



Annual Report
and Financial
Statements
2012



Tesco at a glance 2011/12

We are one of the world's largest retailers with operations in 14 countries*, employing almost 520,000 people and serving millions of customers every week.

£72.0bn **+7.4%**

Group sales

Group sales growth

£3.8bn **+5.3%**

Group profit before tax

Group profit before tax growth

+1.6%

Underlying profit before tax**

+2.1%

Underlying diluted earnings per share***

14.76p

Full year dividend per share



* In India, we have an exclusive franchise agreement with Trent, the retail arm of the Tata Group. We are supporting the development of their Star Bazaar format. Continuing operations exclude Japan which has been treated as discontinued following our decision to sell the business.

** See glossary for full accounting definitions.
† Calculated on a constant tax rate basis.

US

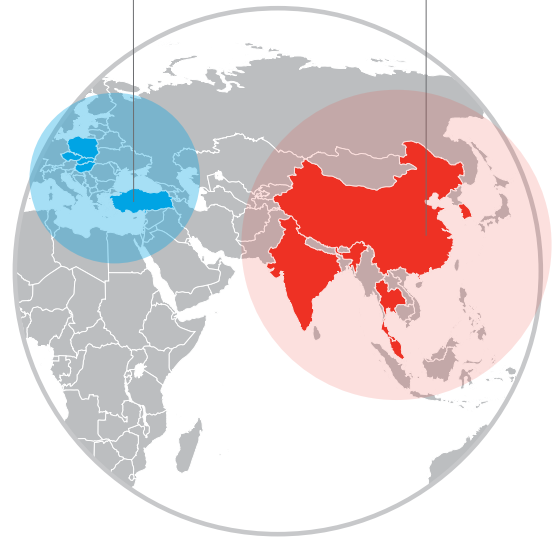
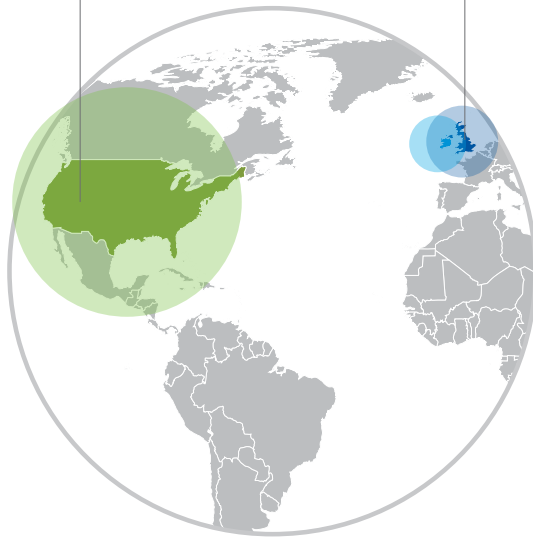
UK

Europe

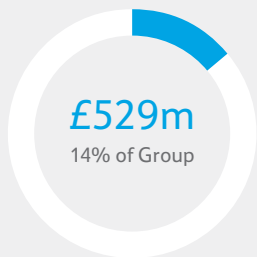
Asia*

Republic of Ireland
Poland
Hungary
Czech Republic
Slovakia
Turkey

South Korea
Thailand
China
Malaysia
India



Trading profit



Trading profit growth
+0.4%

Stores
1,351

2nd in all except Turkey
department stores, hypermarkets,
supermarkets, compact
supermarkets, convenience
card in all markets – over 7 million
active members across Europe
Republic of Ireland 2000, Prague
planned launches in Warsaw
and in at least one major city
in each market in the next few years



US

Revenue[±]

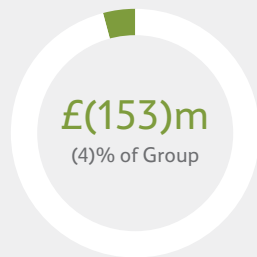


Revenue growth[±]
+27.3%

Employees
5,056

Market position
Loyalty scheme

Trading loss



Improvement in trading loss
+17.7%

Stores
185

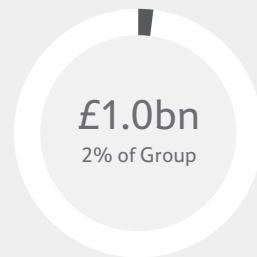
A West Coast start-up business
Friends of Fresh & Easy – two-thirds
of a million active members

Fascia brand:



Tesco Bank

Revenue[±]

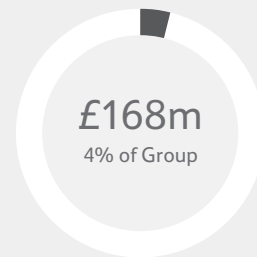


Revenue growth[±]
+13.6%

Employees
2,818

Insurance
Savings
Cash
Future launches
Loyalty scheme

Trading profit



Trading profit growth
(36.4)%

Baseline profit growth
+29.3%

Car, home, pet, travel, life, over 50s,
health, dental, breakdown
Fixed rate, internet, instant access,
retail bonds
Loans, credit cards, ATMs, travel
money
Mortgages, current accounts
Clubcard



± Revenue excludes the accounting impact of IFRIC 13.

OVERVIEW

1 Chairman's statement

STRATEGIC REVIEW

3 Chief Executive's review*

9 Strategy in action*

24 Business model*

PERFORMANCE REVIEW

29 Key performance indicators*

33 Financial review*

GOVERNANCE

38 Board of Directors

40 Principal risks and uncertainties*

48 General information*

50 Directors' report on corporate governance

64 Directors' remuneration report

FINANCIAL STATEMENTS

88 Statement of Directors' responsibilities

89 Independent auditors' report to the members of Tesco PLC

90 Group income statement

91 Group statement of comprehensive income

92 Group balance sheet

93 Group statement of changes in equity

94 Group cash flow statement

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

95 Notes to the Group financial statements

142 Tesco PLC – Parent Company balance sheet

143 Notes to the Parent Company financial statements

151 Independent auditors' report to the members of Tesco PLC

152 Five year record

IBC Financial calendar

IBC Glossary

www.tescopl.com/ar2012

The easy way to get online

This year online, you can hear from our leadership team, explore our business through our interactive map and download our financial statements in Excel. Visit www.tescopl.com/ar2012 or use your smartphone to scan the QR codes in the Report to go straight to the relevant information online.



Scan here to visit the 2011/12 Annual Report online homepage



* These sections form the Business Review and have been prepared pursuant to the Companies Act 2006. Together with the Board of Directors section and the Directors' report on corporate governance, these sections form the Report of the Directors.

Chairman's statement



Sir Richard Broadbent
Chairman

“There are many things that strike a newcomer to Tesco. This is a business with an unusual range and depth of core competencies; it has outstanding operational effectiveness; it understands deeply what it means to orientate a business around the customer; it is passionate, and successful, about developing talent from within; and it manages a complex operating environment with great team work.”

Nearly six months after taking over from Sir David Reid, it is good to have this opportunity to share my perspective on recent developments which I will do under three headings: context; transition; and governance.

Context

There are many things that strike a newcomer to Tesco. This is a business with an unusual range and depth of core competencies; it has outstanding operational effectiveness; it understands deeply what it means to orientate a business around the customer; it is passionate, and successful, about developing talent from within; and it manages a complex operating environment with great team work.

It is also a business that is not afraid to learn and change, capacities perhaps more than any others which are essential to long-term growth. In this respect there are three areas in particular worth identifying.

First, Tesco is a business with significant strategic optionality. It has expertise and capital, human and financial, that can be leveraged in different geographies, in different sectors of retailing and through new and different channels, notably of course the internet. The development of these opportunities can make Tesco a stronger company and benefit the UK as a whole. And with such opportunity also comes responsibility – to ensure that the trade-offs between different investments are reached in a disciplined way; and that the optimum balance is struck overall between current returns and future growth.

Second, as the business grows internationally, it is important not only that we explain ourselves to the world but also that we listen and see ourselves as others do. Since arriving at Tesco last year I have visited many different parts of the business around the world, met many of our staff, talked to shareholders, suppliers, commentators, community leaders and to customers. This is the broader context of our business to which we need continuously to relate, openly, honestly and constructively for the long-term benefit of our business.

Third, I have been impressed by the skills, commitment and values held by the people who work at Tesco and all of whom not only contribute to its success but make the company what it is. They are a great team and all those with a stake in Tesco have reason to admire and be grateful for their efforts. I would like to thank them, on behalf of the whole Board, for all that they do.

Transition

This has been a year of transition.

Philip Clarke took over as Chief Executive at the beginning of the year and he has been shaping both the organisation of the business and the management team which inevitably, after a long period of stability, are entering a period of change and development. This work takes time but is essential to our future as a strong and profitable company.

All successful companies go through periods of transition. Indeed, the capacity to change and develop over time is fundamental to truly world-class companies. The critical issue for those responsible is to fully acknowledge the need for and to manage change in a measured and timely fashion when it is called for.



Scan here to hear more from Sir Richard Broadbent, or visit www.tescopl.com/ar2012/chairman

Chairman's statement

We have moved to address performance issues in the UK. The challenge of refocusing the UK business to ensure it sustains healthy market leadership is important enough to make it worth giving up some profit in the short term to safeguard the business in the long term. We laid out in April how we intend to do this.

Elsewhere, we have continued the substantial re-orientation of the US business to give it the best possible opportunity to secure its future with all the potential for longer-term growth that would bring. We have announced our intention to exit from Japan. We are willing to invest for the long term but where we cannot see a profitable, scalable business earning good returns within an acceptable timescale, we prefer to pursue better opportunities. And we have slowed down the development of Tesco Bank to increase its focus on quality, service and risk management.

These are substantial changes, in management, organisation and business and they need to be seen as part of a continuing process of moving the company forward, making changes where necessary to ensure long-term stability and sustainable profitability.

Governance

Governance is the framework that articulates a company's values and supports its behaviours. During the year, we updated our governance framework and processes as described in more detail on page 50. An important aspect of these changes was the creation of the Board Corporate Responsibility Committee to ensure that the Board maintains a strategic focus on corporate responsibility in its widest sense, reflecting the importance to the Group of how it engages externally. When a company has significant economic and social scale it is essential that it reflects on the full nature of its accountability for its activities, and how it should discharge that responsibility to the communities in which it operates. This will be an important focus for the new Committee.

There have been a number of changes to the Board. In addition to Sir David Reid, David Potts retired during the year, Richard Brasher stepped down from the Board in March, and Andrew Higginson will retire in September. We thank them all for their contribution to the business over the years. We are also pleased to welcome Deanna Oppenheimer to the Board as a Non-executive Director. Deanna brings valuable international, retail, banking and digital experience to our Board.

Financial results

In the year, we delivered sales growth of 7.4%. Profit growth was modest, with a strong international performance largely offset by a reduction in UK profits. Trading profit grew by 1.3%, and profit before tax grew by 5.3%. Return on capital employed improved from 12.9% last year to 13.3%, and we continued our long record of dividend growth for shareholders, with the full year dividend up 2.1% to 14.76p.

The fact that in a year when economic headwinds have been evident in practically every part of the globe our business increased sales, profits, return on capital and dividends speaks for its overall resilience.

Looking ahead

Last year was a challenging one for the business and we are acutely aware that this was reflected for our shareholders in the share price. 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.

If I have one overriding impression of Tesco after six months, it is that here is a truly international business, deploying its expertise across the world to drive opportunity, growth and returns, all of which ultimately benefit the UK. I look forward to being part of it.



Sir Richard Broadbent
Chairman

Chief Executive's review

Building
for the
future



Philip in conversation with Ellen and Jobe at the Tesco Extra store in Baldock

“My first year as Chief Executive has been a year where we have implemented important changes at Tesco, a year when we have built strength for the future.”

It has been a year of significant change and one in which we took decisive action on some very important issues for Tesco: our reset of expectations for the UK for the forthcoming year, the announcement of our intention to dispose of our business in Japan, the focus on moving Fresh & Easy closer to profitability and the renewed focus on delivering a reliable Tesco Bank. As a part of this we made several key management changes during the year which have allowed some significant new appointments as we renew and reinvigorate the Tesco team.

This has very much laid the ground for the future; a future where we will make sure that our capital and our talent are put to work where it benefits most our customers and hence our shareholders. The future Tesco will demonstrate greater innovation and creativity as we address the needs of consumers around our world – both in store and online.

We regularly deliver over 75 million shopping trips a week and as a retailer are only as good as the last trips. Ensuring that Tesco is highly valued by customers on each and every one of those shopping trips will be what makes Tesco achieve sustainable success. That is what we set out to do every day.

I believe that we have faced into challenges with real determination and taken decisions for the future. I know that it has been a tough year to be a Tesco shareholder. I know too that my whole team and I are confident that the changes we are making are the right things to do – for customers, staff, the business and its shareholders – and that the long-term opportunities for Tesco remain undiminished.



Scan here to hear more from Philip Clarke, or visit www.tescopl.com/ar2012/ceoreview

Chief Executive's review

Performance in 2011/12

We delivered modest profit growth in a challenging economic environment, with a strong international performance largely offset by a reduction in UK profits. Whilst the year gave us many things to be proud of, overall it was not the most pleasing performance. My team and I are resolved to get Tesco back to winning, particularly at home.

Group sales increased by 7.4% to £72 billion, while Group trading profit was up 1.3% on last year and underlying profit before tax rose to £3.9 billion, an increase of 1.6%. Group capital expenditure in the year was £3.8 billion. Group return on capital employed ('ROCE') increased – to 13.3% (last year 12.9%).

The Board has proposed a final dividend of 10.13p per share, taking the full year dividend to 14.76p, which is an increase of 2.1% on last year.

The decisions we have taken during the year have had an impact on our financial performance. We decided to forego some short-term profit to re-invest in the long-term health of the business, with a clear focus on improving the shopping trip for customers.

The UK business clearly did not meet our own expectations in the year and, partly as a result of this, we decided to accelerate our plan to make improvements which has meant a necessary reset to expectations for our growth in 2012/13 as well. This acceleration and reset were announced with our Christmas trading update in January.

Despite this significant re-investment programme, we remain committed to driving higher returns for shareholders. Although our investment plans in the UK make achieving our ROCE target more challenging in the short term, we still expect to deliver a ROCE of 14.6% by 2014/15, with broadly based growth from around the Group.

Strategic update

In last year's Annual Report, I set out an evolution of our strategy into seven parts:

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

This strategy remains as relevant now as it did a year ago and I'm pleased to be able to update you on the progress we have made on each of these strategic objectives. I also set out immediate management priorities for the business last year – keeping the UK strong and growing; becoming outstanding internationally, not just successful; becoming a multi-channel retailer wherever we trade; delivering on the potential of retail services; applying Group skill and scale; and delivering higher returns. You will see how these priorities have shaped our actions through the year.

To grow the UK core



The deli counter in our Hertford Superstore has a flat glass front, bright lighting and warmer, more engaging signage

In the UK, high petrol prices and falling real incomes affected customers' discretionary spending in the year. The combination of disappointing sales in the second half of the year and our decision to increase investment into the shopping trip meant that our UK performance was weaker than planned. Sales grew by 6.2%, supported by excellent new store performance, but trading profit declined by (1.0)%.

The issue we are addressing is that the shopping trip just hasn't been improving fast enough and our standards haven't been as consistent as our customers have come to expect. As a result, we are taking action to improve each aspect of the customer offer. This will involve significant revenue and capital investment in a comprehensive plan encompassing six key areas.

The UK Plan – Building a Better Tesco

Our Plan for the UK business has six elements:

Service & Staff: helping our people deliver great service by investment in recruitment, training and equipment, dedicated to particular departments such as produce so that our customers notice the change.

Stores & Formats: making our stores better places in which to shop and work, with the pace of new store development moderating, and the pace of refreshing our existing stores stepping up.

Price & Value: delivering great value for money through the right blend of price, promotions, couponing and loyalty.

Range & Quality: building the right ranges of quality products, reviewing and refreshing our entire range of Tesco brand products, making our ranging more store and format-specific, and bringing dunnhumby, our marketing insight business, back into the heart of Tesco.

Brand & Marketing: making sure that we get back to having the right conversation with our customers about Tesco.

Clicks & Bricks: making this a potent combination for our customers, with the roll-out of Click & Collect and the transformation of our range and online presence.

We are clear on what we need to do, we have trialled substantial elements of the changes and we know they work. Our investment programme has already started and we expect this to deliver stronger results. The Big Price Drop in September 2011 was the first step, but the changes we are making are about much more than price. They are a combination of price, quality, range and service, including a significant investment to create an additional 20,000 jobs over the next two years. These changes will reinvigorate the shopping trip for customers, and consequently deliver improved performance for shareholders.

To be an outstanding international retailer in stores and online

Our international businesses performed strongly, with trading profits up 18%, or by 22% before the impact of a crisis tax levied in Hungary. We have seen progress in our established businesses, such as in Central Europe, South Korea and Thailand, and from our newer, rapidly growing businesses, such as Fresh & Easy in the United States and Tesco Malaysia. It is encouraging that we are winning market share in almost all of our markets and, in some countries, at a faster rate than for many years.

Asia: another strong performance

I am pleased with the performance of our businesses in Asia. Sales and profit grew well – sales by over 10%, and trading profit by over 20%. We delivered solid like-for-like sales growth and an excellent contribution from new stores.

Our business in Thailand had an extraordinary year. The worst flooding for 70 years caused us to close over 150 stores temporarily and all four of our distribution depots. The superb dedication of our team enabled us to keep supply lines open for customers and to support staff affected by the flooding, and we have come out of the crisis stronger. We grew like-for-like sales and profits in the year. South Korea had another good year, although I anticipate a modest reduction in like-for-like sales next year as restrictions on trading hours for large retailers are implemented across the country.

In China, we have continued to focus on building scale in three regions of the country. With the economic environment currently proving challenging for mainstream retailers, we have decided to take a more cautious stance on the market, at least for now. We have decided not to commit substantial new capital to freehold shopping centres, and we have also elected to hold back on the pace of new hypermarket development this year. We will only open 16 stores, instead of stepping up as we had planned. We still believe that China can be an engine of growth and we can speed up again when the outlook improves.

We took an important step this year in deciding to exit Japan. It is right to focus on our larger, profitable and growing businesses in the Asia region. It is never easy to make decisions of this kind and I would like to thank our staff in Japan for their continued hard work and professionalism through this time.

Europe: growth in a difficult environment

Following a strong performance in Europe in the first half of the year, the performance in the second half was weaker than expected. Sales for the year grew by 8% and trading profit increased marginally, by 0.4%. Trading profit growth would have been in line with sales had it not been for the impact of the crisis tax imposed in Hungary, which cost £38 million in the year.

The economic background was particularly difficult in Hungary and in the Republic of Ireland this year. Given the current conditions, we are focusing on growth primarily through our existing stores in these markets, rather than investing substantial new capital. In addition to these headwinds in two of our largest markets, profits were held back by disruption connected to the opening of our new distribution centre in Poland, but this is behind us now.

We have made good progress with the closer integration of our European businesses this year, from sharing infrastructure to buying as a single region. This means that we can leverage the skill and scale of the Tesco Group to deliver a better shopping trip for customers and higher returns for shareholders. One example of this is our recent launch of grocery dotcom in Prague, with initial sales well ahead of plan, and our dotcom business in Warsaw will be launched soon.



Our Extra format stores delivered an encouraging performance through the year

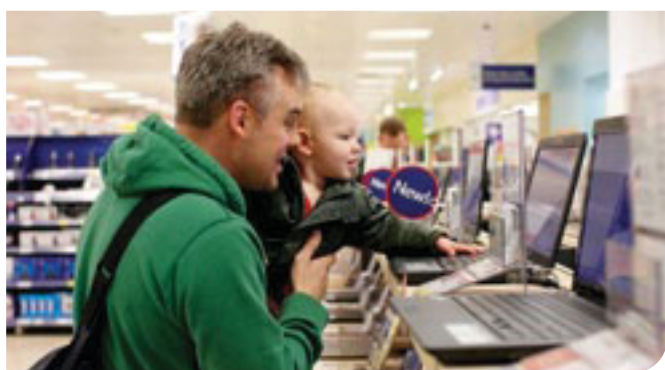
United States: on the path to profitability

It has been a year of encouraging progress in Fresh & Easy. Sales grew by 27%, with almost 12 percentage points coming from like-for-like stores. We have also delivered reduced trading losses for the first time, with an 18% improvement on last year. After four years of rising losses, this is a decisive change of trend, driven by further improvements to our customer offer. Features such as in-store bakeries, more loose produce, additional ranges and new Fresh & Easy products have been very popular with customers and we have seen an acceleration in our already strong growth in customer numbers.

The progress we have made gives us more confidence that we will deliver a further significant reduction in losses in the coming year. The timing of break-even will be later than we had previously expected, as we will focus on getting more of our existing stores to reach profitability before we step up the rate of new store openings. We can then reach sufficient scale to cover our substantial central overhead costs and we anticipate that we will reach the break-even point during 2013/14.

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

It has been tough to achieve growth in sales of discretionary items – not least in the UK, where we have seen a number of specialist general merchandise retailers go into administration – and our UK like-for-like growth in general merchandise, clothing and electricals has remained negative. To adjust to this, we have been allocating more space to the most popular products and improving merchandising. We are committing less capital to new space for non-food and instead focusing more resource on continuing to develop our online capability.



Baldock Extra Electricals department. We are seeing the early benefits of our changes, but much remains to be done

Europe and Asia delivered stronger performances in general merchandise, clothing and electricals, despite subdued consumer confidence even in the better performing economies. I was pleased with the performance of clothing in Central Europe, with sales growing by 12% at constant exchange rates. This is testament to the strength of the F&F brand and also to the performance of our new Extra format stores. We ended the year with 44 of the new Extras in Europe and three in Asia. These stores are introducing our customers to a different way of shopping, with stronger ranging and new services, with extremely encouraging results. Different categories of food and general merchandise have their own distinctive look and feel within the Extra store, known as 'Worlds', such as Baby World and Sports World. We are making similar changes to the look and feel within our large UK stores, partly as a result of the encouraging performances in Europe.

To grow retail services in all our markets

Tesco Bank is a key part of the potential we see in retail services. Since we took full control of the Bank in 2008, our focus has been on developing our own systems and infrastructure and recruiting and developing a new team to run the operation. I'm delighted to say that this period of migration from The Royal Bank of Scotland ('RBS') to our own platforms is now nearing an end. Building a bank is a complex task and I took the decision during the year to slow down the migration, so as to minimise the customer impact. This final stage of migration will be completed imminently, at which point the business can put more emphasis on growth and on developing the potential we see in financial services.

We have delivered good business growth in the year with revenue up 14%, driven by a good performance in the insurance business. The Bank's profit figure includes several accounting adjustments, so we measure business performance using baseline profitability, which increased by a very encouraging 29%. The Bank's capital position has also remained strong through the year, supported by a 7% growth in savings balances.

With the migration almost completed, the Bank is well positioned for future growth. We are also on track to launch new products, starting with mortgages, to broaden into a full-service retail bank.



Customers can purchase insurance and other Tesco Bank products in store, alongside their weekly shop

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

We have reinforced our commitment to be a good corporate citizen this year: as a retailer, an employer and a neighbour. We employ over half a million people worldwide, which allows us to make a real difference in the communities where we operate. Our core business involves two vital roles in the heart of the community: providing customers with safe, good quality, affordable, nutritious food and creating good jobs and careers. Beyond this, we have demonstrated that we put our responsibilities to communities at the heart of what we do in a huge variety of ways: I want to pay tribute to just some of the great achievements of the last year.

Even when their own homes were in danger or flooded, our people in Thailand went to extraordinary lengths for customers. Some even gave up their days off and travelled for hours by boat to continue to get essential supplies to our customers. There is no better example of our colleagues living true to the Tesco Values: 'No one tries harder for customers' and 'Treat people how we like to be treated'.

Our responsibility to our people is to provide them with good jobs and careers. In the last year, we have created thousands of jobs across our businesses, invested in a state-of-the-art, zero-carbon training academy in South Korea and have continued our work in the employment of young people, university graduates and the long-term unemployed.

Our customer offering is based on strong relationships with our suppliers. For example, we now have supplier academies in all of our Central European markets for suppliers to present their products to our buyers. This enables us to support the growth of our suppliers whilst sourcing the best local and regional products for our customers.

Any business on the scale of Tesco has the opportunity to make a significant difference in tackling climate change. We were proud to be recognised by the Carbon Disclosure Project again this year, with Tesco named the top retailer in the world. We will continue our work as we progress towards our ambitious target of being a zero-carbon business by 2050.



Our state-of-the-art, zero-carbon training academy in South Korea, to train staff from across the Tesco Group

To be a creator of highly valued brands



Finest sold well over £1 billion in the UK alone this year. In April 2012 we relaunched Tesco Value as Everyday Value, with quality improvements to hundreds of products

Across our markets our own-label programme encompasses a broad spectrum of ranges to appeal to diverse customer needs, giving customers the quality products they are looking for at competitive prices.

In the last year we have expanded our offering, launching new ranges such as Venture Brands in the UK and Europe – including Chokablok chocolate and ice cream and Carousel children's toys – which offer customers premium quality at great prices.

We have started to differentiate our ranges more clearly, such as our sub-brands Gourmet and Eat Well in Fresh & Easy and Goodness, which is a range of healthy and nutritious children's products now also available in the UK.

We recently relaunched our UK Tesco Value range as Everyday Value, with quality improvements to hundreds of products and new, brighter packaging. This is the first stage in a refresh of our entire range of over 8,000 Tesco brand products in the UK in the next two years, including a comprehensive update to our Tesco Standard range.

This is an area of substantial and growing strategic importance for us, as we recognise the role that our brands play in attracting customers and as we start to leverage our expertise in brand management across our markets.

Chief Executive's review

To build our team so that we create more value

Strengthening our management

This time last year we were in the early days of some of our new management structures. I had just introduced a matrix structure throughout Tesco with CEOs for each of our key business areas – the UK, Asia, Europe, and the US – supported by integrating functions, such as Property, Human Resources and Marketing. I am very pleased with how this structure has bedded in and expect to see even greater value creation as a result.

The introduction of a dedicated UK Operating Board has enabled greater focus at home and given the importance of the changes we are currently making for customers, I have recently decided to assume direct responsibility for the UK business during the process of its renewal.

I have continued to strengthen both the Executive Committee and our senior management teams through the last year, drawing on our deep pool of internal talent.

We have also been fortunate to welcome our new Chairman, Sir Richard Broadbent, following Sir David Reid's decision to retire. I want to thank David for his lasting contribution to Tesco over 26 years on our Board and, on a personal level, for all the help he has given me in settling into my role as CEO.

Building the Tesco team



We will create 20,000 more jobs in the UK over the next two years and many more around the world

Tesco's most important asset will always be its people, who live by our Values to do their very best for customers. Many of our plans for the coming year are built on investment in our people. We employ more than half a million people across the globe and this will continue to increase, with plans to create an additional 20,000 jobs in the UK alone in the coming two years and to continue to grow our teams around the world. It is the quality, commitment and dedication of our people that gives me so much confidence that we can and will achieve our plans for the years ahead.

Delivering higher returns

In April last year we set out a target to increase our already good level of ROCE to 14.6% by 2014/15. We improved ROCE from 12.9% to 13.3% in 2011/12. Although it is likely that we will see a small reduction in 2012/13 as a result of our UK investment plans, we continue to see a number of opportunities to drive returns and we still expect to deliver our targeted increase to 14.6% by 2014/15.

Doing the right thing

I am confident that we are ready to tackle whatever challenges lie ahead. The decisive action that we have taken in the past year and the management changes which have reinvigorated the Tesco team have laid the ground for the future; a future where we will make sure that our capital and our talent are put to work where it benefits most our customers and hence our shareholders. We have and will continue to focus on doing the right thing for customers, for communities, for staff, for the business and for our shareholders.

Philip Clarke
Chief Executive

Strategy in action

IN THIS SECTION

- 10 **UK:** Giving our customers the best shopping trip
- 12 **UK:** Refreshing our stores for customers and staff
- 14 **Online:** Making 'Clicks & Bricks' a reality for customers
- 16 **International:** Moving into the next phase of growth
- 18 **International:** Footholds in newer markets
- 20 **Retail services:** A Tesco Bank for Tesco customers
- 22 **Our dedication to the community:** Thailand

Having given you an overview of the implementation of our strategy over the past year, this section sets out some detailed case studies showing our strategy in action.

In the next few pages, you'll read about the £1 billion commitment we're making to improve the shopping trip in the UK, our exciting innovations online, what we mean by Group skill and scale, our businesses in newer markets, the progress of Tesco Bank over the last three years and our team's extraordinary response to the flooding in Thailand.

UK: Giving our customers the best shopping trip

We always want to provide our customers with the best shopping experience and set the standard in the UK. Focusing on food first, we are making a £1 billion commitment this year to improve the shopping trip, driving a strong pace of improvement in the things that matter for customers – service, range, quality, price, availability and the store environment.



More staff, better service

One of the largest elements of our investment is in increased staffing levels, training and equipment for key departments in existing stores – such as produce and meat. We saw marked improvements in customers' perceptions and sales performance of 200 pilot stores. This success has given us the confidence to move quickly to apply these changes to all of our large stores – an investment of over £200 million.

We are improving the look and feel of many of our fresh departments using more engaging signage, stronger graphics, warmer colours and better lighting



Creating more good jobs and careers

Over the next two years, we will create 20,000 new jobs to deliver new levels of excellence in customer service. Customers will benefit from more staff on the shop floor at busy times, greater staff expertise and enhanced service across the store.

The investment goes to the heart of our promise to create good jobs and careers, with opportunities focused on young people who are currently unemployed. British Prime Minister David Cameron described the investment as “a massive confidence boost for the UK economy”.

The Fruit and Veg team

Fresh food is an area where customers really appreciate having dedicated, specially trained and knowledgeable staff. With the additional investment in staffing, training and equipment, the Fruit and Veg team can focus on fresh produce, improving product availability and presentation for customers.

We are also increasing the number of staff across the whole of fresh food – meat, produce and chilled convenience foods.

Quality and innovation

We are reviewing and refreshing our entire range of over 8,000 Tesco brand products starting with the relaunch of Tesco Value as Everyday Value, with quality improvements to hundreds of products. Helping customers manage on tight budgets, Value was already growing at twice the rate of the market as a whole: these changes will further strengthen its position. We will also be comprehensively updating our other Tesco ranges this year.

We have already stepped up the pace of innovation with our new Venture Brand exclusive products – such as Chokablok ice cream, Parioli authentic Italian ranges and the Latham's range of premium pet food.

With such a strong variety of ranges to appeal to the needs of different customers, we will also be applying more personalisation and localisation in stores to help them tailor their ranges much more for their local area.



The best shopping experience

- 20,000 more staff
- Dedicated fresh food teams ✓
- 8,000 refreshed products ✓
- Over 3,000 lower prices ✓
- 430 refreshed stores ✓
- No one tries harder for customers*



The Big Price Drop

In September 2011, we launched The Big Price Drop, investing more than £500 million to reduce the prices of over 3,000 everyday products. Big Price Drops target the products that customers buy week in, week out. The progress is encouraging and we're now more competitive. It's an important step in the journey but there's more to do to get the blend right on price, promotions, couponing and loyalty.

Over the page

UK: Refreshing our stores for customers and staff

The way stores look and feel is an important part of the shopping trip. Customers wanted a warmer, friendlier look and feel, so we have accelerated our Refresh programme to improve the environment in all our stores.

Investing over £200 million of additional capital, we will refresh 430 stores in the coming year, representing about 25% of our UK space. Bringing in a warmer, friendlier look and feel will go hand in hand with our work on quality and range, so that we offer customers great products displayed in an attractive, inviting store environment.

Listening to our staff

Most of our changes are visible to customers but we are making some equally important changes behind the scenes. We ran a programme this year for staff to email or text in comments about what they felt needed to be fixed in their stores. With 40,000 comments received, we've responded by rolling out new and better equipment, like checkout chairs and handheld printers. This has helped deliver the best staff Viewpoint feedback survey results for five years.

The Extra format

Customers are noticing the changes we are making in stores across all of our formats – Extra, Superstores, Metro and Express

– but we're also making some changes that particularly affect our larger stores. We're drawing on the great success of our new Extra format in Europe to make sure that our UK Extras continue to meet our customers' changing needs, as they increasingly combine shopping in store and online.

Future investment

In the last few years, both convenience and online shopping have been growing rapidly. While our existing large stores in the UK perform very well, recognising the current economic climate and the growing importance of online shopping, we are not planning to open many more of the very biggest. Instead, more of our investment is going into refreshing our existing stores. New investment will be channelled into Express stores and our online offer.



Bakery

Customers love being able to choose from freshly baked breads and cakes and see our bakers at work in the background. Displaying the goods in baskets, not on standard shelves, also helps to make our bakeries much more appealing.



Scan here to see some of the improvements we're making in store, or visit www.tescopl.com/ar2012/ukvideo

Fixtures and fittings, lighting and space

We are refreshing our stores, inside and out, to make them more inviting. Wooden cladding and brighter signage welcome customers into the store. Inside, different areas are being given a more distinctive look and feel, such as wooden fixtures in Bakery, or sleek shelving and lighting in Health & Beauty. Our produce aisles are more spacious, and our counters have less functional, more engaging signage, flat glass fronts and better lighting, to show off our meat, fish, cheese and deli products at their best.





Click & Collect

As the option of ordering online and picking up in store continues to grow in popularity, our stores are ideal collection points. We will add 700 new collection points for Tesco Direct orders in the next year – customers can already collect from over 770 stores, including 70 Express stores. We will also continue to increase the number of stores with collection points for grocery, as well as trialling convenient joint collection points.



Retail services

The services we offer in store – like an optician, pharmacy, phone shop or customer restaurant – all help customers to get more out of their everyday shopping trip. We ended the year with over 180 opticians and are planning to increase the number of our phone shops to over 260 in the coming year.



Clothing

The UK clothing market, worth £33 billion, is one of the few areas of discretionary spend that continues to grow and is a category where the internet has so far had a limited impact. Our Central European Extras have shown us that Clothing tends to benefit from more space and better lighting on the shop floor, as customers love seeing more of our range. As well as giving Clothing more space in store, we will be improving the ranges and quality we offer to ensure broad appeal.



Online: Making 'Clicks & Bricks' a reality for customers

Growing our online businesses in all our markets is a strategic priority for us and it shows how we are adapting to our customers' changing needs. Stores continue to sit at the heart of our business, but we are aiming to become a multi-channel retailer wherever we trade.

Customers increasingly expect to be able to shop where, when and how they want: the boundary between stores and online is blurring. In developing our online offer, we are drawing on our convenient store network and our expertise to meet our customers' needs and help make their lives easier, progressing towards an offering where customers can shop with us 'anywhere, any time, any how'.

We've taken online far beyond everyday grocery shopping. Digital technology allows us to meet the 'on the go' needs of our customers – with **blinkbox** you can stream entertainment on the move and with our virtual stores in South Korea you can even shop during your commute to work.

We want to offer our customers convenient options to shop with us using those access points – stores, computers and mobile devices – which are part of their daily lives. Whether customers want to shop on the move using their smartphones, or take their time at home, we are innovating to help them shop however they want, with quick and easy apps and improved platforms.



Online grocery

When we first launched a grocery home shopping service in 1997 we were viewed as pioneers, and we have grown to be the world's largest and most profitable online grocery retailer with sales of well over £2 billion.

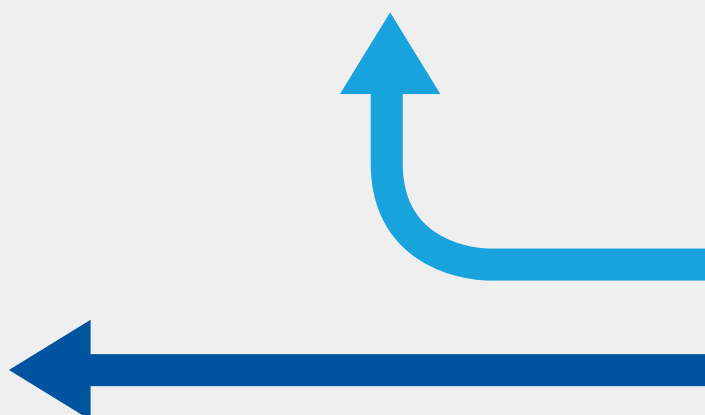
As technology moves forward so do we. We use it to help make shopping easier for customers with a mobile web platform for shopping on the go, features like 'Favourites' and tailored online offers developed for Tesco via analysis from dunnhumby, our marketing insight business.

Where customer demand is very high we have complemented our in-store picking model with a number of specialised dotcom-only stores. In January, we opened our fourth in Enfield. We currently fulfil over 80% of London orders from our dotcom-only stores, providing our customers with our total food range – more than can be offered from any one store.

Tesco Direct

We have upgraded our Tesco Direct website to better showcase our great quality range and offer customers improved functionality and ease of use. For the first time it is now configured for mobile devices. We will be moving our other UK Clothing and Entertainment websites onto the same platform later in the year.

By Christmas we will have increased our Direct range to 200,000 items, thanks in part to third-party Sellers. Having introduced our first Sellers at Tesco Direct recently, we are offering our customers additional ranges teamed with Clubcard points and convenient store collection points, while our Seller Partners benefit from our volume of online traffic and expertise.



Scan here to see how we're developing our online offer, or visit www.tescopl.com/ar2012/onlinevideo

Click & Collect

Click & Collect is a key component of our multi-channel offering. Our store and distribution networks mean we can give customers the opportunity to pick up products whenever it suits them from over 770 stores, close to where they live or work. 70% of online **general merchandise** orders are handled in this way.

Click & Collect is becoming increasingly relevant for all product groups. We currently have 45 stores that offer **grocery** Click & Collect and we expect this number to increase quickly. Our customers appreciate this innovative, quick and convenient service which fits well into their busy schedules.



Social media

As our customers spend an increasing amount of time online we are able to use social media to build trust and understanding of our business. This in turn helps to drive loyalty.

We have built our business on listening to our customers and acting on their feedback. Social media allows us to have conversations with them on any issue at any time – in the UK, we now have more than 680,000 'likes' on our Facebook page.

In 2011 we acquired BzzAgent – a unique business combining word-of-mouth marketing with a commercial application of social media, helping to drive consumer advocacy and broaden our capability and innovation in product marketing.

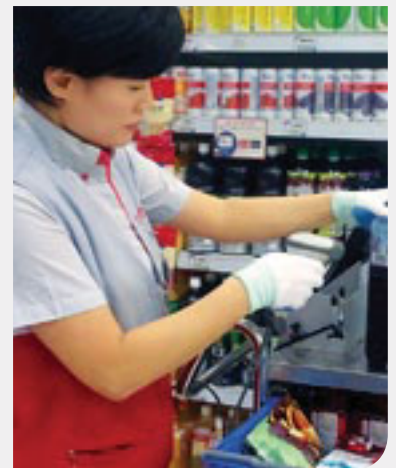
Social media also helps us to be more effective and innovative in existing tasks such as recruitment and staff communication. For example, our staff use Yammer – a private social network for businesses – to share best practice and celebrate success, often by posting photos, and we use it operationally for sharing messages and asking for feedback.



International growth

We already have profitable online grocery businesses in South Korea and the Republic of Ireland, launched dotcom in the Czech Republic this year and are planning to begin soon in Warsaw. In the next few years, we are planning to launch online grocery shopping in at least one major city in each of our markets, using our operating model to roll this out quickly and cost-effectively.

In Asia, we're innovating to access the biggest opportunities – for example, in addition to our online grocery service, our virtual stores in South Korea enable busy customers to shop on their way to work. The Homeplus app has been downloaded over a million times.



International: Moving into the next phase of growth

Since the mid-1990s, we have built an international business of more than 3,200 stores, which delivered more than £1 billion trading profit for the first time this year. As we strive to become an outstanding international retailer, we are drawing on Tesco's skill and scale to move into the next phase of growth.

Retailing is a local business. Customers love local and regional products; we pride ourselves on having local people running our operations; and we use local knowledge to source and to allocate space to the most popular products. However, lots of what we do – especially behind the scenes – is best done in the same way across our markets. We are increasingly realising our vision to win locally by applying our skills globally.

'Group skill and scale' describes this step in our evolution to becoming a global business. By Group skill, we mean applying expertise from individual countries to all of our markets: Clubcard is a great example. Having invested millions of pounds to develop the UK scheme in the late 1990s, we have been able to introduce a loyalty scheme to each of our markets for a fraction of the cost.

By Group scale, we mean using the size of the Tesco business to benefit our customers by lowering prices, improving quality, and sourcing new and different products from the best suppliers around the world. Globally sourcing food, general merchandise, and the goods that we use in store is one way that we are doing this. We buy some products from the same source for all our markets, such as bananas, and we buy others for a whole region, such as F&F clothing for Central Europe. Buying on a larger scale means that we can achieve a better cost price and create headroom to invest in improving the shopping trip for customers.



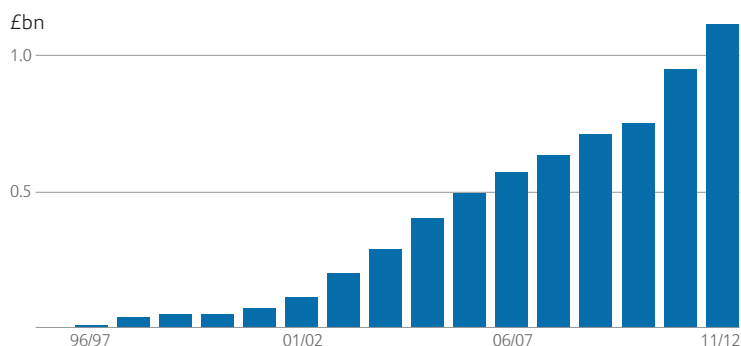
Scan here to find out more about our international businesses, or visit www.tescopl.com/ar2012/asiaandeurope

Consistent property blueprints

As we continue to grow our international businesses there is a significant opportunity to make savings from applying standardised property blueprints. With the same specialist team designing the stores, we can build great stores for customers more quickly, more cheaply and with a reduced carbon footprint. We also ensure the new space is best used by reducing the space given to offices and chillers in the back, providing more room on the shop floor.

