

Financial Statements

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Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and Financial Statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year that 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 have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and have elected to prepare the Parent Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 101 'Reduced Disclosure Framework' (UK Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether IFRSs as adopted by the European Union and applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Group and Company financial statements respectively; 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 are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and 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. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Having taken all the matters considered by the Board and brought to the attention of the Board during the year into account, we are satisfied that the Annual Report and Financial Statements, taken as a whole, is fair, balanced and understandable.

The Board believes that the disclosures set in this Annual Report provide the information necessary for shareholders to assess the Group's performance, business model and strategy.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names and functions are listed on pages 54 to 55, confirms that, to the best of their knowledge:

- the Group financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
- the Strategic Report and Directors' Report contained in the Annual Report and Financial Statements include a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

By order of the Board

Tim Fallowfield
Company Secretary and Corporate Services Director
 2 May 2017

Independent auditors' report to the members of J Sainsbury plc

Our opinion on the financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 11 March 2017 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including FRS 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

What we have audited

J Sainsbury plc's financial statements for the 52 weeks ended 11 March 2017 comprise:

| Group | Parent company |
|---|---|
| Consolidated income statement | Balance sheet |
| Group statement of comprehensive income | Statement of changes in equity |
| Group balance sheet | Related notes 1 to 12 to the financial statements |
| Group cash flow statement | |
| Group statement of changes in equity | |
| Related notes 1 to 37 to the financial statements | |

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

Overview of our audit approach

Risks of material misstatement

- Supplier arrangements
- Aspects of revenue recognition
- HRG acquisition purchase price allocation
- Financial Services customer receivables impairment
- IT environment

Audit scope

- We performed a full scope audit of the complete financial information of the following components: J Sainsbury plc, Sainsbury's and Argos trading entities and Sainsbury's Bank. We performed audit procedures on specific balances including for the property companies, joint ventures and the insurance company due to the size and risk of certain individual balances within these components.
- The components where we performed full or specific audit procedures accounted for 92 per cent of profit before tax before items noted below, 99 per cent of revenue and 96 per cent of total assets.

Materiality

- Overall Group materiality is £34 million which represents 5.1 per cent of profit before tax before items noted below.

Our assessment of risk of material misstatement

We identified the risks of material misstatement described below as those that had the greatest effect on our overall audit strategy, the allocation of resources in the audit and the direction of the efforts of the audit team. In addressing these risks, we have performed the procedures below which were designed in the context of the financial statements as a whole and, consequently, we do not express any opinion on these individual areas.

Changes from the prior year

The Group acquired Home Retail Group plc in the year and we have reflected this in our risk assessment, the results of which are below.

We have identified similar risks of material misstatements in Home Retail Group compared to the pre-existing Sainsbury's Group. We have therefore included the risks relating to legacy Home Retail Group components Argos and Argos Financial Services together where appropriate in the risks below and we have adopted a similar audit strategy where possible.

We have designated Argos as a full scope component and performed audit procedures on specific balances including in the Argos Financial Services and Argos Asia entities.

Risk

Supplier arrangements

Refer to the Audit Committee Report (page 68); Accounting policies (page 114); and note 2 of the Consolidated Financial Statements (page 114)

The Group receives material discounts from suppliers, referred to as supplier arrangements. Complex supplier arrangements recognised in the income statement for the financial year are £343 million (2015/16: £371 million). These arrangements are described in note 2 to the financial statements.

We focused our audit procedures on the areas where management applies judgement, where the processing is either manual or more complex and where the quantum of agreements is high.

Our response to the risk

- We walked through the controls in place within the supplier arrangements process. We were able to take a controls-reliance approach over certain aspects of the process, testing the key controls.
- We selected a sample of suppliers to whom we sent confirmations across all 'deal' types to confirm key deal input terms. We did not receive any responses where suppliers disagreed with the deal terms recorded. Where we did not receive a response from the supplier, we performed alternative procedures, including obtaining evidence of initiation and settlement of the arrangement.
- We tested the existence and valuation of balance sheet amounts recognised in accounts receivable and as a contra-asset in accounts payable by reviewing post period end settlement. We also performed a 'look-back' analysis of prior period balance sheet amounts to check that these amounts were appropriately recovered.
- We tested the settlement of a sample of supplier arrangements recognised in the income statement, which included settlement in cash or by off-set to accounts payable.
- Using data extracted from the accounting system, we tested the appropriateness of journal entries and other adjustments to supplier arrangements to corroborating evidence.
- We tested deals recorded post period end and obtained the supplier agreement to validate that the deal was correctly recorded post period end.
- We read management's disclosure in respect of supplier arrangements amounts recorded in the income statement and balance sheet to confirm completeness and accuracy of amounts disclosed.

What we concluded to the Audit Committee

Supplier arrangement amounts are appropriately recognised in the income statement and balance sheet.

Risk

Aspects of revenue recognition

Refer to the Audit Committee Report (page 68); Accounting policies (page 120); and note 4 of the Consolidated Financial Statements (page 117)

Our assessment is that the vast majority of the Group's revenue transactions are non-complex, with no judgement applied over the amount recorded. We focused our work on the manual adjustments that are made to revenue.

Our procedures were designed to address the risk of manipulation of accounting records and the ability to override controls.

