
Property	6.0	742	6.5	577
Other (alternative assets)	8.0	907	8.1	741
Cash	3.8	19	3.6	109
Total market value of assets		7,206		6,169

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 rates of return on equities and cash have both been set with reference to the expected 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 rates take 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 financial year

Changes in the fair value of defined benefit pension assets are as follows:

	2013 £m	2012 £m
Opening fair value of defined benefit pension assets	6,169	5,608
Expected return	463	422
Actuarial gains/(losses)	94	(168)
Contributions by employer	486	457
Additional contribution by employer*	180	–
Actual member contributions	10	11
Foreign currency translation	9	(1)
Benefits paid	(205)	(160)
Closing fair value of defined benefit pension assets	7,206	6,169

* As part of the 2011 triennial valuation, the Company agreed with the Trustees to increase security and, on top of the normal contributions, made an additional contribution of £180m to the UK Pension Scheme on 30 March 2012.

Changes in the present value of defined benefit pension obligation are as follows:

	2013 £m	2012 £m
Opening defined benefit pension obligation	(8,041)	(6,964)
Current service cost	(482)	(495)
Past service gains	–	3
Interest cost	(411)	(404)
Losses on change of assumptions	(830)	(373)
Experience gains	1	43
Foreign currency translation	(16)	–
Benefits paid	205	160
Actual member contributions	(10)	(11)
Closing defined benefit pension obligation	(9,584)	(8,041)

Note 26 Post-employment benefits continued

The amounts that have been charged to the Group Income Statement and Group Statement of Comprehensive Income for the year ended 23 February 2013 are set out below:

	2013 £m	2012 £m
Analysis of the amount charged to operating profit:		
Current service cost	(482)	(495)
Past service gains	–	3
Total charge to operating profit	(482)	(492)
Analysis of the amount (charged)/credited to finance (cost)/income:		
Expected return on defined benefit pension assets	463	422
Interest on defined benefit pension obligation	(411)	(404)
Net pension finance income (Note 5)	52	18
Total charge to the Group Income Statement	(430)	(474)
Analysis of the amount recognised in the Group Statement of Comprehensive Income:		
Actuarial gains/(losses) on defined benefit pension assets	94	(168)
Experience gains arising on defined benefit pension obligation	1	43
Foreign currency translation	(7)	–
Losses on change of assumptions on defined benefit pension obligation	(830)	(373)
Total losses recognised in the Group Statement of Comprehensive Income	(742)	(498)

The cumulative losses recognised through the Group Statement of Comprehensive Income since the date of transition to IFRS are £1,965m (2012: £1,223m).

Summary of movements in deficit during the financial year

	2013 £m	2012 £m
Deficit in schemes at beginning of the year	(1,872)	(1,356)
Current service cost	(482)	(495)
Past service gains	–	3
Net pension finance income	52	18
Contributions by employer	486	457
Additional contribution by employer	180	–
Foreign currency translation	(7)	(1)
Actuarial losses	(735)	(498)
Deficit in schemes at the end of the year	(2,378)	(1,872)
Deferred tax asset (Note 6)	539	465
Deficit in schemes at the end of the year net of deferred tax	(1,839)	(1,407)

History of movements

The historical movement in defined benefit pension schemes' assets and liabilities and history of experience gains and losses are as follows:

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Total market value of assets	7,206	6,169	5,608	4,696	3,420
Present value of liabilities relating to unfunded pension schemes	(91)	(60)	(65)	(54)	(39)
Present value of liabilities relating to partially funded pension schemes	(9,493)	(7,981)	(6,899)	(6,482)	(4,875)
Pension deficit	(2,378)	(1,872)	(1,356)	(1,840)	(1,494)
Actuarial gains/(losses) on defined benefit pension assets	94	(168)	278	733	(1,270)
Experience gains/(losses) on defined benefit pension obligation	1	43	(25)	(1)	(117)

Post-employment benefits other than pensions

The Company operates a scheme offering post-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 23 February 2013 of £12m (2012: £11m) was determined in accordance with the advice of independent actuaries. During the full year £1m (2012: £1m) has been charged to the Group Income Statement and £1m (2012: £1m) of benefits were paid.

Notes to the Group financial statements

Note 26 Post-employment benefits continued

A change of 1% in assumed healthcare cost trend rates would have the following effect:

	2013 £m	2012 £m
Effect of a 1% increase in assumed healthcare cost trend rates on:		
Service and interest cost	–	–
Defined benefit obligation	2	2
Effect of a 1% decrease in assumed healthcare cost trend rates on:		
Service and interest cost	–	–
Defined benefit obligation	(1)	(1)

Expected contributions
The Company expects to make normal cash contributions of approximately £525m to defined benefit schemes in the financial year ending 22 February 2014.