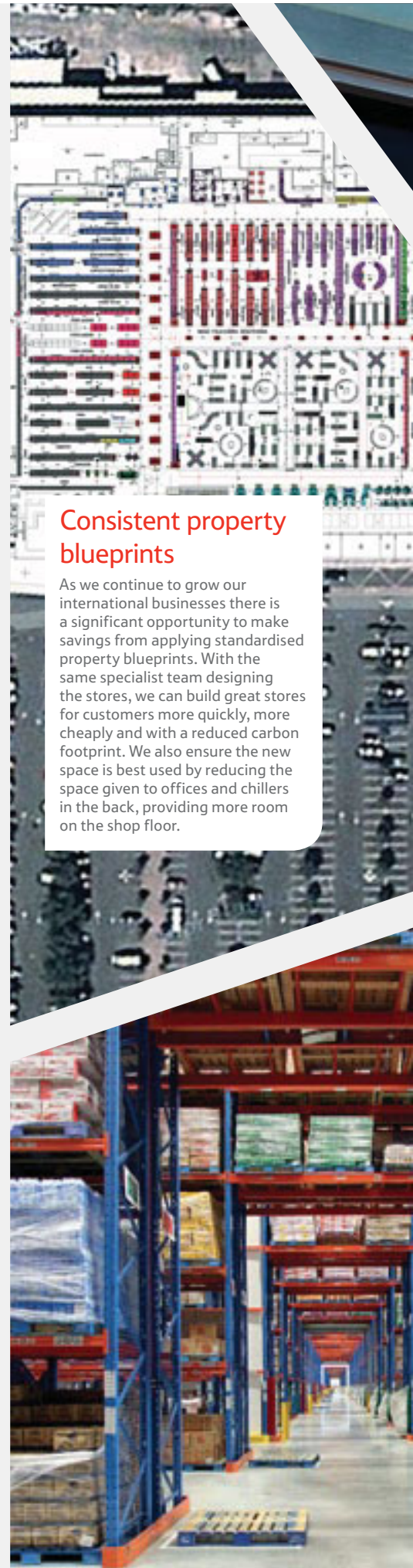
Our evolution to becoming a global business

International trading profit of over £1 billion*



Since the mid-1990s, we have built an international business with more stores than we have in the UK, which has delivered more than £1 billion trading profit for the first time – larger than any of our UK competitors. With strong market positions, we are well positioned to move into the next phase of growth.

* 11/12 trading profit excludes Japan, which has been treated as discontinued following our decision to sell the business. 10/11 has been re-presented to be consistent. The data up to and including 05/06 is statutory operating profit; from 06/07 it is trading profit.



Smaller format stores

Smaller format stores complement our established store networks to meet growing demands for convenience. These formats are not only great for customers but are also cost-effective, utilising our existing distribution networks and requiring less capital.



One platform, many markets – the best everywhere

Rolling out the same processes and systems across the Group delivers a better shopping trip for lower cost. Shelf-ready packaging and best practice replenishment processes support great availability for customers in store, while warehouse processes minimise stock loss and wastage. We increase back-office efficiency through our shared service centre in India with the same team designing common features, such as self-service checkouts, for all our markets.



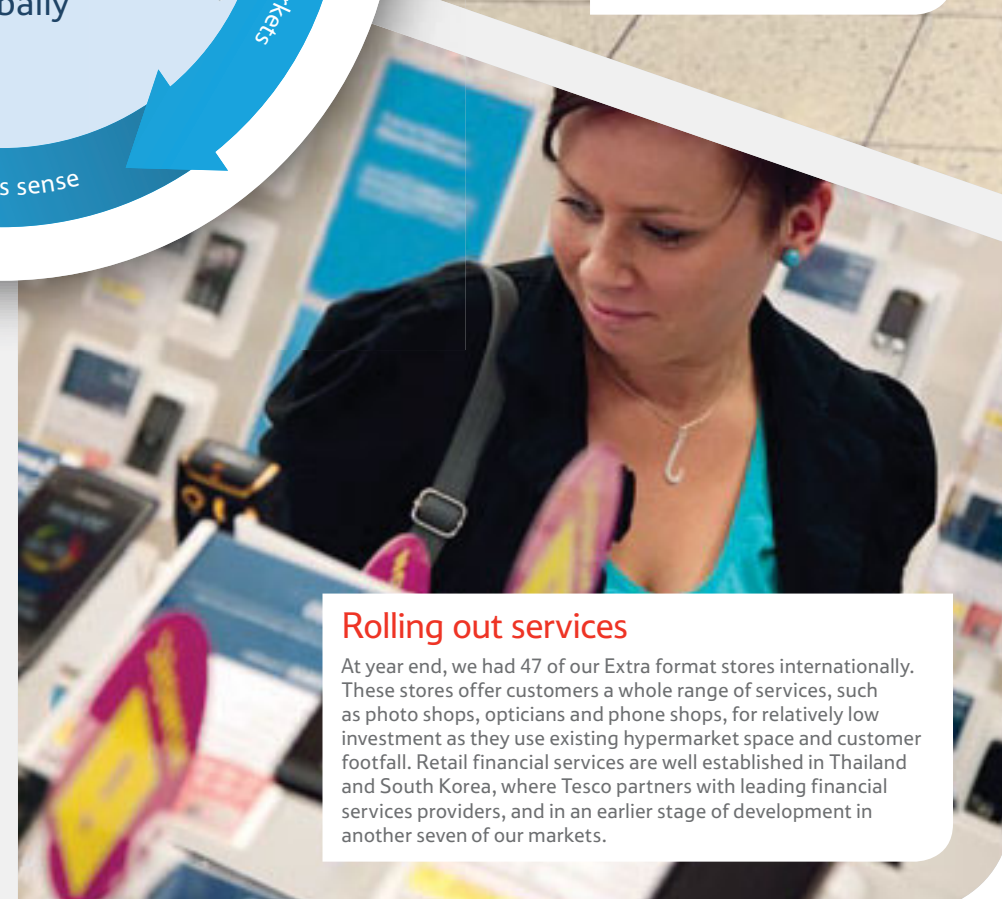
Reaping the benefits of centralised distribution

As we buy more and more products on a regional or global scale, it becomes easier and more effective to organise our distribution across borders. We have opened new depots in Poland and China this year, building them to a Group blueprint and implementing best practice processes, equipment and systems.



Rolling out services

At year end, we had 47 of our Extra format stores internationally. These stores offer customers a whole range of services, such as photo shops, opticians and phone shops, for relatively low investment as they use existing hypermarket space and customer footfall. Retail financial services are well established in Thailand and South Korea, where Tesco partners with leading financial services providers, and in an earlier stage of development in another seven of our markets.



International: Footholds in newer markets

China: three regions the size of countries

A large, rapidly growing market, China offers real long-term potential for growth, despite a currently challenging consumer environment.

South region

Present in this region for only four years, we continue to adapt our offer to meet consumer needs in this warmer part of China



North region

Hymall opened here in 2001 and 11 years later we have 39 stores trading. Our first Extra opened in Shenyang in December. Freezing cold in winter, our clothing and food ranges are very different to the East and South



East region

The 'home' of Tesco in China is Shanghai and here we are trading our first Express convenience stores



Our strategy in China is to focus on building scale in three regions which together have a population of over 600 million.

Diversity and complexity

A market of China's scale brings not only significant opportunities but also huge diversity and complexity. To be successful, we need a deep understanding of regional, provincial and city-level differences, as well as an ability to leverage our global expertise and systems in order to build scale. Our vision of winning locally by applying our skills globally is key to our ambition to drive long-term, sustainable growth in China.

The importance of being local...

Even within a single region temperatures, tastes and preferred brands can all vary, so our operation is 'local' in many ways. For example, our buying teams are based in different regions and even in specific provinces and cities to be close to our customers and suppliers. We have appointed more local Directors this year to strengthen our China Board and have ongoing plans to recruit and develop local talent.

... and operating responsibly

Our stores are active in their local communities, for example through 'Care for the Needy', where we donate daily essentials to elderly and infirm people. Drawing on our Group expertise and technologies, our new distribution centre in Jiashan uses 45% less energy than a traditional depot. These are just two examples of how we operate responsibly through a combination of being local and applying our skills globally.

Group skill and scale

Tesco's skill and scale are crucial to differentiating our business in China. Our new distribution centre was an important first step to streamlining our supply chain, allowing us to buy on a greater scale and giving us more control over the storage and transportation of fresh produce. Drawing on our brand capabilities, we have recently relaunched the packaging for 250 of our own-brand products, with hundreds more to follow in the coming year. Our Shenyang Extra store has benefited from the success of our new format in Europe, with the senior team trained in our Extra store in Bratislava, Slovakia.

Scan here to hear more from our Fresh & Easy colleagues, or visit www.tescopl.com/ar2012/freshandeasyvideo



Fresh & Easy: progress in the United States

The changes we have made to stores this year are building real momentum in Fresh & Easy, driving growing customer numbers and sales and delivering reduced losses for the first time.

The Fresh & Easy shopping trip

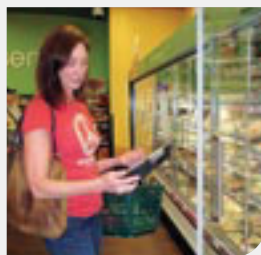
Our Fresh & Easy business is about wholesome, fresh, high-quality food in the heart of the neighbourhood, with great staff giving the best customer service. We have made changes this year to bring out these features and give them more prominence in our stores. With a friendlier store environment and atmosphere, the quality of our fresh and prepared produce more apparent and the launch of our Friends card to thank our loyal customers, we have driven 12% like-for-like sales growth this year and total sales growth of 27%.

The journey to profitability

The results of these changes mean that we are more confident about the outlook for the business, although clearly much remains to be done. We have reduced trading losses by 18% and are on track for another significant reduction in 2012/13, even if the timing of break-even will now be later than our earlier expectation. This is because we will focus on more stores reaching profitability first, before pushing on faster with the expansion we need to create sufficient scale to cover our overheads. We ended the year with 185 stores and will have approaching 230 stores by the end of the coming year.



Doors on our fridges and freezers, wooden floors and brighter walls all make our stores more inviting for customers



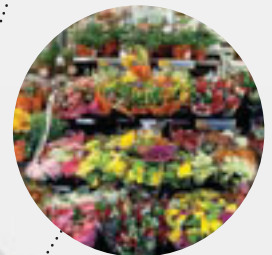
Fresh & Easy superstars go the extra mile for customers and help create a culture of personal service



New prepared ranges from the Fresh & Easy Kitchen, offering wholesome, natural and tasty meals



Customers can see and feel the quality of our loose fresh produce



Welcoming customers with new fresh ranges: flowers, fresh bread and coffee to go



Friends loyalty card thanks our customers for shopping with Fresh & Easy



Retail services: A Tesco Bank for Tesco customers

Tesco Bank brings Tesco's Values, customer focus and trusted brand name to a big market and is differentiated by being a bank that has Tesco at its centre. We offer simple, convenient, value for money products in what can be a highly complex market.

Since we took full ownership of Tesco Bank in 2008 we have been in a period of transition. In just over three years we have developed a completely new infrastructure for the business, built up a new team and brought in new expertise – effectively building a new bank from scratch. We are now completing the very final stages of this huge project, as we move towards offering a full-service retail bank.

At its core, Tesco Bank is underpinned by the Tesco brand and Clubcard, and its operations are effective because of our people, systems and IT.

Being part of Tesco delivers benefits for customers and Tesco Bank. For example, the insight we gain from Clubcard allows us to understand our customers' needs well, helping us to provide them with the most relevant offers in a clear and simple way and at a great price.

Tesco Clubcard credit card rewards customers with Clubcard points whenever they use their card. Clubcard customers can also receive preferential deals when buying Tesco Bank products – including discounts on car, home, pet and travel insurance – and can use Clubcard points to buy Tesco Bank insurance. This year, Tesco Bank gave customers around £70 million of Clubcard points to spend in store or on Clubcard rewards.

The Tesco Values sit at the heart of Tesco Bank. Our core purpose is 'To create value for customers to earn their lifetime loyalty', so our people focus on providing great customer service. At our Glasgow and Newcastle customer service centres, staff are not incentivised to sell, which means

that discussions with customers can focus solely on meeting their banking and insurance needs. Over the last three years, we have built a strong team with experience and expertise, growing dramatically from 300 to 2,800 people.

In terms of systems and IT, our new platforms have enabled some significant customer service improvements. Instant decisions are now available on loan applications, and customers can open and fund savings accounts in just ten minutes, which had previously taken around two weeks.

While we have completed the majority of the transition from The Royal Bank of Scotland's ('RBS') systems and platforms to our own, we did encounter some technical issues during the summer of 2011. We pride ourselves on being a bank that customers can rely on and trust, and to ensure that the continuing process was as smooth as possible for customers and staff, we decided to slow the remaining transition of our 2.8 million credit card accounts. This is now nearing completion.

Even with all this work going on, we have grown the business during 2011/12. The savings book was up 7% versus a market of 3%, and the underlying performance of the Bank remained good, with strong growth in baseline profit (which excludes key non-trading provisioning movements).

In the last three years, we have seen significant growth across key Bank products. We have laid our foundations for growth and, with the transition from RBS almost complete, we are now in a position to grow the business faster.



Savings and loans:

Our savings book continues to grow well, with retail savings deposits increasing by around £330 million this year. Clubcard insight supports our competitive customer offering and high quality loan book. Even though loan balances have been temporarily reduced this year as we have undergone migration, customer accounts in loans and savings have increased by 30% since 2008. We are continuing to attract new customers who know that the Bank is reliable, trustworthy and good value.



Scan here to watch our video about Tesco Bank, or visit www.tescopl.com/ar2012/tescobankvideo





Transaction services:
 Our transaction services – ATMs and travel bureaux – offer customers convenience while they are on the go. Both saw strong growth in the year, with ATM transactions up 9% and travel money transactions up 12%. We ended the year with 3,265 ATMs, up from 2,600 three years ago, and we have close to 200 travel bureaux across our store network.



Insurance:
 Our products help support customers in their daily lives, giving them peace of mind wherever they are. Simple to understand, our range of products continues to prove popular with customers. Around 1.5 million people now insure their cars and homes with Tesco Bank. Since 2008, our car insurance gross written premiums have increased by 39% and pet insurance gross written premiums are up by 44%.



Credit cards:
 We are increasing our share of the market, with 57% growth in credit card transactions since 2008. Three years ago, Tesco Bank credit cards made up 9% of all MasterCard and Visa credit card transactions in the UK – that figure is now 12%. Customers benefit from the added 'Tesco' extras that come with their credit card, such as collecting one Clubcard point for every £4 spent.

New products:
 Tesco Bank has been growing well even without new product launches, but the products we've launched on our own systems have enjoyed huge success. Our Fixed Rate Saver, launched in October 2010, has grown to £1.5 billion and our retail bonds have attracted investments of £185 million. These initiatives diversify our funding base and increase the long-term funding available to the Bank.
 We always want to give our customers the best products and the best

experience, so we believe getting it right at launch is more important than rushing the process. Once we have completed the final stage of migration, we can push on faster with more substantial new products, starting with mortgages.
 Current accounts are planned to follow and we welcome the recommendation of the Independent Commission on Banking to make it easier for customers to switch between banks.

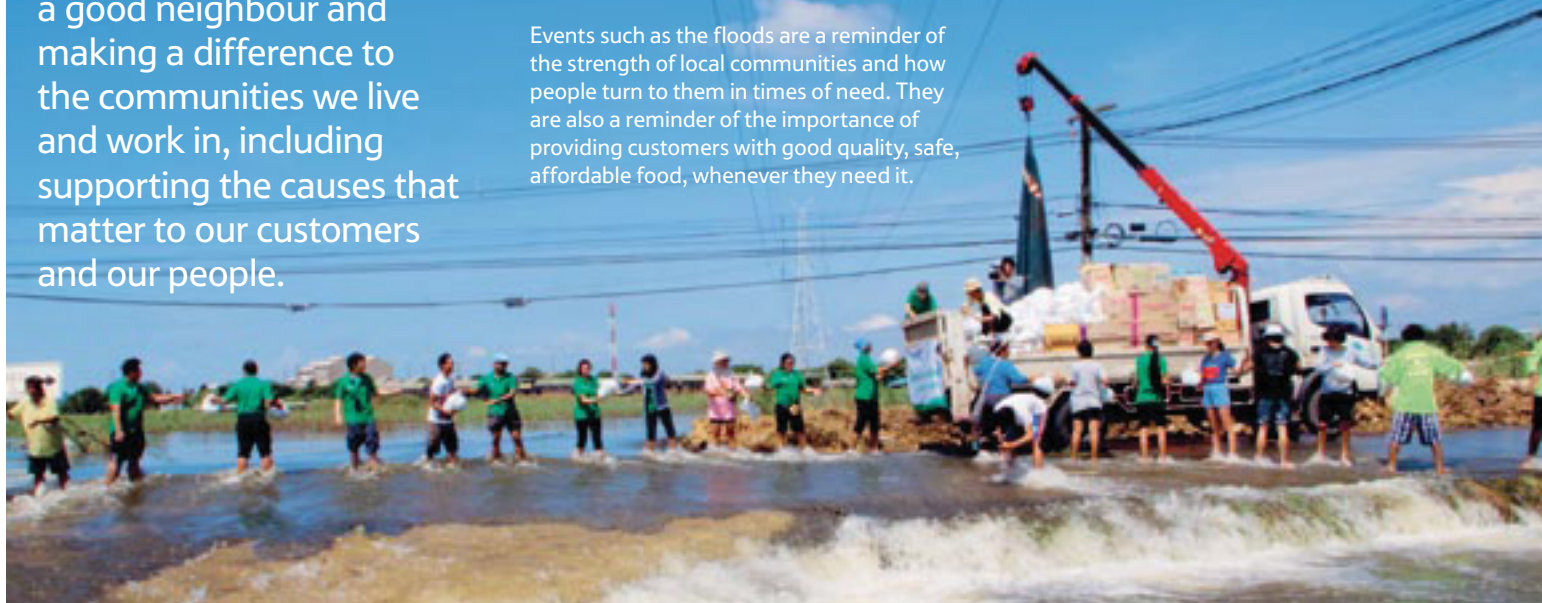
Rates are subject to change and are correct as at April 2012. Fixed rate saver: one-off payment and money cannot be withdrawn until the end of the term.

Our dedication to the community: Thailand

Our stores are important parts of local communities. We are committed to being a good neighbour and making a difference to the communities we live and work in, including supporting the causes that matter to our customers and our people.

In 2011, Thailand suffered its worst floods in 70 years. At Tesco Lotus our staff went to incredible lengths through immensely difficult conditions to get essential supplies into our stores for customers.

Events such as the floods are a reminder of the strength of local communities and how people turn to them in times of need. They are also a reminder of the importance of providing customers with good quality, safe, affordable food, whenever they need it.





Like all Thai retailers, we faced a major challenge with the flood crisis but at Tesco Lotus the team worked incredibly hard to find ways to get products into store and support local people.

Our people came into work even when their own homes were flooded. We used trains and planes to bring products in and worked together across the Group to secure deliveries. Tesco in Malaysia provided three million litres of water and eight million packets of noodles and our global suppliers helped to secure canned fish, eggs and UHT milk.

We used our stores as donation centres for customers who wanted to support flood victims and contributed almost £500,000 of essential products. For our staff affected, we provided financial support as well as relief bags, food, temporary accommodation and transport.

Through teamwork at Tesco Lotus and the support of the Group, we were able to help the people of Thailand during this difficult time – a recovery effort that is still continuing. I would like to thank the whole team again for their extraordinary dedication.

Chris Bush

CEO Tesco Lotus at the time of the floods, now COO Tesco UK



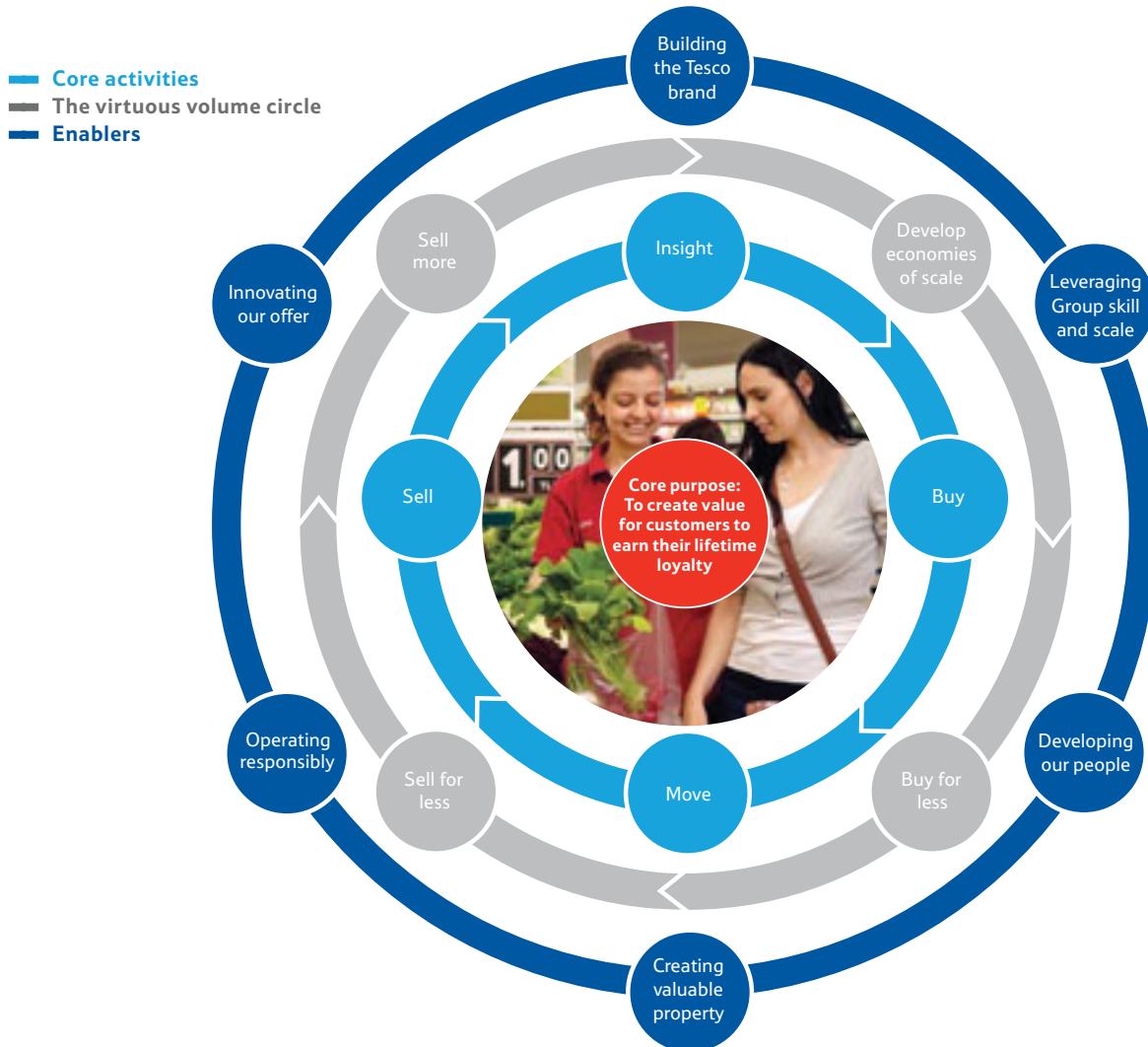
Scan here to see our Thai team in action, or visit www.tescopl.com/ar2012/thailandvideo



Business model

Our strategy is put into action through our business model. At its heart is our core purpose: ‘To create value for customers to earn their lifetime loyalty’.

Business model



Core activities

Our core business model is simple: we buy, move and sell products and services to our customers and use customer insight to do this slightly better each time.

Insight:

Improving the customer offer

Listening to customers in a wide variety of ways is key to what we do. We engage with customers through a range of focus groups and ongoing research trackers, and actively seek feedback on what is good or not so good, such as through our Every Comment Helps scheme in the UK. Online and social media make it easier to listen and respond to large numbers of customers in real time, through webchats, Facebook and Twitter. The insight from all of these conversations increasingly feeds into the customer offer so that we can continually drive incremental improvements for customers.

Our loyalty schemes, such as Clubcard or Legou Tesco Membercard in China, are not only great for our customers but also provide data insight to enable us to continually improve the shopping trip. With a loyalty scheme in all of our markets and around 44 million active customers in total, we are in a unique position to understand customers' shopping patterns. Our marketing insight business, dunnhumby, provides analysis which we feed back into our business model, shaping our product and range development and enabling us to offer customers the best products and promotions for their particular needs.

Buy:

A great range of products

In food, general merchandise and services, we work with our suppliers and develop our brands to bring a great range to our customers.

The relationship with our suppliers is the foundation of our customer offer. We work with a broad range of suppliers, from global produce suppliers and international FMCG companies to local suppliers who provide products for a single region in one of our markets. We sell over £1 billion of local products annually in the UK and, across Europe, our series of 'meet the buyer' events helped us to stock hundreds of new local products this year.

Business model

With our established private label programme, we produce great quality Tesco brands at a range of price points, from Everyday Value up to Finest. Our product brands also have established market positions. For example, F&F, which is the market leader in clothing in the Czech Republic, Slovakia and Hungary, is itself diversified into distinct sub-brands for different clothing styles.

In services, we often work with specialist partners to source the best product offerings. For example, we created a joint venture between Vodafone and Tesco Hungary this year, and Tesco Bank insurance underwriting is primarily provided in partnership with Ageas Insurance Limited.

Move:

The right products at the right time

Our network of distribution centres ('DCs') and advanced technology support a modern, efficient and cost-effective supply chain.

An efficient distribution system starts with understanding which products our stores need. We do this in two ways. First, we forecast what customers will buy, using sophisticated, detailed models to consider variables such as seasonality, weather forecasts and likely response to promotions. Second, our ordering systems automatically update in real time based on what customers do actually buy, so that we can quickly and accurately supply stores with the right products at the right time.

We plan our distribution processes, systems and network of DCs to maximise efficiency. Labour scheduling and transport planning systems enable our pickers and drivers to operate highly effectively, and we develop our distribution networks to minimise the mileage needed to get products to store in perfect condition. We also use transport other than lorries such as our four train services in the UK, which save 15,000 tonnes of CO₂ per year.

Continually striving to make every part of the process productive, through primary distribution, we use our network to pick products up from some of our suppliers and transport them to our depots, which can be more cost-effective than individual suppliers delivering to us. We also use return journeys from stores to depots to pick up waste materials which we sell for recycling.

Sell:

The best shopping trip

Whether in store, online or a combination of both, we pride ourselves on delivering a great shopping trip for our customers, week in, week out.

One of Tesco's Values is 'No one tries harder for customers', and this can be seen in how we strive to improve the shopping trip. This represents every element of the customer shopping experience, including price, range, quality, availability and service. Our loyalty schemes are key to the customer offering, thanking customers each time they shop at Tesco.

We take a multi-format approach to our store network, to be able to meet our customers' needs for different types of shopping trip, from large Extra stores that offer a full range of food, general merchandise and services, to Metro and Express convenience stores.

'Selling' refers to a broader and broader range of activities as we develop our multi-channel offer. We launched a grocery home shopping service in the UK in 1997. Since then, we have grown this business to over £2 billion of annual sales, launched grocery home

shopping in South Korea, the Republic of Ireland and the Czech Republic, and launched further online businesses, such as Direct, Clothing and Entertainment. We are increasingly offering customers the option of combining stores and online with Click & Collect, which makes the most of our convenient store locations, giving customers an easy way to pick up products ordered online.

We also offer a wide range of services to our customers. With opticians, pharmacies and phone shops available in our larger stores, and Tesco Bank products available to buy in store, over the phone or online, we are deepening our customers' relationship with Tesco, bringing our values of convenience, simplicity, reliability and great customer service into what can be complex markets.

We don't always sell our products ourselves. In South Korea and the Czech Republic, we operate franchise chains alongside our own stores, and we have also recently announced a new franchise model for our F&F clothing brand in Saudi Arabia.

The virtuous volume circle

By keeping our customer focus central to our business model, we are able to provide a leading customer offer: a broad range of products and services at great prices, sold in shops in convenient locations and, increasingly, available online. A great customer offer drives the virtuous volume circle, which means that we can continuously improve our offer. By selling more products, we are able to work with our suppliers to drive mutually beneficial economies of scale, creating headroom to invest and to offer lower prices to customers. An important element of our Plan to improve business performance in the UK is centred on investing in the shopping trip so that customers will reward us by buying more from Tesco.

Enablers

Our core business model is supported by enablers which maximise the potential of our core activities to give our customers the best shopping trip and ensure that our activities are carried out in a sustainable way.

Leveraging Group skill and scale:

Making our business Better, Simpler, Cheaper, Faster

Sharing best practice systems, processes and approaches across all of our markets takes our business model to the next level. By identifying best practice in each market, we can improve our offering around the Group. For example, some of the very popular brands we have developed in Fresh & Easy in the US have recently been introduced into the UK and South Korea. As our international experience grows, we are increasingly benefitting from sharing best practice – with our UK Operating Board all having spent some of their careers in our international businesses.

Group skill and scale supports each of our core activities: utilising Insight, Buying, Moving and Selling. Utilising Insight as a Group, with a loyalty scheme in all of our markets, means we can continually innovate the customer offer. Our Turkish business launched Clubcard this year, which would not normally be possible for a business of its size. Buying as a Group is cost-effective, creating headroom to invest in the customer shopping trip, such as by sourcing consumables in Central Europe as a Group. Moving as a Group, with distribution centre blueprints, systems, and the early stages of borderless distribution, makes our deliveries simpler and faster, with new distribution centres opened in both Poland and China this year. Selling as a Group, with our Extra format already in eight international markets, including the Czech Republic, Thailand and China, offers customers a better shopping experience.

Of course we don't believe in 'one size fits all'. There are many things that are best done locally because customer tastes and lifestyles are not uniform. Our businesses are run predominantly by local teams, not by expats, so that our operations can be close to the customers we serve, and our local ranges both support our smaller suppliers and give customers a tailored product offering.

Developing our people:

Our most important asset

Great service can make a customer's day, and we achieve this when our people live the Tesco Values: 'No one tries harder for customers' and 'Treat people how we like to be treated'. Our business is built on the commitment of more than half a million people across the world and, in return for their commitment, we offer them good jobs and careers with Tesco. Developing our people takes many forms, from training in our state-of-the-art training academy in Asia, to offering jobs to the long-term unemployed through Regeneration Partnerships and supporting the development of women to management positions.

Creating valuable property:

The best located and best designed stores

Our site research and property capabilities enable us to identify and develop the best sites for our stores. Tesco has great depth of experience in property development all around the world.

Optimal sites for new store developments and extensions are identified by our site research departments. We have a flexible approach to property acquisition, considering both freehold and leasehold sites and assessing each opportunity on its merits. Using a range of data, such as demographics and competitor activity, we forecast sales for a new store to a high degree of accuracy, so that we can develop the stores with the greatest potential.

Once a site has been identified, approved and secured, our property development and construction teams design and develop the site. Years of experience have fed into Group-wide blueprints and specifications so that all of our development takes place to the highest standard.

In many of our international markets, Tesco owns or leases whole malls, which are anchored by a Tesco hypermarket. Operating the mall and renting out the space to other retailers, cafés and cinemas creates a great destination shopping centre for customers, as well as bringing in significant rental income, which makes Tesco one of the largest mall operators in the world.

Operating responsibly:

Ensuring that growth is sustainable

By operating responsibly, we not only benefit and secure the future of our business but we can bring real benefits to the communities in which we operate.

At the heart of our commitment to operating responsibly is providing our customers with good quality, safe and affordable food. This is easily taken for granted in developed economies, but can be a real challenge in economies with low penetration of modern retail and under-developed supply chains.

We can only achieve this by working with our suppliers to ensure our supply chain is both resilient and efficient. Strong, fair, mutually beneficial, long-term partnerships with suppliers, from local to global, are at the heart of this. The strength of our supply network was evident during the Thai floods this year, enabling us to secure essential supplies from Malaysia and other markets.

We are committed to the responsible sourcing of raw materials, ensuring the resilience of our supply chain and managing our impact on the environment. We work with the wider industry on core issues, such as water scarcity, and co-chair the Sustainability Steering Group of the Consumer Goods Forum, which has pledged to help end deforestation by 2020. We aim to be a zero-carbon business by 2050 and are mapping the biggest opportunities to cut carbon in our supply chain, as well as continually exploring new energy efficiency measures to be introduced across the Group.

Innovating our offer:

Constantly improving our customer offer

To continue to meet customers' changing needs, we are constantly innovating our offer in a whole variety of ways. Innovation can bring greater convenience to an existing way of shopping, as with self-service checkouts. It can offer customers a new way of shopping, as with Click & Collect grocery or our virtual stores in South Korea. It can combine our presence in shops and online into a compelling customer proposition: for example, a customer registered with Blinkbox can automatically receive a digital copy of most new Hollywood releases when they buy the DVD with a Clubcard in store. By drawing on the breadth of our expertise and by always putting the customer first, we continue to serve customers how they want to be served in a changing and increasingly joined-up world.

Building the Tesco Brand:

To be seen as the most highly valued business in the world

Through everything we do, we strive towards our vision of being seen as the most highly valued business in the world – valued not only by our customers, but also by the communities we serve, our staff and our shareholders. Protecting and developing our brand reputation is the foundation of customer loyalty and of how we are seen by our many stakeholders and enables our business model to operate effectively. For example, our diversification into services such as Tesco Bank is built on customers' trust in the Tesco brand to offer good value, simple solutions and great customer service; and our recruitment and retention of great staff depends on our reputation for customer service and offering good jobs and careers.

Performance review

IN THIS SECTION

- 29 Key performance indicators
- 33 Financial review

This section provides detailed information on our financial and non-financial performance over the past year.

In Key performance indicators, you will find sections covering Group performance, Group financial ratios and all seven parts of our strategy. Our Financial review section then takes you through the financial performance of each of our business segments in the year.

More detailed definitions for our Group performance and Group financial KPIs can be found in the glossary on the inside back cover.

Key performance indicators

Our KPIs measure how we are doing across the Group in terms of both operational and financial performance in the context of the key elements of our strategy.

More detailed definitions for our Group performance and Group financial KPIs can be found in the glossary on the inside back cover.

All KPIs exclude the results from our operation in Japan for 2011/12 unless stated otherwise.

Group performance

Growth in underlying profit before tax

1.6%

08/09	09/10	10/11	11/12
9.8%*	8.7%	12.3%	1.6%

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.

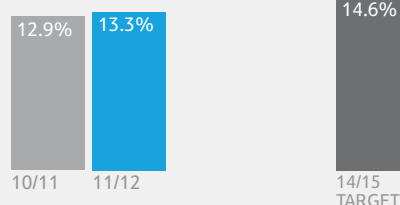
Performance

We saw modest progress in the year, with the rate of improvement impacted by two events: the Hungary crisis tax (£38 million) and the increase in provision for Payment Protection Insurance ('PPI') in Tesco Bank (£57 million). Growth before these impacts was 5.4%.

* Restated for IFRS 2 and IFRIC 13.

Return on Capital Employed ('ROCE')

13.3%



Definition

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

Performance

Although our UK performance was weaker than planned, ROCE improved by 40 basis points, benefiting from Japan now being classified as a discontinued operation.

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

2.1%

08/09	09/10	10/11	11/12
11.0%	7.7%	10.8%	2.1%

Definition

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

Performance

The growth in underlying diluted EPS reflects modest progress in earnings in the year. The proposed full year dividend per share grew by 2.1%, in line with this, to 14.76p, continuing our unrivalled record of consecutive years of dividend growth in the FTSE 100.

Group financial ratios

Total shareholder return ('TSR')

08/09	09/10	10/11	11/12
8.0%	9.5%	6.7%	(3.0)%

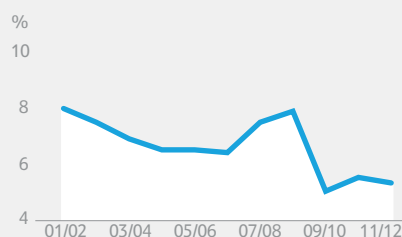
Definition

TSR is the notional annualised return from a share: the percentage change in the share price, plus the dividends paid and reinvested, over the last five years. For example, five-year TSR for 11/12 is the annualised growth in the share price from 06/07 and dividends paid and reinvested in Tesco shares, as a percentage of the 06/07 share price.

Performance

Returns reduced reflecting the effect on our share price of our decision to invest significantly in the customer offer in the UK.

Capital expenditure ('capex') % of sales



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

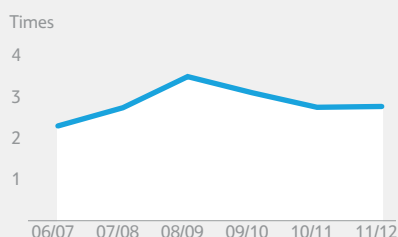
This year we reduced our rate of capital investment to reflect the challenging trading environment and increased our focus on lower capital-intensive investments with high returns, such as online and convenience.

Last year we set a target of 5% to 5.5% of sales. We will reduce capex to £3.3 billion in 12/13 and, beyond that, comfortably less than 5.0% of sales.

Key performance indicators

Group financial ratios continued

Net indebtedness



Definition

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

Performance

Net indebtedness remained broadly flat, reflecting a slower than expected working capital improvement and higher pension deficit, offset by cash generated from retail operations (excluding working capital). Our target for net indebtedness is 2.5 times.

Gearing

08/09	09/10	10/11	11/12
74.4%*	54.0%	40.8%	38.4%†

Definition

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

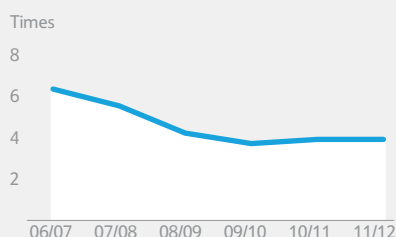
Performance

Our gearing continued to decrease, reflecting our stable debt position despite our investment in assets growing.

* Restated for IFRS 2 and IFRIC 13.

† Includes Japan.

Fixed charge cover



Definition

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

Performance

Our fixed charge cover remained broadly flat due to increased rent offsetting our reduced interest and increase in operating cashflow ('EBITDAR'). Our target is a level of cover in the band of 4 to 4.5 times.

Group strategy: To grow the UK core

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

08/09	09/10	10/11	11/12
3.0%	2.6%	1.0%	0.0%

Definition

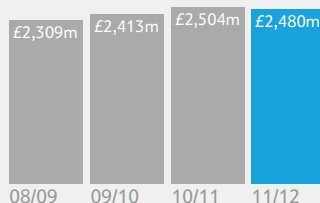
The growth in sales from stores that have been open for at least a year.

Performance

Having delivered a disappointing performance, particularly during the second half, our UK Plan aims to drive stronger like-for-like sales.



UK trading profit



Definition

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

Performance

Having delivered a solid first half profit outcome, profits weakened in the second half, reflecting a disappointing sales performance and the initial investment in improving the shopping trip for customers which we began during the second half of the year.

Customer rating of overall shopping experience as excellent or good

76%



Definition

Percentage of customer ratings, measured in exit interviews.

Performance

Three quarters of customers find their shopping experience good or excellent, and 98% find it reasonable, good or excellent. With our UK Plan, we aim to improve customers' shopping experiences from reasonable to good and from good to excellent.

Source: Marketing Sciences.

Growth in UK online sales

+10%

Definition

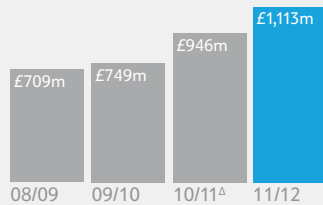
The year-on-year sales growth from total tesco.com and online telecoms.

Performance

We are pleased with the performance of our online businesses. Our largest business, grocery, accelerated its already strong rate of growth through the year.

Group strategy: 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

We delivered strong profit growth of 18% against a background of very difficult economic conditions in several of our large markets.

Δ Re-presented to exclude Japan.

Proportion of customers pleased with their shopping trip

≥95%
in 9 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

The pleasing results reflect the improvements we have been driving internationally through different customer initiatives.

Source: Country customer satisfaction tracker.

Growth in international online sales

+40%

Definition

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

Performance

From a low base we are starting to see accelerating growth, with our established international online operations in South Korea and the Republic of Ireland doing well.

Group strategy: 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

With a leading position among our supermarket peers, we are driving substantial improvements to our range in order to increase our competitiveness among specialist retailers, with plans for 200,000 products on Tesco Direct by Christmas.

Proportion of UK customers buying general merchandise, clothing and electricals

37%
down from 39%
last year

Definition

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

Performance

With the current subdued economic conditions, we are seeing 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. This excludes the US, where we operate convenience stores.

Performance

Our position reflects the strength of the F&F brand and of our Extra stores, which are introducing our customers to different ways of shopping, with stronger ranging and a distinctive look and feel for different categories.

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

27%

Definition

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

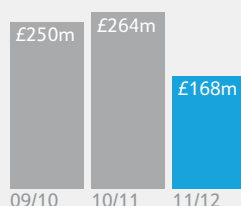
Performance

From this already substantial proportion of Group sourcing, we expect to increase the amount that we buy together in the coming years as we leverage Group skill and scale.

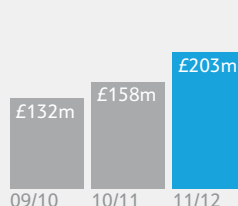
Group strategy: To grow retail services in all our markets

Bank profit

Trading profit



Baseline profit



Definition

Trading profit measures the profit generated by the business in its operations. Baseline profit is measured before key non-trading provisioning movements, including Payment Protection Insurance ('PPI'), and before fair value, and provides information on business performance.

Performance

Baseline profit rose 29% in the year, reflecting strong business growth. By contrast, trading profit fell 36%, impacted by the increase in a provision for claims from historic sales of PPI; and the unwinding of the fair value provision, an accounting adjustment made at the time of acquisition in 2008.

Key performance indicators

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

Reduction in CO₂ emissions

08/09	09/10	10/11	11/12
4.8%	7.8%	7.7%	5.0%

Definition

The year-on-year reduction in greenhouse gas emissions from existing stores and distribution centres built before 2006/07, adjusted to exclude emissions from acquisitions and extensions.

Performance

We met our target for 2011/12 to reduce our CO₂ emissions by 5%. Cumulatively, we have reduced our emissions from existing stores and distribution centres by 26% since 2006/07.

Supplier Viewpoint

74%

Definition

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

Performance

In 2011/12, we exceeded our target of 70%, representing generally strong supplier relationships.

Donation of pre-tax profits to charities and good causes

1.9%

over £74.5m in total

Definition

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

Performance

We exceeded our target of donating 1% of pre-tax profits to charities and good causes, contributing over £74.5 million.

For further Corporate Responsibility KPIs, please see our Corporate Responsibility Review 2012 at www.tescopl.com/crreview.

Group strategy: To be a creator of highly valued brands

Customer loyalty

9

markets – 1st or 2nd place

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

Definition

The number of markets where we are placed 1st or 2nd for the proportion of customers who do over 50% of their shopping with a single retailer.

Performance

We are particularly pleased that we lead on loyalty in four of our markets and are second in a further five. This is an important indicator of our customers' satisfaction with the shopping trip and the Tesco brand and is supported by a loyalty scheme 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. Range & Quality is one part of our Plan for the UK, with Tesco Value now relaunched as Everyday Value and upgrades to over 8,000 Tesco standard lines planned.

Group strategy: To build our team so that we create more value

Staff retention

90%

in the UK

Definition

The proportion of staff with over a year's service who have worked for Tesco in the UK throughout the year.

Performance

Our strong retention rate in the UK reflects our focus on creating good jobs and long-term careers, providing career development and an excellent benefits package.

Staff being trained for their next role

5.9%

across the Group

Definition

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

Performance

We exceeded our 5.6% target this year, demonstrating our commitment to supporting and developing our people so that they are able to advance their careers.

Financial review



Laurie McIlwee
Chief Financial Officer

“Our financial results demonstrate the breadth of the Tesco Group. Thanks to strong performances internationally – particularly in Asia – we have been able to deliver modest profit growth for the Group. Going forward, a financial strategy of increased capital discipline and restraint will support the changes we are making for customers and will drive higher cash generation and higher returns for shareholders.”

^Δ Group results exclude the results from our operation in Japan which have been treated as discontinued following our decision to sell the business.

Group results^Δ

Group results 2011/12

52 weeks ended 25 February 2012	2011/12	Growth
Group sales (inc. VAT)*	£72,035m	7.4%
Group revenue (exc. VAT, inc. IFRIC 13)	£64,539m	6.8%
Group trading profit	£3,761m	1.3%
Group trading profit (pre Bank PPI** provision increase and Hungary sales tax)	£3,856m	5.2%
Underlying profit before tax	£3,915m	1.6%
Underlying profit before tax (pre Bank PPI provision increase and Hungary sales tax)	£4,010m	5.4%
Group profit before tax	£3,835m	5.3%
Underlying diluted earnings per share	37.41p	2.1% [†]
Dividend per share	14.76p	2.1%

* Group sales (inc. VAT) exclude the accounting impact of IFRIC 13.

** Payment Protection Insurance ('PPI').

† Underlying diluted earnings per share ('EPS') growth calculated on a constant tax rate basis; 3.2% at actual tax rates.

In a challenging year for consumers in many of our markets, as they try to manage household budgets pressured by inflation, austerity and high fuel prices, we have made modest progress at a Group level. The international businesses performed strongly, delivering an 18% increase in profits, which helped to compensate for the reduction in trading profit in the UK.

We have acted where our strategy was not delivering as we had hoped. In the United States, we reduced losses, moving towards break-even, before accelerating investment; in Japan, we announced our decision to exit the market after eight years; in China, we stepped back from the freehold shopping centre programme and have decided to hold back on the pace of new leasehold hypermarket development for the time being; at the Bank, we slowed down the migration to our own platforms to ensure it was as smooth as possible; and in the UK, we took a significant step to correct our pricing position with The Big Price Drop and, in January, acted decisively to address the underperformance in our home market. These actions will make Tesco better for our customers and are supported by a financial strategy that will also make Tesco better for shareholders.

Segmental results

UK

UK results 2011/12

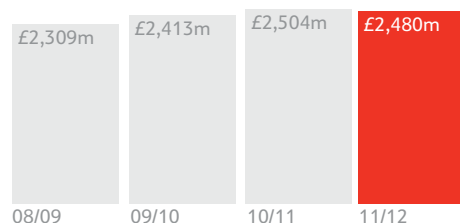
	2011/12	Growth
UK sales	£47,355m	6.2%
UK revenue (exc. VAT, exc. impact of IFRIC 13)	£42,798m	5.0%
UK trading profit	£2,480m	(1.0)%
Trading margin (trading profit/revenue)	5.79%	(35)bp*

* Basis points.

In the UK we saw strong total sales growth driven by a good new store performance, but our like-for-like growth was disappointing, particularly in the second half of the year. This was not helped by reduced inflation resulting from our Big Price Drop and a weak Christmas, which was affected by the substantial increase in competitor couponing activity. Like-for-like sales growth recovered somewhat after Christmas.

Financial review

UK trading profit



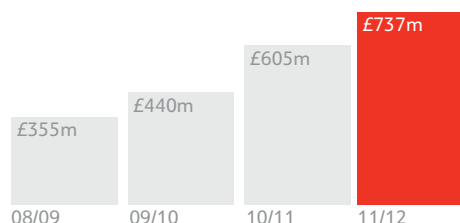
Against this background of slower than planned like-for-like growth and a further weakening in our performance relative to the wider industry, we took the decision in January to accelerate a plan – which had been developed over the course of 2011 – to make substantial changes to the UK business. The combined revenue and capital investment involved in these initiatives will exceed £1 billion, supported by a significant reset to the level of UK margins in order to give us the financial resources we need to make comprehensive improvements for customers.

Asia†

	Actual rates		Constant rates
	2011/12	Growth	Growth
Asia sales	£11,627m	10.5%	10.4%
Asia revenue (exc. VAT, exc. impact of IFRIC 13)	£10,828m	10.5%	10.3%
Asia trading profit	£737m	21.8%	21.5%
Trading margin (trading profit/revenue)	6.81%	64bp	62bp

We delivered a good performance across all our markets in Asia, with solid like-for-like growth. Our performance in Thailand was obviously impacted by the devastating floods but the business has returned to strong growth as the country gets back to normal. Asia margins grew by over 60 basis points in the year, mainly due to the swift resolution of our insurance claim in Thailand, which has mitigated the profit impact of store closures during the flooding. South Korea and Malaysia both had a good year for sales and margin growth, although this was offset by increased losses in China where, in common with other businesses, we faced a challenging year.

Asia trading profit



† Asia results from 2011/12 exclude results from our operation in Japan which have been treated as discontinued following our decision to sell the business. 2010/11 results have been re-presented to be consistent.

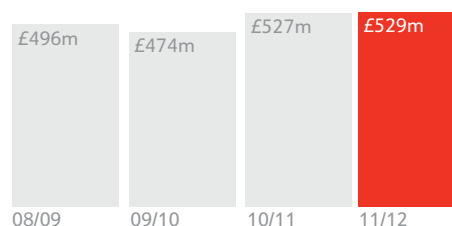
Europe

	Actual rates		Constant rates
	2011/12	Growth	Growth
Europe sales	£11,371m	7.7%	7.8%
Europe revenue (exc. VAT, exc. impact of IFRIC 13)	£9,866m	7.3%	7.5%
Europe trading profit	£529m	0.4%	(0.4)%
Trading margin (trading profit/revenue)	5.36%	(37)bp	(42)bp

A resilient overall performance in Europe was impacted by two factors. Despite a strong sales performance in Poland, profits were held back by significant disruption connected to the opening of our new distribution centre and a non-food stock write-off. The crisis tax of £38 million in Hungary had a material impact on profits. Excluding this, we saw double-digit profit growth for the Central European businesses – a pleasing performance in light of the broader economic issues affecting the eurozone. Our Irish business delivered a robust performance in the context of the severity of the recession there.

The particular circumstances of the Republic of Ireland and Hungary have led us to focus on driving trade from our existing stores and we have scaled back our investment in new space. Focusing our efforts on our existing stores has driven strengthening like-for-likes and continued increases in market share in both markets.

Europe trading profit

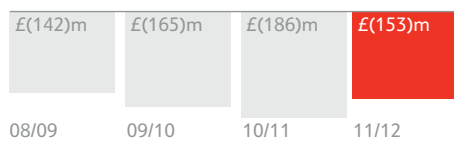


United States

	Actual rates		Constant rates
	2011/12	Growth	Growth
US sales	£638m	27.1%	31.5%
US revenue (exc. VAT, exc. impact of IFRIC 13)	£630m	27.3%	31.7%
US trading profit/(loss)	£(153)m	Improved 17.7%	Improved 15.1%

In the US, Fresh & Easy delivered another strong sales performance and we have reduced losses by nearly 18% year-on-year – the first full-year reduction in losses since our entry into the market.

US trading loss



An increasing number of stores are reaching shop-door profitability, which means that they are operating profitably, before taking account of central costs. Thirty stores are already making a positive contribution to cashflow, and 118 more are very close to doing so. We intend to focus on delivering this store-level profitability, before pushing on faster with expansion in the number of stores. As a result of this more measured approach to new capital expenditure, we now anticipate crossing into break-even in the US during 2013/14.

Tesco Bank

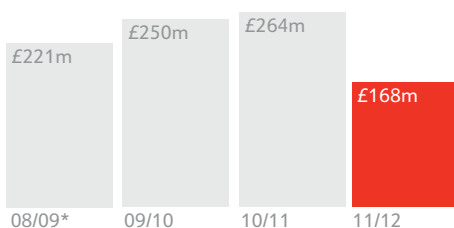
Tesco Bank results 2011/12		
	2011/12	Growth
Tesco Bank revenue (exc. VAT, exc. impact of IFRIC 13)	£1,044m	13.6%
Tesco Bank trading profit	£168m	(36.4)%
Tesco Bank trading margin	16.09%	(1,264)bp
Tesco Bank baseline profit	£203m	29.3%

Tesco Bank increased its baseline profitability very strongly by 29%. This measures business growth, before key non-trading provisioning movements. This performance was particularly pleasing given the need to take a conservative approach on new savings and loans business during the final stages of systems migration. As we put more than three years of transition behind us, the Bank is well placed to deliver good growth, starting in the coming year.

Trading profit was impacted by a number of factors. The unwind of the fair value provision, dating from the time of acquisition in 2008, reduced by £133 million in the year, to £22 million, and will be immaterial going forward. We increased our provision against possible claims arising from the sale of PPI by £57 million in the first half of the year. With no further adjustments in the second half, we ended the year with a net provision of £75 million. Our decision to slow down the final stages of migration also impacted profit by around £40 million which will now begin to reverse.

Bad debts reduced by 5.2% in the year due to the application of our robust credit policy. The Bank's overall capital position improved, from an already good position. Liquidity has also improved, with the retail bond issues giving us greater diversity in the Bank's funding position.

Tesco Bank trading profit



* On a 2008/09 pro-forma basis.

Group balance sheet

Net debt remained stable for the year at £6.8 billion. This is a little behind our expectations at the half-year, due to the impact of the Christmas trading result on cash flow and to lower working capital inflow, linked to higher stock levels than planned. Group capital expenditure was slightly below our half-year expectation, at £3.8 billion, due to tight control of spending. Operating cash flow from retail operations was down slightly year-on-year, at £3.8 billion, again affected by lower working capital inflow.

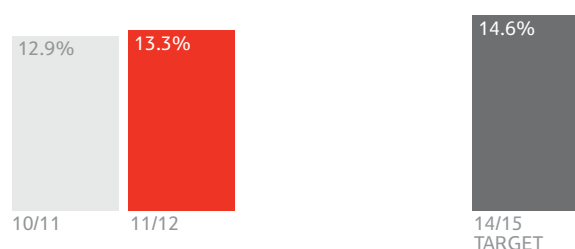
Our strategy to release value from our property portfolio has had another successful year, generating £376 million of property profits from around £1 billion of disposals. The launch of our first property fund in Asia completed successfully after the year end, raising over £379 million from 17 mature stores and malls in Thailand. With the fund seeing strong demand on launch, and since trading above its listing price, this is a strong indication of the overall value of our operations in Thailand and elsewhere in Asia. The market value of our global property currently exceeds £37 billion.

Finally, our IAS 19, or accounting, pension deficit increased to £1.4 billion after tax, largely as a consequence of market conditions. We announced proposed changes to the terms of our defined benefits scheme in March, in order to make it more sustainable over the long term. We also made a one-off cash contribution of £180 million to the scheme after the year end, in anticipation of the forthcoming outcome of the triennial actuarial valuation, which we believe gives a more accurate indication of the likely costs of future funding of the scheme.

Group financial metrics

A year ago I set out four key financial metrics or measures to help investors monitor our capital returns performance, debt and overall balance sheet. Taking each in turn, we have improved return on capital employed ('ROCE') from 12.9% last year to 13.3%. This improvement benefits from Japan now being classified as discontinued as a result of our decision to exit the market.

Target return on capital employed



We held our two debt metrics, fixed charge cover and net indebtedness, broadly flat this year. Both measures will of course be directly affected by the UK investment plan we have announced for the coming year. Our target for fixed charge cover is between 4 and 4.5 times and, for net indebtedness, is 2.5 times.

On our fourth key metric, capital expenditure as a proportion of sales, we were exactly in the middle of our target range of 5 to 5.5%.

Financial review

“Our financial strategy of capital discipline and restraint supports a more sustainable level of growth, which focuses on getting more out of the businesses we currently have, benefits from less capital-intensive forms of investment and applies higher hurdle rates to new opportunities.”

Looking forward

Capital expenditure

Our future plans include a reduced level of Group capital expenditure: down to £3.3 billion in 2012/13 and, beyond that, comfortably less than 5% of sales. This reflects our movement into a new phase of growth for the Group, moving beyond the diversification and expansion phase, to a phase where the allocation of capital is based on the balance of growth and returns that each investment can deliver.

Capital allocation

Our plans lead to further significant changes in our capital allocation for the Group. Having already started some of this work in the UK, we are seeing higher returns on the new space that we have opened as a result.

Across the Group more of our capital is going into smaller, higher-returning store formats.

We will be investing less overall capital in our UK business, as we reduce the net new space opening programme by 38% in the coming year, and focus store openings on smaller stores, and on food more than non-food.

Within the overall UK spend, we will be spending much more on the refresh of our existing stores, increasing our investment to over £200 million, in addition to an increase in our online investment to around £150 million.

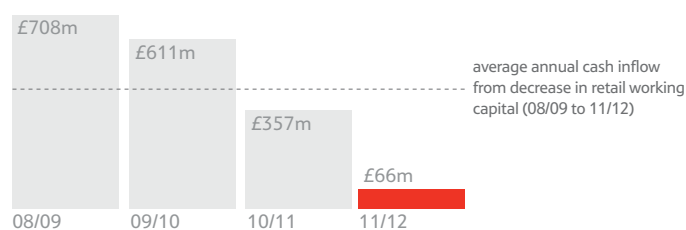
Capital work-in-progress

The level of capital work-in-progress (“WIP”) on the UK balance sheet now stands at around £2 billion. Building out stores faster than we acquire new sites will be a key contributor to UK space growth over the next few years, and will reduce this level of WIP. The completion of mixed use schemes within the WIP balance will also play a significant role in bringing it down to a more appropriate level, although the construction phase on these schemes will add to the WIP balance in 2012/13, followed by a rapid reduction thereafter. In some instances, we may also dispose of standalone sites that do not meet our new, more rigorous returns hurdles.

Cash

This financial strategy means an increasingly cash generative outlook for Tesco in the next few years, with an overall reduction in Group capital expenditure, a return to growth in the cash contribution from the UK business, the international businesses making an increasingly positive contribution and a return to strong cash inflows from working capital.

Cash inflows from decrease in retail working capital



In line with our financial strategy, working capital management will result in a return to strong cash inflows from working capital in the coming years.

Returns

Capital restraint and improved cash generation both result in an improving ROCE. Last year, we laid out our commitment to improve ROCE to 14.6% by 2014/15. Our investment plans in the UK make it likely that we will see a small reduction in 2012/13. However, we described a number of significant opportunities to increase returns last year, such as driving growth in the Bank, benefiting from regional scale in Central Europe and moving the US to profitability, as well as the structural benefit of maturing international businesses. These opportunities still exist and indeed our decision to divest the Japanese business has already made a contribution.

Our financial strategy of capital discipline and restraint supports a more sustainable level of growth, which focuses on getting more out of the businesses we currently have, benefits from less capital-intensive forms of investment and applies higher hurdle rates to new opportunities. This in turn drives higher returns and a higher level of cash generation. In supporting the plans that make Tesco better for customers, I believe this financial strategy is also better for shareholders.

Governance

IN THIS SECTION

38	Board of Directors
40	Principal risks and uncertainties
42	General information
50	Corporate governance
64	Directors' remuneration report

All of our business activities take place within a governance framework, which supports our culture and our core Values: 'No one tries harder for customers' and 'Treat people how we like to be treated.'

This section starts with the Board because governance is built on the Board's active and committed engagement. You will find further sections on risks to our strategy and how we manage them, on our approach to corporate governance and on executive remuneration.

Board of Directors

Our Board currently comprises the Chairman, Sir Richard Broadbent, five Executive Directors and eight independent Non-executive Directors. Biographies for each of our Directors and our Company Secretary are set out below.

1. Sir Richard Broadbent – 58 ▲ ♦

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.

2. Philip Clarke – 51

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.

Committee membership (from 26 February 2012)

- ▲ = Nominations Committee
- = Audit Committee
- = Remuneration Committee
- ♦ = CR Committee

3. Tim Mason – 54

Deputy Group CEO and CMO and CEO Fresh & Easy

Tim Mason has been President and Chief Executive Officer, Fresh & Easy Neighborhood Market since January 2006 and became Deputy Group CEO and Chief Marketing Officer in March 2011. He was appointed to the Board on 16 February 1995. He joined Tesco in 1982.

4. Andrew Higginson – 54

CEO – Retail Services

Andrew Higginson was appointed to the Board on 17 November 1997. Prior to his appointment as Chief Executive of Retail Services in July 2008 he was Group Finance and Strategy Director. He was Chairman of Tesco Bank until 26 February 2012 and will retire from Tesco PLC on 1 September 2012. He is a Non-executive Director of BSKyB plc.

5. Laurie Mcllwee – 49

Chief Financial Officer

Laurie Mcllwee 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 Finance and General Management roles in the UK, USA, Central Europe and the Middle East. Laurie is a Fellow of the Chartered Institute of Management Accountants and a member of The Hundred Group of Finance Directors.

6. Lucy Neville-Rolfe, CMG – 59

Executive Director (Corporate and Legal Affairs)

Lucy Neville-Rolfe was appointed to the Board on 14 December 2006. She joined Tesco in 1997 from the Cabinet Office. She is Deputy Chair of the British Retail Consortium, a Non-executive Director of ITV plc and of the Carbon Trust. She is also a member of the London Business School's Governing Body, the China Britain Business Council, the UK India Business Council and the Corporate Leaders Group on Climate Change.

7. Patrick Cescau – 63 ▲ ■ ♦

Senior Independent Director

Patrick Cescau was appointed a Non-executive Director on 1 February 2009 and became Senior Independent Director in July 2010. He was Group Chief Executive of Unilever from 2005 to 1 January 2009, and prior to this he was Chairman of Unilever plc and Vice Chairman of Unilever NV. He has also been a Non-executive Director of Pearson plc since 2002, becoming Senior Independent Director in April 2010, and IAG (International Airlines Group) since September 2010. Patrick was appointed a Chevalier de la Légion d'honneur in 2005. In June 2009, Patrick joined the Board of INSEAD.



10

7

4

8

13

11

2

8. Gareth Bullock – 58 ■**Non-executive Director**

Gareth Bullock was appointed a Non-executive Director on 3 July 2010 and will (subject to approval by the FSA) be appointed to the Board of Tesco Bank as a Non-executive Director. He was Group Executive Director of Standard Chartered PLC until his retirement in April 2010. He 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.

9. Stuart Chambers – 55 ▲ ●**Non-executive Director**

Stuart Chambers was appointed a Non-executive Director on 3 July 2010 and will (subject to approval by the FSA) be appointed to the Board of Tesco Bank as a Non-executive Director. 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 and the Mars Corporation. He is a Non-executive Director of Smiths Group PLC, where he is Chairman of the Remuneration Committee, and of Manchester Airport Group PLC. Stuart was appointed Non-executive Director of Rexam PLC on 1 February 2012 and Non-executive Chairman effective from 22 February 2012.

10. Karen Cook – 58 ●**Non-executive Director**

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

11. Ken Hanna – 58 ▲ ● ■**Non-executive Director**

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

12. Ken Hydon – 67 ■**Non-executive Director**

Ken Hydon was appointed a Non-executive Director on 23 February 2004 and is Chairman of the Audit Committee. He retired from the position of Finance Director of Vodafone Group Plc in 2005. He is also a Non-executive Director of Reckitt Benckiser plc and Pearson plc, and was a Non-executive Director at The Royal Berkshire NHS Foundation Trust from 2005 until 2012.

13. Deanna Oppenheimer – 53 +**Non-executive Director**

Deanna Oppenheimer was appointed a Non-executive Director on 1 March 2012 and will (subject to approval by the FSA) be appointed to the Board of Tesco Bank as a Non-executive Director. 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 Barclays, 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.

14. Jacqueline Tammenoms Bakker – 58 ● +**Non-executive Director**

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

15. Jonathan Lloyd – 45**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.

Ages as at 25 February 2012.



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.

A successful risk management process balances risks and rewards and relies on a sound judgement of their likelihood and impact. The Board has overall responsibility for ensuring that the Group has an appropriate approach to risk management and internal control within the context of achieving the Group's objectives. Our process for identifying and managing risks is set out in more detail from page 60 of the Directors' report on corporate governance.

The table below sets out the principal risks faced by the Group, their movement during the year and examples of relevant key controls and mitigating factors. The Board considers these to be the most significant risks and, whilst they are not directly comparable, they have been ranked in terms of relative importance to the Group at this time. They do not comprise all risks associated with the Group. Additional risks not presently known to management, or currently deemed to be less material, may also have an adverse effect on the business. The principal risks associated with operating Tesco Bank are considered separately in the section of the table below headed 'Tesco Bank/ Financial Services Risks'.



KEY







Arrows: change in net risk assessment from 2010/11

↑ Net risk has increased






↔ Level of net risk is unchanged









↓ Net risk has decreased

Principal risks	Change from 2010/11	Key controls and mitigating factors
<p>Performance risk in the business</p> <p>Risk that business units (including the UK) underperform against plan and against competitors and our business fails to meet the stated strategy in full. Like all retailers, the business is susceptible to economic downturn affecting consumer spending</p>		<ul style="list-style-type: none"> • Board, Executive Committee and various operational committees 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 goals and objectives set for subsidiary CEOs, with high proportion of reward based on achievement • Diversification strategy minimises impact of changes in economic climate
<p>Operational threats to the business</p> <p>Risk that the business fails to maintain an optimum level of investment in capital, revenue or people and thus is limited in its ability to serve customers and grow</p>		<ul style="list-style-type: none"> • Operational threats reviewed regularly by Board, Executive Committee, UK Trading Group and various operational committees • Governance committees, including Compliance Committees, guide and monitor policies • All business units have stretching operational targets based on the Steering Wheel balanced scorecard system; KPIs are monitored continually and reported regularly to Board • Clear goals and objectives set for subsidiary CEOs, with high proportion of reward based on achievement • People Matters Group regularly reviews talent planning, appointments and new roles • Diversification strategy minimises impact of changes in economic climate

Principal risks	Change from 2010/11	Key controls and mitigating factors
<p>Reputational risk</p> <p>Failure to protect the Group's reputation and brand could lead to a loss of trust and confidence, a decline in customer base and affect our ability to recruit and retain good people</p>		<ul style="list-style-type: none"> • Tesco Values embedded in how we do business at every level • An embedded Group Code of Business Conduct guides 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 • Governance committees, including Corporate Responsibility, Sustainability, Compliance and Information Security Committees, guide and monitor policies
<p>People</p> <p>Failure to attract, retain, develop and motivate the best people with the right capabilities at all levels could limit our ability to succeed</p>		<ul style="list-style-type: none"> • 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 • Clear processes to understand and respond to employees' needs through our People Matters Group, staff surveys, regular performance reviews, involvement of trade unions in relevant markets and regular communication of business developments • Pay, pension and share plan arrangements help us to attract and retain good people
<p>Business strategy</p> <p>If our strategy follows the wrong direction or is not effectively communicated or implemented then the business may suffer</p>		<ul style="list-style-type: none"> • Diversification and pursuit of growth in emerging markets under our strategy is reducing 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 • 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
<p>Competition and consolidation</p> <p>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</p> <p>The consolidation of competitors, key geographical areas or markets through mergers or trade agreements could also adversely impact our market share</p>	<p>Competition (UK, US and Asia)</p> <p style="text-align: center;">  </p> <p>Competition (Europe)</p> <p style="text-align: center;">  </p> <p>Consolidation</p> <p style="text-align: center;">  </p>	<ul style="list-style-type: none"> • 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 • 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
<p>Financial strategy</p> <p>Risks relate to an incorrect or unclear financial strategy or plans</p>		<ul style="list-style-type: none"> • Regular review of strategy, risks and financial performance by Board and Executive Committee, with external advice as required • Consistent Operational Plans and Budgets developed throughout the Group to ensure delivery • Steering Wheel balanced scorecard system helps monitor delivery

Principal risks and uncertainties

Principal risks	Change from 2010/11	Key controls and mitigating factors
<p>Fraud, compliance and internal controls</p> <p>As the business grows in size and geographical scope, the potential for fraud and dishonest activity by our suppliers, customers and employees increases</p>		<ul style="list-style-type: none"> • Appropriate procedures and controls, including segregation of duties, are set out and audited across the business to reduce fraud risks; Internal Audit and Loss Prevention & Security undertake detailed investigations into all business areas and report their findings to the Audit Committee • Clear behavioural guidance given to employees through Tesco Values and the Group Code of Business Conduct • Compliance Committee formulates and monitors implementation of, and compliance with, relevant policies and procedures; annual governance returns completed by each business unit • External Audit rotational coverage of areas and assessment of controls • Updated policies and procedures for Bribery Act compliance
<p>IT systems and infrastructure</p> <p>Any significant failure in the IT processes of our retail operations would impact our ability to trade. Failure to invest appropriately in IT would constrain the growth of the business and fail to safeguard personnel, supplier or customer data</p>		<ul style="list-style-type: none"> • Extensive controls and reviews to maintain integrity and efficiency of IT infrastructure and data • 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 • Investment in IT systems and innovations to improve business efficiency and customers' shopping experience • Information Security Committee meets regularly to review the development and implementation of IT policies
<p>Group Treasury (excluding Tesco Bank)</p> <p>Risks relate to the availability of funds across the Group to meet business needs, fluctuations in interest and foreign exchange rates and credit risks relating to the risk of default by counterparties to financial transactions. The principal risks associated with operating Tesco Bank are covered in the Tesco Bank/Financial Services Risks section below. Further detail on the management of financial risks by the Group can be found in the 'Financial risks review' section following this table and in Note 22 of the financial statements</p>		<ul style="list-style-type: none"> • Regular review of strategy, risks and financial performance by Board and Executive Committee, with external advice as required • Financial risks relating to underlying business needs are mandated to our Treasury function which has clear policies and operating parameters and its activities are routinely reviewed and audited • Internal Audit reports on financial control systems • Development of cross-functional Eurozone Committee to monitor and manage the risks associated with instability in the eurozone as a result of the depth of the financial crisis
<p>Property</p> <p>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</p>	<p>UK</p>  <hr/> <p>International</p> 	<ul style="list-style-type: none"> • Property Acquisition and related committees closely control all aspects of property acquisition, planning and construction processes to ensure standards are met and risks are minimised • Group and country Compliance Committees monitor legal and regulatory compliance in property activities • China Property Company Board closely monitors property matters in China • Mall management systems in place to assist tenant management

Principal risks	Change from 2010/11	Key controls and mitigating factors
<p>Product safety</p> <p>Failures could damage customer trust and confidence, impacting our customer base and therefore financial results</p>	<p>UK and US</p>  <p>International (exc. US)</p> 	<ul style="list-style-type: none"> Detailed, established procedures, operating globally, to ensure product integrity Strict trading law and technical safety testing regime with regular reporting; Group Compliance Committee reviews compliance with laws and policies Partnering with suppliers for mutual understanding of required standards Monitoring of developments to respond to changing customer trends and legislation such as labelling and dietary responsibilities Clear and tested crisis management processes
<p>Climate change and sustainability</p> <p>The main environmental risk we face is climate change. It is essential we work to mitigate it through energy efficiency, the sustainable management of other resources and waste minimisation. We are also committed to supporting customers by giving them the information they need to make their own choices</p>		<ul style="list-style-type: none"> Engagement with key stakeholders and experts in developing environmental policy, including through the Sustainable Consumption Institute we endowed at Manchester University Climate change strategy is part of our Community Plan and is reviewed regularly by our Sustainability Committee and Executive Committee and reported to the Board Targets are regularly reviewed as part of the Community segment of the Steering Wheel balanced scorecard system
<p>Economic and political risks</p> <p>In each country where we operate, we may be impacted by legal, regulatory and tax changes, increased scrutiny by competition authorities, political developments and the economic environment</p>	<p>Economic</p>  <p>Political</p> 	<ul style="list-style-type: none"> External uncertainties carefully considered when developing strategy and reviewing performance Ongoing monitoring of developments through local CEOs We try to anticipate and contribute to important changes in public policy wherever we operate Engagement with governmental and non-governmental organisations to represent views of our customers and employees Business development follows thorough due diligence work
<p>Pension risks</p> <p>Our IAS 19 deficit could increase if returns on corporate bonds are higher than the investment return on the pension scheme's assets. There are also increasing risks of legal and regulatory changes introducing more burdensome requirements</p>		<ul style="list-style-type: none"> Diversified investment strategy with increased control and visibility through the appointment of an in-house investment team Changes to benefits proposed which will reduce the scheme's life expectancy and inflation 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
<p>Activism and terrorism</p> <p>A major incident or terrorist event could impact on staff safety or the Group's ability to trade</p>		<ul style="list-style-type: none"> Appropriate contingency plans Security systems and processes that reflect best practice
<p>Health and safety</p> <p>Failure to provide safe environments for our staff and customers could lead to injuries or loss of life</p>		<ul style="list-style-type: none"> Operation of stringent processes that reflect best practice; policies are monitored and audited regularly KPIs across the business help prevent incidents with quarterly reporting of performance against KPIs Group Compliance Committee and business unit Compliance Committees regularly monitor compliance with laws and internal policies Lucy Neville-Rolfe is the Executive Director responsible for health and safety issues

Principal risks and uncertainties


Tesco Bank/Financial Services Risks

Tesco Bank ('the Bank') primarily operates in the UK retail financial services market offering savings products, unsecured consumer lending products and general insurance products as well as travel money and ATM services. The section below sets out principal risks relating specifically to the Bank.

The Bank's Enterprise Wide Risk Management Framework identifies the main controls and actions. There are a number of key components of the framework common to all of the major risk categories, including the following:

Component	Description of the component
Independent Risk function	Reporting to the Chief Risk Officer ('CRO') and responsible for designing and implementing risk management frameworks and for independently monitoring the risk profile, providing oversight and challenge to the business
Three lines of defence	Line managers are responsible for establishing an effective control framework within their area of operations and for identifying and controlling all risks within risk appetite and policy limits (first line of defence). The second line of defence is the independent Risk function. Internal Audit is the third line of defence and is responsible for the independent assessment of the effectiveness of the implementation of the overall risk and control measures
Policy framework	Risk is responsible for the policy framework, with the Bank's policy documents providing the rules and guiding principles that define the approach to specific subjects and covering all aspects of risk
Integrated risk reporting	Reporting is provided monthly to senior governance committees. Exposures are monitored against triggers and limits on a daily, weekly or monthly frequency as required. Exceptions are reported monthly to the Bank's Asset & Liability Management Committee ('ALCO'), the Risk Management Committee ('RMC') and to each meeting of Board Risk Committee ('BRC')
Stress testing	Stress testing is the process under which the Bank's business plans, capital and liquidity are subjected to severe adverse impacts. Stress testing is a mandatory requirement of the FSA who require that banks implement their own stress testing processes. Stress testing is essential to effective risk management and is a key component of the Bank's Internal Capital Adequacy Assessment Process ('ICAAP') and Internal Liquidity Adequacy Assessment ('ILAA') processes

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

Principal risks	Change from 2010/11	Key controls and mitigating factors
<p>Transformation risk</p> <p>The Transformation Programme is a significant change programme designed to develop platforms and processes to enable the Bank to conduct banking and insurance business independently of The Royal Bank of Scotland Group ('RBS'). The key remaining component of the Transformation Programme is the migration of the credit card portfolio</p> <p>In addition, the Bank has well-developed plans for launching mortgages, subject to FSA approval</p>		<ul style="list-style-type: none"> • There is strong programme governance in place with a tiered committee structure headed by the Bank's Executive-level Project Assessment Committee ('PAC') • The Bank operates standard project management disciplines which are employed to deliver effective programme and risk and issue management

Principal risks	Change from 2010/11	Key controls and mitigating factors
<p>Credit risk – external environment</p> <p>The downside risks to the UK economy remain high, including fragile consumer confidence, a squeezing of real incomes, increasing unemployment and some consumers increasing borrowing and switching to variable rate mortgages</p> <p>On the wider economic front subdued UK growth, continued fiscal austerity and the continuing eurozone debt crisis is impacting confidence and may impact the ability to sustain debt servicing and repayment in the event of an economic shock</p>		<ul style="list-style-type: none"> • The Bank's credit risk appetite is based on lending responsibly to manage the credit risk profile of its portfolio within agreed parameters • Credit portfolios continue to be closely monitored with changes made to acquisition and limit management strategies to mitigate, as far as possible, downside economic risks • The Bank has minimal direct exposure to non-UK sovereigns and proactively monitors and manages the non-retail portfolios to reduce exposure to specific names or geographies
<p>Legal and regulatory compliance risk</p> <p>Legal and regulatory compliance risk is the risk of consequences arising as a result of non-compliance with the laws and regulations affecting the Bank's governance, prudential arrangements, business activities, risk management and its conduct with customers</p>		<ul style="list-style-type: none"> • The Bank's aim is to meet all legal and regulatory requirements by maintaining an effective control framework • A dedicated risk team is responsible for the identification of regulatory risks, the management and oversight of policies and processes and the provision of assurance in relation to regulatory risk and compliance
<p>Conduct risk</p> <p>There remains significant regulatory focus in relation to 'Conduct risk' or 'Treating Customers Fairly'. Specifically there has been continued industry-wide focus on provision of redress in relation to past sales of Payment Protection Insurance ('PPI')</p>		<ul style="list-style-type: none"> • The Bank's Treating Customers Fairly Board and the Bank's Board reviews and challenges delivery of fair outcomes for customers • A programme to proactively remediate disadvantaged PPI customers has commenced
<p>Insurance risk</p> <p>The Bank defines insurance risk as the risk we accept through our insurance products in return for a premium. These risks may or may not occur as expected and the amount and timing of these risks are uncertain and determined by events outside of our control</p> <p>The Bank is exposed to insurance risks through its historic distribution arrangement with RBS, which is expected to terminate in quarter four of 2012, and through its ownership of 49.9% of Tesco Underwriting Limited ('TU')</p>		<ul style="list-style-type: none"> • The Bank's aim is to actively manage insurance risk exposure with particular focus on those risks that impact profit volatility • Regular, independent reviews of reserves are undertaken with reporting to the Bank's RMC, Audit Committee, BRC and Board • The Bank uses reinsurance to limit exposure above pre-determined limits • Risk appetite and a suite of risk policies are in place to manage risk in TU • The Bank's Insurance Risk function provides independent oversight of TU which is appropriate to the Bank's role as key shareholder

Principal risks and uncertainties

Principal risks	Change from 2010/11	Key controls and mitigating factors
<p>Funding/liquidity risk</p> <p>Liquidity risk is the risk that the Bank has insufficient cash resources to meet its obligations as they fall due or can do so only at excessive cost</p> <p>Funding risk is the risk that the Bank does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient</p> <p>External market conditions continue to exhibit signs of stress (with wholesale funding markets constrained) and significant competition for retail deposits</p> <p>The Group relies on significant amounts of on demand retail funding</p>		<ul style="list-style-type: none"> • The Bank aims to have a conservative Balance Sheet structure with prudent risk appetite supported by explicit targets and metrics which enable it to meet its financial obligations, including under stressed conditions • The Bank holds a significant and diversified stock of highly marketable liquid assets, in excess of internal and regulatory requirements • The Bank's significant retail deposit base means that there is currently less reliance on wholesale markets as a source of funding and historic practice indicates that such deposits tend to be relatively stable
<p>Operational risk</p> <p>Operational risk is the potential error, loss, harm or failure caused by ineffective or inadequately defined processes, system failure, improper conduct, human error or from external events</p>		<ul style="list-style-type: none"> • The Bank's aim is to minimise all operational risks and reputational impacts • A Risk and Control Self Assessment process is used by the business to identify, assess, quantify, monitor and report its operational risks and management's effectiveness in mitigating them. Regular reporting is provided to RMC and remedial actions taken as required
<p>Outsourcing risk</p> <p>A significant number of services and processes are provided by third party service providers and a key operational risk is the failure of an outsourced service provider</p>		<ul style="list-style-type: none"> • The Procurement policy provides consistent and robust standards for supplier sourcing and selection • The Bank's Strategic Relationship Management process enables the monitoring of the performance of third-party outsourcers and suppliers against agreed service level agreements, the management of the relationships and the improvement of supply or termination of contract where appropriate
<p>People risk</p> <p>Increased market demand for specialist personnel could result in increased costs of recruitment and retention or reduced organisational effectiveness if a sufficient number of skilled staff cannot be employed</p>		<ul style="list-style-type: none"> • The Bank's People Matters Group, an Executive committee of the Bank, oversees key aspects of people risk, including talent management, performance management, retention and succession planning
<p>Market risk</p> <p>Market risk is defined as the risk that the value of the Bank's assets, liabilities, income or costs might vary due to changes in the value of financial market prices; this includes interest rates, foreign exchange rates, credit spreads and equities</p>		<ul style="list-style-type: none"> • The Bank has no trading book • There is low appetite for exposure to interest rate risk in the banking book ('IRRBB') and other market risks, such as credit spreads, which are monitored and reported through ALCO and RMC

OVERVIEW	STRATEGIC REVIEW	PERFORMANCE REVIEW	GOVERNANCE	FINANCIAL STATEMENTS
Board of Directors	Principal risks and uncertainties	General information	Corporate governance	Directors' remuneration report

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 counterparties 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 the principal risks and uncertainties table above and in Note 22 to the financial statements on page 126.

Funding and liquidity The Group finances its operations by a combination of retained profits, disposals of property assets, long- and medium-term debt capital market issues, short-term commercial paper, bank borrowings and leases. The objective is to ensure continuity of funding. The policy is to smooth the debt maturity profile, to arrange funding ahead of requirements and to maintain sufficient undrawn committed bank facilities and a strong credit rating so that maturing debt may be refinanced as it falls due. Tesco Group has a long-term rating of A- (stable) from Fitch, Baa1 (stable) from Moody's and A- (stable) from Standard & Poor's. New funding of £2.5 billion was arranged during the year, including a net £1.1 billion from property disposals and £1.4 billion from long-term debt. At the year end, net debt was £6.8 billion (2011: £6.8 billion).

Interest rate risk management Our objective is to limit our profit and loss downside from rising interest rates. Forward rate agreements, interest rate swaps, caps and floors are 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 90% (2011: 71%). 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% (2011: 5.4%).

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 £1,944 million were outstanding (2011: £1,615 million) as detailed in Note 21. We translate overseas profits at average foreign exchange rates which we do not currently further manage.

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 decreased the net value, after the effects of hedging, of the Group's overseas assets by £22 million (last year decrease of £344 million).

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

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.

Statement of compliance

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

Cautionary statement regarding forward-looking information

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

The Group cautions investors that a number of important factors, including those in this document, could cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to, those discussed under 'Principal risks and uncertainties' on pages 40 to 47 of this Annual Report.

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, Turkey and the US. The Group also provides retail banking and insurance services through its subsidiary, Tesco Bank. The Group is currently in the process of disposing of its Japan operations.

Group results Group revenue (excluding VAT) rose by £4 billion to £64.5 billion, representing an increase of 6.8%. Group profit before tax increased by £194 million to £3,835 million. Profit for the year was £2,814 million, of which £2,806 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 6 July 2012 to members on the Register at the close of business on 27 April 2012. Together with the interim dividend of 4.63p per ordinary share paid in December 2011, the full year dividend will be 14.76p compared with 14.46p for the previous year, an increase of 2.1%.

Fixed assets Capital expenditure (excluding business combinations) amounted to £3.8 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 £27.7 billion which has been included in these financial statements.

Share capital and control of the Company Details of the Company's share capital, including changes during the year in the issued share capital and details of the rights attaching to the Company's ordinary shares, are set out in Note 27 on page 136. No shareholder holds securities carrying special rights with regards to control of the Company and there are no restrictions on voting rights.

During the financial year, the Company purchased and cancelled 70.8 million ordinary shares of 5p each in the capital of the Company, representing 0.9% of its issued share capital as at 25 February 2012, for a total consideration of £290 million (including expenses). The shares were purchased in order to offset dilution resulting from the issue of shares in connection with the Company's employee share incentive schemes. The Company was subsequently authorised by shareholders at the 2011 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.

Company's shareholders The Company has been notified of the following significant holdings of voting rights in its shares as at 25 February 2012 and as at the date of this report:

	% of issued share capital as at 25 February 2012	% of issued share capital as at the date of this report
Berkshire Hathaway Inc.	5.08	5.08
Blackrock, Inc.	4.96	4.96
Norges Bank	No notification	4.01
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; Sir Terry Leahy; Tim Mason; Laurie McIlwee; Lucy Neville-Rolfe CMG; David Potts; Sir David Reid; and Jacqueline Tammenoms Bakker. The biographical details of the present Directors are set out on pages 38 and 39 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 64 to 86.

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

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

OVERVIEW	STRATEGIC REVIEW	PERFORMANCE REVIEW	GOVERNANCE	FINANCIAL STATEMENTS
Board of Directors	Principal risks and uncertainties	General information	Corporate governance	Directors' remuneration report

Political and charitable donations Cash donations to charities amounted to £25,646,209 (2011: £15,613,319). Total contributions to community projects including cash, cause-related marketing, gifts-in-kind, staff time and management costs amounted to £74,588,818 (2011: £64,254,910). There were no political donations (2011: £nil). During the year, the Group made contributions of £28,137 (2011: £55,085) in the form of sponsorship for political events: Conservative Party £4,790; Labour Party £12,011; Liberal Democrat Party £6,636; Scottish National Party £4,700.

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 came into force on 4 February 2010 in the UK and places obligations on grocery retailers with a turnover greater than £1 billion to build a compliance programme, which includes training staff and providing information to the OFT as requested. 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 small team including an auditor. We have developed an audit plan and our approach enables us to identify any gaps in our processes so they can be quickly fixed. This approach is working well, as evidenced by our having identified a gap relating to the information given to suppliers in connection with delisting. We responded immediately by strengthening internal processes to ensure that all information provided to suppliers complies with the Code requirements in this area.