Note 27 Called up share capital

	2013		2012	
	Ordinary shares of 5p each		Ordinary shares of 5p each	
	Number	£m	Number	£m
Allotted, called up and fully paid:				
At beginning of the year	8,031,812,445	402	8,046,468,092	402
Share options exercises	18,632,251	1	23,490,825	1
Share bonus awards issues	3,610,234	–	32,656,313	2
Shares purchased for cancellation	–	–	(70,802,785)	(3)
At end of the year	8,054,054,930	403	8,031,812,445	402

During the financial year, 19 million (2012: 23 million) ordinary shares of 5p each were issued in relation to share options for an aggregate consideration of £57m (2012: £69m).

During the financial year, 4 million (2012: 33 million) shares of 5p each were issued in relation to share bonus awards for an aggregate consideration of £0.2m (2012: £1.6m).

Between 24 February 2013 and 12 April 2013 options over 1,288,429 ordinary shares were exercised under the terms of the Savings-related Share Option Scheme (1981) and the Irish Savings-related Share Options Scheme (2000). Between 24 February 2013 and 12 April 2013 options over 2,741,490 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 23 February 2013, the Directors were authorised to purchase up to a maximum in aggregate of 804.0 million (2012: 803.6 million) ordinary shares.

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

Note 28 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:

Trading transactions

	Sales to related parties		Purchases from related parties		Amounts owed by related parties		Amounts owed to related parties	
	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m
Joint ventures	303	263	516	480	13	5	21	36
Associates	2	2	952	1,691	–	–	12	368

Sales to related parties consists of services/management fees and loan interest.

Purchases from related parties include £387m (2012: £351m) of rentals payable to the Group's joint ventures (including those joint ventures formed as part of the sale and leaseback programme) and £952m (2012: £1,691m) of fuel purchased from Greenergy International Limited. In addition, duty on the fuel purchases paid by the Group to Greenergy International Limited was £1,056m (2012: £1,950m).

Non-trading transactions

	Sale and leaseback of assets		Loans to related parties		Loans from related parties		Injection of equity funding	
	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m
Joint ventures	493	450	459	384	16	16	24	49
Associates	503	–	21	21	–	–	132	–

Transactions between the Group and the Group's pension plans are disclosed in Note 26.

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 13 February 2013, the Group completed a new sale and leaseback transaction involving UK property assets, structured as a 50-50 joint venture with the Cambridge University Endowment Fund. Four trading stores and three mixed use sites under development were sold for a total consideration of £493m.

During the year, the Group completed two sale and leaseback transactions involving property assets in Thailand. On 14 March 2012, seventeen trading malls were sold to the Tesco Lotus Growth Fund, an associated entity of the Group, for net consideration of £360m. On 4 December 2012, a further five trading malls were sold for a consideration of £143m.

Transactions with key management personnel

Members of the Board of Directors and Executive Committee of Tesco PLC are deemed to be key management personnel.

Key management personnel compensation and their transactions with Tesco Bank are disclosed below:

	2013 £m	2012 £m
Salaries and short-term benefits	13	13
Pensions	3	4
Share-based payments	2	9
Loss of office costs	3	–
	21	26

Of the total remuneration to key management personnel, £7m (2012: £6m) relates to Executive Committee members who are not on the PLC Board.

Transactions of key management personnel with Tesco Bank during the financial 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 23 February 2013	12	–	5	–
At 25 February 2012	12	–	13	2

Notes to the Group financial statements

Note 29 Reconciliation of profit before tax to cash generated from operations

	2013 £m	2012 £m
Profit before tax	1,960	4,038
Net finance costs (Note 5)	282	235
Share of post-tax profits of joint ventures and associates (Note 13)	(54)	(91)
Operating profit of continuing operations	2,188	4,182
Operating loss of discontinued operations	(1,257)	(324)
Depreciation and amortisation	1,590	1,498
Profits/losses arising on property-related items from continuing operations	210	(396)
Profits/losses arising on property-related items from discontinued operations	239	21
Loss arising on sale of non property-related items	–	4
Profit/(loss) arising on sale of subsidiaries and other investments	35	(5)
Impairment of goodwill (Note 10)	575	–
Net charge of impairment of property, plant and equipment and intangible assets not included in property-related items	629	75
Adjustment for non-cash element of pensions charge	(4)	35
Additional contribution into pension scheme	(180)	–
Share-based payments (Note 25)	53	125
Tesco Bank non-cash items included in profit before tax	170	166
Increase in inventories	(54)	(420)
Increase in development stock	(40)	(41)
Increase in trade and other receivables	(104)	(139)
Increase in trade and other payables and provisions	197	679
Tesco Bank (increase)/decrease in loans and advances to customers (Note 17)	(1,220)	150
Tesco Bank decrease/(increase) in trade and other receivables	359	(278)
Tesco Bank increase in customer and bank deposits and trade and other payables	487	356
(Increase)/decrease in working capital	(375)	307
Cash generated from operations	3,873	5,688

The increase in working capital includes the impact of translating foreign currency working capital movements at average exchange rates rather than year end exchange rates.

Note 30 Analysis of changes in net debt

	At 25 February 2012* £m	Tesco Bank at 25 February 2012 £m	Cash flow £m	Business combinations £m	Other non-cash movements £m	Net debt of disposal group £m	Elimination of Tesco Bank £m	At 23 February 2013* £m
Cash and cash equivalents	1,725	580	193	1	26	(13)	(1,055)	1,457
Short-term investments	1,243	–	(721)	–	–	–	–	522
Joint venture loan and other receivables	359	34	10	–	73	–	(42)	434
Bank and other borrowings	(11,007)	(576)	1,575	(1)	(694)	(1)	638	(10,066)
Finance lease payables	(166)	–	32	–	(1)	7	–	(128)
Net derivative financial instruments	1,003	(52)	24	–	166	–	31	1,172
Net debt of the disposal group	5	–	–	–	–	7	–	12
	(6,838)	(14)	1,113	–	(430)	–	(428)	(6,597)

* These amounts relate to the net debt excluding Tesco Bank but including the disposal group.

Note 31 Business combinations and other acquisitions

During the current financial year, the Group completed business combination transactions with total cash consideration of £30m, which are not considered material to the Group individually or in aggregate.

Note 32 Commitments and contingencies

Capital commitments
At 23 February 2013, there were commitments for capital expenditure contracted for, but not provided for of £1,278m (2012: £1,599m), principally relating to store development.

Contingent liabilities
Tesco PLC has irrevocably guaranteed the liabilities of the following Irish subsidiary undertakings for the financial year ended 23 February 2013, which undertakings have been exempted pursuant to Section 17(1) of the Companies (Amendment) Act 1986 of Ireland from the provisions of Section 7 (other than subsection (1)(b)) of that Act:

Monread Developments Limited, Edson Properties Limited, Edson Investments Limited, Cirrus Finance (2009) Limited, Commercial Investments Limited, Chirac Limited, Clondalkin Properties Limited, Golden Island Management Services Limited, Tesco Ireland Pension Trustees Limited, Orpingford, Tesco Trustee Company of Ireland Limited, WSC Properties Limited, Thundridge, Pharaway Properties Limited, R.J.D. Holdings, Nabola Development Limited, PEJ Property Development Limited, Cirrus Finance Limited, Tesco Ireland Limited, Wanze Properties (Dundalk) Limited, Valiant Insurance Company Limited, Tesco Ireland Holdings Limited.

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 that a settlement will be required and the value of such a payment can be reliably estimated.

Tesco Bank
At 23 February 2013, Tesco Bank had commitments of formal standby facilities, credit lines and other commitments to lend, totalling £8.5bn (2012: £7.4bn). 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 institutions 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 initial borrowings from HM Treasury are on an interest-only basis and, as from 1 April 2012, this has increased from 12 month LIBOR plus 30 basis points to 12 month LIBOR plus 100 basis points. The FSCS meets its obligations by raising management expense levies which will be capped based on limits advised by the PRA and FCA. 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. As at 23 February 2013, Tesco Bank accrued £7m (2012: £5m) in respect of its current obligation to meet expenses levies, based on indicative costs published by the FSCS.

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, which could be significant, has been made in these financial statements, so this element is treated as a contingent liability.

Note 33 Capital resources

The following table shows the composition of regulatory capital resources of Tesco Personal Finance PLC ('TPF'), being the regulated entity, at the balance sheet date:

	2013 £m	2012 £m
Tier 1 capital:		
Shareholders' funds and non-controlling interests	687	661
Tier 2 capital:		
Qualifying subordinated debt	372	375
Other interests	25	22
50% of material holdings	(64)	(53)
Other supervisory deductions	–	(259)
Total regulatory capital	1,020	746

Notes to the Group financial statements

Note 33 Capital resources continued

The movement of tier 1 capital during the financial year is analysed as follows:

	2013 £m	2012 £m
At beginning of the year	661	708
Share capital and share premium	45	112
Profit attributable to shareholders	158	65
Other reserves	(1)	6
Ordinary dividends	(105)	(108)
50% of material holdings	(11)	–
Increase in intangible assets	(60)	(122)
At end of the year	687	661

During the year the Group revised the capital disclosure of the holding in its insurance regulated associate (Tesco Underwriting Limited). This change reduced the tier 1 capital ratio in the previous year to 14.15% from 15.28%. There is no change in the risk asset ratio.

It is TPF's 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 PRA. TPF has carried regulatory capital reserves in excess of its capital requirements throughout the financial year.