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 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 strengthening internal processes to ensure that all new starters are trained within Code timelines. Annual refresher training is provided via a bespoke e-learning programme.

All alleged breaches of the Code raised by suppliers this year have been dealt with internally. We have had no instance this year of a supplier initiating the Dispute Resolution Procedure set out in the Code.

The CCO submits 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 On 5 March 2012, Ek-Chai Distribution System Co. Ltd. ('Tesco Lotus'), announced the final offering price of the Initial Public Offering of Tesco Lotus Retail Growth Freehold and Leasehold Property ('TLGF'). Tesco Lotus subscribed for 25% of the available units in TLGF. The units commenced trading on the Stock Exchange of Thailand on 19 March 2012.

On 30 March 2012, the Company paid a contribution of £180 million into the UK defined benefit pension scheme.

Auditors A resolution to reappoint PricewaterhouseCoopers LLP as auditors of the Company and the Group will be proposed at the 2012 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.

Corporate governance

“Governance provides the framework supporting the core values which define what is and what is not acceptable. It informs our actions and decisions and supports the culture and behaviours that we wish to foster.”

Sir Richard Broadbent
Chairman



Introduction from the Chairman

Our approach to governance begins with the recognition that it is not a set of rules but the framework supporting the core values which define 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.

We are introducing a number of changes to our governance framework from the beginning of 2012/13 to keep it aligned with this vision and relevant to our growing business. The main features of the new arrangements, which are described more fully below, are:

- a revised definition of Matters Reserved to the Board;
- an updated delineation of the roles of Chairman and Chief Executive;
- updated and expanded terms of reference for Board Committees;
- the elimination of a number of existing Committees and the creation of one new Committee to oversee Corporate Responsibility; and
- clarification of the role and structure of the independent Board of Tesco Bank and its relationship with the PLC Board.

A governance framework requires appropriate processes to support it, which achieve a balance between prompting thoughtful judgement when required and not stifling commercial behaviour through delay, risk aversion or rigidity. The new governance framework has given us the opportunity also to review the processes which support and underlie it and we are introducing a number of improvements in 2012/13.

Governance also requires the active and committed engagement of Board and management. The development of the Board, to ensure that its skills, balance and experience are optimum, is a continuous process and the developments of the past year are described more fully below. The Executive Committee and its supporting governance framework and processes have also been developed during the year by the Chief Executive, Philip Clarke.

We believe that these changes will enhance the way that the Group operates. Our aim is to ensure that the Group continues to benefit from structures and processes which support effective strategic debate and questioning; appropriate monitoring of performance; the capacity to formulate the right questions; and the strength to hold difficult questions on behalf of shareholders.

Sir Richard Broadbent
Chairman

IN THIS SECTION

50 Introduction from the Chairman

GOVERNANCE STRUCTURES

51 Governance structures
51 Compliance with the UK Corporate Governance Code

DIRECTORS AND BOARD RESPONSIBILITIES

52 Board composition and independence
52 Election of Directors
52 Explanation of the roles of Chairman, CEO, SID, Non-executive Directors and Company Secretary
53 Diversity
53 Board responsibilities
54 Board performance evaluation
55 Board attendance

COMMITTEE INFORMATION

56 Nominations Committee
57 Remuneration Committee
58 Audit Committee

MANAGEMENT OF THE GROUP

59 Executive Committee
60 Risk management and internal controls including Tesco Bank
62 Whistle-blowing
62 Anti-corruption
62 Code of Business Conduct

SHAREHOLDERS

63 Relations with stakeholders
63 The Tesco PLC AGM

OVERVIEW	STRATEGIC REVIEW	PERFORMANCE REVIEW	GOVERNANCE	FINANCIAL STATEMENTS
Board of Directors	Principal risks and uncertainties	General information	Corporate governance	Directors' remuneration report

Governance structures

Over the past few months, we have been reviewing and updating the Group's corporate governance framework, to ensure that it remains relevant to the business both today and in future and supports our management in discharging their responsibilities. Copies of all the documents referred to below are available in full on the Company's website at www.tescopl.com/plc/ir/corpgov/boardprocess.

The Matters Reserved to the Board and the delineation of responsibilities between the Chairman and Chief Executive have both been clarified and updated to reflect best practice, while taking into account the needs of the business.

We have taken the opportunity to simplify the Board Committees. There are now four committees:

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

The remit of the Audit and Remuneration Committees is substantially unchanged, although the terms of reference of both of these Committees have been reviewed in line with best practice to ensure that they remain relevant to the business.

The remit of the Nominations Committee has been broadened so that it can deepen its focus on succession planning and the development of talent and, in addition, consider governance matters, including overseeing the structure and remit of the Board and its Committees. The number of meetings is being increased to four a year.

A new Corporate Responsibility Committee has been created to ensure that the Board maintains an adequate focus on corporate responsibility in its widest sense. This reflects the importance to the Group of how it is perceived externally. The new Committee is responsible for defining and overseeing the Group's corporate and social obligations.

We have also reviewed the governance framework for Tesco Bank (which, in line with regulatory requirements, has an independent Board) to ensure that the importance of robust, independent and competent challenge at the level of the Bank's Board is balanced with appropriate alignment with, and oversight of, the PLC Board.

The structure of the Bank Board and its Committees remains unchanged and the Bank Board continues to have three Board Committees: Audit; Risk; and Remuneration. The constitution of the Bank Board has, however, been revised and will now comprise a Non-executive Chairman, together with broadly equal representation of the Bank's executive management, Tesco PLC Non-executive Directors and independent Non-executive Directors.

Compliance with the UK Corporate Governance Code

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

Provision B.1.2 of the Code requires at least half of the Board, excluding the Chairman, to comprise Non-executive Directors determined by the Board to be independent. Tesco has complied with this provision except for the first four days of the financial year, when it had one more Executive Director than Non-executive Directors (excluding the Chairman). However, following Sir Terry Leahy's retirement and the appointment of Philip Clarke as his successor as CEO in March 2011, there has been at least an equal number of Non-executive and Executive Directors.

Prior to 2 March 2011 Philip Clarke was the Executive Director responsible for Asia, Europe & IT.

Provision B.6.3 of the Code requires the Non-executive Directors, led by the Senior Independent Director, to evaluate the performance of the Chairman, taking into account the views of Executive Directors. As the new Chairman, Sir Richard Broadbent, only assumed his role of Chairman on 30 November 2011, it has been adjudged too soon in his tenure to make a fair and reasonable assessment of his Chairmanship.

The Board considers that Tesco PLC complied in all material respects with the Code for the whole of the year ended 25 February 2012. Further information on Code can be found at www.frc.org.uk.

Corporate governance

Board composition and independence

As at 25 February 2012, the Board of Tesco PLC comprised the Non-executive Chairman, Sir Richard Broadbent, six Executive Directors and seven independent Non-executive Directors. Sir Terry Leahy retired as Group CEO on 2 March 2011 and was replaced by Philip Clarke. Sir David Reid retired as Chairman on 30 November 2011 and was replaced by Sir Richard Broadbent. David Potts stepped down as a Tesco PLC Executive Director on 7 December 2011.

The following changes have been announced since the end of the 2011/12 financial year: Deanna Oppenheimer joined the Board as a Non-executive Director on 1 March 2012 and Richard Brasher stepped down from the Board of Tesco PLC on 15 March 2012. Andrew Higginson will retire on 1 September 2012.

Board development is a continuous process, but we believe that the size and experience of the Board is appropriate given the diverse markets the Group operates in and the breadth of operations and services offered by the Group.

Biographies for the Directors can be found on pages 38 and 39 of this Annual Report.

Changes to the Board since 26 February 2011

Sir Terry Leahy	Executive Director	Retired as CEO on 2 March 2011
Philip Clarke	Executive Director	Appointed CEO on 2 March 2011
Sir David Reid	Chairman	Retired on 30 November 2011
Sir Richard Broadbent	Chairman	Appointed as a Non-executive Director on 2 July 2011 and as Chairman on 30 November 2011
David Potts	Executive Director	Stepped down from the Board on 7 December 2011, retires on 30 June 2012

Changes to the Board since 25 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	Retires on 1 September 2012

Election of Directors

The Directors will comply with the requirement in paragraph B.7.1 of the Code to each submit themselves for re-election every year, if they wish to continue serving, and are considered by the Board to be eligible. The Company's Articles of Association require all new Directors to be submitted for election by shareholders in their first year following appointment. Accordingly the whole Board will be proposed for re-election or election, as the case may be, at this year's AGM.

The Chairman and CEO

There is a clear and effective division of accountability and responsibility between the roles of our Chairman and CEO and this is set out in writing. The Chairman leads the Board, ensuring its effectiveness whilst taking account of the interests of stakeholders and promoting the highest standards of corporate governance. The Chairman has regular one-to-one meetings with the CEO and other members of the executive team and also has separate group and individual meetings with the Non-executive Directors.

The CEO has executive responsibility for the day-to-day operations and performance of the Group, making proposals to the Board for the strategic development of the Group and ensuring effective communication to employees and shareholders.

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. Patrick was Group Chief Executive of Unilever from 2005 to 2009. Prior to that he was Chairman of Unilever plc and Vice Chairman of Unilever NV. He has been a Non-executive Director of Pearson plc since 2002 and a Director of INSEAD since 2009.

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 Chairman appraisal and succession.

Non-executive Directors

Our Non-executive Directors have a wide range of skills and experience. They provide constructive challenge and help to develop our strategy. The Non-executive Directors have satisfied themselves with regard to the integrity of the Group's financial information, financial controls and risk management systems.

The independence of each Non-executive Director is assessed annually and the Board makes a careful assessment of the time commitment required from the Chairman and Non-executive Directors to discharge their roles properly.

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

Length of service of each Non-executive Director		
Non-executive Director	Date of appointment	Years in post at 2012 AGM
Sir Richard Broadbent	2 July 2011	1 year
Gareth Bullock	3 July 2010	2 years
Patrick Cescau	1 February 2009	3 years 5 months
Stuart Chambers	3 July 2010	2 years
Karen Cook	1 October 2004	7 years 9 months
Ken Hanna	1 April 2009	3 years 3 months
Ken Hydon	23 February 2004	8 years 4 months
Deanna Oppenheimer	1 March 2012	4 months
Jacqueline Tammenoms Bakker	1 January 2009	3 years 6 months

Company Secretary

The role of the Company Secretary is to develop, implement and sustain good corporate governance, including:

- 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;
- supporting the Board as necessary, including advising on Directors' duties;
- when appropriate, providing a discreet but challenging voice to the Board;
- ensuring that appropriate Directors' and Officers' insurance is in place;
- ensuring that the granting of share awards is in accordance with long-term incentive plans;
- ensuring that the Board is kept informed of shareholder opinion; and
- ensuring that the Company is compliant with statutory and regulatory governance requirements.

Diversity

At Tesco, we are proud to be a diverse business and we have always valued the benefits which diversity brings. Developing a more inclusive and diverse workforce, reflecting the communities in which we do business, supports our stated strategic priority to build a team to create more value than any other, and developing talent at every level in the organisation has always been a core value for Tesco.

We approach diversity in its widest sense, recognising that successful world-class businesses flourish through embracing geographical, ethnic, skill, age and gender diversity. Within this context we accept the spirit and aspirations of the Davies Report, including the representation of women at the highest levels in the organisation. The fact that women represent 60% of our workforce in the UK gives us a real opportunity to develop female leaders. We have made significant progress in recent years in developing and bringing through senior women. In the last four years (since 2007), the number of female directors at Tesco has increased by 45, an increase of nearly 76%, and we are working hard to help women succeed in senior roles more generally throughout the Company. There are currently four women on our PLC Board (29%) and women in senior management positions account for 31% across the Group 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, and to help all of us create the necessary conditions both at home and overseas. 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 parents, partners and active members of their local community.

Participation in corporate governance discussions

Outside the Boardroom there has been a substantial level of discussion of corporate governance and remuneration issues over the past year and we have been an active participant in the debate, responding to a number of consultations, including those carried out by the Department of Business, Innovation and Skills in relation to Narrative Reporting and Executive Remuneration, the EU Green Paper on Corporate Governance and the debate led by Lord Davies on Women on Boards.

Board responsibilities

The Board held eight scheduled meetings during the last year. It also held a strategy off-site meeting. The Board's agenda is managed to ensure that shareholder value, societal issues and governance all play an appropriate part in its deliberations and judgements.

The Board delegates to management the day-to-day operation of the business, in accordance with appropriate risk parameters. The Board monitors compliance with policy and achievement against objectives, by holding management accountable for its activities through regular updates. In addition, each 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.

Corporate governance

During the year ended 25 February 2012, the Board considered a wide range of issues, including:

- receiving reports from key businesses within the Group;
- receiving regular reports on the financial position of the Group and the various businesses within the Group;
- approving the budget and long-term plan for the Group;
- approving interim and full-year results;
- discussing and approving Group strategy;
- considering opportunities for business development;
- discussing risk management and controls within the Group, including a detailed review of the Key Risk Register;
- receiving reports from the Remuneration Committee, Audit Committee and Nominations Committee and other key committees within the Group including the Compliance Committee and Corporate Responsibility Committee;
- receiving reports on governance issues affecting the Group; and
- conducting a review of the effectiveness of the Board.

Directors' 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 members of the Board are required to:

- consider each conflict situation separately on its particular facts;
- consider the conflict situation in conjunction with the rest of their duties under 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.

Training and development

All new Directors receive a personalised induction programme, tailored to their experience, background and particular areas of focus, which is designed to develop their knowledge and understanding of the Group's culture and operations. The programme has evolved over time to take into account feedback from new Directors and the development of best practice, and will usually include a combination of meetings with senior management from across the Group, comprehensive briefing materials and opportunities to visit the Group's operations across the world. The Chairman agrees the personalised induction plan for each new Director and ensures that it meets the individual needs of that Director. Directors also receive a tailored induction in relation to those Board Committees they will serve on.

The need for Director development is regularly assessed by the Nominations Committee and training sessions are arranged to help upskill the Directors on 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, inter alia, on recent corporate governance developments, risk reporting by Tesco Bank and the challenges and opportunities offered by the internet. Further training in a number of key areas is planned for the coming year.

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 2011 the Board spent several days looking at the US operations and 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 performance evaluation

The Board conducted an external Board evaluation during the year. The review was led by an experienced facilitator 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. The review recognised that with both a new Chairman and a new Chief Executive appointed during the year this was a time of transition. The Board welcomed the opportunity this presented to complete a broad updating of governance and Committee structures. Overall, the review suggested that there was good engagement between Board members and that Board processes (including the performance of Committees, a new forward agenda and the quality of information flows) were of a good standard. There was a high level of alignment about the key strategic issues facing Tesco.

An important part of the review was establishing criteria against which the future performance of the Chairman, the Directors individually and the Board as a team could be reviewed. The Board endorsed a set of criteria under these headings as follows:

Board performance evaluation criteria	
Chairman	Board leadership and management
	Coaching and development
	Ensuring accountability
Directors	Strategic orientation
	Results orientation
	Collaboration
	Independence
	Engagement
Board	Balance
	Alignment
	Resilience
	Energy
	Openness
	Efficiency

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. For further details, please refer to the sections dealing with the Audit Committee (on page 58) and the Remuneration Committee (on page 57).

Our CEO reviews the performance of each Executive Director and the outgoing Chairman has reviewed the performance of the CEO and each Non-executive Director. Having completed these evaluations, the CEO and Chairman have confirmed that each individual whose performance they have assessed continues to be effective and committed to their role. The new Chairman, Sir Richard Broadbent, only assumed his role on 30 November 2011, so it was judged to be too soon for the Senior Independent Director to carry out a performance assessment.

During the year, both the outgoing Chairman and the new Chairman met with the Non-executive Directors, without the Executive Directors present, to discuss Board issues and how to build the best possible team.

Board attendance

The Board held eight scheduled meetings in the year ended 25 February 2012, 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 the 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. None of the Executive Directors holds more than one FTSE 100 external Non-executive Directorship and Philip Clarke resigned his position as Non-executive Director of Whitbread PLC effective from 1 March 2011, immediately prior to taking up his role as CEO. The other directorships held by the Non-executive Directors are set out in their biographies, which can be found on pages 38 and 39.

	Full Board meetings	
	Number of possible meetings attended	Actual meetings attended
Non-executive Directors		
Sir Richard Broadbent	4	4
Gareth Bullock	8	8
Patrick Cescau	8	8
Stuart Chambers	8	8
Karen Cook	8	7
Ken Hanna	8	8
Ken Hydon	8	8
Jacqueline Tammenoms Bakker	8	8
Executive Directors		
Philip Clarke	8	8
Andrew Higginson	8	7
Tim Mason	8	7
Laurie McIlwee	8	8
Lucy Neville-Rolfe CMG	8	8
Past Non-executives (at date of Annual Report)		
Sir David Reid (Chairman) (Retired 30 Nov 2011)	6	6
Past Executive Directors (at date of Annual Report)		
Sir Terry Leahy (Retired 2 March 2011)	0	0
David Potts (Stepped down 7 December 2011)	7	6
Richard Brasher (Stepped down 15 March 2012)	8	8

Nominations Committee

“The Nominations Committee plays an essential role in leading the process of assessing the skills the Board needs to discharge its duties competently. It also reviews the Board’s composition, structure and size, to assist the ongoing development of the Board over time.”

Sir Richard Broadbent
Nominations
Committee Chairman



The Nominations Committee met once in the year to discuss the ongoing shape and capability of the Board. There were also a number of ad hoc meetings during the year to discuss Board succession matters, as well as reviewing the performance and development of the Executive Directors and the senior executive levels below the Board. In future, it is intended that there will be four scheduled meetings a year of the Committee.

The remit of the Nominations Committee was expanded with effect from 26 February 2012, so that, in addition to its existing responsibility for reviewing the Board’s structure, size and composition, identifying, nominating and reviewing candidates for appointment to the Board and putting in place plans for succession, the responsibilities of the Committee will include:

- reviewing the leadership needs of the organisation, both executive and non-executive;
- reviewing the Group’s talent management programmes;
- reviewing Board succession over the longer term, in order to maintain an appropriate balance of skills and experience and to ensure progressive refreshing of the Board; and
- monitoring of the Group’s compliance with corporate governance guidelines.

The Committee was chaired by Sir David Reid during his tenure and is now chaired by Sir Richard Broadbent following his appointment as Chairman. The Company Secretary attends meetings in his capacity as Secretary of the Committee. Where matters discussed relate to the Chairman, the Senior Independent Non-executive Director chairs the meeting.

During the year consideration was given to finding an appropriate replacement for retiring Chairman, Sir David Reid. The Nominations Committee considered the skills and experience that would be required for this position and to create a detailed role description. After a rigorous selection process, which was led by the Senior Independent Director and included interviews with the Executive and Non-executive Directors, Sir Richard Broadbent was chosen as the strongest candidate for Chairman.

The Committee’s revised terms of reference, which were approved by the Board on 14 February 2012, are available at www.tescopl.com/plc/ir/corpgov/boardprocess.

Nominations Committee members

Members	Number of possible meetings attended	Actual meetings attended
Sir Richard Broadbent (member since 2 July 2011 and Chairman since 30 November 2011)	1	1
Gareth Bullock	1	1
Patrick Cescau	1	1
Stuart Chambers	1	1
Karen Cook	1	1
Ken Hanna	1	1
Ken Hydon	1	1
Jacqueline Tammenoms Bakker	1	1
Philip Clarke	1	1
Past Committee members		
Sir Terry Leahy until 2 March 2011	0	0
Sir David Reid (Chairman) until 30 November 2011	0	0

Note: the membership of the Committee has been revised with effect from 26 February 2012 and is now as follows: Sir Richard Broadbent (Chairman), Patrick Cescau, Stuart Chambers and Ken Hanna.

Remuneration Committee

“The Remuneration Committee assesses executive remuneration arrangements which are used to attract, retain and motivate senior management and provide appropriate alignment between reward and performance.”

Stuart Chambers
Remuneration
Committee Chairman



Remuneration Committee members

Members (all independent Non-executive Directors)	Number of possible meetings attended	Actual meetings attended
Patrick Cescau	5	5
Stuart Chambers	5	5
Karen Cook	5	5
Ken Hanna	5	5
Jacqueline Tammenoms Bakker	5	5

Note: the membership of the Committee has been revised with effect from 26 February 2012 and is now as follows: Stuart Chambers (Chairman), Karen Cook, Ken Hanna and Jacqueline Tammenoms Bakker.

The Remuneration Committee's role is to determine and recommend to the Board the remuneration policy for Executive Directors and oversee the level and structure of remuneration of senior management, ensuring that the remuneration arrangements attract, retain and motivate the Executive Directors and senior management needed to run the Company successfully.

The Chairman of the Board, the CEO, Group Personnel Director and external advisors normally attend meetings, although some part of every meeting is devoted to discussion among only the Non-executive Directors. The Company Secretary attends in his capacity as Secretary of the Committee.

The Committee met five times this year. The responsibilities of the Remuneration Committee and an explanation of how it applies the Directors' remuneration principles of the Code and other applicable rules and regulations governing remuneration, are set out in the Directors' Remuneration Report on pages 64 to 86.

The Committee received training this year on a range of areas, including disguised remuneration, Department for Business, Innovation and Skills reporting requirements, ABI principles, market practice and trends in best practice.

The Committee conducted a review of its effectiveness during the year, which confirmed that the Committee operates effectively.

The Committee reviews its membership regularly to ensure that it is refreshed and that no undue reliance is placed on particular individuals. Deloitte are the appointed remuneration consultants and details of all connections with the Company are given on page 78: Remuneration Report.

The Committee approved new terms of reference on 14 February 2012 and these are available at www.tescopl.com/plc/ir/corpgov/boardprocess.

Audit Committee

“The Audit Committee plays a key role in reviewing the effectiveness of the Group’s internal controls, external auditors and internal audit department. It also provides assurance on the Group’s risk management processes.”

Ken Hydon
Audit Committee
Chairman



Audit Committee members

Members (all independent Non-executive Directors)	Number of possible meetings attended	Actual meetings attended
Ken Hydon (Chairman)	5	5
Gareth Bullock	5	5
Patrick Cescau	5	5
Ken Hanna	5	5

Regular attendees at the invitation of the Committee include:

- Chairman of the Board;
- Chief Executive Officer;
- Chief Financial Officer and his team;
- Head of Internal Audit;
- Executive Director (Corporate and Legal Affairs);
- Other Executive Directors as appropriate; and
- External Auditors.

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

The Chairman of the Tesco Bank Audit Committee attends the Committee twice a year to provide an update on the work of the Bank’s Audit Committee in overseeing the Bank’s internal control and risk assurance processes.

The Audit Committee structure requires the inclusion of at least one member with recent and relevant financial experience. The Committee Chairman and at least one other member fulfil this requirement, and all other Committee members have an appropriate understanding of financial matters.

The Audit Committee’s primary responsibilities include, 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;
- review formally 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 coordinated plans for business continuity; and
- review the Company’s plans for the prevention and detection of fraud, bribery and corruption.

The Committee met five times this year. While fulfilling the above responsibilities, during the year the Committee received detailed updates from several businesses within the Group, as well as discussing a number of topics, including:

- fraud risks;
- business continuity and crisis management;
- whistle-blowing;
- Groceries Supply Code of Practice;
- property risks; and
- IT controls.

A Board visit is organised each year to one or more of the Group's businesses and the Committee takes advantage of these visits to meet with local management and discuss how the Group's internal controls and risk management processes are embedded in those businesses. There were also regular meetings via videoconference with local management in several of our international companies.

The need for training is kept under review and the annual agenda ensures substantial time is dedicated to technical updates, which are generally provided by external experts. This year training was provided, inter alia, on accounting standards, emerging issues, true and fair requirements and corporate reporting. In addition, while in the US, training was given on US risk and control processes. Training is also provided on an ongoing basis to meet the specific individual needs of Committee members.

The Committee carried out an effectiveness review during the year, which concluded that the Committee was effective and had been provided with sufficient resources to carry out its duties.

The Committee also regularly reviews its membership, to ensure that it is refreshed and that no undue reliance is placed on particular individuals. It was felt unnecessary to make changes this year.

The Committee considered the appointment of auditors and recommended PricewaterhouseCoopers LLP's ('PwC') reappointment. Their remuneration is disclosed in Note 3 of the financial statements.

The Committee has regular private meetings with the external auditors and the Head of Internal Audit during the year, at which an honest and open working relationship is maintained and developed.

The Committee approved revised terms of reference on 14 February 2012, which are available at www.tescopl.com/plc/ir/corpgov/boardprocess.

Management of the Group

Executive Committee

The CEO is supported in formulating and implementing the Group's strategic plan and in managing the Group by the Executive Committee, which is chaired by the CEO. Membership comprises the Executive Directors and seven senior executives:

- 1 **Gordon Fryett** CEO Europe and Group Property Director – Gordon Fryett 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.
- 2 **Kevin Grace** Group Commercial Director – Kevin Grace 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.
- 3 **Alison Horner** Group Personnel Director – Alison Horner joined Tesco in 1999 as a Personnel Manager, moving to UK and Ireland operations in 2003 where she held a number of line management roles including Operations Director.
- 4 **Trevor Masters** CEO Asia – Trevor Masters 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.
- 5 **Mike McNamara** Chief Information Officer – Mike McNamara joined Tesco in 1998 and has held a number of roles in IT and Operations Development.
- 6 **Bob Robbins** Group Business Improvement Director – Bob Robbins 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.
- 7 **Ken Towle** Online Food and Internet Retailing Director – Ken Towle joined Tesco in 1985 and has held a number of roles including various UK operations roles and President and CEO of Tesco China.



7

Corporate governance

The Executive Committee has authority for decision-making in all areas except those set out in the Schedule of Matters Reserved for the Board, and meets formally on a regular basis. The Company Secretary attends in his capacity as Secretary of the Committee.

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

The Committee has set up further subcommittees, focusing on Commercial, Compliance, Internet Retailing, People Matters, Property Strategy, Sustainability and Technology. These subcommittees have as members an appropriate mixture of Executive Directors and senior management from relevant functions.

Risk Management and Internal Controls

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

Background

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

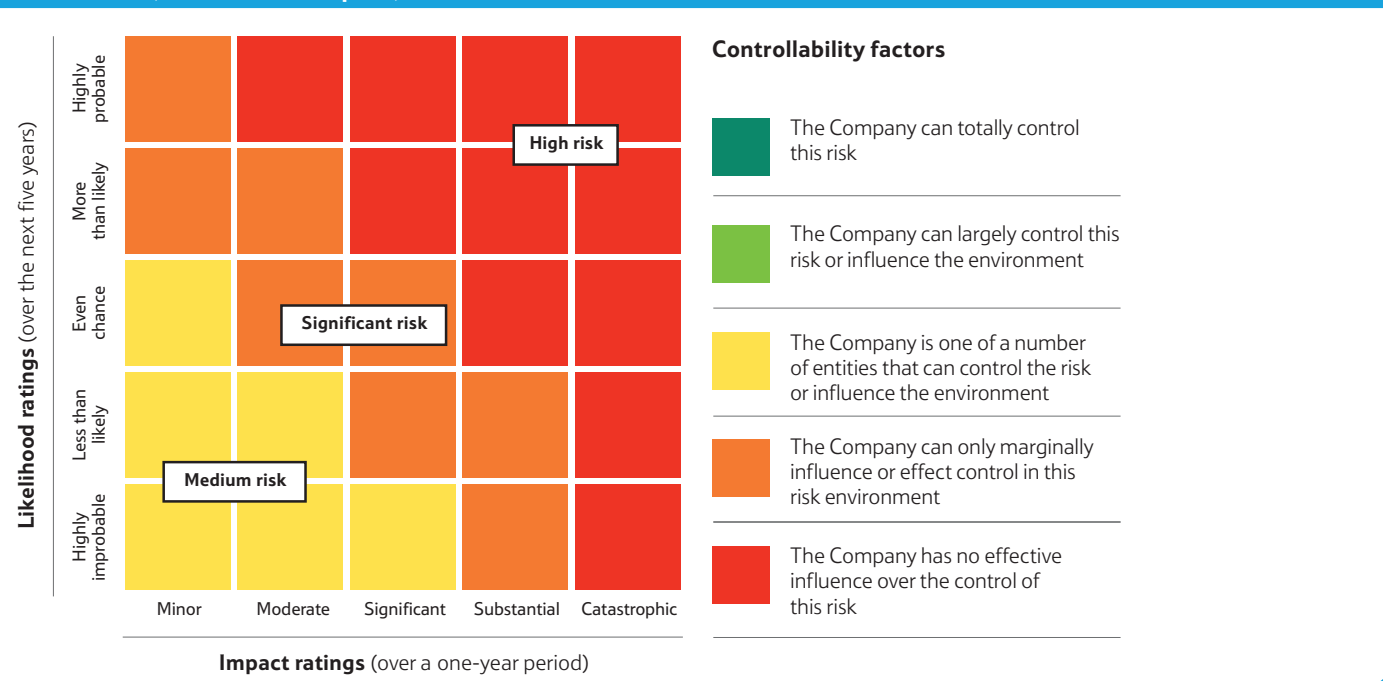
Key to delivering effective risk management is ensuring that our people have a good understanding of the Group's strategy and our policies, procedures, values and expected performance. We have a structured internal communications programme that provides employees with a clear definition of the Group's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

Risk management

The Group maintains a Key Risk Register. The Register contains the key risks faced by the Group, including their impact and likelihood, as well as the controls and procedures implemented to mitigate these risks (see diagram below). The content of the Register is determined through regular discussions with senior management and review by the Executive Committee and the full Board. A balanced approach allows the degree of controllability to be taken into account when we consider the effectiveness of mitigation, recognising that some necessary activities carry inherent risk which may be outside the Group's control. Our key risks are summarised on pages 40 to 47 of the Principal risks and uncertainties section of this Annual Report.

The risk management process is cascaded through the Group, with operating subsidiary boards maintaining their own risk registers and assessing their control systems. The same process also applies functionally in those parts of the Group requiring greater overview. For example, the Audit Committee's terms of reference require it to

Risk matrix (likelihood to impact)



OVERVIEW	STRATEGIC REVIEW	PERFORMANCE REVIEW	GOVERNANCE	FINANCIAL STATEMENTS
Board of Directors	Principal risks and uncertainties	General information	Corporate governance	Directors' remuneration report

oversee the Finance Risk Register. The Board assesses significant social, environmental and ethical ('SEE') risks to the Group's short and long-term value, and incorporates SEE risks into the Key Risk Register where they are considered material or appropriate. During the year the Board regularly reviewed the Risk Register and also undertook an in-depth assessment of product safety.

We recognise the value of the ABI Guidelines on Responsible Investment Disclosure and confirm that, as part of its regular risk assessment procedures, the Board takes account of the significance of SEE matters to the business of the Group. We recognise that a number of investors and other stakeholders take a keen interest in how companies manage SEE matters and so we report more detail on our SEE policies and approach to managing material risks arising from SEE matters and the KPIs we use both on our website (www.tescopl.com/plc/corporate_responsibility/) and in our Corporate Responsibility Review 2012. To provide further assurance, the Group's Corporate Responsibility KPIs are audited on a regular basis by Internal Audit.

Internal controls

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

The CEO of each subsidiary business is required to certify by way of an annual governance return that the Group's governance and compliance policies and processes have been adopted. The returns received from across the Group are reviewed and discussed by the Compliance Committee and the results of that review are also considered by the Audit Committee as part of the Annual Assessment of Risk Management and Internal Controls, which is prepared by Internal Audit as part of the year end process. For certain joint ventures, the Board places reliance upon the internal control systems operating within our partners' infrastructure and the obligations upon partners' boards relating to the effectiveness of their own systems.

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

In respect of Group financial reporting, 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 the maintenance of the Group's 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. This incorporates risks such as wrong or unclear accounting policies, ineffective financial close processes, inaccurate or incomplete Group financial and management accounts, reputational risk, IT risks, fraud and people risks. Group Internal Audit also reviews the effectiveness of controls operating in the Group Finance function. The results of Group Finance's risk register review and Group Internal Audit's findings are reported to the Audit Committee on an annual basis.

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

Monitoring

The Board oversees the monitoring system and has set specific responsibilities for itself and the various committees as set out below. Both Internal Audit and our external auditors play key roles in the monitoring process, as do several committees including the Compliance Committee and the Corporate Responsibility Committee. The minutes

of the Audit Committee and the other Board committees are distributed to the Board and each Committee submits a report for formal discussion at least once a year. These processes provide assurance that the Group is operating legally, ethically and in accordance with approved financial and operational policies.

Audit Committee

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

Internal Audit

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

External audit

PwC, the Company's external auditor, 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 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 review 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.

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

PwC also 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.

Corporate governance

Tesco Bank

The management of risk is an integral part of the Bank's business. Tesco Bank has established an Enterprise Wide Risk Management Framework, designed to support the identification, assessment, management and control of the material risks that threaten the achievement of the Bank's strategic business objectives. The Bank has developed a risk strategy which is designed to support the successful delivery of strategic business objectives through clearly defined strategic risk objectives which support risk appetite. The risk appetite reflects the level and type of risks that the Bank is willing to take to deliver its strategic business objectives.

The Bank's Board has overall responsibility for the Bank business. It agrees the strategy for the business, approves the risk appetite of Tesco Bank as well as specific high level policies and the delegated authorities. The Bank's Board monitors the risk profile of the Bank.

Executive management is responsible for establishing an effective control framework and ensuring all risks are identified and controlled within the risk appetite and policy limits. The independent Risk function is responsible for developing risk appetite and the policy framework and for independently monitoring the risk profile, providing assurance where required. Risk also provides frameworks, tools and techniques to assist management in meeting their responsibilities, as well as acting as a central coordinator to ensure that enterprise wide risks are being effectively addressed. Tesco Bank Internal Audit is responsible for the independent assessment of the effectiveness of the implementation of the risk and control measures across the business. They assess whether the internal control systems are effective both in design and practice.

The Internal Capital Adequacy Assessment Process ('ICAAP') is the Bank's internal assessment of capital adequacy designed to address the requirements under Pillar 2 of the Basel II framework. The ICAAP process considers all of the risks faced by the Bank, the likely impact of them if they were to occur, how these risks can be mitigated and the amount of capital that is prudent to hold against them both currently and in the future. The Bank performs a full ICAAP regularly which is reviewed and approved by its Board.

The Bank holds a liquid asset portfolio that its Board deem to be sufficient to cover potential future stressed cash outflows. Through its Internal Liquidity Adequacy Assessment ('ILAA') process, stress events are simulated and the impact on cash flows, including any available contingency funding, is assessed and reviewed against the current and planned liquid asset portfolio. The ILAA is reviewed and approved by the Bank's Board regularly.

The Bank maintains a Key Risk Register, which is subject to regular review to enable management to identify all key risks, current and emerging. As the risk profile shifts over time the potential impact on the business is considered in terms of additional management action required and/or possible extra capital or liquidity requirements. The content of the Register is developed by the Risk function through ongoing discussion with senior management and is reviewed on a regular basis.

Whistle-blowing

The Group operates a whistle-blowing policy which is reviewed annually. In every business we operate a confidential telephone and email service which enables concerned employees 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 that endanger our staff, customers or the environment. During the year 2011/12 the majority of the calls related to personnel issues, which is common in most businesses, with a number of security issues also raised.

All complaints made are treated as confidential and are investigated by the relevant department and where we know the individual, the callers are updated. Where there is a serious issue, this will be escalated to the country CEO. This policy is monitored by the Compliance Committees in country, by the Group Compliance Committee annually and by the Group Audit Committee annually. In addition the whistle-blowing line was previously internally audited in 2010 and will be audited again during the current year.

Anti-corruption

We maintain the highest standards of ethics and integrity in the way we do business around the world. Bribery and corruption in all forms is illegal and unacceptable. It damages competition and markets, increases costs, reduces quality for customers and damages trust.

Wherever we operate we will always abide by the law. Any act of fraud, bribery or corruption would be treated with extreme seriousness by Tesco. We expect our business partners to adopt the same approach. Those breaking these laws are liable to be prosecuted. Alleged offenders who are UK citizens may also be prosecuted in the UK, no matter where the offence was committed.

In accordance with our Anti-corruption Guidelines, the CEO of each business is responsible for ensuring compliance with all local legislation and Company policies and report adherence to this to the Tesco Group Executive Committee and the Group Compliance Committee. To ensure the implementation of our bribery and corruption policy, a message has been sent to staff from their CEO reminding them of both our Values and our zero tolerance approach to all forms of bribery and corruption. The policy is available on our Group Intranet and staff are made aware of it. In addition, key staff across the business have completed anti-bribery training, using an e-learning tool which includes training on the new Bribery Act, as well as our policy, and which also requires them to pass an assessment. The e-learning tool has been translated into all of the principal languages used in the countries in which we operate. There will be annual refresher training.

Code of Business Conduct

The Code of Business Conduct explains to staff their most important individual responsibilities and obligations while working for Tesco. All members of staff must comply with the Code of Business Conduct. Acting legally and following our Group and local policies and best practice are some of the ways in which we ensure that we always do our best for our customers and for each other.

The Code provides guidance on key issues which may arise as staff work for Tesco and indicates who they should contact if they think that they, or another member of staff, may have breached those rules. Key members of staff are required to provide an annual statement of compliance with the terms of the Code. Disciplinary action may result for breaches of the Code.

The areas covered by the Code include:

The way we trade
<ul style="list-style-type: none"> • Competition • Trade restrictions and sanctions • Relationships with commercial suppliers
Personal and business integrity
<ul style="list-style-type: none"> • Fraud, bribery and corruption • Conflicts of interest • Insider dealing and market abuse • Gifts and improper payments • Political activity
The resources of the Company and our customer
<ul style="list-style-type: none"> • Intellectual Property • Responsible use of Company IT • Confidential Information and data protection • Accurate accounting and money laundering
Our people
<ul style="list-style-type: none"> • Equal opportunities • Unacceptable behaviours

Relations with stakeholders

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

We engage regularly with our employees 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.

Our programme of engaging with stakeholders including customers, staff, suppliers, investors, government, regulators, non-governmental organisations and others, is set out in more detail in our Corporate Responsibility Review 2012 and on our website.

Shareholder engagement

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

During the year, our CEO and Finance Director met with a number of our leading shareholders to discuss issues relating to the performance of the Group and its strategy, as well as new developments within the business. Our outgoing and incoming Chairmen also met with a number of our leading shareholders to discuss the Group's strategy and a range of governance matters.

In addition to this, our Investor Relations team engages with shareholders on a regular basis and on a wide range of issues. Our Corporate and Legal Affairs Director, Lucy Neville-Rolfe, leads the Company's contact with socially responsible investors and has regular meetings, on both a one-to-one and group basis, to discuss the work the Group is doing on corporate responsibility and governance-related issues.

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

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

Every shareholder may choose to receive a full Annual Report and Financial Statements or the Annual Review and Summary Financial Statements, either in paper or electronic form. These reports, together with publicly made trading statements, are available on the Group's website, www.tescoplc.com.

The Tesco PLC AGM

The Annual General Meeting offers the opportunity for the Board, including the Chairmen of the Audit, Corporate Responsibility, Remuneration and Nominations Committees, to communicate the Company's progress directly to shareholders. Our last Annual General Meeting in July 2011 was held in Nottingham. The 2012 AGM will be held in Cardiff at 11am on Friday 29 June. The choice of location is based on our policy of widening the opportunity for our shareholders to attend the AGM, by moving to different locations in the UK each year.

The whole Board attends the AGM and is available to answer questions from shareholders present. To encourage shareholder participation, we offer electronic proxy voting and voting through the CREST electronic proxy appointment service. At our Annual General Meeting, all resolutions are proposed and voted upon individually by the 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 the Regulatory News Services and the Tesco PLC website.

By Order of the Board

Jonathan Lloyd
Company Secretary
4 May 2012

Tesco PLC
Registered Number: 445790 Registered in England and Wales
Registered Office: Tesco House, Delamare Road, Cheshunt,
Hertfordshire EN8 9SL
VAT Registration Number: GB 220 4302 31

Directors' remuneration report

“Our remuneration arrangements are simple, aligned with strategy and targeted to be consistent with shareholder expectations.”

Stuart Chambers
Remuneration Committee
Chairman



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 25 February 2012.

IN THIS SECTION

64 Introduction from Stuart Chambers, Chairman of the Remuneration Committee

REMUNERATION STRATEGY AND POLICY FOR EXECUTIVE DIRECTORS

65 Executive Directors' remuneration strategy and policy

68 Fixed remuneration

69 Share ownership guidelines

69 Service agreements

70 Performance related remuneration

REMUNERATION DECISIONS FOR EXECUTIVE DIRECTORS BASED ON PERFORMANCE IN 2011/12

71 Salaries for 2011/12

72 Performance related remuneration for 2011/12

74 Aligning pay with performance

OTHER INFORMATION

76 Outside appointments

76 Non-executive Directors

CORPORATE GOVERNANCE

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

AUDITED INFORMATION

80 Data tables

Dear Shareholder

As outlined in last year's report, we introduced new remuneration arrangements for the 2011/12 financial year following detailed discussions with shareholders. The new arrangements provide simpler, more strategically aligned incentives that are consistent with our shareholders' expectations.

We simplified pay by reducing the number of incentive plans in which Executives participate (to an annual bonus and a performance share plan) and by reducing the number of performance measures. Executives are now incentivised to achieve underlying profit growth and strategic objectives over an annual period and to deliver sustained earnings and return on capital performance in the long term.

We have also returned to a collegiate remuneration approach with all Executives participating in the same plans and being paid in relation to delivery of the same performance. This philosophy applies throughout the organisation at Group as well as at business and country level, with over 5,000 of our senior managers globally participating in reward arrangements linked to local business performance but consistent in structure with those of the Executive Directors.

At the heart of Tesco's remuneration arrangements is a performance focused culture. For many years the business has delivered strong underlying profit growth and improved returns for shareholders. Underlying profit between 2007 and 2011 improved 50% and despite a period of increased investment, return on capital has shown an improving trend. Remuneration paid during this period reflected this performance.

Although sales and profits increased in 2011/12 over the previous year to a record level for the Group, the threshold profitability for the annual bonus (representing 70% of the annual bonus opportunity) was not achieved and therefore no bonus will be paid in respect of the financial part of the bonus. A number of the strategic targets were delivered and a payout of 13.54% of the maximum was approved in respect of this performance. The overall payout is significantly lower than for 2010/11. Half the bonus will be paid in cash and half will be deferred into shares for a further three years. The CEO has, however, elected to not take any bonus for 2011/12.