Note 34 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	
	2013 £m	2012 £m	2013 £m	2012 £m
Within one year	13	39	6	32
Greater than one year but less than five years	52	58	15	20
After five years	212	222	107	114
Total minimum lease payments	277	319	128	166
Less future finance charges	(149)	(153)		
Present value of minimum lease payments	128	166		
Analysed as:				
Current finance lease payables	6	32		
Non-current finance lease payables	122	134		
	128	166		

Note 34 Leasing commitments continued

Operating lease commitments – Group as lessee
Future minimum rentals payable under non-cancellable operating leases are as follows:

	2013 £m	2012 £m
Within one year	1,404	1,289
Greater than one year but less than five years	4,999	4,797
After five years	10,867	11,237
Total minimum lease payments	17,270	17,323

Future minimum rentals payable under non-cancellable operating leases after five years are analysed further as follows:

	2013 £m	2012 £m
Greater than five years but less than ten years	4,756	4,667
Greater than ten years but less than fifteen years	3,128	3,245
After fifteen years	2,983	3,325
Total minimum lease payments – after five years	10,867	11,237

Future minimum rentals payable under non-cancellable operating leases associated with the discontinued operations in the US are excluded from the above tables (2012: £709m). See Note 7 for further details on discontinued operations.

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, therefore minimum lease payments exclude those falling after the buy-back date.

Operating lease commitments with joint ventures and associates
Since 1988 the Group has entered into several joint ventures and sold and leased back properties to and from these joint ventures. In addition, the Group also entered into property sale and leaseback transactions with an associate in this financial year. 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 to 30 full-year lease terms. The Group reviews the substance as well as the form of the arrangements when determining the classification of leases as operating or finance. 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:

	2013 £m	2012 £m
Within one year	258	241
Greater than one year but less than five years	348	398
After five years	260	297
Total minimum lease receivables	866	936

Tesco PLC – Parent Company balance sheet

	notes	23 February 2013 £m	25 February 2012 £m
Non-current assets			
Investments	5	14,540	13,675
Derivative financial instruments	10	1,913	1,706
		16,453	15,381
Current assets			
Derivative financial instruments	10	198	19
Debtors	6	12,017	8,807
Current asset investments	7	522	1,289
Cash and cash equivalents		5	–
		12,742	10,115
Creditors – amounts falling due within one year			
Borrowings	9	(292)	(1,437)
Derivative financial instruments	10	(91)	(90)
Other creditors	8	(8,218)	(5,708)
		(8,601)	(7,235)
Net current assets		4,141	2,880
Total assets less current liabilities		20,594	18,261
Creditors – amounts falling due after more than one year			
Borrowings	9	(9,436)	(9,433)
Derivative financial instruments	10	(694)	(620)
		(10,130)	(10,053)
Net assets		10,464	8,208
Capital and reserves			
Called up share capital	13	403	402
Share premium	14	5,020	4,964
Profit and loss reserve	14	5,041	2,842
Total equity		10,464	8,208

The notes on pages 127 to 134 form part of these financial statements.

Philip Clarke
Laurie McIlwee

Directors
The Parent Company financial statements on pages 126 to 134 were authorised for issue by the Directors on 1 May 2013 and are subject to the approval of the shareholders at the Annual General Meeting on 28 June 2013.

Tesco PLC
Registered number 00445790

Notes to the Parent Company financial statements

Note 1 Accounting policies

Basis of preparation
The Parent Company financial statements have been prepared on a going concern basis using the historical cost convention modified for the revaluation of certain financial instruments and in accordance with generally accepted accounting principles ('UK GAAP') and the Companies Act 2006.

The financial year represents the 52 weeks to 23 February 2013 (prior financial year 52 weeks to 25 February 2012).

A summary of the Company's significant accounting policies is 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 taken advantage of the FRS 29 'Financial Instruments: Disclosures', exemption and not provided derivative financial instrument disclosures of 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 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 Group.

Current asset investments
Current asset investments relate to money market deposits which are recognised initially at fair value, and subsequently at amortised cost. All income from these investments is included in the 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 that are denominated in foreign currencies are translated into Pounds Sterling at the exchange rates prevailing at the balance sheet date of the financial year.

Share-based payments
The fair value of employee share option plans is calculated at the grant date using the Black-Scholes model. The resulting cost is charged to the 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 shares or options to employees of subsidiary entities, this is treated as a capital contribution.

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

Debtors
Debtors are recognised initially at fair value, and subsequently at amortised cost using the effective interest rate method, less provision for impairment.

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 Company after deducting all of its liabilities. Equity instruments issued by the Company are recorded as the proceeds received, net of direct issue costs.

Borrowings
Interest-bearing bank loans and overdrafts are initially recognised 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 differences between cost and redemption value being recognised in the Company Profit and Loss Account over the period of the borrowings on an effective interest basis.

Other creditors
Other creditors are recognised initially at fair value, and subsequently at amortised cost using the effective interest rate method.

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.

Derivative financial instruments are recognised and stated at fair value. Where derivatives do not qualify for hedge accounting, any gains or losses on remeasurement are immediately recognised in the 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 items 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 reporting date 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 falling due after more than one year.

Notes to the Parent Company financial statements

Note 1 Accounting policies continued

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 Company Profit and Loss Account, together with any changes in the fair value of the hedged item that is attributable to the hedged risk.

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 Company Profit and Loss Account in the same period during which the hedged transaction affects the Company Profit and Loss Account. The classification of the effective portion when recognised in the Company Profit and Loss Account is the same as the classification of the hedged transaction. Any element of the remeasurement criteria of the derivative instrument which does not meet the criteria for an effective hedge is recognised immediately in the Company Profit and Loss Account.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, no longer qualifies for hedge accounting or is de-designated. 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 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 Company Profit and Loss Account.

Pensions

The Company participates in the Tesco PLC Pension Scheme 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 the 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 tax 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-discontinued 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.

Note 2 Auditor remuneration

	2013 £m	2012 £m
Fees payable to the Company's auditor for the audit of the Company and Group financial statements	0.8	0.7

Note 3 Employment costs, including Directors' remuneration

	2013 £m	2012 £m
Wages and salaries*	20	16
Social security costs	2	2
Pension costs	2	1
Share-based payment expense**	6	7
	30	26

* The wages and salaries expense includes a recharge from Tesco Stores Limited for Board-related functions.
** The share-based payment expense includes an amount of £3m relating to liabilities of Tesco Japan that were not transferred to the acquiring company on disposal.

The average number of employees (all Directors of the Company) during the financial year was 13 (2012: 15).

The Schedule VI requirements for Directors' remuneration are included within the Directors' Remuneration Report on pages 44 to 66.

Note 4 Dividends

For details of dividends see Note 8 in the Group financial statements.

Note 5 Investments

	Shares in Group undertakings £m	Shares in joint ventures £m	Total £m
Cost			
At 25 February 2012	14,194	16	14,210
Additions	1,449	–	1,449
Disposals	(45)	–	(45)
At 23 February 2013	15,598	16	15,614
Impairment			
At 25 February 2012	535	–	535
Impairment	539	–	539
At 23 February 2013	1,074	–	1,074
Net carrying value			
At 23 February 2013	14,524	16	14,540
At 25 February 2012	13,659	16	13,675

For a list of the Company's principal operating subsidiary undertakings and joint ventures see Note 13 in the Group financial statements.

Notes to the Parent Company financial statements

Note 6 Debtors

	2013 £m	2012 £m
Amounts owed by Group undertakings	11,823	8,611
Amounts owed by joint ventures and associates*	173	177
Other debtors	17	15
Deferred tax asset**	4	4
	12,017	8,807

Amounts owed by Group undertakings are either interest-bearing or non interest-bearing depending on the type and duration of debtor relationship.

* Of the amounts owed by joint ventures and associates, £112m (2012: £117m) is due after more than one year.
** The deferred tax asset recognised by the Company, and the movements thereon, during the financial year are as follows:

	Financial instruments £m	Other timing differences £m	Total £m
At 25 February 2012	6	(2)	4
Charge to the Profit and Loss Account for the year	(1)	1	–
At 23 February 2013	5	(1)	4

Note 7 Current asset investments

	2013 £m	2012 £m
Short-term investments	522	1,243
Short-term deposits and cash at bank	–	46
	522	1,289

Note 8 Other creditors

	2013 £m	2012 £m
Amounts falling due within one year:		
Other tax and social security	1	2
Amounts owed to Group undertakings	8,167	5,640
Other liabilities	47	66
Accruals and deferred income	3	–
	8,218	5,708

Amounts owed to Group undertakings are either interest-bearing or non interest-bearing depending on the type and duration of creditor relationship.

Note 9 Borrowings

	Par value	Maturity year	2013 £m	2012 £m
Bank loans and overdrafts	–	–	58	123
Loans from joint ventures	–	–	10	10
5.625% MTN	€1,500m	2012	–	1,304
5% MTN	£600m	2014	642	619
2% USD Bond	$500m	2014	328	317
5.125% MTN	€600m	2015	566	526
4% RPI MTN*	£290m	2016	295	288
5.875% MTN	€1,039m	2016	1,071	1,042
2.7% USD Bond	$500m	2017	328	318
5.5% USD Bond	$850m	2017	674	659
3.375% MTN	€750m	2018	653	638
5.5% MTN	£350m	2019	352	352
6.125% MTN	£900m	2022	948	892
5% MTN	£389m	2023	404	401
3.322% LPI MTN**	£296m	2025	299	290
6% MTN	£200m	2029	255	251
5.5% MTN	£200m	2033	251	249
1.982% RPI MTN†	£247m	2036	248	242
6.15% USD Bond	$1,150m	2037	911	896
4.875% MTN	£173m	2042	174	174
5.125% MTN	€600m	2047	641	635
5.2% MTN	£279m	2057	274	274
Other MTNs	–	–	122	124
Other loans	–	–	224	246
			9,728	10,870

* The 4% RPI MTN is redeemable at par, including indexation for increases in the RPI over the life of the MTN.
** The 3.322% LPI MTN is redeemable at par, including indexation 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%.
† The 1.982% RPI MTN is redeemable at par, including indexation for increases in the RPI over the life of the MTN.