Our long-term rewards are assessed based on earnings and return on capital employed over a three-year period. Despite the challenges in 2011/12, the three-year performance shows progress with underlying diluted earnings per share growth of 29% and reported ROCE performance improving by 50 basis points. The Remuneration Committee therefore determined that 46.5% of the Performance Share award and 100% of the share options granted in 2009 would vest, reflecting this progress made over the longer term.

As announced in January 2012, our plan for 2012/13 is to substantially increase investment in the shopping trip – particularly in the UK. Consequently we anticipate minimal Group trading profit growth for the year. The objective is that this investment in customer experience will strengthen our underlying business and generate long-term sustainable growth. We will also reduce levels of capital expenditure as we modify our approach to UK expansion. In this context, the Committee has set performance targets for 2012/13 awards that remain motivational for management while still ensuring that significant rewards can only be earned if there has been exceptional value delivered for shareholders. No bonus will be paid to Executives unless performance is greater than budget, representing year-on-year growth in profit. For the performance share plan we have repositioned our earnings targets for initial vesting but earnings growth required for maximum vesting and our ROCE goals remain the same.

We are not proposing any other changes to Executive Director remuneration arrangements in 2012/13. However, we will continue to monitor our approach to pay against the backdrop of evolving regulation and the wider climate on executive pay, to ensure that remuneration remains simple, aligned with our strategy and fair to Executives and shareholders.

We have made a number of changes to the way in which we present information in our Remuneration Report this year to make it more accessible and easy to understand. While the Department of Business, Innovation and Skills ('BIS') proposals are not yet final we have taken steps to disclose, in advance, additional information in certain areas which we believe will be helpful for shareholders. We have included more detail on how bonus and long-term incentive payouts were determined and details of remuneration paid over the past five years.

I hope you will find this summary clear and informative. However, if you would like further detail I would direct you to the full Directors' Remuneration Report which follows this introductory letter.

Stuart Chambers

Chairman of the Remuneration Committee

Remuneration strategy

Executive Directors' remuneration strategy

Tesco has a long-standing strategy of rewarding talent and experience. We seek to provide incentives for improving the underlying drivers of performance, delivering strong, sustainable and profitable growth, thereby creating long-term substantial additional value for shareholders. We operate in a keenly competitive and rapidly changing retail environment. Business success depends on the talents of the key team, but outstanding business performance comes only from teamwork.

Our success is predicated on the abilities of a strong management team across all levels and geographical locations of the business. Motivating and incentivising this team to deliver sustainable long-term performance is fundamental to our ongoing success. During 2012/13 we are making significant investments in our business foundations to ensure a strong platform for future sustained growth. We are investing in the customer experience in the UK as well as our online platforms to ensure that customers receive value for money and the high level of service they expect from Tesco. We are also continuing to invest in our international portfolio where we see significant opportunities for growth.

We strongly believe that our incentives should support the continued growth and strengthening of our returns from across the Group, and that all our staff should share in the success of the business alongside our shareholders.

Remuneration policy

The Remuneration Committee undertook a detailed review of executive remuneration arrangements during 2010/11, the outcome of which was set out in last year's Directors' Remuneration Report. The Committee believes that the new remuneration arrangements provide a simplified, more collegiate remuneration package, with an enhanced focus on meeting both our short-term and long-term, operational and strategic goals. 2012/13 will be a challenging year for the business and our remuneration arrangements should reflect this. The Committee believes that the structure implemented last year remains appropriate and supports long-term growth.

The key features of our remuneration policy at Tesco are:

- **Alignment with strategy** – Our remuneration arrangements are designed to ensure that Executive Directors are aligned with the delivery of our long-term strategic objectives and the creation of shareholder value. 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 short-term performance is measured in relation to underlying profit performance and the delivery of key strategic objectives. Our long-term performance is measured by assessing the growth in our earnings per share and the level of our return on capital, measures which are central to 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. All Executives 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 employees are shareholders in the business to create alignment with our shareholders. The CEO is required to hold shares with a value of four times salary with other Executives being required to hold shares with a value of three times salary. Most Executives already hold shares in excess of this requirement.

Directors' remuneration report

We are not proposing any significant changes to the structure of remuneration for 2012/13, as these arrangements were only introduced a year ago. We will, however, continue to monitor our approach to pay to ensure that it remains appropriate, aligned with our strategy and fair to Executives and shareholders in the context of the rapidly evolving environment around executive pay.

Remuneration arrangements throughout the Group

Remuneration arrangements at Executive Director level and throughout the Group are designed around a set of common Tesco pay values. Ensuring that employees are focused on delivering the same core objectives is an important part of Tesco's reward philosophy:

- **Annual bonus** – Annual bonuses throughout the Group are linked to local business performance but are consistent in structure to that of the Executives with a focus on underlying profit growth and performance against key strategic objectives.
- **Share incentives** – Over 5,000 of our senior employees across the globe participate in the Performance Share Plan based on the same performance conditions as Executive Directors. This senior population also receives some of their bonus in Tesco shares deferred for a period.

- **Employees as shareholders** – It is an important part of the Tesco values that all of our employees, not just senior management, have the opportunity to become Tesco shareholders. Over 210,000 of our people participate in our all-employee schemes and we delivered over 26 million shares in 2011 under our Shares In Success Plan, a plan which awards free shares to all UK employees based on Company performance.

When determining Executive 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 the Committee considers the general Group wage increase. In the last few years executive salary increases have been at a similar level to the general employee increase.

Remuneration framework

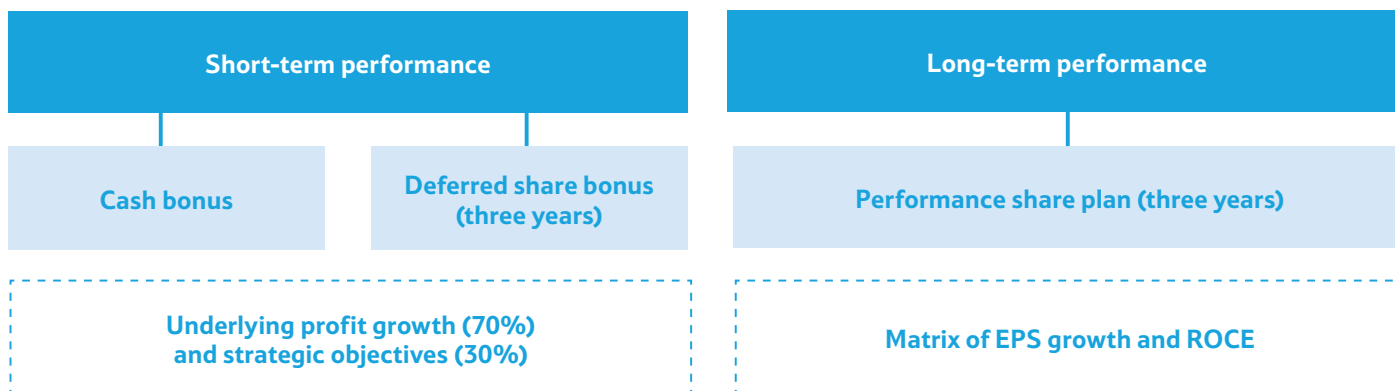
The following chart and accompanying table on page 67, provide a summary of the different elements of pay, their purpose and linkage to our strategy, and the key features of each component:

Fixed element

Base salary

c. 14% – 40% depending on individual incentive arrangements and performance

Performance related element



c. 60% – 86% depending on individual incentive arrangements and performance

Remuneration policy for Executive Directors

At a glance summary of Executive Directors' remuneration for 2012/13				
Element	Link to strategy/performance measures	CEO	Other Directors	Changes to the policy for 2012/13
Base salary	<p>Set at levels to attract and retain talented individuals.</p> <p>When determining pay the Committee examines salary levels at the major retailers, the leading FTSE companies and gives consideration to appropriate international competitors.</p>	<ul style="list-style-type: none"> £1,100,000. 	<ul style="list-style-type: none"> Executive Directors – £852,000. Corporate and Legal Affairs Director – £639,000. 	<ul style="list-style-type: none"> No changes to the policy.
Annual bonus (One-year performance) (Cash and shares)	<p>70% of bonus based on underlying profit performance.</p> <p>30% of bonus based on performance against key strategic objectives.</p> <p>These measures have been selected as they are considered to be closely aligned to long-term shareholder value creation.</p> <p>All objectives are specific and measurable and a number relate to financial performance.</p> <p>Strategic objectives include specific measures based on environmental, social and governance ('ESG') factors, an integral part of the corporate strategy. The inclusion of these specific measures will help reinforce positive and responsible behaviour by senior management in relation to the underlying drivers of performance.</p>	<ul style="list-style-type: none"> 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 in the event that results are materially misstated. 	<ul style="list-style-type: none"> Maximum opportunity of 200% of base salary. 	<ul style="list-style-type: none"> No changes to the policy.
Performance share plan (Three-year performance) (Shares)	<p>Based on a matrix of ROCE/EPS growth performance.</p> <p>To enhance shareholder value by incentivising Executives to grow earnings over the long term while maintaining a sustainable level of return of capital.</p> <p>To provide alignment of the economic interests of Executives and our shareholders and to act as a retention tool.</p>	<ul style="list-style-type: none"> Maximum award of 275% of base salary. Clawback provisions apply to awards, allowing the Committee to scale back awards in the event that results are materially misstated. Maximum awards of up to 200% of base salary can also be granted under the Discretionary Share Option Plan. However, it is not intended that this plan will be used and it will only be used in exceptional circumstances. 	<ul style="list-style-type: none"> Maximum award of 225% of base salary. 	<ul style="list-style-type: none"> No changes to the policy.
Pension (Cash)	<p>To provide a market-leading retirement benefit that will foster loyalty and retain experience, which supports our culture of developing talent internally.</p> <p>A key incentive and retention tool throughout the organisation.</p>	<ul style="list-style-type: none"> 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 (other than for Tim Mason). 		<ul style="list-style-type: none"> No changes to the policy. The Company is currently consulting with employees regarding some changes to the pension scheme which will also impact Executive Directors. See page 68 for more details.
Benefits	<p>To provide a market-competitive level of benefits for our Executive Directors.</p>	<ul style="list-style-type: none"> Core benefits – Benefits include car allowance, life assurance, disability and health insurance, 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 employees. US CEO allowance – The US CEO receives a net expatriate allowance of £282,000 p.a. to cover costs incurred in relation to his US assignment. 		<ul style="list-style-type: none"> No changes to the policy.

Directors' remuneration report

Fixed remuneration for 2012/13

Salary and pension	
Base salary	
Policy	<ul style="list-style-type: none"> • Base pay is designed to attract and retain talented individuals. • It is set to reflect individual capability, responsibilities and market-competitive positioning.
Benchmarking group	<ul style="list-style-type: none"> • The Committee examines salary levels at the major retailers, the leading FTSE companies and ensures consideration is also given to appropriate international competitors.
Relationship to all employee pay	<ul style="list-style-type: none"> • 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 2.4%. The average increase for senior management below Board level last year was 2.4%, and for other employees the average increase was typically around 2.5%. • Pay levels Group-wide are determined with consideration to a number of factors, including the prevailing economic environment, discussions with employee representative groups, and current market practice.
Review date	<ul style="list-style-type: none"> • Base salaries are typically reviewed with effect from 1 July each year. • The next salary review will be 1 July 2012 and salaries following this review will be disclosed in next year's report.
Pension	
Philosophy	<ul style="list-style-type: none"> • Pension provision is central to our ability to foster loyalty and retain experience, which is why Tesco wants to ensure that the Tesco PLC Pension Scheme is a highly valued benefit.
Pension policy	<ul style="list-style-type: none"> • All Executive Directors are members of the Tesco PLC Pension Scheme, which provides a pension of up to two-thirds of base salary on retirement, normally at age 60, dependent on service. • Pension drawn before age 60 will be actuarially reduced to reflect early retirement. • The Final Salary Scheme is now closed to new entrants and has been replaced in the UK for new entrants throughout the organisation by a defined benefit pension scheme based on career average earnings. • Our defined benefit pension is a key incentive and retention tool throughout the organisation and remains an important part of our reward package for all UK employees.
SURBS	<ul style="list-style-type: none"> • 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. • The balance of any pension entitlement for all Executive Directors is delivered through an unapproved retirement benefits scheme ('SURBS'). Except for Tim Mason (US CEO), the SURBS is 'secured' by using a fixed charge over a cash deposit in a designated account.
Employee contribution	<ul style="list-style-type: none"> • Over the last few years employee pension contributions by our Executive Directors have been increasing progressively. • In 2011/12 the level of employee contribution was 10% of salary which is in line with contribution levels by senior management below Board level. Contributions for 2012/13 will remain at this level.

The Company is currently consulting with employees regarding some proposed changes to the pension scheme. These changes, which would be expected to come into effect from 1 June 2012 and only apply to benefits that build up in the future, will apply to all participants in the scheme including the Executive Directors. There are two proposed changes. The first is that, whilst the Normal Pension Age remains unchanged, the age at which a full pension is paid will increase by two years – and which 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.

Further details of the pension benefits earned by the Directors can be found on page 80.

Share ownership guidelines

Guidelines

- | | |
|---|---|
| Four times base salary for the CEO | • The purpose is to create alignment with interests of shareholders |
| Three times base salary for other Executive Directors | • This requirement is at the upper end of typical market practice for similar sized companies |

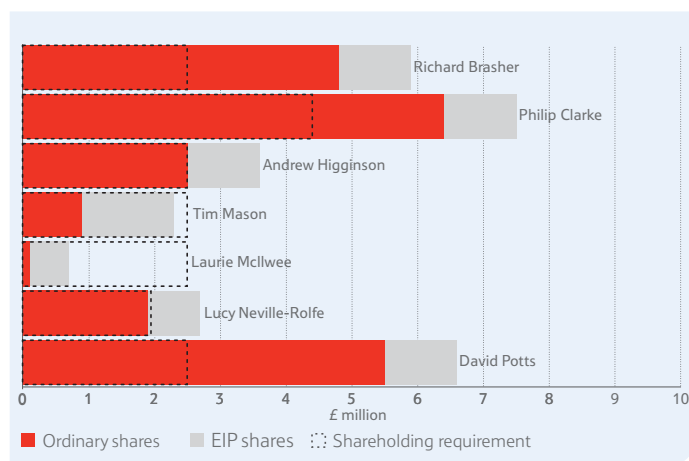
The Remuneration Committee believes that a significant shareholding by Executive Directors aligns their interests with shareholders and demonstrates their ongoing commitment to the business.

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 typically 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** – Most executives already meet the shareholding requirement but those who do not will generally 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.

Shares held by Executive Directors at 25 February 2012

The chart below illustrates the value of Executive Directors' shareholdings, based on the three-month average share price to 25 February 2012 of 359p 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 other directors. When the shareholding guidelines were increased last year, 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 Model Code. At all other times, Executive Directors and Executive Committee members must seek advance clearance from the Chairman before dealing in shares on their own behalf or in respect of their connected persons.

Service agreements

Key provisions		
Provision	Current service contracts	Policy for new appointments
Notice period	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Rolling service contract. • No fixed expiry date. 	
Termination payments (Does not apply if notice as per the service agreement is provided or for termination by reason of resignation or unacceptable performance or conduct)	<ul style="list-style-type: none"> • Termination payments in lieu of notice calculated based on basic salary and the average annual bonus paid for the last two years. • No account will be taken of pension. • Termination payments will be subject to mitigation 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. 	<ul style="list-style-type: none"> • Termination payments in lieu of notice based on basic salary and benefits only.

The Committee has taken into account the feedback received from shareholders and shareholder representative bodies regarding best practice in relation to the inclusion of bonuses in Directors' termination arrangements. To ensure full alignment with best practice, the Committee has decided that the policy for new executives joining the Board will be to restrict termination payments in lieu of notice to a sum based on salary and benefits only. This was reflected in the new service contract for Philip Clarke on his appointment to CEO.

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

Directors' remuneration report

Performance related remuneration for 2012/13

Short-term performance

The table below sets out a summary of the maximum opportunity under the short-term remuneration arrangements for 2012/13:

At a glance short-term bonus opportunity

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

The following short-term performance measures apply for the 2012/13 annual bonus arrangements:

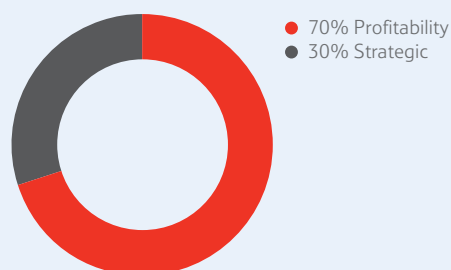
Short-term performance measures for 2012/13

Profitability (70% of short-term performance)	Strategic (30% of short-term performance)
Measured in relation to underlying profit performance.	Based on performance against key metrics. For 2012/13 these metrics will be: <ol style="list-style-type: none"> 1. UK like-for-like sales growth 2. UK return on capital employed 3. Customer experience 4. Group internet sales 5. Group employee satisfaction 6. Group CO₂ reduction
Link to strategy – This measure incentivises the delivery of strategy by encouraging the creation of annual shareholder value through improved bottom-line financial results.	<p>Link to strategy – These measures contain a mix of financial, strategic and corporate responsibility targets and were selected to incentivise sustainable improvements in the underlying drivers of performance.</p> <p>In light of our strategic focus on the customer shopping trip over the next 12 months, for the annual bonus for 2012/13 we have replaced our Group new space expansion metric with an objective focused on customer experience. This will allow us to directly measure whether or not our investment in customers is feeding through to an improved customer experience.</p> <p>In addition for 2012/13 the Committee is introducing an underpin to the annual bonus so that no portion of the annual bonus related to strategic measures can be earned unless a minimum level of profit growth has been achieved.</p>

85% of bonus entitlement is based directly or indirectly on financial metrics. These measures are considered to be important for laying foundations for future performance improvement.

The balance of measures is illustrated in the pie chart below:

Balance of measures for short-term bonus



This balance of both profitability metrics, and specific measures based on environmental, social and governance ('ESG') factors, will support the delivery of our corporate strategy, and help reinforce positive and responsible behaviour by senior management. This will ensure that the value that is delivered to shareholders is sustainable.

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 bonus paid in the 2012/13 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 (potentially to zero) in the event that results are materially misstated.

Long-term performance

At a glance long-term plan opportunity for 2012/13

- Maximum award of **275%** of salary for the CEO
- Maximum award of **225%** of salary for the other Executive Directors.
- Shares vest in **three years'** time subject to performance targets being met.
- Clawback provisions apply.

Tesco believes that the best way to enhance shareholder 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.

As applied for the first time in 2011, 2012 awards will 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.

As announced in January 2012, our plan for 2012/13 is to substantially increase investment in the delivery of an even better shopping trip for customers – particularly in the UK. The objective is that this investment in customer experience will strengthen our underlying business and generate long-term sustainable earnings growth and returns. In light of this the Committee has reviewed targets for the 2012 PSP award to ensure that they remain motivational for management while still representing long-term value creation for shareholders.

While we have lowered the EPS growth vesting entry point compared to 2011/12 (from 7% p.a. to 5% p.a.) to ensure that it remains appropriate and motivational for management, we have kept the maximum vesting point the same, at 12% p.a. growth, to ensure that awards are only paid in full if there has been significant value creation for shareholders. In April 2011, we set a target to increase our already strong level of ROCE to 14.6% by 2014/15. We have improved ROCE from 12.9% to 13.3% in the last year and remain committed to our target. Therefore the ROCE target remains unchanged. The Committee believes the targets remain stretching and the combination of growing earnings while improving capital returns will result in value creation for shareholders.

Targets for 2012/13 awards

The vesting matrix and targets for the three years to 2014/15 are illustrated below:

	% of initial PSP award vesting	EPS growth p.a.	
		Threshold	Stretch
ROCE	14.6%	45%	100%
	13.6%	20%	85%

Straight-line vesting between these points

Targets for 2011/12 awards

The vesting matrix for 2011 awards is provided below:

	% of initial PSP award vesting	EPS growth p.a.		
		Threshold	Target	Stretch
ROCE	14.6%	45%	75%	100%
	13.6%	20%	60%	85%

Prior to 2011 PSP awards, ROCE performance outcomes were adjusted to take into account acquisitions which were not envisaged when the targets were set. The Remuneration Committee reserves the right to make such adjustments under the new plan 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) in the event that results are materially misstated.

Remuneration decisions for Executive Directors in 2011/12

Despite achieving record sales and profits and improved ROCE performance, 2011/12 has been a challenging year for Tesco, particularly in the UK and Tesco Bank. Nevertheless there were encouraging signs for the future in many of our key growth opportunities. Our International business performed strongly, with promising sales growth in all three regions; Asia, Europe and particularly the United States. Online sales, a key strategic area, also grew strongly.

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

At a glance remuneration decisions for 2011/12

Base salary	<ul style="list-style-type: none"> Salary for CEO agreed at appointment (March 2011) at £1,100,000. Salaries for Executive Directors increased by 2.4% with effect from 1 July 2011, in line with the general increase for other employees. Next review is with effect from 1 July 2012.
Annual bonus	<ul style="list-style-type: none"> Despite year-on-year profit growth to record levels, our stretching underlying profit growth targets were not met and therefore no bonus will be paid in respect of this portion of the bonus. However, satisfactory performance was delivered in respect of a number of our strategic objectives and therefore a total of 13.54% of the maximum bonus (27% of salary) will be paid to Executive Directors. The CEO elected not to take any bonus for 2011/12.
Long-term incentives	<ul style="list-style-type: none"> Our long-term rewards were assessed based on earnings growth and return on capital employed delivered over the past three years. Despite the challenges in 2011/12, performance over the long-term was still strong compared to 2008/9. The Remuneration Committee therefore determined that 46.5% of the performance share award (69.7% of the Group element and 0% of the international element) and 100% of the share options (granted under the old framework in 2009) would vest, reflecting the progress made over the longer term.

The following provides further detail on these decisions.

Salaries 2011/12

The base salaries of the Executive Directors following the 2011 review were:

Director	Basic salary 1 July 2011 £000
CEO (from appointment on 2 March 2011)	1,100
Other Executive Directors	852
Director – Corporate and Legal Affairs	639

The average increase for established Executive Directors last year was 2.4%, which was broadly the same as the increase for other senior executives and employees throughout the Group. Salary increases over the last three years have been aligned with those of other employees.

Directors' remuneration report

Short-term performance

Performance measures and payouts		
Performance measures	Maximum opportunity	2011/12 payout
70% based on profitability Underlying profit performance	<ul style="list-style-type: none"> • CEO – Maximum bonus opportunity of 250% of base salary. • Other Executive Directors – Maximum bonus opportunity of 200% of base salary. 	13.54% of maximum opportunity. The CEO elected not to take a bonus.
30% based on strategic performance <ol style="list-style-type: none"> 1. UK like-for-like sales growth 2. UK return on capital employed 3. Group new space expansion 4. Group internet sales 5. Group CO₂ reduction 6. Group employee satisfaction 		0% of salary for the CEO and 27% of salary for other Directors. 0% of financial performance met and 45% of strategic performance objectives met.

The following illustrates performance against short-term targets.

Performance against short-term targets 2011/12		Performance			
Measures		Below	Threshold	Target	Stretch
Profitability Underlying profit		◆			
Strategic UK like-for-like sales growth		◆			
UK return on capital employed		◆			
Group new space expansion				◆	
Group internet sales				◆	
Group CO ₂ reduction					◆
Group employee satisfaction				◆	

Despite year-on-year profit growth, our stretching underlying profit growth targets were not met and therefore no bonus will be paid in respect this portion of the bonus. However, satisfactory performance was delivered in respect of a number of our strategic objectives, particularly Group internet sales, Group CO₂ reduction and Group employee satisfaction and therefore a total of **13.54%** of the maximum bonus will be paid to Executive Directors. The CEO elected not to take a bonus for 2011/12.

Long-term performance

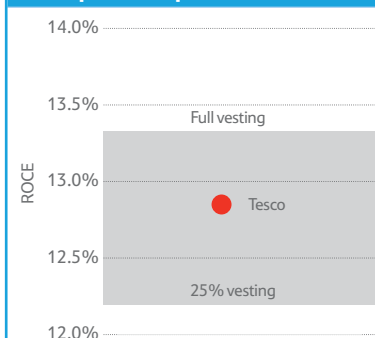
Vesting of 2009/10 to 2011/12 awards

Awards vesting in the year were made under the previous long-term incentive arrangements, 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 payouts		
	Maximum opportunity	2011/12 payout
Earnings per share <ul style="list-style-type: none"> • 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 2009/10. • Performance period ended 2011/12. 	<ul style="list-style-type: none"> • Share options with a face value of 200% of salary at the date of grant. 	100% of maximum opportunity vested.
	<ul style="list-style-type: none"> • Underlying diluted EPS for 2011/12 excludes the discontinued Japan business and was 37.41p. The Committee determined, however, that it was appropriate to base vesting of share option awards on EPS including the impact of Japan to ensure alignment with shareholders. • On this basis, the growth in undiluted EPS above RPI during the performance period exceeded 15% over three years and these options will therefore vest in full on the third anniversary of their grant. • Despite the challenges in 2011/12 earnings, performance is still significantly ahead of 2008/9 performance representing significant value creation for shareholders over this period. • The exercise price for awards is 338.4p per share. At the year end the share price was 318.2p and the share options granted in 2009 were therefore underwater. No value will be delivered to Executives unless the share price increases significantly above this level. 	

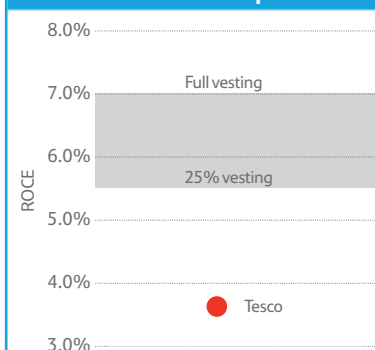
Performance measures and payouts		Maximum opportunity	2011/12 payout
Return on capital employed – Group	<ul style="list-style-type: none"> Maximum vesting for Group ROCE of 13.3% with threshold vesting for Group ROCE of 12.2%. 75% based on performance against target with 25% based on the Committee's assessment of the quality of ROCE performance. Granted in 2009/10. Performance period ended 2011/12. 	<ul style="list-style-type: none"> Maximum award of 100% of salary. 	69.7% of maximum opportunity vested.
Return on capital employed – International	<ul style="list-style-type: none"> Maximum vesting for International ROCE of 7.0% with threshold vesting for International ROCE of 5.5%. 75% based on performance against target with 25% based on the Committee's assessment of the quality of ROCE performance. Granted in 2009/10. Performance period ended 2011/12. 	<ul style="list-style-type: none"> Maximum award of 50% of salary (except for Tim Mason, US CEO). 	0% of maximum opportunity vested.

Group ROCE performance 2011/12



- **Performance for 2011/12** – Post Tax Group ROCE performance was adjusted down to take account, inter alia, of the Japan business which has been discontinued. Based on this performance, 69.7% of the first 75% of the award will vest.
- **Reported ROCE** – Reported ROCE for 2011/12 excludes the discontinued Japan business and was 13.3%. The Committee determined, however, that it was appropriate to base vesting of PSP awards on ROCE including the impact of Japan to ensure alignment with shareholders.
- **Assessment of the quality of ROCE** – The Committee also exercised its judgement as to the extent to which the remaining 25% of the PSP award should vest by reference to the overall quality of ROCE performance, taking into account factors including:
 - the level of ROCE achieved;
 - the expected ROCE for additional and existing capital investment;
 - whether capital spend was in line with strategic objectives and balanced short-term and long-term investment needs; and
 - the level of sales and underlying profit growth and whether this reflected other developments in the marketplace.
- The Committee considered these factors and concluded that there were no reasons to treat the remaining 25% of the award differently and therefore determined that the vesting for the remaining 25% of the award should be in line with vesting for the first 75% of the award. Overall therefore **69.7%** of the maximum award vested.

International ROCE performance 2011/12



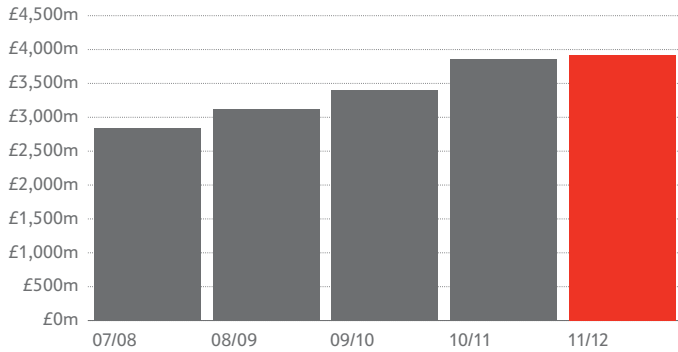
- Post Tax International ROCE 2011/12 including the discontinued Japan business was below the level of International ROCE required for threshold levels of vesting and therefore **0%** of the International award will vest.

Directors' remuneration report

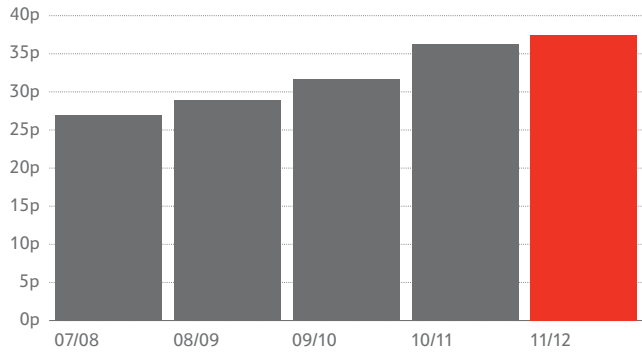
Aligning pay with performance

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

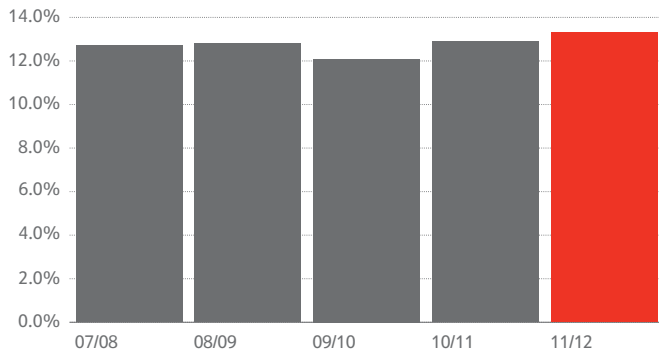
Underlying profit before tax – continuing operations



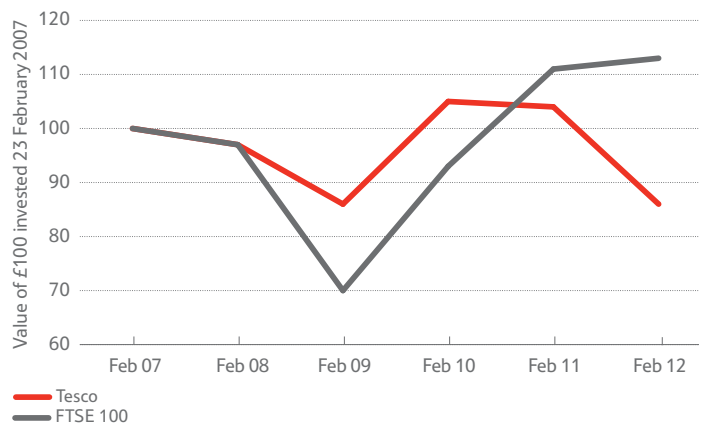
Underlying diluted earnings per share – continuing operations



Return on capital employed ('ROCE')



Total Shareholder Return ('TSR')



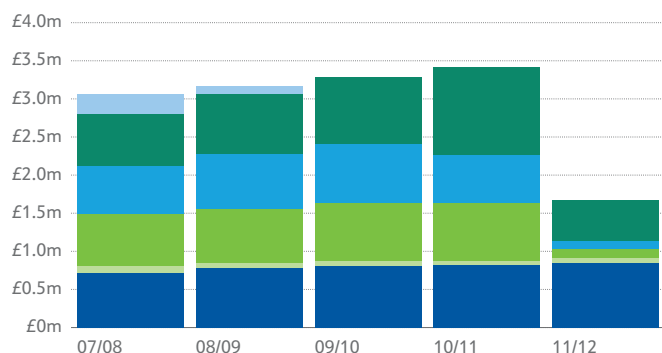
The graph above shows a comparison between the Total Shareholder Return ('TSR') for the Company's shares for the five-year period to 25 February 2012, and the TSR for the companies comprising the FTSE 100 over the same period. This index has been selected to provide an established and broad-based comparator group of retail and non-retail companies.

For further details in relation to the numbers set out in the charts above please see the Five year record on page 152.

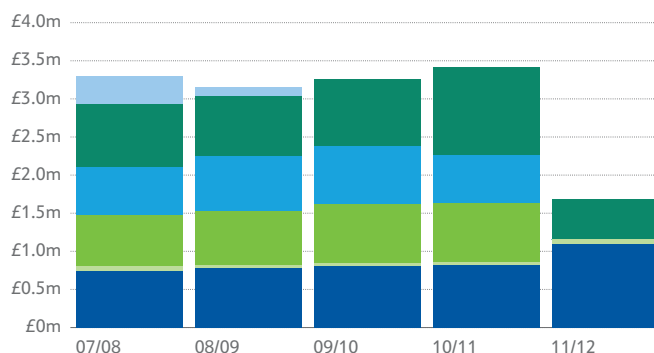
Aligning pay with performance

The following charts illustrate the remuneration received by Executive Directors over the last five years.

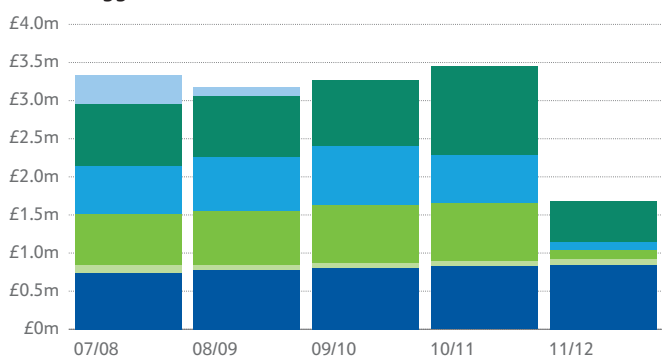
Richard Brasher



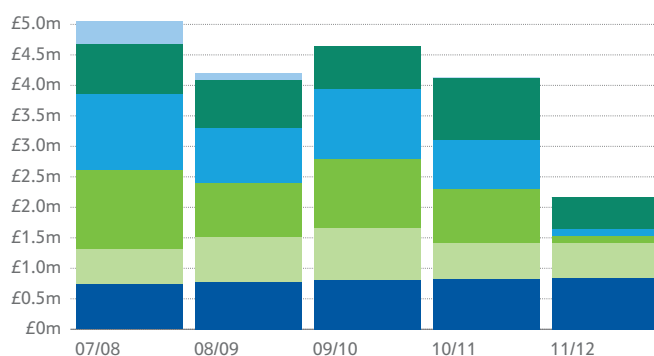
Philip Clarke



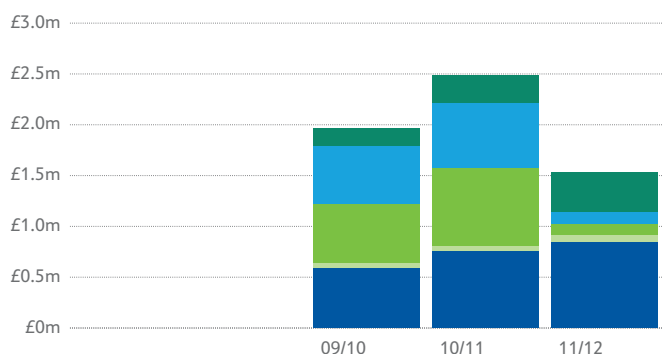
Andrew Higginson



Tim Mason

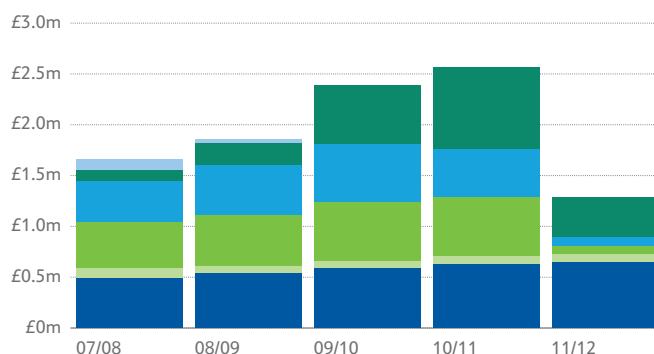


Laurie Mcllwee

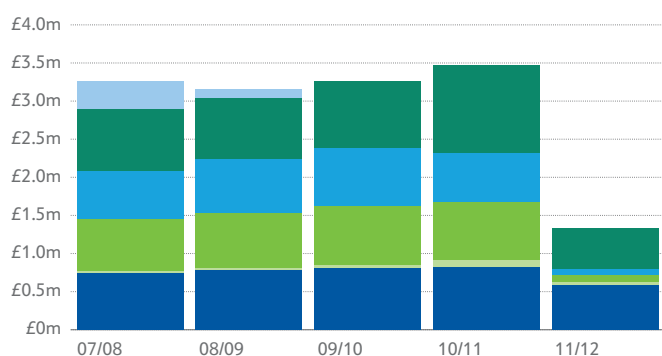


Laurie Mcllwee was promoted to the Board during 2008/09 and therefore the first full year is shown above

Lucy Neville-Rolfe



David Potts



David Potts stepped down from the Board on 7 December 2011. The figures for 2011/12 are to 7 December 2011.

■ Gains on share options (gain at vesting date) ■ Bonus - Cash
■ PSP (value on vesting date) ■ Allowance/benefits
■ Bonus - Deferred shares awarded ■ Salary

Notes

- Salary** – The base salary paid in the year, as reported in the emoluments table for the relevant financial year.
- 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.
- Bonus (deferred shares)** – The value of deferred bonus shares on award, as reported in the emoluments table for the relevant financial year. These deferred shares vest three years after award and are not subject to further performance conditions.
- PSP** – The value of PSP awards that vested in respect of the three-year performance period ending in the relevant financial year. All awards valued based on the share price at the date of vesting, other than for 2011/12 award where the award is valued at the share price on 25 February 2012.
- 2007/08 and 2008/09 PSP** – The PSP awards that vested in this year (other than to Lucy Neville-Rolfe and Laurie Mcllwee) were subject to an additional one-year holding period and as such were not released until the following financial year.
- PSP awards for Lucy Neville-Rolfe and Laurie Mcllwee** – The PSP awards granted to Lucy Neville-Rolfe prior to 2007 and to Laurie Mcllwee prior to 2009 were before they joined the Board and therefore were granted under the senior management performance share plan.
- 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, other than for 2011/12 award where the gain is calculated based on the share price on 25 February 2012.
- Allowance** – From 2011/12 Tim Mason has been paid a net allowance of £282,000 p.a. to cover expatriate costs previously paid by the Company (see Table 1 – Directors' emoluments on page 80 for further details).

Directors' remuneration report

Leaving arrangements for Andrew Higginson, David Potts and Richard Brasher

Andrew Higginson will retire from the Board on 1 September 2012 after 14 years with the business. David Potts stepped down from the Board on 7 December 2011 and will retire from the Company on 30 June 2012 after 39 years with the business. Shortly after the year end, we also announced the departure of Richard Brasher who will leave the Company on 31 July 2012 after 26 years with the business. Cessation arrangements for these Executives will be in accordance with their contracts and the rules of the applicable share plans. Details will appear in next year's Directors' Remuneration Report.

Other information

Outside appointments

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

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

Executive Directors' biographies which include details of any outside appointments can be found on page 38 of this report.

Fees retained for any Non-executive Directorships are set out below.

Non-executive Directorships		
Director	Company in which Non-executive Directorship held	Fee retained in 2011/12 £000
Andrew Higginson	BSkyB PLC	56
Lucy Neville-Rolfe	The Carbon Trust	17
	ITV plc	58

Non-executive Directors

Non-executive Director fees (from start of 2012/13 year)									
	Sir Richard Broadbent	Gareth Bullock	Patrick Cescau	Stuart Chambers	Karen Cook	Ken Hanna	Ken Hydon	Deanna Oppenheimer	Jacqueline Tammenoms Bakker
Senior Independent Director			●						
Remuneration Committee				○	●	●			●
Audit Committee		●	●			●	○		
Corporate Responsibility Committee	○		●					●	●
Nominations Committee	○		●	●		●			
2012/13 Total	£625,000	£82,000	£132,000	£112,000	£82,000	£106,000	£100,000	£82,000	£94,000

● Member of Committee
○ Chairman of Committee

There were no increases to the Non-executive Director fee levels in the year.

The current Non-executive Director fees are as follows:

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

* Fees payable from start of 2012/13 year to take into account the time commitment for the meetings.

Gareth Bullock, Stuart Chambers and Deanna Oppenheimer will be appointed to the Board of Tesco Personal Finance Group Limited subject to FSA approval. They will be paid a fee in respect of this which will be 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

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

Sir Richard Broadbent was appointed Non-executive Chairman from 30 November 2011, and receives an annual fee of £625,000 and has the benefit of a company car and driver.

Between 2 July and 30 November, Sir Richard worked with the former Chairman Sir David Reid to transition the role. During this period he was paid 50% of this annual fee, £312,500 p.a. (£130,208 for this five-month period) reflecting the time commitment required in relation to the transition of the role.

Sir David Reid was Non-executive Chairman until 30 November 2011. He received an annual fee of £640,000 and had the benefit of a company car and driver.

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.