	2013 £m	2012 £m
Repayment analysis:		
Amounts falling due within one year	292	1,437
	292	1,437
Amounts falling due after more than one year:		
Amounts falling due between one and two years	1,093	1,306
Amounts falling due between two and five years	2,934	1,856
Amounts falling due after more than five years	5,409	6,271
	9,436	9,433
	9,728	10,870

Notes to the Parent Company financial statements

Note 10 Derivative financial instruments

The fair value of derivative financial instruments has been disclosed in the Company's Balance Sheet as:

	2013		2012	
	Asset £m	Liability £m	Asset £m	Liability £m
Current	198	(91)	19	(90)
Non-current	1,913	(694)	1,706	(620)
Total	2,111	(785)	1,725	(710)

	2013				2012			
	Asset		Liability		Asset		Liability	
	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m
Fair value hedges								
Interest rate swaps and similar instruments	103	1,065	–	–	81	1,065	–	–
Cross currency swaps	890	2,749	(34)	249	818	2,686	(8)	269
Cash flow hedges								
Interest rate swaps and similar instruments	–	–	(126)	400	–	–	(132)	400
Cross currency swaps	237	642	(31)	531	233	304	(41)	988
Index-linked swaps	80	833	–	–	30	809	–	–
Forward foreign currency contracts	–	93	(1)	72	1	285	(4)	616
Derivatives not in a formal hedge relationship*								
Forward foreign currency contracts	–	–	–	–	–	–	(7)	969
Derivatives in cash flow hedge and not in a formal relationship**								
Cross currency swaps	–	–	(10)	325	–	–	(1)	318
Derivatives not in a formal hedge relationship								
Index-linked swaps	603	3,089	(530)	3,589	539	3,089	(468)	3,089
Forward foreign currency contracts	198	2,630	(53)	919	23	782	(49)	1,034
Total	2,111	11,101	(785)	6,085	1,725	9,020	(710)	7,683

* These are designated as net investment hedges at Group level but for PLC financial statements are classified as 'not in a formal hedge relationship'.
** These are designated as cash flow hedges and net investment hedges at Group level but for PLC financial statements are classified as cash flow hedges and 'not in a formal hedge relationship'.

Note 11 Share-based payments

The Company'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 25 in the Group financial statements.

Share option schemes
The number of options and WAEP of share option schemes relating to the Company employees are:

	Savings-related Share Option Scheme		Approved Share Option Scheme		Unapproved Share Option Scheme		Nil cost share options	
For the year ended 23 February 2013	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 25 February 2012	25,912	355.62	64,330	373.06	14,368,570	385.59	16,030,275	0.00
Granted	3,189	282.00	–	–	–	–	3,606,494	0.00
Forfeited	(11,711)	348.94	(7,146)	419.80	(379,704)	419.80	(2,991,480)	0.00
Exercised	–	–	–	–	–	–	(2,327,513)	0.00
Outstanding at 23 February 2013	17,390	346.61	57,184	367.22	13,988,866	384.66	14,317,776	0.00
Exercisable as at 23 February 2013	3,276	410.00	28,600	314.68	11,218,026	375.98	5,630,056	0.00
Exercise price range (pence)	–	410.00	–	312.75 to 318.60	–	312.75 to 473.75	–	0.00
Weighted average remaining contractual life (years)	–	0.20	–	2.51	–	4.74	–	5.24

Note 11 Share-based payments continued

For the year ended 25 February 2012	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 26 February 2011	33,834	342.93	64,330	373.06	14,368,570	385.59	12,399,127	0.00
Granted	4,944	364.00	–	–	–	–	4,742,273	0.00
Forfeited	(5,028)	343.54	–	–	–	–	(603,508)	0.00
Exercised	(7,838)	313.89	–	–	–	–	(507,617)	0.00
Outstanding at 25 February 2012	25,912	355.62	64,330	373.06	14,368,570	385.59	16,030,275	0.00
Exercisable as at 25 February 2012	–	–	28,600	314.68	7,413,586	395.27	9,468,818	0.00
Exercise price range (pence)	–	–	–	312.75 to 318.60	–	312.75 to 473.75	–	0.00
Weighted average remaining contractual life (years)	–	–	–	3.51	–	4.98	–	6.12

Share bonus schemes

The number and WAFV of share bonuses awarded during the financial year relating to the Company employees are:

	2013		2012	
	Shares number	WAFV pence	Shares number	WAFV pence
Shares in Success	–	–	5,045	416.26
Executive Incentive Scheme	37,424	308.25	195,497	411.75
Performance Share Plan	649,113	317.10	500,615	407.09

Note 12 Pensions

The total cost of the pension scheme to the Company was £1.5m (2012: £1.2m). Further disclosure relating to the Tesco PLC Pension Scheme can be found in Note 26 of the Group financial statements.

Note 13 Called up share capital

	2013 Ordinary shares of 5p each		2012 Ordinary shares of 5p each	
	Number	£m	Number	£m
Allotted, called up and fully paid:				
At beginning of the year	8,031,812,445	402	8,046,468,092	402
Share options	18,632,251	1	23,490,825	1
Share bonus awards	3,610,234	–	32,656,313	2
Shares purchased for cancellation	–	–	(70,802,785)	(3)
At end of the year	8,054,054,930	403	8,031,812,445	402

During the financial year, 19 million (2012: 23 million) ordinary shares of 5p each were issued in relation to share options for an aggregate consideration of £57m (2012: £69m).

During the financial year, 4 million (2012: 33 million) shares of 5p each were issued in relation to share bonus awards for an aggregate consideration of £0.2m (2012: £1.6m).

Between 24 February 2013 and 12 April 2013 options over 1,288,429 ordinary shares were exercised under the terms of the Savings-related Share Option Scheme (1981) and the Irish Savings-related Share Options Scheme (2000). Between 24 February 2013 and 12 April 2013 options over 2,741,490 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 23 February 2013, the Directors were authorised to purchase up to a maximum in aggregate of 804.0 million (2012: 803.6 million) ordinary shares.

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

Notes to the Parent Company financial statements

Note 14 Reserves

	2013 £m	2012 £m
Share premium		
At beginning of the year	4,964	4,896
Premium on issue of shares less costs	56	68
At end of the year	5,020	4,964
Profit and loss reserve		
At beginning of the year	2,842	2,621
Share-based payments	61	111
Shares purchased for cancellation – profit and loss reserve	–	(290)
Shares purchased for cancellation – capital redemption reserve	–	3
Dividends authorised in the year	(1,184)	(1,180)
Net movement on cash flow hedges	2	79
Profit after tax for the year	3,320	1,498
At end of the year	5,041	2,842

Independent auditors' report to the members of Tesco PLC

We have audited the Parent Company financial statements of Tesco PLC for the financial year ended 23 February 2013 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 70, 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 and express an opinion on 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. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 23 February 2013;
- 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 Report of the directors for the financial year ended 23 February 2013 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 financial year ended 23 February 2013.

Mark Gill (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
1 May 2013

Five year record

	2009	2010	2011[2]	2012[1]	2013[1]
Financial statistics (£m)					
Sales including VAT excluding IFRIC 13	59,426	62,537	67,074	71,402	72,363
Revenue excluding IFRIC 13					
UK	38,028	39,104	40,766	42,803	43,579
Rest of Europe	8,862	8,724	9,192	9,866	9,319
Asia	7,068	8,465	9,802	10,828	11,479
US	206	349	495	–	–
Tesco Bank	163	860	919	1,044	1,021
Group revenue excluding IFRIC 13	54,327	57,502	61,174	64,541	65,398
Trading profit					
UK	2,309	2,413	2,504	2,478	2,272
Rest of Europe	496	474	527	529	329
Asia	355	440	605	737	661
US	(142)	(165)	(186)	–	–
Tesco Bank	68	250	264	225	191
Group trading profit	3,086	3,412	3,714	3,969	3,453
Operating profit[3]	3,169	3,457	3,917	4,182	2,188
Operating profit margin[3]	5.8%	6.0%	6.4%	6.5%	3.3%
Share of post-tax profits of joint ventures and associates	110	33	57	91	54
Net finance costs	(362)	(314)	(333)	(235)	(282)
Profit before tax	2,917	3,176	3,641	4,038	1,960
Taxation	(779)	(840)	(864)	(874)	(574)
Profit for the year from continuing operations	2,138	2,336	2,777	3,164	1,386
Discontinued operations	–	–	(106)	(350)	(1,266)
Profit for the period	2,138	2,336	2,671	2,814	120
Attributable to:					
Owners of the parent	2,133	2,327	2,655	2,806	124
Non-controlling interests	5	9	16	8	(4)
Underlying profit before tax – continuing operations[4]	3,124	3,395	3,853	4,149	3,549
Other financial statistics					
Diluted earnings per share – continuing operations	26.96p	29.19p	34.25p	39.23p	17.30p
Underlying diluted earnings per share – continuing operations	28.87p	31.66p	36.26p	40.31p	35.97p
Dividend per share[5]	11.96p	13.05p	14.46p	14.76p	14.76p
Return on capital employed ('ROCE')[6]	12.8%[7]	12.1%	12.9%[8]	14.7%	12.7%
Total shareholder return[4]	8.0%	9.5%	6.7%	(3.0)%	2.1%
Net debt (£m)	9,600	7,929	6,790	6,838	6,597
Enterprise value (£m)[9]	35,907	41,442	39,462	32,324	36,578
Group retail statistics					
Number of stores	4,332[12]	4,836[12]	5,265[10]	6,049	6,784
Total sales area – 000 sq ft[11]	88,556[12]	95,231[13]	103,172[10]	110,563	116,236
Average employees	468,508	472,094	488,347	514,615	537,784
Average full-time equivalent employees	364,015	366,413	382,049	401,791	416,441
UK retail statistics					
Number of stores	2,306	2,507	2,715	2,979	3,146
Total sales area – 000 sq ft[11]	32,389	34,237	36,722	39,082	40,495
Average full-time equivalent employees	194,420	196,604	200,966	205,852	213,304
Revenue per employee – £[14]	195,597	198,897	202,850	207,931	204,305
Weekly sales per sq ft – £[15]	25.34	25.22	24.95	24.86	24.15