Corporate Governance

Membership of the Remuneration Committee	<p>Stuart Chambers (Committee Chairman) Patrick Cescau (to 25 February 2012) Karen Cook Ken Hanna Jacqueline Tammenoms Bakker</p> <ul style="list-style-type: none"> • The Directors' biographies can be found on pages 38 and 39 of this Report. • Members' attendance at Committee meetings is listed in the Corporate governance section on page 57 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	<p>The Committee's key responsibilities are to:</p> <ul style="list-style-type: none"> • Determine and recommend to the Board the remuneration policy for Executive Directors and the Chairman. • 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. • 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. <p>As required by the FSA, 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 employees, 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.</p>

Directors' remuneration report

Corporate governance continued		
Remuneration Committee activities 2011/12	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
February 2011	<ul style="list-style-type: none"> Review of performance against short-term annual bonus, long-term PSP and share option awards for 2010/11. Review of the first draft of the 2010/11 Directors' Remuneration Report. Committee effectiveness review. 	<ul style="list-style-type: none"> Review of proposed changes to the Executive Directors' remuneration arrangements. Approval of new CEO package.
April 2011	<ul style="list-style-type: none"> Review of short-term bonus, long-term PSP and share options performance and vesting outturns for 2010/11. Approval of short-term bonus and long-term PSP targets for 2011/12 awards. Review of 2010/11 Directors' Remuneration Report. 	<ul style="list-style-type: none"> Final approval for the changes to Executive Directors' remuneration arrangements. Approval of PSP Rules. Overview of reward for Executive Committee members and approval of package for members who fall within the Remuneration Committee's terms of reference. Update on pension taxation legislation.
June 2011	<ul style="list-style-type: none"> Update on shareholder feedback. Benchmarking of Executive Director base salary and total compensation against the market. Determination of base salaries with effect from 1 July 2011. Consideration of the relationship between Executive Director reward and reward at the level below the Board. Review of the Chairman's fee and approval of package for new Chairman. 	<ul style="list-style-type: none"> Review of approach to assessing shareholding guideline policy.
October 2011	<ul style="list-style-type: none"> Annual report from the Remuneration Committee Chairman of Tesco Personal Finance PLC. Update on market practice and developments in corporate governance. Follow-up from Committee effectiveness review. 	<ul style="list-style-type: none"> Professional development update on disguised remuneration legislation, BIS consultation and updated ABI guidelines. Principles regarding PSP leaver provisions.
February 2012	<ul style="list-style-type: none"> Review of performance against short-term annual bonus, long-term PSP and share option awards for 2011/12. Review of the first draft of the 2011/12 Directors' Remuneration Report. Committee effectiveness review. 	<ul style="list-style-type: none"> Update on disguised remuneration legislation. Professional development update on ISS Guidelines and High Pay Commission report. Review of Committee terms of reference. Update on feedback from shareholders.
April 2012 (Following year end)	<ul style="list-style-type: none"> Review of short-term bonus, long-term PSP and share options performance and vesting outturns for 2011/12. Approval of short-term bonus and long-term PSP targets for 2012/13 awards. Review of 2011/12 Directors' Remuneration Report. 	<ul style="list-style-type: none"> Professional development update on BIS consultation.
Number of meetings	<ul style="list-style-type: none"> Normally four meetings per year. Five meetings were held during 2011/12. 	
External advisors	<p>Deloitte LLP</p> <p>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.</p> <p>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.</p>	
Internal advisors	<ul style="list-style-type: none"> Jonathan Lloyd, the Company Secretary, is Secretary to the Committee. Sir David Reid (Non-executive Chairman to 30 November 2011), Sir Richard Broadbent (Non-executive Chairman from 30 November 2011), 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.tescopl.com/plc/ir/corpgov/boardprocess .	

OVERVIEW	STRATEGIC REVIEW	PERFORMANCE REVIEW	GOVERNANCE	FINANCIAL STATEMENTS
Board of Directors	Principal risks and uncertainties	General information	Corporate governance	Directors' remuneration report

Governance Oversight Committee

The Governance Oversight Committee was established following the introduction of the Group New Business Incentive Plan, with a remit to review the allocation of capital across the Group to ensure that it was appropriate and aligned with shareholders' interests. Following a review of the Company's corporate governance structure, the outcomes of which are outlined in more detail in the Corporate Governance report, it was determined that this oversight role would be performed by other Committees.

Compliance

In carrying out its duties, the Remuneration Committee gives full consideration to best practice. The Committee was constituted and operated throughout the period in accordance with the principles outlined in the Listing Rules of the Financial Services Authority derived from the UK Corporate Governance Code. The auditors' report, set out on page 89, covers the disclosures referred to in this report that are specified for review by the Financial Services 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 Services Authority Listing Rules.

This report also complies with disclosures required by the Directors' Remuneration Report Regulations 2002.

Details of Directors' emoluments and interests are set out on pages 80 to 86 of this Report.

Stuart Chambers

Chairman of the Remuneration Committee

Remuneration report

Tables 1-10 are audited information

Table 1 Directors' emoluments

	Fixed emoluments		Performance related emoluments		Total 2011/12 £000	Total 2010/11 £000
	Salary £000	Benefits ² £000	Short-term cash £000	Short-term deferred shares £000		
Executive Directors						
Richard Brasher	845	63	115	115	1,138	2,262
Philip Clarke	1,093	62	–	–	1,155	2,260
Andrew Higginson	845	74	115	115	1,149	2,287
Tim Mason	845	559	115	115	1,634	3,094
Laurie McIlwee	845	62	115	115	1,137	2,206
Lucy Neville-Rolfe	640	81	87	87	895	1,756
David Potts ¹	584	32	86	86	788	2,308
Non-executive Directors						
Sir Richard Broadbent ¹	266	15	–	–	281	–
Gareth Bullock	82	–	–	–	82	52
Patrick Cescau	120	–	–	–	120	109
Stuart Chambers	100	–	–	–	100	64
Karen Cook	82	–	–	–	82	80
Ken Hanna	94	–	–	–	94	92
Ken Hydon	100	–	–	–	100	98
Sir David Reid ¹	501	52	–	–	553	693
Jacqueline Tammenoms Bakker	82	–	–	–	82	76
Total	7,124	1,000	633	633	9,390	17,437

Appointments and retirements

¹ Sir Richard Broadbent was appointed as a Non-executive Director on 2 July 2011 and became Chairman on 30 November 2011. The figures in this table are from 2 July 2011.

Sir David Reid retired on 30 November 2011. The figures in this table include all remuneration paid or earned in the period up to 30 November. Sir Terry Leahy retired on 2 March 2011 after 14 years as CEO. He was paid £80,531 in the 2011/12 year including accrued holiday pay. He did not receive any payments or benefits outside of his normal contractual arrangements.

David Potts stepped down from the Board on 7 December 2011 but will remain employed by the Company until 30 June 2012. The figures in this table include all remuneration paid or earned in the period up to 7 December 2011. In the period between 7 December 2011 and 25 February 2012 he was paid £261,000 and received benefits with a value of £9,000.

David Potts also received a bonus of £58,000 in respect of the period between December 2011 and February 2012 in line with other Directors. He did not receive any payments outside of his normal contractual arrangements.

Benefits

² Benefits are made up of car benefits, chauffeurs, disability and health insurance, staff discount, membership at gyms and leisure clubs and Free Shares awarded under the all employee Share Incentive Plan ("SIP"). Under the SIP, shares in the Company are allocated up to HMRC approved limits (currently £3,000 p.a.) and the amount allocated is determined by the Board. The majority of UK based employees are eligible to participate in the SIP.

Tim Mason's benefits comprise the benefits above and a net expatriate allowance of £282,000 for the year, the gross value of which is £555,000.

Table 2 Directors' pension details

	Age at 25 February 2012	Years of Company service	Total accrued pension at 25 February 2012 £000	Increase in accrued pension during the year £000	Increase in accrued pension (net of inflation) (a) £000	Transfer value of (a) at 25 February 2012 (less Director's contributions) £000	Transfer value of total accrued pension at 26 February 2011 (old basis) £000	Transfer value of total accrued pension at 26 February 2011 (new basis) £000	Transfer value of total accrued pension at 25 February 2012 £000	Increase in transfer value (less Director's contributions) £000
Richard Brasher	50	25	410	26	7	108	5,482	5,122	6,551	1,429
Philip Clarke	51	37	573	158	137	2,332	6,269	5,898	9,727	3,829
Andrew Higginson	54	14	401	37	19	357	6,097	5,852	7,628	1,776
Tim Mason	54	30	477	27	4	83	7,478	7,180	9,005	1,825
Laurie McIlwee	49	11	293	55	43	655	3,253	3,018	4,464	1,446
Lucy Neville-Rolfe	59	15	305	28	14	313	5,334	5,297	6,811	1,514
David Potts	54	39	482	28	4	85	7,735	7,426	9,302	1,876

Pension arrangements

- The accrued pension is that which would be paid annually on retirement at 60 based on service to 25 February 2012.
- Some of the Executive Directors' benefits are payable from an unapproved pension arrangement. This is secured by a fixed and floating charge on a cash deposit.
- Inflation over the year has been allowed for using the September 2011 statutory CPI revaluation order.
- The basis used for calculating transfer values was revised during the year because of the change from RPI to CPI increases in deferment.

Retired Directors

- Sir Terry Leahy retired from the Board on 2 March 2011. At the date of leaving he had an accrued pension of £887,000 p.a. The transfer value at the point of leaving was £20,257,000 based on market conditions at 25 February 2012.
- David Potts stepped down from the Board of Tesco PLC on 7 December 2011. He will retire from Tesco on 30 June 2012.

Table 3 Gains on share options and share options held by Directors and not exercised at 25 February 2012

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

	Date of grant	Options at 26 February 2011	Options exercised in year	Options at 25 February 2012	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
Total		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
Total		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
Total		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	07.05.2013	07.05.2020
Total		1,541,131	–	1,541,131			
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
Total		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
Total		1,039,455	–	1,039,455			
David Potts	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
Total		1,506,656	–	1,506,656			
Total		10,940,221	–	10,940,221			

Executive 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%. EPS growth for the period 2008/9 to 2010/11 exceeded RPI by 23% and therefore the share options awarded in 2008 vested in full on 12 May 2011.
- Executives have until the tenth anniversary of the date of grant to exercise their options.
- No options were granted to Executive Directors under Executive Share Option Plans in 2011/12.
- No Executive Share Options were exercised and no options lapsed in the year.

Market prices of Tesco PLC shares

- The share price as at 25 February 2012 was 318.2p. The share price during the 52 weeks to 25 February 2012 ranged from 312.35p to 420.05p.

Retired Directors

- Sir Terry Leahy retired on 2 March 2011. At 25 February 2012 Sir Terry held options over 3,994,525 shares at option prices of between 312.75p and 473.75p. In accordance with the scheme rules, these options may be exercised until 2 March 2014.
- David Potts stepped down from the Board on 7 December 2011 but will remain employed by the Company until 30 June 2012. The figures for David Potts in this table are at 7 December 2011.

Remuneration report

Table 4 Gains on share options and share options held by Directors and not exercised at 25 February 2012

Savings-related share option scheme (1981)

	Date of grant	As at 26 February 2011	Options granted in year	Options exercised in year	Options lapsed in year	As at 25 February 2012	Exercise price (pence)	Value realisable 2011/12 £000	Value realisable 2010/11 £000
Richard Brasher	08.11.2006	1,066	–	1,066	–	–	307.0	1	–
	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	–	–
		4,698	824	1,066	–	4,456		1	2
Philip Clarke	08.11.2006	1,066	–	1,066	–	–	307.0	1	–
	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	–	–
		4,698	824	1,066	–	4,456		1	2
Andrew Higginson	08.11.2006	1,066	–	1,066	–	–	307.0	1	–
	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	–	–
		4,698	–	1,066	–	3,632		1	2
Tim Mason	08.11.2006	1,066	–	1,066	–	–	307.0	1	–
	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	–	–
		4,698	824	1,066	–	4,456		1	2
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	–	–
			3,632	824	–	–	4,456		–
Lucy Neville-Rolfe	08.11.2006	1,066	–	1,066	–	–	307.0	1	–
	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	–	–
		4,698	824	1,066	–	4,456		1	2
David Potts	08.11.2006	1,066	–	–	–	1,066	307.0	–	–
	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	–	–
		4,698	824	–	–	5,522		–	2
Total		31,820	4,944	5,330	–	31,434		5	12

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).
- All Directors exercised their 2006 options on 1 February 2012 when the market price was 321.45p.

Retired Directors

- No options were granted to Sir Terry Leahy in the year. In line with the plan rules, all of Sir Terry's options under this plan were exercised or lapsed during the year.
- David Potts stepped down from the Board on 7 December 2011 but will remain employed by the Company until 30 June 2012. The figures for David Potts in this table are at 7 December 2011.

OVERVIEW	STRATEGIC REVIEW	PERFORMANCE REVIEW	GOVERNANCE	FINANCIAL STATEMENTS
Board of Directors	Principal risks and uncertainties	General information	Corporate governance	Directors' remuneration report

Table 5 Long Term Performance Share Plan

	Date of award/ grant	Share price on award date (pence)	As at 26 February 2011	Shares awarded/ options granted in year	Shares Exercised Released in year	Shares lapsed	As at 25 February 2012	Date of exercise/ release	Share price on exercise/ release	Value realisable £000	Date of release/date from which exercisable	Expiry date
Richard Brasher	14.11.2007	471.10	220,264	8,957	–	–	229,221	–	–	–	14.07.2010	14.11.2017
	08.07.2008	353.76	364,947	13,650	–	93,756	284,841	–	–	–	08.07.2011	08.07.2018
	15.10.2009	374.00	340,901	13,864	–	–	354,765	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	290,844	11,827	–	–	302,671	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	–	476,767	–	–	476,767	–	–	–	11.07.2014	11.07.2021
Total			1,216,956	525,065	–	93,756	1,648,265					
Philip Clarke	08.07.2008	353.76	364,947	13,650	–	93,756	284,841	–	–	–	08.07.2011	08.07.2018
	15.10.2009	374.00	340,901	13,864	–	–	354,765	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	290,844	11,827	–	–	302,671	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	–	752,331	–	–	752,331	–	–	–	11.07.2014	11.07.2021
Total			996,692	791,672	–	93,756	1,694,608					
Andrew Higginson	08.07.2008	353.76	364,947	13,650	–	93,756	284,841	–	–	–	08.07.2011	08.07.2018
	15.10.2009	374.00	340,901	13,864	–	–	354,765	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	290,844	11,827	–	–	302,671	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	–	476,767	–	–	476,767	–	–	–	11.07.2014	11.07.2021
Total			996,692	516,108	0	93,756	1,419,044					
Tim Mason	08.07.2008	353.76	243,299	6,720	250,019	–	0	11.07.11	411.50	1,029	–	–
	15.10.2009	374.00	227,268	9,243	–	–	236,511	–	–	–	15.07.2012	–
	14.10.2010	433.90	193,896	7,885	–	–	201,781	–	–	–	14.07.2013	–
	11.07.2011	407.19	–	476,767	–	–	476,767	–	–	–	11.07.2014	–
Total			664,463	500,615	250,019	–	915,059			1,029		
Laurie McIlwee	08.07.2008	353.76	66,243	1,646	67,889	–	0	11.07.11	411.50	279	–	–
	15.10.2009	374.00	255,676	10,396	–	–	266,072	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	290,844	11,827	–	–	302,671	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	–	476,767	–	–	476,767	–	–	–	11.07.2014	11.07.2021
Total			612,763	500,636	67,889	–	1,045,510			279		
Lucy Neville-Rolfe	14.11.2007	471.10	144,619	5,880	–	–	150,499	–	–	–	14.07.2010	14.11.2017
	08.07.2008	353.76	255,464	9,554	–	65,629	199,389	–	–	–	08.07.2011	08.07.2018
	15.10.2009	374.00	255,676	10,396	–	–	266,072	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	218,133	8,869	–	–	227,002	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	–	357,575	–	–	357,575	–	–	–	11.07.2014	11.07.2021
Total			873,892	392,274	–	65,629	1,200,537					
David Potts	14.11.2007	471.10	220,264	6,083	226,347	–	0	14.07.11	405.73	918	–	–
	08.07.2008	353.76	364,947	10,079	281,270	93,756	0	14.07.11	405.73	1,141	–	–
	15.10.2009	374.00	340,901	13,864	–	–	354,765	–	–	–	15.07.2012	15.10.2019
	14.10.2010	433.90	290,844	11,827	–	–	302,671	–	–	–	14.07.2013	14.10.2020
	11.07.2011	407.19	–	476,767	–	–	476,767	–	–	–	11.07.2014	11.07.2021
Total			1,216,956	518,620	507,617	93,756	1,134,203			2,059		
Total			6,578,414	3,744,990	825,525	440,653	9,057,226			3,367		

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 since 2006 have been made in the form of unfunded promises to deliver shares. Laurie McIlwee was appointed on 27 January 2009. His 2008 award was made in the form of conditional shares under the senior management Performance Share Plan.
- All 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 return on capital employed targets. For the first 75% of the PSP awards granted on 15 October 2009 the Group ROCE target was 13.3% and the International ROCE target was 7.0%. The Group ROCE for 2011/12 was adjusted down to take account of the discontinued Japanese business. As a result, Group targets for the first 75% of the award were partially met and 69.7% of these awards will vest in July 2012. The Committee considered the quality of ROCE and determined that no exceptional circumstances exist and therefore the remaining 25% discretionary part of the award will vest in line with the level of vesting for the first 75% of the award. The International ROCE for 2011/12 including the discontinued Japanese business did not meet targets and no part of these awards will vest in July 2012. The balance of the awards will lapse.
- For PSP awards granted on 14 October 2010 the Group ROCE targets for the first 75% of the award are 12.5% (25% vesting) to 13.6% (100% vesting). The International ROCE targets for the first 75% are 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.

Retired Directors

- No new awards were made to Sir Terry Leahy in the year. In line with the plan rules, Sir Terry's 2008 award vested in the same proportion as the other Directors' awards above. David Potts stepped down from the Board on 7 December 2011 but will remain employed by the Company until 30 June 2012. The figures for David Potts in this table are at 7 December 2011.

Remuneration report

Table 6 Group New Business Incentive Plan

	Date of award/ grant	As at 27 February 2010	Shares awarded in year	Options exercised/ shares released in year	As at 26 February 2011	Date from which exercisable	Expiry date
Sir Terry Leahy	14.11.2007	2,773,919	112,819	–	2,886,738	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 a nil cost option. 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 CEO, Sir Terry Leahy, retired on 2 March 2011 and his interest in this award will continue until the normal vesting dates.

Performance against targets

- The vesting of the award made to the former Group CEO (Sir Terry Leahy) under this plan is conditional on achievement against Group and International performance conditions. Once performance against the Group and International targets has been determined, the extent to which the award made to the former Group CEO 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 second tranche (2011/12) 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 targets were also not met so no part of this award has vested to date. The next assessment of performance will be in respect of 2012/13. It is currently considered unlikely that any portion of these awards 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%

Table 7 US Long Term Incentive Plan

	Date of award	As at 26 February 2011	Shares awarded in year	Shares lapsed in year	As at 25 February 2012
Tim Mason	14.11.2007	2,219,133	–	2,219,133	–

- The US CEO no longer participates in this plan and his entire award lapsed on 4 July 2011.

Table 8 Executive Incentive Plan

	Date of award/grant	Share price on award (pence)	As at 26 February 2011	Shares awarded/options granted	Shares released/options exercised	As at 25 February 2012	Share price on exercise/release (pence)	Value realisable £000	Date of release/date from which exercisable
Richard Brasher	02.05.2008	424.05	160,442	4,431	164,873	–	408.225	673	02.05.2011
	19.05.2009	351.16	129,325	5,259	–	134,584	–	–	19.05.2012
	22.06.2010	388.05	198,899	8,088	–	206,987	–	–	22.05.2013
	27.05.2011	411.75	–	155,518	–	155,518	–	–	13.05.2014
Total			488,666	173,296	164,873	497,089		673	
Philip Clarke	02.05.2008	424.05	94,659	2,614	97,273	–	408.225	397	02.05.2011
	19.05.2009	351.16	129,325	5,259	–	134,584	–	–	19.05.2012
	22.06.2010	388.05	198,899	8,088	–	206,987	–	–	22.05.2013
	27.05.2011	411.75	–	155,518	–	155,518	–	–	13.05.2014
Total			422,883	171,479	97,273	497,089		397	
Andrew Higginson	02.05.2008	424.05	94,659	2,614	97,273	–	408.225	397	02.05.2011
	19.05.2009	351.16	129,325	5,259	–	134,584	–	–	19.05.2012
	22.06.2010	388.05	198,899	8,088	–	206,987	–	–	22.05.2013
	27.05.2011	411.75	–	155,518	–	155,518	–	–	13.05.2014
Total			422,883	171,479	97,273	497,089		397	
Tim Mason	02.05.2008	424.05	321,632	8,883	330,515	–	408.225	1,349	02.05.2011
	19.05.2009	351.16	266,030	10,819	–	276,849	–	–	19.05.2012
	22.06.2010	388.05	295,356	12,011	–	307,367	–	–	22.05.2013
	27.05.2011	411.75	–	197,979	–	197,979	–	–	13.05.2014
Total			883,018	229,692	330,515	782,195		1,349	
Laurie McIlwee	22.06.2010	388.05	149,174	6,066	–	155,240	–	–	22.05.2013
	27.05.2011	411.75	–	155,518	–	155,518	–	–	13.05.2014
Total			149,174	161,584	–	310,758		–	
Lucy Neville-Rolfe	02.05.2008	424.05	105,343	2,909	108,252	–	408.225	442	02.05.2011
	19.05.2009	351.16	90,526	3,681	–	94,207	–	–	19.05.2012
	22.06.2010	388.05	149,174	6,066	–	155,240	–	–	22.05.2013
	27.05.2011	411.75	–	116,638	–	116,638	–	–	13.05.2014
Total			345,043	129,294	108,252	366,085		442	
David Potts	02.05.2008	424.05	94,659	2,614	97,273	–	408.225	397	02.05.2011
	19.05.2009	351.16	129,325	5,259	–	134,584	–	–	19.05.2012
	22.06.2010	388.05	198,899	8,088	–	206,987	–	–	22.05.2013
	27.05.2011	411.75	–	155,518	–	155,518	–	–	13.05.2014
Total			422,883	171,479	97,273	497,089		397	
Total			3,134,550	1,208,303	895,459	3,447,394		3,655	

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 2008 and 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.

Retired Directors

- Sir Terry Leahy was awarded his 2010/11 bonus in the form of an option over 336,670 shares on 27 May 2011 at a share price of 408.225p per share. In line with the plan rules, his 2008 and 2009 awards were released on 6 May 2011 and his 2010 and 2011 awards were exercised on 27 February 2012.
- David Potts stepped down from the Board on 7 December 2011 but will remain employed by the Company until 30 June 2012. The figures for David Potts in this table are at 7 December 2011.

Remuneration report

Table 9 Directors' interests in the Long Term Incentive Plan

	Award date	Price on award	Number of shares as at 26 February 2011	Shares awarded	Shares released	Number of shares as at 25 February 2012	Share price on release	Value realisable	Release date
Laurie Mcllwee	21.05.08	415.45	39,299	976	40,275	0	408.225	164	06.05.11
	20.05.09	356.05	48,817	1,779	0	50,596	–	–	20.05.12
Total			88,116	2,755	40,275	50,596		164	

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

Table 10 Disclosable interests of the Directors, including family interests

	25 February 2012 (or at date of retirement/resignation if earlier)		26 February 2011 (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	1,258,585	3,501,665	1,220,793	2,906,992
Philip Clarke	1,832,007	4,352,977	1,824,638	3,491,697
Andrew Higginson	707,081	4,076,589	1,349,712	3,491,697
Tim Mason	1,975,704	1,545,587	3,876,520	1,545,829
Laurie Mcllwee	75,506	2,144,448	222,301	1,483,050
Lucy Neville-Rolfe	458,036	2,516,326	452,886	2,067,219
David Potts	1,708,622	3,005,260	1,851,253	2,927,209
Non-executive Directors				
Sir Richard Broadbent	53,996	–	23,847	–
Gareth Bullock	–	–	–	–
Patrick Cescau	18,340	–	–	–
Stuart Chambers	5,500	–	5,500	–
Karen Cook	–	–	–	–
Ken Hanna	25,000	–	–	–
Ken Hydon	60,093	–	30,093	–
Sir David Reid	194,554	–	194,337	–
Jacqueline Tammenoms Bakker	16,472	–	–	–
Total	8,389,496	21,142,852	11,051,880	17,913,693

Ordinary shares

1 Ordinary shares shown in this table include conditional shares held by Laurie Mcllwee and shares held under a promise by 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 8 which are subject to a holding period, shares held by Laurie Mcllwee under the Long Term Incentive Plan shown in Table 9 which are subject to a holding period and shares held under the all-employee Share Incentive Plan which are subject to a holding period.

Between 25 February 2012 and 1 May 2012, 445 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. In addition, Stuart Chambers purchased 19,500 ordinary shares on 24 April 2012 at a price of 321.35p per share. 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 Executive Share Option schemes and 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 8 respectively.

Retired Directors

- Sir Terry Leahy retired on 2 March 2011. At this date he held 7,075,849 ordinary shares and options over 9,353,645 shares.
- David Potts stepped down from the Board on 7 December 2011 but will remain employed by the Company until 30 June 2012. The figures for David Potts in this table are at 7 December 2011.

Financial statements

IN THIS SECTION

88	Statement of Directors' responsibilities
89	Independent auditors' report to the members of Tesco PLC
90	Group income statement
91	Group statement of comprehensive income
92	Group balance sheet
93	Group statement of changes in equity
94	Group cash flow statement
94	Reconciliation of net cash flow to movement in net debt note
95	Notes to the Group financial statements
142	Tesco PLC – Parent Company balance sheet
143	Notes to the Parent Company financial statements
151	Independent auditors' report to the members of Tesco PLC
152	Five year record
IBC	Financial calendar
IBC	Glossary

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

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

The Directors are responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the 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 Business Review contained within this document includes a fair review of the business and important events impacting it, as well as a description of the principal risks and uncertainties faced by the business.

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

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

Independent auditors' report to the members of Tesco PLC

We have audited the Group financial statements of Tesco PLC for the 52 weeks ended 25 February 2012 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 88, 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 25 February 2012 and of its profit and cash flows for the 52 weeks 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 Directors' Report for the 52 weeks ended 25 February 2012 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 49, 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 52 weeks ended 25 February 2012 and on the information in the Directors' Remuneration Report that is described as having been audited.

Richard Winter (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
4 May 2012

Group income statement

Year ended 25 February 2012	notes	52 weeks 2012 £m	52 weeks 2011* £m
Continuing operations			
Revenue	2	64,539	60,455
Cost of sales		(59,278)	(55,330)
Gross profit		5,261	5,125
Administrative expenses		(1,652)	(1,640)
Profits/losses arising on property-related items		376	432
Operating profit		3,985	3,917
Share of post-tax profits of joint ventures and associates	13	91	57
Finance income	5	176	150
Finance costs	5	(417)	(483)
Profit before tax	3	3,835	3,641
Taxation	6	(879)	(864)
Profit for the year from continuing operations		2,956	2,777
Discontinued operations			
Loss for the year from discontinued operations	7	(142)	(106)
Profit for the year		2,814	2,671
Attributable to:			
Owners of the parent		2,806	2,655
Non-controlling interests		8	16
		2,814	2,671
Earnings per share from continuing and discontinued operations			
Basic	9	34.98p	33.10p
Diluted	9	34.88p	32.94p
Earnings per share from continuing operations			
Basic	9	36.75p	34.43p
Diluted	9	36.64p	34.25p

Non-GAAP measure: underlying profit before tax

	notes	52 weeks 2012 £m	52 weeks 2011* £m
Profit before tax from continuing operations		3,835	3,641
Adjustments for:			
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	1/5	(44)	(19)
IAS 19 'Employee Benefits' – non-cash Group Income Statement charge for pensions	1	17	113
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	1	38	48
IFRS 3 'Business Combinations' – intangible asset amortisation charges and costs arising from acquisitions	1	22	42
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	1	17	8
Restructuring and other one-off costs	1	30	20
Underlying profit before tax from continuing operations	1	3,915	3,853

* See Note 1 Accounting policies for details of reclassifications.

The notes on pages 95 to 141 form part of these financial statements.

Group statement of comprehensive income

Year ended 25 February 2012	notes	52 weeks 2012 £m	52 weeks 2011 £m
Change in fair value of available-for-sale financial assets and investments		13	2
Currency translation differences		(22)	(344)
Actuarial (losses)/gains on defined benefit pension schemes	26	(498)	595
Gains/(losses) on cash flow hedges:			
Net fair value gains/(losses)		241	(22)
Reclassified and reported in the Group Income Statement		(142)	8
Tax relating to components of other comprehensive income for the year	6	73	(153)
Total other comprehensive income for the year		(335)	86
Profit for the year		2,814	2,671
Total comprehensive income for the year		2,479	2,757
Attributable to:			
Owners of the parent		2,466	2,746
Non-controlling interests		13	11
		2,479	2,757
Total comprehensive income attributable to equity shareholders arises from:			
Continuing operations		2,607	2,851
Discontinued operations		(141)	(105)
		2,466	2,746

The notes on pages 95 to 141 form part of these financial statements.

Group balance sheet

	notes	25 February 2012 £m	26 February 2011* £m
Non-current assets			
Goodwill and other intangible assets	10	4,618	4,338
Property, plant and equipment	11	25,710	24,398
Investment property	12	1,991	1,863
Investments in joint ventures and associates	13	423	316
Other investments	14	1,526	938
Loans and advances to customers	17	1,901	2,127
Derivative financial instruments	21	1,726	1,139
Deferred tax assets	6	23	48
		37,918	35,167
Current assets			
Inventories	15	3,598	3,162
Trade and other receivables	16	2,657	2,330
Loans and advances to customers	17	2,502	2,514
Derivative financial instruments	21	41	148
Current tax assets		7	4
Short-term investments		1,243	1,022
Cash and cash equivalents	18	2,305	2,428
		12,353	11,608
Assets of the disposal group and non-current assets classified as held for sale	7	510	431
		12,863	12,039
Current liabilities			
Trade and other payables	19	(11,234)	(10,484)
Financial liabilities:			
Borrowings	20	(1,838)	(1,386)
Derivative financial instruments and other liabilities	21	(128)	(255)
Customer deposits and deposits by banks	23	(5,465)	(5,110)
Current tax liabilities		(416)	(432)
Provisions	24	(99)	(64)
		(19,180)	(17,731)
Liabilities of the disposal group classified as held for sale	7	(69)	–
Net current liabilities		(6,386)	(5,692)
Non-current liabilities			
Financial liabilities:			
Borrowings	20	(9,911)	(9,689)
Derivative financial instruments and other liabilities	21	(688)	(600)
Post-employment benefit obligations	26	(1,872)	(1,356)
Deferred tax liabilities	6	(1,160)	(1,094)
Provisions	24	(100)	(113)
		(13,731)	(12,852)
Net assets		17,801	16,623
Equity			
Share capital	27	402	402
Share premium		4,964	4,896
Other reserves		40	40
Retained earnings		12,369	11,197
Equity attributable to owners of the parent		17,775	16,535
Non-controlling interests		26	88
Total equity		17,801	16,623

* See Note 1 Accounting policies for details of reclassifications.

The notes on pages 95 to 141 form part of these financial statements.

Philip Clarke
Laurie McIlwee

Directors

The financial statements on pages 90 to 141 were authorised for issue by the Directors on 4 May 2012 and are subject to the approval of the shareholders at the Annual General Meeting on 29 June 2012.

Group statement of changes in equity

	Retained earnings									Non-controlling interests £m	Total equity £m
	Issued share capital £m	Share premium £m	Other reserves £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Treasury shares £m	Retained earnings £m	Total £m		
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

	Retained earnings									Non-controlling interests £m	Total equity £m
	Issued share capital £m	Share premium £m	Other reserves £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Treasury shares £m	Retained earnings £m	Total £m		
At 27 February 2010	399	4,801	40	13	12	463	(180)	9,048	14,596	85	14,681
Profit for the year	–	–	–	–	–	–	–	2,655	2,655	16	2,671
Other comprehensive income											
Change in fair value of available-for-sale financial assets and investments	–	–	–	–	–	–	–	2	2	–	2
Currency translation differences	–	–	–	–	–	(339)	–	–	(339)	(5)	(344)
Actuarial gains on defined benefit pension schemes	–	–	–	–	–	–	–	595	595	–	595
Losses on cash flow hedges	–	–	–	–	(14)	–	–	–	(14)	–	(14)
Tax relating to components of other comprehensive income	–	–	–	–	1	31	–	(185)	(153)	–	(153)
Total other comprehensive income	–	–	–	–	(13)	(308)	–	412	91	(5)	86
Total comprehensive income	–	–	–	–	(13)	(308)	–	3,067	2,746	11	2,757
Transactions with owners											
Purchase of treasury shares	–	–	–	–	–	–	(50)	–	(50)	–	(50)
Share-based payments	–	–	–	–	–	–	89	131	220	–	220
Issue of shares	3	95	–	–	–	–	–	–	98	–	98
Purchase of non-controlling interests	–	–	–	–	–	–	–	6	6	(6)	–
Dividends paid to non-controlling interests	–	–	–	–	–	–	–	–	–	(2)	(2)
Dividends authorised in the year	–	–	–	–	–	–	–	(1,081)	(1,081)	–	(1,081)
Total transactions with owners	3	95	–	–	–	–	39	(944)	(807)	(8)	(815)
At 26 February 2011	402	4,896	40	13	(1)	155	(141)	11,171	16,535	88	16,623

The notes on pages 95 to 141 form part of these financial statements.

Group cash flow statement

Year ended 25 February 2012	notes	52 weeks 2012 £m	52 weeks 2011* £m
Cash flows from operating activities			
Cash generated from operations	29	5,688	5,613
Interest paid		(531)	(614)
Corporation tax paid		(749)	(760)
Net cash generated from operating activities		4,408	4,239
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired		(65)	(89)
Proceeds from sale of property, plant and equipment, investment property and non-current assets classified as held for sale		1,141	1,906
Purchase of property, plant and equipment and investment property		(3,374)	(3,178)
Proceeds from sale of intangible assets		–	3
Purchase of intangible assets		(334)	(373)
Net decrease/(increase) in loans to joint ventures		122	(194)
Investments in joint ventures and associates		(49)	(174)
Investments in short-term and other investments		(1,972)	(683)
Proceeds from sale of short-term and other investments		1,205	719
Dividends received from joint ventures and associates		40	62
Interest received		103	128
Net cash used in investing activities		(3,183)	(1,873)
Cash flows from financing activities			
Proceeds from issue of ordinary share capital		69	98
Increase in borrowings		2,905	2,217
Repayment of borrowings		(2,720)	(4,153)
Repayment of obligations under finance leases		(45)	(42)
Purchase of non-controlling interests		(89)	–
Dividends paid to equity owners		(1,180)	(1,081)
Dividends paid to non-controlling interests		(3)	(2)
Own shares purchased		(303)	(31)
Net cash used in financing activities		(1,366)	(2,994)
Net decrease in cash and cash equivalents		(141)	(628)
Cash and cash equivalents at beginning of the year		2,428	3,102
Effect of foreign exchange rate changes		24	(46)
Cash and cash equivalents including cash held in disposal group at the end of the year		2,311	2,428
Cash held in disposal group		(6)	–
Cash and cash equivalents at the end of the year	18	2,305	2,428

Reconciliation of net cash flow to movement in net debt note

Year ended 25 February 2012	note	52 weeks 2012 £m	52 weeks 2011* £m
Net decrease in cash and cash equivalents		(141)	(628)
Elimination of net decrease/(increase) in Tesco Bank cash and cash equivalents		126	(219)
Investment in Tesco Bank		(112)	(446)
Debt acquired on acquisition		(98)	(17)
Net cash outflow to repay Retail debt and lease financing		262	2,870
Dividend received from Tesco Bank		100	150
Increase/(decrease) in Retail short-term investments		221	(292)
(Decrease)/increase in Retail joint venture loan receivables		(122)	159
Other non-cash movements		(330)	(480)
Elimination of other Tesco Bank non-cash movements		46	42
(Increase)/decrease in net debt for the year		(48)	1,139
Opening net debt	30	(6,790)	(7,929)
Closing net debt	30	(6,838)	(6,790)

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.

* See Note 1 Accounting policies for details of reclassifications.

The notes on pages 95 to 141 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 25 February 2012 (prior financial year 52 weeks ended 26 February 2011). For the UK, the Republic of Ireland and the US, the results are for the 52 weeks ended 25 February 2012 (prior financial year 52 weeks ended 26 February 2011). For all other operations, the results are for the calendar year ended 29 February 2012 (year ended 28 February 2011).

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 Japan which is consistent with the Group's long-term strategic priority to drive growth and improve returns by focusing on its larger businesses in the region. 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 business are presented separately in the Group Balance Sheet. See Note 7 for further details.

Cash and cash equivalents reclassification

During the financial year, the Group identified certain assets held by Tesco Bank that had a maturity profile of less than three months that would be more appropriately classified as cash and cash equivalents in accordance with IAS 7 'Statement of Cash Flows'. The assets identified comprised loans and advances to banks, certificates of deposit (included within other investments) and other receivables. The amounts relating to these balances have accordingly been reclassified in the Group Balance Sheet and the Group Cash Flow Statement as cash and cash equivalents. The impact of these reclassifications, with no change to net assets, is to:

- increase cash and cash equivalents by £558m and £283m at 26 February 2011 and 27 February 2010 respectively;
- decrease other investments by £170m and £165m at 26 February 2011 and 27 February 2010 respectively, such that other investments were £698m at 27 February 2010;
- decrease loans and advances to banks by £404m and £144m at 26 February 2011 and 27 February 2010 respectively, such that loans and advances to banks were £nil at 27 February 2010;
- increase trade and other receivables by £16m and £26m at 26 February 2011 and 27 February 2010 respectively, such that trade and other receivables were £1,914m at 27 February 2010; and
- increase cash flows from operating activities by £270m and increase net cash used in investing activities by £5m for the 52 weeks ended 26 February 2011.

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.

Notes to the Group financial statements

Note 1 Accounting policies continued

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 a provision for potential customer redress. In the prior year, the Financial Services Authority ('FSA') formally issued Policy Statement 10/12 ('PS 10/12'), which introduced new guidance in respect of Payment Protection Insurance ('PPI') customer redress and evidential provisions to the FSA Handbook with an implementation date of 1 December 2010. The Group will continue 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 this provision 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 variable in this calculation could have the potential to significantly impact the provision recognised.

Insurance reserves

The Group recognises insurance commission arising from the sale of general insurance policies sold under the Tesco brand. The level of commission is dependent upon the profitability of the underlying insurance policies, which is in turn dependent on the level of reserves held by the insurance trading partner to underwrite the policies in place. Calculation of the required level of insurance claims reserves is dependent on a detailed actuarial review. Management also undertakes an assessment of other risks which are outside the scope of this review but that are inherent in assessing potential claims liabilities including court/legal rulings on individual large losses, the extent to which claims developments impact the reinsurance protection in place and the proportion of claims settling with periodic payment orders. A change in the estimate of any of the key variables in this calculation could have the potential to significantly impact the reserve balance recognised which would therefore also impact the insurance commission revenue recognised in the income statement. The nature of these factors is such that it is not possible at this time to quantify the uncertainty around the eventual cost.

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 new International Financial Reporting Standards

The Group has adopted the following amended standards and interpretations as of 27 February 2011.

- IAS 24 (amended) 'Related party disclosures'
- IFRIC 14 (amended) 'Prepayments of a minimum funding requirement'
- IFRIC 19 'Extinguishing financial liabilities with equity instruments'

The Group has adopted all amendments published in 'Improvements to IFRSs' issued in May 2010. The adoption of the above standards, interpretations and amendments has not had any significant impact on the amounts reported in the Group financial statements but may impact the accounting 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 (such as credit card interchange, late payment, balance transfer fees 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.

Note 1 Accounting policies continued

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.

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.

Notes to the Group financial statements

Note 1 Accounting policies continued

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.

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 Other Comprehensive Income or directly in the Group Statement of Changes in Equity, in which case it is recognised in the Group Statement of Other 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.

Note 1 Accounting policies continued

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

Financial instruments

Financial assets and financial liabilities are recognised on the Group 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.

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.

Notes to the Group financial statements

Note 1 Accounting policies continued

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.

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.

Other recent accounting developments

As of the date of authorisation of these financial statements, the following standards were in issue but not yet effective and not yet been endorsed by the EU. 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 the 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.
- 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 2013. 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 2013. 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 2013. 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 2013. 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 2013. It includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11.
- 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 statement of financial position while the IFRS 7 amendment will require more extensive disclosures than are required under IFRS.

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

The Directors believe that underlying profit before tax and underlying diluted earnings per share measures provide additional useful information for shareholders on underlying trends and performance. These measures are used for 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.

Note 1 Accounting policies continued

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.
- 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.
- IAS 36 'Impairment of Intangibles' – impairment of goodwill arising on acquisitions. The remaining carrying value of goodwill relating to Japan was not fully recoverable and was fully impaired during the prior financial year. The resulting non-cash charge does not reflect the underlying performance of the Group.
- 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 financial year, the Group announced its decision to sell its operations in Japan (previously reported as part of the Asia 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;
 - Europe – Czech Republic, Hungary, Poland, Republic of Ireland, Slovakia, Turkey; and
 - the United States of America ('US')
- 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 25 February 2012 At constant exchange rates*	UK £m	Asia £m	Europe £m	US £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)	47,355	11,615	11,380	660	1,044	72,054	(19)	72,035
Revenue (excluding IFRIC 13)	42,798	10,816	9,878	652	1,044	65,188	(22)	65,166
Effect of IFRIC 13	(550)	(35)	(39)	(2)	–	(626)	(1)	(627)
Revenue	42,248	10,781	9,839	650	1,044	64,562	(23)	64,539
Trading profit/(loss)	2,480	735	525	(158)	168	3,750	11	3,761
Trading margin†	5.8%	6.8%	5.3%	(24.2%)	16.1%	5.8%		5.8%

Year ended 25 February 2012 At actual exchange rates**	UK £m	Asia £m	Europe £m	US £m	Tesco Bank £m	Total at actual exchange £m
Continuing operations						
Sales including VAT (excluding IFRIC 13)	47,355	11,627	11,371	638	1,044	72,035
Revenue (excluding IFRIC 13)	42,798	10,828	9,866	630	1,044	65,166
Effect of IFRIC 13	(550)	(35)	(40)	(2)	–	(627)
Revenue	42,248	10,793	9,826	628	1,044	64,539
Trading profit/(loss)	2,480	737	529	(153)	168	3,761
Trading margin†	5.8%	6.8%	5.4%	(24.3%)	16.1%	5.8%

* 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 26 February 2011* At actual exchange rates**	UK £m	Asia £m	Europe £m	US £m	Tesco Bank £m	Total at actual exchange £m
Continuing operations						
Sales including VAT (excluding IFRIC 13)	44,571	10,524	10,558	502	919	67,074
Revenue (excluding IFRIC 13)	40,766	9,802	9,192	495	919	61,174
Effect of IFRIC 13	(649)	(37)	(33)	–	–	(719)
Revenue	40,117	9,765	9,159	495	919	60,455
Trading profit/(loss)	2,504	605	527	(186)	264	3,714
Trading margin†	6.1%	6.2%	5.7%	(37.6%)	28.7%	6.1%

Reconciliation of trading profit to profit before tax

	2012 £m	2011* £m
Trading profit	3,761	3,714
Adjustments:		
Profit/losses arising on property-related items	376	432
IAS 19 'Employee Benefits' – non-cash Group Income Statement charge for pensions	(35)	(95)
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	(48)	(64)
IFRS 3 'Business Combinations' – intangible asset amortisation charges and costs arising from acquisitions	(22)	(42)
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	(17)	(8)
Restructuring and other one-off costs	(30)	(20)
Operating profit	3,985	3,917
Share of post-tax profits from joint ventures and associates	91	57
Finance income	176	150
Finance costs	(417)	(483)
Profit before tax	3,835	3,641
Taxation	(879)	(864)
Profit for the year from continuing operations	2,956	2,777

Segment assets

At 25 February 2012	UK £m	Asia £m	Europe £m	US £m	Tesco Bank £m	Other/ unallocated £m	Total continuing operations	Discontinued operations	Total £m
Total segment non-current assets	14,978	8,471	6,835	1,086	4,799	1,749	37,918	–	37,918
Total segment non-current assets includes:									
Investments in joint ventures and associates	134	217	–	–	72	–	423	–	423
At 26 February 2011*									
Total segment non-current assets	14,456	7,557	6,601	945	4,340	1,187	35,086	81	35,167
Total segment non-current assets includes:									
Investments in joint ventures and associates	79	173	–	–	64	–	316	–	316

* See Note 1 Accounting policies for details of reclassifications.

** 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 25 February 2012	UK £m	Asia £m	Europe £m	US £m	Tesco Bank £m	Total continuing operations	Discontinued operations	Total £m
Capital expenditure (including acquisitions through business combinations):								
Property, plant and equipment	1,495	1,140	663	143	22	3,463	4	3,467
Investment property	–	8	102	–	–	110	–	110
Goodwill and other intangible assets	179	29	68	22	143	441	–	441
Depreciation:								
Property, plant and equipment	(617)	(306)	(277)	(45)	(16)	(1,261)	(4)	(1,265)
Investment property	–	(15)	(24)	–	–	(39)	–	(39)
Amortisation of intangible assets	(113)	(12)	(22)	–	(44)	(191)	(3)	(194)
Impairment losses	(27)	(5)	(3)	(9)	–	(44)	(77)	(121)
Reversal of prior year impairment losses	27	1	8	–	–	36	–	36

Year ended 26 February 2011*	UK £m	Asia £m	Europe £m	US £m	Tesco Bank £m	Total continuing operations	Discontinued operations	Total £m
Capital expenditure (including acquisitions through business combinations):								
Property, plant and equipment	1,486	958	603	192	62	3,301	19	3,320
Investment property	–	17	7	–	–	24	–	24
Goodwill and other intangible assets	159	26	23	82	163	453	2	455
Depreciation:								
Property, plant and equipment	(607)	(265)	(263)	(40)	(11)	(1,186)	(8)	(1,194)
Investment property	–	(17)	(14)	–	–	(31)	–	(31)
Amortisation of intangible assets	(109)	(13)	(22)	–	(47)	(191)	(4)	(195)
Goodwill impairment losses	–	–	–	–	–	–	(55)	(55)
Impairment losses	(14)	–	(3)	(8)	–	(25)	–	(25)
Reversal of prior year impairment losses	14	13	11	–	–	38	–	38

* See Note 1 Accounting policies for details of reclassifications.

Note 3 Income and expenses

Continuing operations	2012 £m	2011* £m
Profit before tax is stated after charging/(crediting) the following:		
Rental income, of which £499m (2011: £417m) relates to investment properties	(605)	(541)
Direct operating expenses arising on rental earning investment properties	157	122
Costs of inventories recognised as an expense	48,910	45,529
Stock losses	1,155	1,023
Depreciation, amortisation and impairment charged	1,499	1,395
Operating lease expense, of which £133m (2011: £53m) relates to hire of plant and machinery	1,247	1,033

* See Note 1 Accounting policies for details of reclassifications.

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:

	2012 £m	2011* £m
Audit services		
Fees payable to the Company's auditor for the audit of the Company and Group financial statements	0.7	0.6
The audit of the accounts of the Company's subsidiaries pursuant to legislation	3.9	3.6
	4.6	4.2
Non-audit services		
Fees payable to the Company's auditor and network firms for other services:		
Other services pursuant to legislation	–	0.1
Other services relating to taxation	0.6	0.7
Other services relating to information technology	0.4	0.3
All other services	1.5	0.6
Total auditor remuneration	7.1	5.9

In addition to the amounts shown above, the auditors received fees of £0.1m (2011: £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 58 and includes how objectivity and independence is safeguarded when non-audit services are provided by PricewaterhouseCoopers LLP.

* See Note 1 Accounting policies for details of reclassifications.

Note 4 Employment costs, including Directors' remuneration

	2012 £m	2011* £m
Continuing operations		
Wages and salaries	5,719	5,409
Social security costs	473	464
Post-employment defined benefits (Note 26)	492	528
Post-employment defined contributions (Note 26)	20	14
Share-based payments expense (Note 25)	153	287
	6,857	6,702

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

	Average number of employees		Average number of full-time equivalents	
	2012	2011*	2012	2011*
UK	300,373	293,676	205,852	200,966
Asia	117,015	99,704	108,149	94,141
Europe	94,409	89,559	85,071	82,270
US	5,056	4,134	4,297	3,448
Tesco Bank	2,818	1,274	2,719	1,224
Total	519,671	488,347	406,088	382,049

* See Note 1 Accounting policies for details of reclassifications.

Notes to the Group financial statements

Note 5 Finance income and costs

	2012 £m	2011 £m
Continuing operations		
Finance income		
Bank interest receivable and similar income on cash and cash equivalents	114	131
Net pension finance income (Note 26)	18	–
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	44	19
Total finance income	176	150
Finance costs		
Interest payable on short-term bank loans and overdrafts repayable within five years	(62)	(101)
Finance charges payable under finance leases and hire purchase contracts	(11)	(10)
GBP MTN	(226)	(233)
EUR MTN	(180)	(194)
USD MTN	(67)	(57)
Other MTNs	(11)	(17)
Capitalised interest (Note 11)	140	147
Total finance costs	(417)	(465)
Net pension finance cost (Note 26)	–	(18)
Total finance costs	(417)	(483)

GBP MTNs

Interest payable on the 4% RPI GBP MTN 2016 includes £13m (2011: £12m) of Retail Price Index (RPI) related amortisation.

Interest payable on the 3.322% LPI GBP MTN 2025 includes £13m (2011: £10m) of RPI related amortisation.

Interest payable on the 1.982% RPI GBP MTN 2036 includes £11m (2011: £11m) of RPI related amortisation.

Note 6 Taxation

Recognised in the Group Income Statement

	2012 £m	2011 £m
Continuing operations		
Current tax expense		
UK corporation tax	579	694
Foreign tax	196	181
Adjustments in respect of prior years	(42)	(114)
	733	761
Deferred tax expense		
Origination and reversal of temporary differences	230	148
Adjustments in respect of prior years	(12)	12
Change in tax rate	(72)	(57)
	146	103
Total income tax expense	879	864

The Finance Act 2011 included legislation to reduce the main rate of corporation tax from 27% to 26% from 1 April 2011 and to 25% from 1 April 2012. The reduction from 27% to 25% was substantively enacted at the balance sheet date and has therefore been reflected in these Group financial statements.

In addition to the changes in rates of corporation tax disclosed above, a number of further changes to the UK corporation tax system were announced in both the March 2011 and March 2012 UK Budget Statements. A resolution passed by Parliament on 26 March 2012 reduced the main rate of corporation tax to 24% from 1 April 2012. Legislation to reduce the main rate of corporation tax from 24% to 23% from 1 April 2013 is expected to be included in the Finance Act 2012. Further reductions to the main rate are proposed to reduce the rate to 22% by 1 April 2014. None of these expected rate reductions had been substantively enacted at the balance sheet date and are therefore not reflected in these Group financial statements.

The effect of the changes enacted by Parliament on 26 March 2012 to reduce the corporation tax rate from 25% to 24%, with effect from 1 April 2012, is to reduce the deferred tax liability provided at the balance sheet date by £35m (£53m increase in profit and £18m decrease in other comprehensive income).

The proposed reductions of the main rate of corporation tax by 1% per annum to 22% by 1 April 2014 are expected to be enacted separately each year. The overall effect of the further changes from 24% to 22%, if these applied to the deferred tax balance at the balance sheet date, would be to reduce the deferred tax liability by £70m (being £35m recognised in 2013 and £35m recognised in 2014).

Note 6 Taxation continued**Reconciliation of effective tax charge**

	2012 £m	2011* £m
Profit before tax	3,835	3,641
Tax charge at 26.2% (2011: 28.0%)	(1,005)	(1,019)
Effect of:		
Non-deductible expenses	(86)	(107)
Differences in overseas taxation rates	72	99
Adjustments in respect of prior years	54	102
Share of profits of joint ventures and associates	14	4
Change in tax rate	72	57
Total income tax charge for the year	(879)	(864)
Effective tax rate	22.9%	23.7%

* See Note 1 Accounting Policies for details of reclassifications.

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

	2012 £m	2011 £m
Current tax (charge)/credit on:		
Share-based payments	(1)	7
Deferred tax charge on:		
Share-based payments	(5)	(7)
Total tax on items charged to Group Statement of Changes in Equity	(6)	–

Tax relating to components of the Group Statement of Comprehensive Income

	2012 £m	2011 £m
Current tax credit/(charge) on:		
Foreign exchange movements	6	31
Fair value of movement on available-for-sale investments	(2)	(1)
Deferred tax credit/(charge) on:		
Pensions	94	(184)
Fair value movements on cash flow hedges	(25)	1
Total tax on items credited/(charged) to Group Statement of Comprehensive Income	73	(153)

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 27 February 2010	(1,496)	511	56	91	41	36	4	(757)
(Charge)/credit to the Group Income Statement	(101)	35	(2)	5	(10)	(33)	3	(103)
Charge to Group Statement of Changes in Equity	–	–	(7)	–	–	–	–	(7)
(Charge)/credit to Group Statement of Comprehensive Income	–	(184)	–	–	–	1	–	(183)
Foreign exchange and other movements	5	–	–	(2)	1	–	–	4
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)

* Property-related items include deferred tax liability on rolled over gains of £361m (2011: £335m) and deferred tax assets on capital losses of £71m (2011: £70m). The remaining balance relates to accelerated tax depreciation.

Notes to the Group financial statements

Note 6 Taxation continued

Certain deferred tax assets and liabilities have been offset and analysed as follows:

	2012 £m	2011 £m
Deferred tax assets	23	48
Deferred tax liabilities	(1,160)	(1,094)
	(1,137)	(1,046)

No deferred tax is recognised on unremitted earnings of overseas subsidiaries and joint ventures, on the grounds that 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 temporary difference unrecognised at the year end amounted to £3.4bn (2011: £3.0bn). The deferred tax on unremitted earnings at 25 February 2012 is estimated to be £161m (2011: £90m) 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):

	2012 £m	2011 £m
Deductible temporary differences	29	19
Tax losses	484	403
	513	422

As at 25 February 2012, the Group has unused trading tax losses from continuing operations of £1,523m (2011: £1,309m) available for offset against future profits. A deferred tax asset has been recognised in respect of £110m (2011: £109m) of such losses. No deferred tax asset has been recognised in respect of the remaining £1,413m (2011: £1,200m) due to the unpredictability of future profit streams. Included in unrecognised tax losses are losses of £479m that will expire in 2016 (2011: £390m in 2015) and £879m that will expire between 2017 and 2032 (2011: £744m between 2016 and 2031). Other losses will be carried forward indefinitely.

Note 7 Discontinued operations and non-current assets classified as held for sale

	25 February 2012 £m	26 February 2011 £m
Assets of the disposal group	65	–
Non-current assets classified as held for sale	445	431
Total assets of the disposal group and non-current assets classified as held for sale	510	431
Total liabilities of the disposal group	(69)	–
Total net assets classified as held for sale	441	431

The non-current assets held for sale consist mainly of properties in the UK and Thailand due to be sold within one year.

Discontinued operations

The tables below show the results of the discontinued operations in relation to the Group's decision to sell its operations in Japan which are included in the Group Income Statement, Group Balance Sheet and Group Cash Flow Statement respectively.

	52 weeks ended 25 February 2012 £m	52 weeks ended 26 February 2011 £m
Revenue	436	476
Cost of sales*	(539)	(541)
Administrative expenses	(23)	(36)
Loss arising on property related items	(1)	(5)
Finance costs	(1)	–
Loss before tax on discontinued operations	(128)	(106)
Taxation	(14)	–
Loss for the year from discontinued operations	(142)	(106)
Loss per share impact from discontinued operations		
Basic	(1.77p)	(1.33p)
Diluted	(1.76p)	(1.31p)

* Including operating lease expense of £27m (2011: £32m).

Note 7 Discontinued operations and non-current assets classified as held for sale continued

	52 weeks ended 25 February 2012 £m	52 weeks ended 26 February 2011 £m
Non-GAAP measure: underlying loss before tax		
Loss before tax on discontinued operations	(128)	(106)
Adjustments for:		
Restructuring and other one-off costs		
Restructuring costs	23	9
Store impairment cost relating to fair value of assets of the disposal group	57	–
Intangible asset impairment cost relating to fair value of assets of the disposal group	20	–
	100	9
IAS 36 'Impairments of Assets' – impairment of goodwill arising on acquisitions	–	55
Underlying loss before tax on discontinued operations	(28)	(42)

Balance Sheet

	25 February 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 amount to £113m.

Cash Flow Statement

	52 weeks ended 25 February 2012 £m	52 weeks ended 26 February 2011 £m
Net cash flows from operating activities	(53)	(50)
Net cash flows from investing activities	6	(27)
Net cash flows from financing activities	46	73
Net cash flows from discontinued operations	(1)	(4)

Note 8 Dividends

	2012		2011	
	pence/share	£m	pence/share	£m
Amounts recognised as distributions to owners in the financial year:				
Final dividend for the prior financial year	10.09	811	9.16	730
Interim dividend for the current financial year	4.63	369	4.37	351
	14.72	1,180	13.53	1,081
Proposed final dividend for the current financial year	10.13	815	10.09	812

The proposed final dividend was approved by the Board of Directors on 17 April 2012 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 25 February 2012, in accordance with IAS 10 'Events After the Balance Sheet Date'. It will be paid on 6 July 2012 to shareholders who are on the Register of members at close of business on 27 April 2012.

Notes to the Group financial statements

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.

	2012			2011		
	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
Profit/(loss) (£m)						
Continuing operations	2,948	–	2,948	2,761	–	2,761
Discontinued operations	(142)	–	(142)	(106)	–	(106)
Weighted average number of shares (millions)	8,021	24	8,045	8,020	41	8,061
Earnings per share (pence)						
Continuing operations	36.75	(0.11)	36.64	34.43	(0.18)	34.25
Discontinued operations	(1.77)	0.01	(1.76)	(1.33)	0.02	(1.31)
Total	34.98	(0.10)	34.88	33.10	(0.16)	32.94

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

	2012		2011*	
	£m	pence/share	£m	pence/share
Profit from continuing operations (Diluted)	2,948	36.64	2,761	34.25
Adjustments for:				
IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements	(44)	(0.54)	(19)	(0.24)
IAS 19 'Employee Benefits' – non-cash Group Income Statement charge for pensions	17	0.21	113	1.40
IAS 17 'Leases' – impact of annual uplifts in rent and rent-free periods	38	0.47	48	0.60
IFRS 3 'Business Combinations' – intangible asset amortisation charges and costs arising from acquisitions	22	0.27	42	0.52
IFRIC 13 'Customer Loyalty Programmes' – fair value of awards	17	0.21	8	0.10
Restructuring and other one-off costs	30	0.37	20	0.25
Tax effect of adjustments at the effective rate of tax** (2012: 22.9%, 2011: 23.7%)	(18)	(0.22)	(50)	(0.62)
Underlying earnings from continuing operations	3,010	37.41	2,923	36.26

* See Note 1 Accounting policies for details of reclassifications.

** The effective tax rate of 22.9% (2011: 23.7%) excludes certain permanent differences on which tax relief is not available.

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 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
Net carrying value					
At 25 February 2012	677	386	106	3,449	4,618
At 26 February 2011	628	275	119	3,316	4,338
Cost					
At 27 February 2010	1,133	368	335	3,566	5,402
Foreign currency translation	–	(5)	(2)	(48)	(55)
Additions	243	128	2	82	455
Reclassification	(74)	74	7	–	7
Disposals	(2)	(2)	–	–	(4)
At 26 February 2011	1,300	563	342	3,600	5,805
Accumulated amortisation and impairment losses					
At 27 February 2010	574	242	180	229	1,225
Foreign currency translation	–	(5)	–	–	(5)
Amortisation for the year	100	52	43	–	195
Impairment losses for the year	–	–	–	55	55
Disposals	(2)	(1)	–	–	(3)
At 26 February 2011	672	288	223	284	1,467
Net carrying value					
At 26 February 2011	628	275	119	3,316	4,338
At 27 February 2010	559	126	155	3,337	4,177

Notes to the Group financial statements

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 estimate discount rates using pre-tax rates that reflect the current market assessment of the time value of money and the risks specific to the cash-generating units. Changes in selling prices and direct costs are based on past experience and expectations of future changes in the market. Given the current economic climate, a sensitivity analysis has been performed in assessing the recoverable amounts of goodwill.

The pre-tax discount rates used to calculate value in use range from 6% to 17% (2011: 8% to 14%). On a post-tax basis, the discount rates ranged from 5% to 13% (2011: 6% to 12%). 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% (2011: 2% to 5%).

In February 2012 and 2011 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:

	2012 £m	2011 £m
China	622	582
Czech Republic	73	34
Malaysia	86	83
Poland	388	401
South Korea	479	468
Tesco Bank	802	802
Thailand	165	161
Turkey	46	50
UK	681	645
US	102	78
Other	5	12
	3,449	3,316

Note 11 Property, plant and equipment

	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
Net carrying value^{(c)(d)}			
At 25 February 2012	21,810	3,900	25,710
At 26 February 2011	20,774	3,624	24,398
Construction in progress included above^(e)			
At 25 February 2012	1,246	44	1,290

(a) Other assets consist of plant, equipment, fixtures and fittings and motor vehicles.

(b) Includes £140m (2011: £147m) 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% (2011: 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 25 February 2012 of £1,185m (2011: £1,084m).
- (ii) Assets held under finance leases which are analysed below:

	2012		2011	
	Land and buildings £m	Other ^(a) £m	Land and buildings £m	Other ^(a) £m
Cost	149	574	139	580
Accumulated depreciation and impairment losses	(37)	(495)	(24)	(462)
Net carrying value	112	79	115	118

These assets are pledged as security for the finance lease liabilities.

(d) The net carrying value of land and buildings comprises:

	2012 £m	2011 £m
Freehold	19,016	18,094
Long leasehold – 50 years or more	676	677
Short leasehold – less than 50 years	2,118	2,003
Net carrying value	21,810	20,774

(e) Construction in progress does not include land.

Notes to the Group financial statements

Note 11 Property, plant and equipment continued

	Land and buildings £m	Other ^(a) £m	Total £m
Cost			
At 27 February 2010	23,385	8,398	31,783
Foreign currency translation	(257)	(153)	(410)
Additions ^(b)	2,577	697	3,274
Acquisitions through business combinations	22	24	46
Reclassification	(673)	301	(372)
Classified as held for sale	(110)	–	(110)
Disposals	(1,465)	(176)	(1,641)
At 26 February 2011	23,479	9,091	32,570
Accumulated depreciation and impairment losses			
At 27 February 2010	2,700	4,880	7,580
Foreign currency translation	(21)	(55)	(76)
Charge for the year	412	782	1,194
Impairment losses for the year	20	3	23
Reversal of impairment losses for the year	(38)	–	(38)
Reclassification	(199)	3	(196)
Classified as held for sale	(29)	–	(29)
Disposals	(140)	(146)	(286)
At 26 February 2011	2,705	5,467	8,172
Net carrying value^{(c)(d)}			
At 26 February 2011	20,774	3,624	24,398
At 27 February 2010	20,685	3,518	24,203
Construction in progress included above^(e)			
At 26 February 2011	1,267	196	1,463

(b) (c) (d) (e) See page 113 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 estimate discount rates using pre-tax rates that reflect the current market assessment of the time value of money and the risks specific to the cash-generating units. Changes in selling prices and direct costs are based on past experience and expectations of future changes in the market.

The forecasts are extrapolated beyond five years based on estimated long-term growth rates of 1% to 5% (2011: 2% to 5%).

The pre-tax discount rates used to calculate value in use range from 6% to 17% (2011: 6% to 14%) depending on the specific conditions in which each store operates. On a post-tax basis, the discount rates ranged from 5% to 13% (2011: 6% to 12%). 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 whose recoverable amounts do not exceed the asset carrying values. In all cases, impairment losses arose due to stores performing below forecasted trading levels.

The reversal of previous impairment losses arose principally due to improvements in stores' performances over the last year, which increased the net present value of future cash flows.

Note 12 Investment property

	2012 £m	2011 £m
Cost		
At beginning of the year	2,092	1,919
Foreign currency translation	(9)	(35)
Additions	14	24
Acquisitions through business combinations	96	–
Reclassification	44	197
Classified as held for sale	23	(2)
Disposals	(7)	(11)
At end of the year	2,253	2,092
Accumulated depreciation and impairment losses		
At beginning of the year	229	188
Foreign currency translation	(2)	(3)
Charge for the year	39	31
Impairment losses for the year	2	2
Reclassification	(6)	11
At end of the year	262	229
Net carrying value at end of the year	1,991	1,863

The estimated fair value of the Group's investment property is £4.3bn (2011: £4.4bn). 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 Paza rlama Ticaret ve Gide Sanai 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 Bhd	Retail	70%	Malaysia
Tesco Japan Co. Limited	Retail	100%	Japan
Tesco Management (Shanghai) 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 25 February 2012. A full list of the Group's subsidiary undertakings will be annexed to the next Annual Return filed at Companies House. There are no significant restrictions on the ability of subsidiary undertakings to transfer funds to the parent, other than those imposed by the Companies Act 2006.

Notes to the Group financial statements

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 27 February 2010	136	16	152
Additions	88	86	174
Foreign currency translation	(5)	–	(5)
Share of post-tax profits/(losses) of joint ventures and associates	65	(8)	57
Income received from joint ventures and associates	(60)	(2)	(62)
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

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 Jade 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
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 Shenyang Property Co. Limited	Property Investment	50%	People's Republic of China
Tesco (Fujian) Industry 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
Tesco Mobile Limited	Telecommunications	50%	England

* Held by the Parent Company (all other principal subsidiaries are held by an intermediate subsidiary).

The accounting period ends of the joint ventures consolidated in these financial statements range from 31 December 2011 to 29 February 2012. 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.

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:

	2012 £m	2011 £m
Non-current assets	3,173	2,720
Current assets	868	577
Current liabilities	(2,180)	(1,957)*
Non-current liabilities	(1,678)	(1,123)
Goodwill	7	7
Net assets	190	224
Cumulative unrecognised losses	118	–
Interests in joint ventures	308	224
Revenue	492	369
Profit for the year	71	65

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
Greenergy International Limited**	Fuel Supplier	34.4%	England
Tesco Underwriting Limited**	Insurance	49.9%	England

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:

	2012 £m	2011 £m
Assets	782	535
Liabilities	(673)	(452)
Goodwill	6	9
Interests in associates	115	92
Revenue	3,791	1,551
Profit/(loss) for the year	20	(8)

The accounting period ends of the associates consolidated in these financial statements range from 31 December 2011 to 29 February 2012. 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.

* Includes £59m relating to cumulative unrecognised losses.

** Held by an intermediate subsidiary.

Note 14 Other investments

	2012 £m	2011* £m
Loan receivable	259	259
Available-for-sale financial assets	1,267	679
	1,526	938

* See Note 1 Accounting policies for details of reclassifications.

The loan receivable includes an interest-free subordinated loan made by Tesco Bank to Direct Line Insurance Group Plc (formerly Royal Bank of Scotland Insurance Group Limited). This loan has no interest receivable and no fixed repayment date.

Available-for-sale financial assets comprise investments in bonds with varied maturities of which £158m (2011: £32m) is current.

Notes to the Group financial statements

Note 15 Inventories

	2012 £m	2011 £m
Goods held for resale	3,537	3,142
Development properties	61	20
	3,598	3,162

Note 16 Trade and other receivables

	2012 £m	2011* £m
Prepayments and accrued income	420	387
Other receivables	1,848	1,416
Amounts owed by joint ventures and associates (Note 28)	389	527
	2,657	2,330

Included within trade and other receivables are the following amounts receivable after more than one year:

	2012 £m	2011 £m
Prepayments and accrued income	36	31
Other receivables	377	378
Amounts owed by joint ventures and associates	269	432
	682	841

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 25 February 2012, trade and other receivables of £30m (2011: £37m) were past due and impaired. The amount of the provision was £50m (2011: £44m). The ageing analysis of these receivables is as follows:

	2012 £m	2011 £m
Up to three months past due	5	4
Three to six months past due	3	3
Over six months past due	22	30
	30	37

As at 25 February 2012, trade and other receivables of £415m (2011: £144m) were past due but not impaired. The ageing analysis of these receivables is as follows:

	2012 £m	2011 £m
Up to three months past due	194	114
Three to six months past due	114	13
Over six months past due	107	17
	415	144

No receivables have been renegotiated in the current or prior financial years.

* See Note 1 Accounting policies for details of reclassifications.

Note 17 Loans and advances to customers

Tesco Bank has loans and advances to customers.

	2012 £m	2011 £m
Non-current	1,901	2,127
Current	2,502	2,514
	4,403	4,641

The maturity of these loans and advances is as follows:

	2012 £m	2011 £m
At 25 February 2012		
Repayable on demand or at short notice	1	1
Within three months	2,557	2,572
Greater than three months but less than one year	46	47
Greater than one year but less than five years	1,396	1,700
After five years	588	503
	4,588	4,823
Provision for impairment of loans and advances	(185)	(182)
	4,403	4,641

At 25 February 2012, £1.2bn of the credit card portfolio had its legal interest assigned to a special purpose entity for use as collateral in securitisation transactions (2011: £1.4bn). As a result of the early repayment in May 2011, there are no securitisation notes in issue as at 25 February 2012 (2011: £1.2bn).

Provision for impairment of loans and advances

	£m
At 27 February 2010	(314)
Charge for the year	(131)
Amounts written off	268
Recoveries of amounts previously written off	(9)
Unwind of discount	4
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)

Notes to the Group financial statements

Note 17 Loans and advances to customers continued

At 25 February 2012, Tesco Bank's non-accrual loans were £194m (2011: £212m). Loan impairment provisions of £185m (2011: £182m) were held against these loans. During the financial year ended 25 February 2012, the gross income not recognised but which would have been recognised under the original terms of non-accrual loans was £13m (2011: £8m).

At 25 February 2012, loans and advances to customers of £74m (2011 : £73m) were past due but not impaired. The ageing analysis of these loans and advances is as follows:

	2012 £m	2011 £m
Up to one month past due	50	54
Up to two months past due	14	13
Two to three months past due	10	6
	74	73

Note 18 Cash and cash equivalents

	2012 £m	2011* £m
Cash at bank and in hand	1,995	1,769
Short-term deposits	182	85
Certificates of deposit	35	170
Loans and advances to banks	93	404
Cash and cash equivalents	2,305	2,428

Cash of £1,243m (2011: £1,022m) held on money market funds is classed as short-term investments.

* See Note 1 Accounting policies for details of reclassifications.

Note 19 Trade and other payables

	2012 £m	2011 £m
Trade payables	5,971	5,782*
Other taxation and social security	462	514
Other payables	2,651	2,274
Amounts payable to joint ventures and associates (Note 28)	404	4
Accruals and deferred income	1,746	1,910
	11,234	10,484

Included in other payables are amounts of £223m (2011: £181m) which are non-current.

* Includes £264m payable to Greenergy International Limited.

Note 20 Borrowings

Current

	Par value	Maturity year	2012 £m	2011 £m
Bank loans and overdrafts	–	–	399	437
Loan from joint ventures (Note 28)	–	–	16	26
3.875% MTN	€389m	2011	–	346
LIBOR + 0.5% Bond – Tesco Bank	£225m	2012	–	224
5.625% MTN	€1,500m	2012	1,304	–
Other MTNs	–	–	87	303
Finance leases (Note 34)	–	–	32	50
			1,838	1,386

Non-current

	Par value	Maturity year	2012 £m	2011 £m
5.625% MTN	€1,500m	2012	–	1,317
5% MTN	£600m	2014	619	606
2% USD Bond	\$500m	2014	317	–
5.125% MTN	€600m	2015	526	510
4% RPI MTN*	£282m	2016	288	276
5.875% MTN	€1,039m	2016	1,042	997
2.7% USD Bond	\$500m	2017	318	–
5.5% USD Bond	\$850m	2017	659	600
5.2% Tesco Bank Retail Bond	£125m	2018	138	126
3.375% MTN	€750m	2018	638	–
5.5% MTN	£350m	2019	352	351
1% RPI Tesco Bank Retail Bond**	£60m	2019	59	–
6.125% MTN	£900m	2022	892	891
5% MTN	£389m	2023	401	390
3.322% LPI MTN†	£287m	2025	290	279
6% MTN	£200m	2029	251	218
5.5% MTN	£200m	2033	249	215
1.982% RPI MTN‡	£240m	2036	242	231
6.15% USD Bond	\$1,150m	2037	897	804
5% MTN	£173m	2042	174	174
5.125% MTN	€600m	2047	635	577
5.2% MTN	£279m	2057	274	274
Other MTNs	–	–	162	169
Other loans	–	–	354	536
Finance leases (Note 34)	–	–	134	148
			9,911	9,689

* 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 25 February 2012, in respect of which all conditions precedent had been met as at that date:

	2012 £m	2011 £m
Expiring in more than two years	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.

Finance income of £3m (2011: £27m) 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 £263m on hedging instruments was recognised during the financial year, offset by a loss of £260m on hedged items (2011: a loss of £369m on hedging instruments was offset by a gain of £396m 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.

At the start of the year the Group had a South Korean Won denominated liability relating to the future purchase of the minority shareholding of its subsidiary, Homeplus Co., Limited. This liability was designated as a net investment hedge of a proportion of the assets of Homeplus Co., Limited. This option was exercised during the financial year.

Gains and losses accumulated in equity are included in the Group Income Statement on disposal of the overseas operations.

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 caps, interest rate swaps and forward foreign currency contracts. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the Group Income Statement within finance income or costs.

The fair value of derivative financial instruments have been disclosed in the Group Balance Sheet as follows:

	2012		2011	
	Asset £m	Liability £m	Asset £m	Liability £m
Current	41	(128)	148	(255)
Non-current	1,726	(688)	1,139	(600)
	1,767	(816)	1,287	(855)

Note 21 Financial instruments continued

The fair value and notional amounts of derivatives analysed by hedge type are as follows:

	2012				2011			
	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	96	1,751	(68)	2,031	27	1,410	(57)	1,844
Cross currency swaps	818	2,686	(8)	269	717	2,674	(28)	714
Cash flow hedges								
Interest rate swaps and similar instruments	–	–	(132)	400	–	–	(54)	455
Cross currency swaps	233	304	(41)	988	126	298	(151)	784
Index-linked swaps	30	809	–	–	–	–	(8)	772
Forward foreign currency contracts	23	733	(21)	1,211	8	346	(12)	1,269
Net investment hedges								
Forward foreign currency contracts	–	–	(7)	969	19	383	(97)	952
Future purchases of non-controlling interests	–	–	–	–	–	–	(106)	–
Cash flow hedges and net investment hedges								
Cross currency swaps	–	–	(1)	318	–	–	–	–
Derivatives not in a formal hedge relationship								
Interest rate swaps and similar instruments	3	25	(1)	25	1	25	(1)	25
Cross currency swaps	3	146	(4)	56	2	84	(10)	65
Index-linked swaps	539	3,149	(468)	3,149	376	2,639	(311)	2,639
Forward foreign currency contracts	22	923	(62)	1,282	11	523	(20)	720
Future purchases of non-controlling interests	–	–	(3)	–	–	–	–	–
Total	1,767	10,526	(816)	10,698	1,287	8,382	(855)	10,239

The carrying value and fair value of financial assets and liabilities are as follows:

	2012		2011*	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Assets				
Cash and cash equivalents	2,305	2,305	2,428	2,428
Loans and advances to customers – Tesco Bank	4,403	4,440	4,641	4,636
Short-term investments	1,243	1,243	1,022	1,022
Other investments – Tesco Bank	1,526	1,524	938	923
Joint venture and associates loan receivables (Note 28)	384	384	503	514
Other receivables	10	10	25	25
Derivative financial assets:				
Interest rate swaps and similar instruments	99	99	28	28
Cross currency swaps	1,054	1,054	845	845
Index-linked swaps	569	569	376	376
Forward foreign currency contracts	45	45	38	38
Total financial assets	11,638	11,673	10,844	10,835
Liabilities				
Short-term borrowings:				
Amortised cost	(1,806)	(1,841)	(708)	(707)
Bonds in fair value hedge relationships	–	–	(628)	(614)
Long-term borrowings:				
Amortised cost	(4,575)	(4,966)	(4,584)	(4,678)
Bonds in fair value hedge relationships	(5,202)	(5,140)	(4,957)	(4,915)
Finance leases (Group as lessee – Note 34)	(166)	(166)	(198)	(198)
Customer deposits – Tesco Bank	(5,387)	(5,410)	(5,074)	(5,081)
Deposits by banks – Tesco Bank	(78)	(78)	(36)	(36)
Derivative and other financial liabilities:				
Interest rate swaps and similar instruments	(201)	(201)	(112)	(112)
Cross currency swaps	(54)	(54)	(189)	(189)
Index-linked swaps	(468)	(468)	(319)	(319)
Forward foreign currency contracts	(90)	(90)	(129)	(129)
Future purchases of non-controlling interests	(3)	(3)	(106)	(106)
Total financial liabilities	(18,030)	(18,417)	(17,040)	(17,084)
Total	(6,392)	(6,744)	(6,196)	(6,249)

* See Note 1 Accounting policies for details of reclassifications.

Notes to the Group financial statements

Note 21 Financial instruments continued

The fair values of financial instruments have been determined by reference to prices available from the markets on which the instruments are traded, 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 fair value of cash and cash equivalents and short-term investments is the same as their carrying value.

Financial assets and liabilities by category

The accounting classifications of each class of financial assets and liabilities as at 25 February 2012 and 26 February 2011 are as follows:

	Available- for-sale £m	Loans and receivables/ other financial liabilities £m	Fair value through profit or loss £m	Total £m
At 25 February 2012				
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)
At 26 February 2011				
Cash and cash equivalents	170	2,258	–	2,428
Loans and advances to customers – Tesco Bank	–	4,641	–	4,641
Short-term investments	–	1,022	–	1,022
Other investments – Tesco Bank	679	259	–	938
Joint venture and associates loan receivables (Note 28)	–	503	–	503
Other receivables	–	25	–	25
Customer deposits – Tesco Bank	–	(5,074)	–	(5,074)
Deposits by banks – Tesco Bank	–	(36)	–	(36)
Short-term borrowings	–	(1,336)	–	(1,336)
Long-term borrowings	–	(9,541)	–	(9,541)
Finance leases (Note 34)	–	(198)	–	(198)
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	–	(84)	(84)
Cross currency swaps	–	–	656	656
Index-linked swaps	–	–	57	57
Forward foreign currency contracts	–	–	(91)	(91)
Future purchases of non-controlling interests	–	–	(106)	(106)
	849	(7,477)	432	(6,196)

* See Note 1 Accounting policies for details of reclassifications.

Note 21 Financial instruments continued

The following table presents the Group's financial assets and liabilities that are measured at fair value at 25 February 2012, 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).

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 25 February 2012				
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
At 26 February 2011				
Assets				
Available-for-sale financial assets	188	661	–	849
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	28	–	28
Cross currency swaps	–	845	–	845
Index-linked swaps	–	376	–	376
Forward foreign currency contracts	–	38	–	38
Total assets	188	1,948	–	2,136
Liabilities				
Derivative financial instruments:				
Interest rate swaps and similar instruments	–	(112)	–	(112)
Cross currency swaps	–	(189)	–	(189)
Index-linked swaps	–	(319)	–	(319)
Forward foreign currency contracts	–	(129)	–	(129)
Future purchases of non-controlling interests	–	–	(106)	(106)
Total liabilities	–	(749)	(106)	(855)
Total	188	1,199	(106)	1,281

The following table presents the changes in Level 3 instruments:

	2012 £m	2011 £m
At beginning of the year	(106)	(146)
Gains/(losses) recognised in finance costs in the Group Income Statement	33	(6)
(Losses)/gains recognised in the Group Statement of Changes in Equity	(3)	2
Purchase of non-controlling interests	73	44
At end of the year	(3)	(106)

During the financial year, there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into or out of Level 3 fair value measurements. A reasonably possible change in assumptions is unlikely to result in a significant change in the fair value of Level 3 instruments.

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 40 to 47.

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 47.

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 2012 and 2011, net debt was managed using derivative instruments to hedge interest rate risk as follows:

	2012			2011*		
	Fixed £m	Floating £m	Total £m	Fixed £m	Floating £m	Total £m
Cash and cash equivalents	35	2,270	2,305	170	2,258	2,428
Loans and advances to customers – Tesco Bank	1,956	2,447	4,403	2,161	2,480	4,641
Short-term investments	–	1,243	1,243	–	1,022	1,022
Other investments	1,335	191	1,526	755	183	938
Joint venture and associate, loan receivables (Note 28)	–	384	384	–	503	503
Other receivables	–	10	10	–	25	25
Finance leases (Note 34)	(111)	(55)	(166)	(92)	(106)	(198)
Bank and other borrowings	(10,729)	(854)	(11,583)	(9,697)	(1,180)	(10,877)
Customer deposits – Tesco Bank	(1,470)	(3,917)	(5,387)	(398)	(4,676)	(5,074)
Deposits by banks – Tesco Bank	(78)	–	(78)	(36)	–	(36)
Future purchases of non-controlling interests	(3)	–	(3)	(106)	–	(106)
Derivative effect:						
Interest rate swaps	(1,402)	1,402	–	(1,218)	1,218	–
Cross currency swaps	2,635	(2,635)	–	3,459	(3,459)	–
Index-linked swaps	(522)	522	–	(498)	498	–
Caps and collars	(1)	1	–	–	–	–
Total	(8,355)	1,009	(7,346)	(5,500)	(1,234)	(6,734)

Credit risk

Credit risk arises from cash and cash equivalents, trade and other receivables, financial instruments and deposits with banks and financial institutions. The Group policy on credit risk is described on page 47.

The counterparty exposure under derivative contracts is £1.8bn (2011: £1.3bn). The Group considers its maximum credit risk to be £11.6bn (2011: £10.8bn*), 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 (2011: £2.8bn), which mature between 2014 and 2015.

The Group has a European Medium Term Note programme of £15bn, of which £7.4bn was in issue at 25 February 2012 (2011: £8.5bn), plus a Euro Commercial Paper programme of £2bn, none of which was in issue at 25 February 2012 (2011: £nil), and a US Commercial Paper programme of \$4bn, none of which was in issue at 25 February 2012 (2011: £nil).

During 2012 the Group issued £1.4bn of long-term debt of which £0.6bn was issued as part of the European Medium Term Note Programme.

For liquidity risk relating to Tesco Bank, refer to the separate section on Tesco Bank financial risk factors below.

* See Note 1 Accounting policies for details of reclassifications.

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 £18.6bn is considered acceptable as it is offset by financial assets and trade receivables of £14.3bn (2011: £17.1bn offset by financial assets and trade receivables of £13.2bn).

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.

	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
At 25 February 2012						
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)

	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
At 26 February 2011						
Non-derivative financial liabilities						
Bank and other borrowings	(1,278)	(1,587)	(876)	(622)	–	(6,647)
Interest payments on borrowings	(518)	(495)	(395)	(355)	(326)	(3,828)
Customer deposits – Tesco Bank	(4,898)	(173)	(3)	–	–	–
Deposits by banks – Tesco Bank	(36)	–	–	–	–	–
Finance leases	(56)	(36)	(15)	(15)	(16)	(205)
Trade and other payables	(10,303)	(84)	(14)	(7)	(3)	(73)
Derivative and other financial liabilities						
Net settled derivative contracts – receipts	74	68	68	37	14	31
Net settled derivative contracts – payments	(176)	(109)	(88)	(76)	(57)	(697)
Gross settled derivative contracts – receipts	1,619	641	468	672	132	3,368
Gross settled derivative contracts – payments	(1,404)	(652)	(341)	(610)	(60)	(2,631)
Future purchases of non-controlling interests	(85)	(24)	–	–	–	–
Total	(17,061)	(2,451)	(1,196)	(976)	(316)	(10,682)

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 25 February 2012. It should be noted that the sensitivity analysis reflects the impact on income and equity due to all financial instruments held at the balance sheet date. It does not reflect any change in sales or costs that may result from changing interest or exchange rates.

The following assumptions were made in calculating the sensitivity analysis:

- the sensitivity of interest payable to movements in interest rates is calculated on net floating rate debt, deposits and derivative instruments with no sensitivity assumed for RPI-linked debt which has all 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 the Group Statement of Comprehensive Income that would result from changes in UK interest rates and in exchange rates:

	2012		2011	
	Income gain/(loss) £m	Equity gain/(loss) £m	Income gain/(loss) £m	Equity gain/(loss) £m
1% increase in GBP interest rates (2011: 1%)	(3)	–	(14)	–
5% appreciation of the Euro (2011: 5%)	(1)	(40)	2	(46)
5% appreciation of the South Korean Won (2011: 5%)	–	59	(1)	1
5% appreciation of the US Dollar (2011: 5%)	10	50	8	35
5% appreciation of the Czech Koruna (2011: 5%)	1	17	–	(6)

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 principally from foreign currency deals 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. For changes in the USD/GBP exchange rate, the impact on the Group Statement of Comprehensive Income results principally from forward purchases of US Dollars as cash flow hedges.

Capital risk

The Group's objectives when managing capital (defined as net debt plus equity) are to safeguard the Group's ability to continue as a going concern in order to provide returns to shareholders and benefits for other stakeholders, while maintaining a strong credit rating and headroom whilst optimising return to shareholders through an appropriate balance of debt and equity funding. The Group manages its capital structure and makes adjustments to it, in light of changes to economic conditions and the strategic objectives of the Group.