1 During the financial year, the Group decided to sell its operations in the US. Accordingly, these operations have been treated as discontinued in 2013. The 2012 statistics have been re-presented to be consistent with 2013. Prior years have not been re-presented.
2 Excludes Japan.
3 Operating profit includes restructuring costs and profit arising on sale of fixed assets. Operating margin is based upon revenue excluding IFRIC 13.
4 See glossary for definitions.
5 Dividend per share relating to the interim and proposed final dividend.
6 Return on capital employed is profit before interest and tax less tax at the effective rate of tax divided by the calculated average of opening and closing net assets plus net debt plus dividend creditor less net assets held for resale.
7 Excluding acquisition of Tesco Bank and Homever, India start-up costs, and after adjusting for assets held for sale. Calculated on a 52-week basis, ROCE for 2009 is 12.8%.
8 Includes Japan.
9 Market capitalisation plus net debt.
10 Includes franchise stores but excludes Japan.
11 Store sizes exclude lobby and restaurant areas.
12 Restated to include Dobbies stores.
13 Restated to include Dobbies stores and account for a space restatement of 109,000 sq ft driven by a comprehensive remeasurement of One Stop stores.
14 Based on average number of full-time equivalent employees in the UK and revenue excluding IFRIC 13.
15 Based on weighted average sales area and average weekly sales, excluding Dobbies stores.

Financial calendar

Financial year end 2012/13	23 February 2013
Final ex-dividend date	24 April 2013
Record date	26 April 2013
Q1 Interim Management Statement	5 June 2013
Annual General Meeting	28 June 2013
Final dividend payment date	5 July 2013
Half-year end 2013/14	24 August 2013
Interim Results	2 October 2013
Q3 Interim Management Statement	4 December 2013
Financial year end 2013/14	22 February 2014

Please note that dates are provisional and subject to change.

Glossary

Capital expenditure: the additions to property, plant and equipment, investment property and intangible assets (excluding assets acquired under business combinations).

Capex % of sales: capital expenditure as defined above, divided by Group sales including VAT and excluding IFRIC 13.

Constant tax rate: using the prior year's effective tax rate.

EBITDAR: operating profit before depreciation, amortisation, rent and movements in impairments of property, plant and equipment, investment property and intangible assets.

Fixed charge cover: the ratio of EBITDAR (excluding Tesco Bank EBITDAR) divided by financing costs (net interest excluding IAS 32 and 39 impacts and pension finance costs) plus operating lease expenses.

Gearing: net debt divided by total equity.

Net indebtedness: the ratio of adjusted net debt (net debt plus pension deficit and the present value of lease obligations) divided by EBITDAR (excluding Tesco Bank EBITDAR).

Return on capital employed: profit before interest and tax less tax at the effective rate of tax divided by the calculated average of opening and closing net assets plus net debt plus dividend creditor less net assets held for resale.

Total shareholder return: the notional return from a share, measured as the percentage change in the share price, plus the dividends paid with the gross dividends reinvested in Tesco shares. This is measured over either a five-year or a one-year period. For the latter, TSR represents the movement for the current financial year.

Underlying diluted earnings per share: underlying profit less tax at the effective tax rate and minority interest divided by the diluted weighted average number of shares in issue during the year.

Underlying profit before tax: underlying profit before tax excludes the impact of non-cash elements of IAS 17, 19, 32 and 39 (principally the impact of annual uplifts in rents and rent-free periods, pension costs, and the marking to market of financial instruments); the amortisation charge on intangible assets arising on acquisition and acquisition costs, and the non-cash impact of IFRIC 13. It also excludes restructuring and other one-off costs.

Designed and produced by
CONRAN DESIGN GROUP
This Report is printed on Revive 100 Pure White Silk paper and has been independently certified on behalf of the Forest Stewardship Council® (FSC). The inks used are all vegetable oil based.

Tesco PLC
Tesco House
Delamare Road
Cheshunt
Hertfordshire EN8 9SL

www.tescoplc.com/ar2013