To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, buy back shares and cancel them, or issue new shares. During 2012, the Group purchased and cancelled £290m ordinary shares.

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 £521m (2011: £1,861m) and new bonds issued primarily to finance maturing debt in 2012/13 totalling £1,358m (2011: £125m). 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 FSA. 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 FSA 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.

Expressed as an annual probability of default, the upper and lower boundaries and the midpoint for each of the asset quality grades are as follows:

At 25 February 2012 and 26 February 2011

Asset quality grade	Annual probability of default			
	Minimum %	Midpoint %	Maximum %	S&P equivalent
AQ1	0.00	0.10	0.20	AAA to BBB-
AQ2	0.21	0.40	0.60	BB+ to BB
AQ3	0.61	1.05	1.50	BB- to B+
AQ4	1.51	3.25	5.00	B+ to B
AQ5	5.01	52.50	100.00	B and below

At 25 February 2012	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Accruing past due £m	Non- accrual £m	Impairment provision £m	Total £m
Assets:									
Other investments	1,526	–	–	–	–	–	–	–	1,526
Loans and advances to customers	630	977	866	690	1,158	73	194	(185)	4,403
Total assets	2,156	977	866	690	1,158	73	194	(185)	5,929
Commitments	4,471	1,716	662	426	147	–	–	–	7,422
Total off-balance sheet	4,471	1,716	662	426	147	–	–	–	7,422

During the financial year, there was a change in the methodology which Tesco Bank uses to measure the customer risk in relation to outstanding loan balances. As a result this has revised the categorisation of some customer accounts since the prior year end in terms of asset quality grading. Despite this change in methodology and the resulting impact on the data presented, there has not been any significant change in the underlying quality of the loans portfolio year on year.

At 26 February 2011*	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Accruing past due £m	Non- accrual £m	Impairment provision £m	Total £m
Assets:									
Other investments	938	–	–	–	–	–	–	–	938
Loans and advances to customers	599	466	924	1,663	886	73	212	(182)	4,641
Total assets	1,537	466	924	1,663	886	73	212	(182)	5,579
Commitments	4,254	1,601	645	444	183	–	–	–	7,127
Total off-balance sheet	4,254	1,601	645	444	183	–	–	–	7,127

* See Note 1 Accounting Policies for details of reclassifications.

Notes to the Group financial statements

Note 22 Financial risk factors continued

Insurance risk

Tesco Bank is exposed to insurance risks through its ownership of 49.9% of Tesco Underwriting Limited ('TU'), an authorised insurance company, and through its historic distribution arrangement with RBS Insurance. 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.

The primary risk that the Group remains exposed to through its previous relationship with RBS Insurance is Reserving Risk – the risk that claims reserves are insufficient to cover the ultimate cost of those insurance claims that have not yet settled. This is particularly relevant to Motor insurance claims where the ultimate cost of large bodily injury claims is uncertain and the time taken to settle such claims can vary significantly depending on the severity of the injury. This risk is, in part, mitigated by the use of reinsurance to limit Tesco Bank's exposure to the cost of individual claims above certain predetermined limits. However, the nature of this exposure results in the process of estimating the ultimate cost of these claims carrying a degree of uncertainty.

Note 23 Customer deposits and deposits by banks

	2012 £m	2011 £m
Customer deposits	5,387	5,074
Deposits by banks	78	36
	5,465	5,110

Included within customer deposits is £300m (2011: £177m) that is non-current.

Note 24 Provisions

	Property provisions £m	Other provisions £m	Total £m
At 27 February 2010	111	100	211
Foreign currency translation	(3)	–	(3)
Amount released in the year	(18)	(50)	(68)
Amount provided in the year	48	–	48
Amount utilised in the year	–	(11)	(11)
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

The balances are analysed as follows:

	2012 £m	2011 £m
Current	99	64
Non-current	100	113
	199	177

Property provisions comprise obligation for future rents payable net of rents receivable on onerous and vacant property leases, terminal dilapidations and future rents above market value on unprofitable stores. The majority of these provisions are expected to be utilised over the period to 2020.

The other provisions balance relates to a provision for Tesco Bank customer redress in respect of potential customer complaints arising from historic sales of PPI and a provision for customer insurance cancellations. The PPI provision is likely to be utilised over several years, although the timing of utilisation is uncertain. The balance is classified as current at the year end.

The British Bankers Association initiated a judicial review on 24 January 2011 in relation to the regulation of PPI sales practices. The Group did not participate in this action and continued to deal with customer complaints in line with the FSA requirements throughout the duration of the legal proceedings undertaken by the other banks involved.

Note 24 Provisions continued

During the first half of the financial year, the Group undertook a review of historic sales practices in place over the period in which PPI was sold to customers. During the financial year, the Group announced its intention to begin a programme of proactive customer contact, inviting customers who think they were mis-sold PPI during a specific time period to seek reimbursement from the Group. This programme has entered an initial pilot phase. The principal purpose of the pilot was to test operational processes in order to ensure that they were fit for purpose and could cope with the volume associated with a full programme of customer contact. Following the decision to pro-actively contact customers, the provision was increased by £57m in the first half of the financial year.

The Group will continue to handle claims and redress customers in accordance with PS10/12. This will include ongoing analysis of historical claims experience in accordance with the guidance.

Note 25 Share-based payments

For continuing operations, the Group Income Statement charge for the year recognised in respect of share-based payments is £153m (2011: £288m), which is made up of share option schemes and share bonus payments. Of this amount, £125m (2011: £220m) will be settled in equity and £28m (2011: £68m) 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 not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceding the offer date.
- ii) The Irish Savings-related Share Option Scheme (2000) permits the grant to Irish employees of options in respect of ordinary shares linked to a building society/bank save-as-you-earn contract for a term of three or five years with contributions from employees of an amount between €12 and €320 per four-weekly period. Options are capable of being exercised at the end of the three- or five-year period at a subscription price not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceding the offer date.
- iii) The Approved Executive Share Option Scheme (1994) was adopted on 17 October 1994. The exercise of options granted under this scheme will normally be conditional upon the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the Discretionary Share Option Plan (2004). There were no discounted options granted under this scheme.
- iv) The Unapproved Executive Share Option Scheme (1996) was adopted on 7 June 1996. The exercise of options granted under this scheme will normally be conditional upon the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the Discretionary Share Option Plan (2004). There were no discounted options granted under this scheme.
- v) The International Executive Share Option Scheme (1994) was adopted on 20 May 1994. This scheme permits the grant to selected non-UK executives of options to acquire ordinary shares on substantially the same basis as their UK counterparts. The exercise of options granted under this scheme will normally be conditional 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 executives. Options are normally exercisable between three and ten years from the date of grant for nil consideration.
- vii) The Performance Share Plan (2004) was adopted on 5 July 2004 and amended on 29 June 2007. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options granted before 29 June 2007 are normally exercisable between four and ten years from the date of grant for nil consideration. Options granted after 29 June 2007 are normally exercisable between three and ten years from the date of grant for nil consideration. The exercise of options will normally be conditional 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.

Notes to the Group financial statements

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 will be 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 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	11,240,457	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

For the year ended 26 February 2011

	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 27 February 2010	138,234,520	323.37	5,455,068	326.70	14,550,891	361.57	85,907,622	351.46	54,880,748	363.64	9,185,455	0.00
Granted	29,920,166	386.00	1,470,162	386.00	3,793,684	419.85	21,447,502	419.81	17,065,475	420.00	4,148,918	0.00
Forfeited	(7,971,500)	328.09	(666,990)	320.21	(1,030,137)	395.79	(3,915,038)	401.52	(3,192,794)	382.05	(499,596)	0.00
Exercised	(18,957,476)	256.02	(537,638)	261.38	(2,466,841)	270.56	(10,927,268)	274.37	(3,687,375)	283.46	(435,650)	0.00
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
Exercisable as at 26 February 2011	15,506,889	366.48	668,423	381.98	6,090,853	375.33	32,577,023	348.13	19,138,101	364.16	3,744,903	0.00
Exercise price range (pence)		248.00 to 410.00		248.00 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		4.92		4.61		4.98		6.74

Share options were exercised on a regular basis throughout the financial year. The average share price during the financial year ended 25 February 2012 was 385.43p (2011: 417.80p).

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.

	2012			2011		
	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 (%)	4.1%	4.1%	0.0%	3.5%	3.5%	0.0%
Expected volatility (%)	23 – 27%	26%	26%	26 – 30%	25%	25%
Risk-free interest rate (%)	1.5 – 1.8%	2.0%	2.6%	1.6 – 2.2%	2.3 – 3.2%	2.7%
Expected life of option (years)	3 or 5	6	6	3 or 5	6	6
Weighted average fair value of options granted (pence)	69.85	62.91	408.14	93.41	77.86	414.06
Probability of forfeiture (%)	14 – 16%	10%	0%	14 – 16%	10%	0%
Share price (pence)	404.00	402.75	408.14	436.00	419.89	414.06
Weighted average exercise price (pence)	364.00	402.75	0.00	386.00	419.89	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. Each year, shares are awarded as a percentage of earnings up to a maximum of £3,000. Eligible Republic of Ireland employees are able to participate in a Share Bonus Scheme, an all-employee profit-sharing scheme. Each year, employees receive a percentage of their earnings as either cash or shares.

Senior management also participate in performance-related bonus schemes. The amount paid to employees is based on a percentage of salary and is paid partly in cash and partly in shares. Bonuses are awarded to eligible employees who have completed a required service period and depend on the achievement of corporate targets. The accrued cash element of the bonus at the balance sheet date is £13m (2011: £38m).

Selected senior management participate in the selected senior management Performance Share Plan. Awards made under this plan will normally vest three years after the date of the award for nil consideration. Vesting will normally be conditional on the achievement of specified performance targets related to the return on capital employed over a three-year performance period.

Senior management participate in the senior management 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:

	2012		2011	
	Number of shares	WAFV pence	Number of shares	WAFV pence
Shares in Success	26,597,598	416.26	25,360,677	416.23
Irish Share Bonus Scheme	156,313	419.50	141,970	397.70
Executive Incentive Scheme	9,482,746	415.89	12,765,004	398.68
Performance Share Plan	21,075,604	389.13	2,405,730	399.78
US Long-Term Incentive Plan	132,786	405.63	192,078	433.05

Notes to the Group financial statements

Note 26 Post-employment benefits

Pensions

The Group operates a variety of post-employment benefit arrangements, covering both funded defined contribution and funded and unfunded defined benefit schemes. The most significant of these are the funded defined benefit pension schemes for the Group's employees in the UK, the Republic of Ireland and South Korea.

Defined contribution plans

The contributions payable for defined contribution schemes of £20m (2011: £14m) have been recognised in the Group Income Statement.

Defined benefit plans

UK

The principal plan within the Group is the Tesco PLC Pension Scheme, which is a funded defined benefit pension scheme in the UK, the assets of which are held as a segregated fund and administered by trustees. Towers Watson Limited, an independent actuary, carried out the latest triennial actuarial assessment of the scheme as at 31 March 2008, using the projected unit method.

At 31 March 2008, the actuarial deficit was £275m. The market value of the schemes' assets was £3,987m and these assets represented 94% of the benefits that had accrued to members, after allowing for expected increases in earnings and pensions in payment. The actuarial assessment as at 31 March 2011 has started and the results will be finalised by June 2012. The Group is currently in consultation with staff and trustees regarding proposed changes to the scheme.

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 25 February 2012.

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 25 February 2012. The schemes' assets are stated at their market values as at 25 February 2012. 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 detailed below:

	2012 %	2011 %
Discount rate	5.2	5.9
Price inflation	3.1	3.5
Rate of increase in salaries	3.2	3.6
Rate of increase in pensions in payment*	2.9	3.3
Rate of increase in deferred pensions*	2.1	2.8
Rate of increase in career average benefits	3.1	3.5

* In excess of any Guaranteed Minimum Pension (GMP) element.

The main financial assumption is the real discount rate (the excess of the discount rate over the rate of price inflation). If this assumption increased/decreased by 0.1%, the UK defined benefit obligation would decrease/increase by approximately £170m and the annual UK current service cost would decrease/increase by approximately £14m.

UK mortality assumptions

The Company conducts analysis of mortality trends under the Tesco PLC Pension Scheme in the UK as part of the triennial actuarial valuation of the Scheme. At the latest triennial actuarial valuation as at 31 March 2008 the following assumptions were adopted for funding purposes:

Base tables:

PMA92C00 for male members with cohort improvements to 2000 and members taken to be one year younger than actual age.

PFA92C00 for female members with cohort improvements to 2000 and members taken to be half a year older than actual age.

These assumptions were used for the calculation of the pension liability as at 25 February 2012 for the main UK scheme.

The mortality assumptions used are based on tables that have been updated in line with medium cohort projections with a minimum improvement of 1% per annum from 31 March 2008 to 25 February 2012. In addition, the allowance for future mortality improvements incorporates medium cohort projections with a minimum improvement of 1% per annum.

The following table illustrates the expectation of life of an average member retiring at age 65 at the balance sheet date and a member reaching age 65 at the same date +25 years:

		2012 years	2011 years
Retiring at reporting date at age 65:	Male	21.8	21.7
	Female	23.6	23.5
Retiring at reporting date +25 years at age 65:	Male	24.2	24.1
	Female	26.1	26.0

Note 26 Post-employment benefits continued

Rates of return on scheme assets

The assets in the defined benefit pension schemes and the expected nominal rates of return are as follow:

	2012		2011	
	Long-term rate of return %	Market value £m	Long-term rate of return %	Market value £m
Equities	8.1	3,377	8.5	3,032
Bonds	4.9	1,365	5.0	1,116
Property	6.5	577	6.8	511
Other (alternative assets)	8.1	741	8.5	564
Cash	3.6	109	4.0	385
Total market value of assets		6,169		5,608

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 having regard to expected returns over the medium term, as calculated by the Company's independent actuary. The expected rate of return on bonds was measured directly from actual yields for gilts and corporate bond stocks. The 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 plan assets are as follows:

	2012 £m	2011 £m
Opening fair value of plan assets	5,608	4,696
Expected return	422	363
Actuarial (losses)/gains	(168)	278
Contributions by employer	457	433
Actual member contributions	11	10
Foreign currency translation	(1)	(9)
Benefits paid	(160)	(163)
Closing fair value of plan assets	6,169	5,608

Changes in the present value of defined benefit obligations are as follows:

	2012 £m	2011 £m
Opening defined benefit obligation	(6,964)	(6,536)
Current service cost	(495)	(499)
Past service gain/(cost)	3	(29)
Interest cost	(404)	(381)
(Losses)/gains on change of assumptions	(373)	342
Experience gain/(loss)	43	(25)
Foreign currency translation	–	11
Benefits paid	160	163
Actual member contributions	(11)	(10)
Closing defined benefit obligation	(8,041)	(6,964)

The amounts that have been charged to the Group Income Statement and Group Statement of Comprehensive Income are set out below:

	2012 £m	2011 £m
Analysis of the amount charged to operating profit:		
Current service cost	(495)	(499)
Past service gain/(cost)	3	(29)
Total charge to operating profit	(492)	(528)
Analysis of the amount (charged)/credited to finance (cost)/income:		
Expected return on pension schemes' assets	422	363
Interest on pension schemes' liabilities	(404)	(381)
Net pension finance income/(cost) (Note 5)	18	(18)
Total charge to the Group Income Statement	(474)	(546)
Analysis of the amount recognised in the Group Statement of Comprehensive Income:		
Actual return less expected return on pension schemes' assets	(168)	278
Experience gains/(losses) arising on the schemes' liabilities	43	(25)
Foreign currency translation	–	2
Changes in assumptions underlying the present value of the schemes' liabilities	(373)	342
Total (loss)/gain recognised in the Group Statement of Comprehensive Income	(498)	597

Notes to the Group financial statements

Note 26 Post-employment benefits continued

The cumulative losses recognised through the Group Statement of Comprehensive Income since the date of transition to IFRS are £1,037m (2011: £539m).

Summary of movements in deficit during the financial year

	2012 £m	2011 £m
Deficit in schemes at beginning of the year	(1,356)	(1,840)
Current service cost	(495)	(499)
Past service gain/(cost)	3	(29)
Other finance income/(cost)	18	(18)
Contributions by employer	457	433
Foreign currency translation	(1)	2
Actuarial (loss)/gain	(498)	595
Deficit in schemes at end of the year	(1,872)	(1,356)

History of movements

The historical movement in defined benefit pension schemes' assets and liabilities and history of experience gains and losses are as follows:

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Total market value of assets	6,169	5,608	4,696	3,420	4,089
Present value of liabilities relating to unfunded schemes	(60)	(65)	(54)	(39)	(34)
Present value of liabilities relating to partially funded schemes	(7,981)	(6,899)	(6,482)	(4,875)	(4,893)
Pension deficit	(1,872)	(1,356)	(1,840)	(1,494)	(838)
Experience (losses)/gains on scheme assets	(168)	278	733	(1,270)	(465)
Experience gains/(losses) on plan liabilities	43	(25)	(1)	(117)	(20)

Post-employment benefits other than pensions

The Company operates a scheme offering post-employment 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 25 February 2012 of £11m (2011: £12m) was determined in accordance with the advice of independent actuaries. During the financial year, £1m (2011: £1m) has been charged to the Group Income Statement and £1m (2011: £1m) of benefits were paid.

A change of 1% in assumed healthcare cost trend rates would have the following effect:

	2012 £m	2011 £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 £486m to defined schemes in the financial year ending 23 February 2013. In addition to this the Company paid a contribution of £180m on 30 March 2012, ahead of the completion of the triennial valuation.

Note 27 Called up share capital

	2012		2011	
	Number	£m	Number	£m
Allotted, called up and fully paid:				
At beginning of the year	8,046,468,092	402	7,985,044,057	399
Share options exercises	23,490,825	1	36,535,102	2
Share bonus awards issues	32,656,313	2	24,888,933	1
Shares purchased for cancellation	(70,802,785)	(3)	–	–
At end of the year	8,031,812,445	402	8,046,468,092	402

During the financial year, 23 million (2011: 37 million) ordinary shares of 5p each were issued in relation to share options for an aggregate consideration of £69m (2011: £97m).

During the financial year, 33 million (2011: 25 million) shares of 5p each were issued in relation to share bonus awards for an aggregate consideration of £2m (2011: £1m).

Note 27 Called up share capital continued

During the financial year, the Group purchased and cancelled 70.8 million (2011: nil) shares of 5p each representing 1% (2011: 0%) of the called up capital as at 25 February 2012 at an average price of £4.07 (2011: n/a) per share. The total consideration including expenses was £290m (2011: £nil). The excess of the consideration over the aggregate nominal value of the shares purchased has been charged to retained earnings.

Between 26 February 2012 and 13 April 2012 options over 2,779,741 ordinary shares have been exercised under the terms of the Savings-related Share Option Scheme (1981) and the Irish Savings-related Share Option Scheme (2000). Between 26 February 2012 and 13 April 2012, options over 937,548 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 25 February 2012, the Directors were authorised to purchase up to a maximum in aggregate of 803.6 million (2011: 802.1 million) ordinary shares.

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

Capital redemption reserve

Upon cancellation of the shares purchased as part of the share buy-back, a capital redemption reserve is created representing the nominal value of the shares cancelled. This is a non-distributable reserve.

Note 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	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Joint ventures	263	281	480	449	5	18	36	4
Associates	2	3	1,691	1,104	–	6	368	264

Sales to related parties consists of services/management fees and loan interest.

Purchases from related parties include £351m (2011: £306m) of rentals payable to the Group's joint ventures (including those joint ventures formed as part of the sale and leaseback programme) and £1,691m (2011: £1,104m) of fuel purchased from Greenergy International Limited. In addition, duty on the fuel purchases paid by the Group to Greenergy International Limited was £1,950m (2011: £1,877m).

Non-trading transactions

	Sale and leaseback of assets		Loans to related parties		Loans from related parties		Injection of equity funding	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Joint ventures	450	1,652	380	502	16	26	49	94
Associates	–	–	4	1	–	–	–	69

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 31 January 2012, the Group completed a new sale and leaseback transaction involving UK property assets, structured as a joint venture with a UK investor. Ten trading stores and one store under development were sold for proceeds of £450m at an average net yield of 4.9%.

Transactions with key management personnel

From 27 February 2011, members of the Board of Directors and Executive Committee of Tesco PLC are deemed to be key management personnel. Before that time only members of the Board of Directors were deemed to be key management personnel.

Key management personnel compensation and their transactions with Tesco Bank are disclosed below:

	2012 £m	2011 £m
Salaries and short-term benefits	13	10
Pensions	4	3
Share-based payments	9	27
	26	40

Of the total remuneration to key management personnel, £6m (2011: £nil) is due to Executive Committee members who are not on the PLC Board.

Notes to the Group financial statements

Note 28 Related party transactions continued

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 25 February 2012	12	–	13	2
At 26 February 2011	7	–	10	1

Note 29 Reconciliation of profit before tax to cash generated from operations

	2012 £m	2011* £m
Profit before tax	3,835	3,641
Net finance costs (Note 5)	241	333
Share of post-tax profits of joint ventures and associates (Note 13)	(91)	(57)
Operating profit	3,985	3,917
Operating loss of discontinued operations	(127)	(106)
Depreciation and amortisation	1,498	1,420
Profits/losses arising on property-related items from continuing operations	(376)	(432)
Profits/losses arising on property-related items from discontinued operations	1	5
Loss arising on sale of non property-related items	4	3
Profit arising on sale of other investments	(5)	–
Impairment of goodwill (Note 10)	–	55
Net charge/(reversal) of impairment of property, plant and equipment (Note 11) and intangible assets (Note 10)	75	(13)
Adjustment for non-cash element of pensions charge	35	95
Share-based payments (Note 25)	125	220
Tesco Bank non-cash items included in profit before tax	166	(83)
Increase in inventories	(461)	(467)
Increase in trade and other receivables	(139)	(152)
Increase in trade and other payables and provisions	679	976
Tesco Bank decrease/(increase) in loans and advances to customers (Note 17)	150	(519)
Tesco Bank increase in trade and other receivables	(278)	(86)
Tesco Bank increase in customer and bank deposits and trade and other payables	356	780
Decrease in working capital	307	532
Cash generated from operations	5,688	5,613

* See Note 1 Accounting policies for details of reclassifications.

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 26 February 2011** £m	Tesco Bank at 26 February 2011* £m	Cash flow £m	Business combinations £m	Other non-cash movements £m	Net debt of disposal group £m	Elimination of Tesco Bank £m	At 25 February 2012** £m
Cash and cash equivalents	1,722	706	(148)	7	24	(6)	(580)	1,725
Short-term investments	1,022	–	221	–	–	–	–	1,243
Joint venture loan and other receivables	493	34	(142)	–	8	–	(34)	359
Bank and other borrowings	(10,282)	(595)	353	(98)	(962)	1	576	(11,007)
Finance lease payables	(198)	–	45	–	(13)	–	–	(166)
Net derivative financial instruments	453	(21)	(94)	–	613	–	52	1,003
Net debt of the disposal group	–	–	–	–	–	5	–	5
	(6,790)	124	235	(91)	(330)	–	14	(6,838)

* See Note 1 Accounting policies for details of reclassifications.

** These amounts relate to the net debt excluding Tesco Bank but including the disposal group.

Note 31 Business combinations and other acquisitions

Business combinations

During the financial year, the Group completed five business combination transactions as follows:

- i) 18 March 2011 – Acquired 100% of the ordinary share capital relating to the 77 stores of Mills Group in the UK for a cash consideration of £10m;
- ii) 1 April 2011 – Acquired 100% of the ordinary share capital relating to the 87 franchised kiosks and 47 stores branded as Zabka and Koruna in the Czech Republic for a cash consideration of £36m;
- iii) 18 April 2011 – Acquired 80.25% of the ordinary share capital of Blinkbox Entertainment Limited in the UK for a cash consideration of £3m;
- iv) 8 June 2011 – Acquired 100% of the ordinary share capital of BzzAgent Inc and BzzAgent Limited for a cash consideration of £9m and deferred contingent consideration of £15m; and
- v) 18 August 2011 – Acquired the remaining 50% of the ordinary share capital of its joint venture Multi Veste Czech Republic 9, s.r.o not already owned by the Group for a total consideration of £24m, split equally between cash and equity.

The table below sets out the provisional fair values to the Group in respect of these acquisitions.

	Provisional fair values on acquisition £m
Non-current assets	107
Current assets	25
Cash	5
Current liabilities	(41)
Non-current liabilities	(98)
Net liabilities acquired	(2)
Non-controlling interests	(1)
Goodwill arising on acquisition	100
	97
Consideration:	
Cash	70
Non-cash	27
Total consideration	97

The goodwill represents synergies within the operating models and the economies of scale expected from incorporating the operations of acquired entities within the Group.

Purchase of non-controlling interest

On 1 July 2011, the Group completed the acquisition of the remaining 6% of the ordinary share capital of Homeplus Co., Limited for a cash consideration of £73m.

Note 32 Commitments and contingencies

Capital commitments

At 25 February 2012, there were commitments for capital expenditure contracted for, but not provided for of £1,599m (2011: £1,719m), principally relating to the store development programme.

Contingent liabilities

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 25 February 2012, Tesco Bank had commitments of formal standby facilities, credit lines and other commitments to lend, totalling £7.4bn (2011: £7.1bn). 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 an institution 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, from 1 April 2012, this has increased from 12 month LIBOR + 30 basis points to 12 month LIBOR + 100 basis points.

The FSCS meets its obligations by raising management expense levies which will be kept based on limits advised by the FSA. 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 25 February 2012, Tesco Bank accrued £5m (2011: £3m) 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.

Notes to the Group financial statements

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:

	2012 £m	2011 £m
Tier 1 capital:		
Shareholders' funds and non-controlling interests	714	761
Tier 2 capital:		
Qualifying subordinated debt	375	235
Other interests	22	18
Supervisory deductions	(365)	(365)
Total regulatory capital	746	649

The movement of tier 1 capital during the financial year is analysed as follows:

	2012 £m	2011 £m
At beginning of the year	761	576
Share capital and share premium	112	446
Profit attributable to shareholders	65	57
Other reserves	6	–
Ordinary dividends	(108)	(162)
Increase in intangible assets	(122)	(156)
At end of the year	714	761

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 FSA. 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	
	2012 £m	2011 £m	2012 £m	2011 £m
Within one year	39	56	32	50
Greater than one year but less than five years	58	81	20	44
After five years	222	206	114	104
Total minimum lease payments	319	343	166	198
Less future finance charges	(153)	(145)		
Present value of minimum lease payments	166	198		
Analysed as:				
Current finance lease payables	32	50		
Non-current finance lease payables	134	148		
	166	198		

Note 34 Leasing commitments continued

Operating lease commitments – Group as lessee

Future minimum rentals payable under non-cancellable operating leases are as follows:

	2012 £m	2011 £m
Within one year	1,289	1,138
Greater than one year but less than five years	4,797	4,246
After five years	11,237	10,631
Total minimum lease payments	17,323	16,015

Future minimum rentals payable under non-cancellable operating leases after five years are analysed further as follows:

	2012 £m	2011 £m
Greater than five years but less than ten years	4,667	4,203
Greater than ten years but less than fifteen years	3,245	3,023
After fifteen years	3,325	3,405
Total minimum lease payments – after five years	11,237	10,631

Future minimum rentals payable under non-cancellable operating leases associated with the discontinued operations in Japan included in the above tables amount to £nil (2011: £132m). 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

Since 1988 the Group has entered into several joint ventures and sold and leased back properties to and from these joint ventures. The terms of these sale and leasebacks vary, however, common factors include: the sale of the properties to the joint venture at market value; options within the lease for the Group to repurchase the properties at market value; market rent reviews; and 20 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:

	2012 £m	2011 £m
Within one year	241	286
Greater than one year but less than five years	398	537
After five years	297	306
Total minimum lease receivables	936	1,129

Note 35 Events after the reporting period

On 5 March 2012, Ek-Chai Distribution System Co. Ltd. ('Tesco Lotus'), announced the final offering price of the Initial Public Offering of Tesco Lotus Retail Growth Freehold and Leasehold Property ('TLGF'). Tesco Lotus subscribed for 25% of the available units in TLGF. The units commenced trading on the Stock Exchange of Thailand on 19 March 2012.

Tesco PLC – Parent Company balance sheet

	notes	25 February 2012 £m	26 February 2011 £m
Non-current assets			
Investments	5	13,675	12,710
Derivative financial instruments	10	1,706	1,131
		15,381	13,841
Current assets			
Derivative financial instruments	10	19	142
Debtors	6	8,807	8,717
Current asset investments	7	1,289	1,022
		10,115	9,881
Creditors – amounts falling due within one year			
Borrowings	9	(1,437)	(699)
Derivative financial instruments	10	(90)	(138)
Other creditors	8	(5,708)	(5,397)
		(7,235)	(6,234)
Net current assets		2,880	3,647
Total assets less current liabilities		18,261	17,488
Creditors – amounts falling due after more than one year			
Borrowings	9	(9,433)	(9,002)
Derivative financial instruments	10	(620)	(567)
		(10,053)	(9,569)
Net assets		8,208	7,919
Capital and reserves			
Called up share capital	13	402	402
Share premium	14	4,964	4,896
Profit and loss reserve	14	2,842	2,621
Total equity		8,208	7,919

The notes on pages 143 to 150 form part of these financial statements.

Philip Clarke
Laurie McIlwee

Directors

The Parent Company financial statements on pages 142 to 150 were authorised for issue by the Directors on 4 May 2012 and are subject to the approval of the shareholders at the Annual General Meeting on 29 June 2012.

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 25 February 2012 (prior financial year 52 weeks to 26 February 2011).

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 Parent Company Profit and Loss Account over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

Where the Company awards options to employees of subsidiary entities, this is treated as a capital contribution.

Financial instruments

Financial assets and financial liabilities are recognised on the 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 Parent Company Profit and Loss Account. If a forecasted hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the Company Profit and Loss Account.

Pensions

The Company participates in the Tesco PLC Pension Scheme which is a multi-employer scheme within the Tesco Group and cannot identify its share of the underlying assets and liabilities of the scheme. Accordingly, as permitted by FRS 17 'Retirement Benefits', the Company has accounted for the scheme as a defined contribution scheme, and the charge for the period is based upon the cash contributions payable.

Taxation

Corporation tax payable is provided on the taxable profit for the year, using 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

	2012 £m	2011 £m
Fees payable to the Company's auditor for the audit of the Company and Group financial statements	0.7	0.6

Note 3 Employment costs, including Directors' remuneration

	2012 £m	2011 £m
Wages and salaries	16	14
Social security costs	2	2
Pension costs	1	1
Share-based payment expense	7	26
	26	43

The average number of employees (all Directors of the Company) during the financial year was 15 (2011: 16).

The Schedule VI requirements for Directors' remuneration are included within the Directors' remuneration report on pages 64 to 86.

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 26 February 2011	13,229	16	13,245
Additions	969	–	969
Disposals	(4)	–	(4)
At 25 February 2012	14,194	16	14,210
Impairment			
At 26 February 2011	535	–	535
At 25 February 2012	535	–	535
Net carrying value			
At 25 February 2012	13,659	16	13,675
At 26 February 2011	12,694	16	12,710

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

	2012 £m	2011 £m
Amounts owed by group undertakings	8,611	8,520
Amounts owed by joint ventures and associates*	177	178
Other debtors	15	13
Deferred tax asset**	4	6
	8,807	8,717

Amounts owed by group undertakings are either interest-bearing or non interest-bearing depending on the type and duration of debtor relationship.

* The amounts owed by joint ventures and associates of £117m (2011: £178m) are 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 26 February 2011	8	(2)	6
Charge to the Profit and Loss Account for the year	(2)	–	(2)
At 25 February 2012	6	(2)	4

Note 7 Current asset investments

	2012 £m	2011 £m
Short-term investments	1,243	1,022
Short-term deposits and cash at bank	46	–
	1,289	1,022

Note 8 Other creditors

	2012 £m	2011 £m
Amounts falling due within one year:		
Other tax and social security	2	2
Amounts owed to group undertakings	5,640	5,217
Other liabilities	66	178
	5,708	5,397

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	2012 £m	2011 £m
Bank loans and overdrafts	–	–	123	101
Loans from joint ventures	–	–	10	20
3.875% MTN	€389m	2011	–	346
5.625% MTN	€1,500m	2012	1,304	1,317
5% MTN	£600m	2014	619	606
2.0% MTN	\$500m	2014	317	–
5.125% MTN	€600m	2015	526	510
4% RPI MTN*	£282m	2016	288	276
5.875% MTN	€1,039m	2016	1,042	997
2.7% MTN	\$500m	2017	318	–
5.5% USD Bond	\$850m	2017	659	600
3.455% MTN	€750m	2018	638	–
5.5% MTN	£350m	2019	352	351
6.125% MTN	£900m	2022	892	891
5% MTN	£389m	2023	401	390
3.322% LPI MTN**	£287m	2025	290	279
6% MTN	£200m	2029	251	218
5.5% MTN	£200m	2033	249	215
1.982% RPI MTN†	£240m	2036	242	231
6.15% USD Bond	\$1,150m	2037	896	804
5% MTN	£173m	2042	174	174
5.125% MTN	€600m	2047	635	577
5.2% MTN	£279m	2057	274	274
Other MTNs	–	–	124	281
Other loans	–	–	246	243
			10,870	9,701

* 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.

	2012 £m	2011 £m
Repayment analysis:		
Amounts falling due within one year	1,437	699
	1,437	699
Amounts falling due after more than one year:		
Amounts falling due between one and two years	1,306	1,321
Amounts falling due between two and five years	1,856	1,401
Amounts falling due after more than five years	6,271	6,280
	9,433	9,002
	10,870	9,701

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:

	2012		2011	
	Asset £m	Liability £m	Asset £m	Liability £m
Current	19	(90)	142	(138)
Non-current	1,706	(620)	1,131	(567)
Total	1,725	(710)	1,273	(705)

	2012				2011			
	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	81	1,065	–	–	13	665	(21)	400
Cross currency swaps	818	2,686	(8)	269	728	2,674	(39)	714
Cash flow hedges								
Interest rate swaps and similar instruments	–	–	(132)	400	–	–	(54)	400
Cross currency swaps	233	304	(41)	988	126	298	(151)	784
Index-linked swaps	30	809	–	–	–	–	(8)	772
Forward foreign currency contracts	1	285	(4)	616	–	–	(1)	145
Net investment hedges								
Forward foreign currency contracts	–	–	(7)	969	19	383	(97)	952
Cash flow hedge and net investment hedges								
Cross currency swaps	–	–	(1)	318	–	–	–	–
Derivatives not in a formal hedge relationship								
Index-linked swaps	539	3,089	(468)	3,089	377	2,639	(310)	2,639
Forward foreign currency contracts	23	782	(49)	1,034	10	400	(24)	550
Total	1,725	9,020	(710)	7,683	1,273	7,059	(705)	7,356

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:

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

Note 11 Share-based payments continued

For the year ended 26 February 2011	Savings-related share option scheme		Approved share option scheme		Unapproved share option scheme		Nil cost share options	
	Options	WAEF	Options	WAEF	Options	WAEF	Options	WAEF
Outstanding at 27 February 2010	36,106	315.87	53,381	280.99	14,549,529	347.65	9,185,455	0.00
Granted	5,516	386.00	35,730	419.80	3,150,544	419.80	4,148,918	0.00
Forfeited	–	–	–	–	–	–	(499,596)	0.00
Exercised	(7,788)	248.00	(24,781)	242.11	(3,331,503)	252.23	(435,650)	0.00
Outstanding at 26 February 2011	33,834	342.93	64,330	373.06	14,368,570	385.59	12,399,127	0.00
Exercisable as at 26 February 2011	–	–	28,600	314.68	4,797,618	377.97	3,744,903	0.00
Exercise price range (pence)	–	–	–	312.75 to 318.60	–	312.75 to 473.75	–	0.00
Weighted average remaining contractual life (years)	–	–	–	4.51	–	5.30	–	6.74

Share bonus schemes

The number and WAFV of share bonuses awarded during the financial year relating to the Company employees are:

	2012		2011	
	Shares number	WAFV pence	Shares number	WAFV pence
Shares in Success	5,045	416.26	5,766	416.23
Executive Incentive Scheme	195,497	411.75	292,085	388.05
Performance Share Plan	500,615	407.09	218,620	433.79
US Long-Term Incentive Plan	–	–	74,997	433.06

Note 12 Pensions

The total cost of the pension scheme to the Company was £1m (2011: £1m). 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

	2012		2011	
	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	8,046,468,092	402	7,985,044,057	399
Share options	23,490,825	1	36,535,102	2
Share bonus awards	32,656,313	2	24,888,933	1
Shares purchased for cancellation	(70,802,785)	(3)	–	–
At end of the year	8,031,812,445	402	8,046,468,092	402

During the financial year, 23 million (2011: 37 million) ordinary shares of 5p each were issued in relation to share options for an aggregate consideration of £69m (2011: £97m).

During the financial year, 33 million (2011: 25 million) shares of 5p each were issued in relation to share bonus awards for an aggregate consideration of £2m (2011: £1m).

During the financial year the Company purchased and cancelled 70.8 million (2011: nil) shares of 5p each representing 1% (2011: 0%) of the called up share capital as at 25 February 2012 at an average price of £4.07 (2011: n/a) per share. The total consideration including expenses was £290m (2011: n/a). The excess of the consideration over the aggregate nominal value of the shares purchased has been charged to the profit and loss reserve.

Notes to the Parent Company financial statements

Note 13 Called up share capital continued

Between 26 February 2012 and 13 April 2012, options over 2,779,741 ordinary shares have been exercised under the terms of the Savings-related Share Option Scheme (1981) and the Irish Savings-related Share Option Scheme (2000). Between 26 February 2012 and 13 April 2012, options over 937,548 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 25 February 2012, the Directors were authorised to purchase up to a maximum in aggregate of 803.6 million (2011: 802.1 million) ordinary shares.

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

Capital redemption reserve

Upon cancellation of the shares purchased as part of the share buy-back, a capital redemption reserve is created representing the nominal value of the shares cancelled. This is a non-distributable reserve. Details of the capital redemption reserve are set out in the Group Statement of Changes in Equity.

Note 14 Reserves

	2012 £m	2011 £m
Share premium		
At beginning of the year	4,896	4,801
Premium on issue of shares less costs	68	95
At end of the year	4,964	4,896
Profit and loss reserve		
At beginning of the year	2,621	2,731
Share-based payments	111	161
Shares purchased for cancellation – profit and loss reserve	(290)	–
Shares purchased for cancellation – capital redemption reserve	3	–
Dividends authorised in the year	(1,180)	(1,081)
Losses on cash flow hedges	79	(6)
Profit after tax for the year	1,498	816
At end of the year	2,842	2,621

Independent auditors' report to the members of Tesco PLC

We have audited the Parent Company financial statements of Tesco PLC for the 52 weeks ended 25 February 2012 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 88, 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 25 February 2012;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the 52 weeks ended 25 February 2012 for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the Group financial statements of Tesco PLC for the 52 weeks ended 25 February 2012.

Richard Winter (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
4 May 2012

Five year record

	2008	2009	2010	2011 ¹	2012 ¹
Financial statistics (£m)					
Sales including VAT excluding IFRIC 13	51,773	59,426	62,537	67,074	72,035
Revenue excluding IFRIC 13	47,298	53,898	56,910	61,174	65,166
Operating profit²	2,791	3,169³	3,457	3,917	3,985
Operating profit margin²	5.9%	5.9%	6.1%	6.4%	6.1%
Share of post-tax profits of joint ventures and associates	75	110	33	57	91
Net finance costs	(63)	(362)	(314)	(333)	(241)
Profit before tax	2,803	2,917³	3,176	3,641	3,835
Taxation	(673)	(779)	(840)	(864)	(879)
Profit for the year from continuing operations	2,130	2,138	2,336	2,777	2,956
Discontinued operations	–	–	–	(106)	(142)
Profit for the period	2,130	2,138	2,336	2,671	2,814
Attributable to:					
Owners of the parent	2,124	2,133 ³	2,327	2,655	2,806
Non-controlling interests	6	5	9	16	8
Underlying profit before tax – continuing operations⁴	2,846	3,124	3,395	3,853	3,915
Other financial statistics					
Diluted earnings per share – continuing operations	26.61p	26.96p	29.19p	34.25p	36.64p
Underlying diluted earnings per share – continuing operations	27.02p	28.87p	31.66p	36.26p	37.41p
Dividend per share ⁵	10.90p	11.96p	13.05p	14.46p	14.76p
Return on capital employed ('ROCE') ⁴	12.7% ⁶	12.8% ⁷	12.1%	12.9% ⁸	13.3%
Total shareholder return ⁴	22.8%	8.0%	9.5%	6.7%	(3.0%)
Net debt (£m)	6,182	9,600	7,929	6,790	6,838
Enterprise value ⁹ (£m)	37,656	35,907	41,442	39,462	32,324
Retail statistics					
Number of stores	3,751	4,332	4,836	5,265 ¹⁰	6,234
Total sales area – 000 sq ft ¹¹	76,867 ¹²	88,556 ¹²	95,231 ¹³	103,172 ¹⁰	112,433
Average employees	444,127	468,508	472,094	488,347	519,671
Average full-time equivalents	345,737	364,015	366,413	382,049	406,088

1 During the financial year, the Group announced its decision to sell its operations in Japan. Accordingly, these operations have been treated as discontinued in 2012. The 2011 statistics have been re-presented to be consistent with 2012. Prior years have not been re-presented.

2 Operating profit includes integration costs and profit arising on sale of fixed assets. Operating margin is based upon revenue excluding VAT.

3 The Group adopted IFRIC 13 'Customer Loyalty Programmes' and the amendments to IFRS 2 'Share-Based Payment' from 24 February 2008. Periods before this date have not been restated.

4 See glossary for definitions.

5 Dividend per share relating to the interim and proposed final dividend.

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

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.

Financial calendar

Financial year end 2011/12	25 February 2012
Final ex-dividend date	25 April 2012
Record date	27 April 2012
Q1 Interim Management Statement	11 June 2012
Annual General Meeting	29 June 2012
Final dividend payment date	6 July 2012
Half-year end 2012/13	25 August 2012
Interim Results	October 2012
Q3 Interim Management Statement	December 2012
Financial year ended 2012/13	23 February 2013

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 a five-year period.

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.

Printed at Pureprint Group Ltd, ISO14001, FSC certified and CarbonNeutral®