Our response to the risk

- We obtained a detailed understanding of these manual adjustments. Due to the manual nature of these adjustments, we performed substantive audit procedures.
- We used our computer-aided analytics tools to identify those revenue journals for which the corresponding entry was not cash. These entries include Nectar points, coupons and vouchers.
- We obtained corroborating evidence for such corresponding entries. For the Nectar points adjustment we obtained evidence from the administrator of the scheme. For third party coupons and vouchers we obtained evidence of collection and settlement.
- Using data extracted from the accounting system, we tested the appropriateness of journal entries impacting revenue, as well as other adjustments made in the preparation of the financial statements. We considered unusual journals such as those posted outside expected hours, or by unexpected individuals, and for large or unusual amounts.

What we concluded to the Audit Committee

Adjustments to revenue have been appropriately recognised.

Risk

Financial Services customer receivables impairment

Refer to the Audit Committee Report (page 68); Accounting policies (page 133); and note 15b of the Consolidated Financial Statements (page 133)

Financial Services customer receivables, through either credit cards, loans or Argos store cards, are significant. Total amounts recognised at 28 February 2017 are £4,602 million (2016: £3,344 million). The provision for impairment is £89 million (2016: £79 million). There is judgement in the assumptions applied to calculate the loan provisions against outstanding balances.

Our response to the risk

The audit of Sainsbury's Bank was completed by a component auditor from another audit firm. We agreed an audit strategy with the component auditor in advance of their testing and we reviewed the results of their work. The primary team performed the specific scope audit of Argos Financial Services. The audit strategy for both Sainsbury's Bank and Argos Financial Services included the following:

- The loan impairment methodology was reviewed to confirm it was consistent with both the IFRS requirements and that previously applied.
- The completeness and accuracy of the data from underlying systems that were used in the impairment models were tested.
- Key assumptions including the probability of default and the size of the loss if default occurred were assessed against internal and external evidence. The key assumptions within the models were compared to knowledge of assumptions used in the banking sector and also with internal historical trends, concluding that, based on the evidence obtained, management's conclusions were supportable.
- Changes to the modelling assumptions were assessed to confirm these were appropriate and in line with accounting standards.
- The accuracy of prior year impairment reserves was considered to assess the quality of management's estimation process.

What we concluded to the Audit Committee

The provision for impairment of Financial Services receivables due from customers is appropriately recognised.

Risk

HRG acquisition purchase price allocation

Refer to the Audit Committee Report (page 68); Accounting policies (page 169); and note 31 of the Consolidated Financial Statements (page 169)

The Group acquired Home Retail Group plc during the year. The provisional business combination fair values are outlined in note 31 to the financial statements.

We focused our risk on the areas where management applies judgement in the accounting and valuation of the acquired assets and liabilities, for example in calculation of the Argos brand.

Our response to the risk

- Our audit of the fair values of the acquired assets and liabilities was subject to full scope audit procedures by the primary team.
- We walked through the controls in place within the purchase price accounting process and understood management's process to be in line with IFRS 3 Business Combinations.
- We corroborated management's assumptions by comparing to relevant available information assisted by our business valuation specialists. In particular, we challenged the discount rate and the useful economic life of the Argos brand.
- We tested the prospective financial information utilised in the calculation of the valuations based on the viewpoint of a market participant as defined by IFRS 13 Fair Value Measurement.
- We evaluated the adequacy of the business combination disclosures to the requirements in IFRS 3.

What we concluded to the Audit Committee

The provisional purchase price allocation is appropriately recognised.

Risk

The IT environment

The IT systems across the Group are complex and there are varying levels of integration between them. The systems are vital to the ongoing operations of the business and to the integrity of the financial reporting process.

For Sainsbury's Bank the key system relating to the customer loan receivable impairment, as described above, is provided by an external party.

Our response to the risk

- We held discussions with management to understand the IT environment and walked through the key financial processes to understand where IT systems were integral to the Group's controls over financial reporting. From this we identified which IT systems to include in the scope for our detailed IT testing.
- We assessed the IT general controls environment for the key systems impacting the accurate recording of transactions and the presentation of the financial statements.
- We designed our IT audit procedures to assess the IT environment, including an assessment of controls over changes made to the system and controls over appropriate access to the systems.
- Where we found that adequate IT general controls were not in place, we performed additional substantive testing to mitigate the risk of material misstatement.
- Sainsbury's Bank's auditors received a report from the auditors on the general control environment of the outsourced systems and followed up on matters arising, performing further procedures as necessary. We discussed the remediation work performed by Sainsbury's Bank's auditors and reviewed their work.

What we concluded to the Audit Committee

We have not identified any misstatements in the financial statements due to the limitations of the IT environment.

The scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of Group-wide controls, changes in the business environment and other factors such as recent Internal Audit results when assessing the level of work to be performed at each entity.

In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts of the components of the Group in the Group financial statements, we selected the head office company, J Sainsbury plc, Sainsbury's and Argos trading entities and Sainsbury's Bank components to perform full scope procedures. These represent the principal business units within the Group based on their size and risk characteristics.

For other entities including Argos Financial Services, the property companies, Argos Asia, joint ventures and insurance components we performed audit procedures on specific accounts which we considered had the potential for the greatest impact on the significant accounts in the financial statements either because of the size of these accounts or their risk profile.

The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage of significant accounts tested for the Group.

Of the remaining balances, none are individually greater than 5 per cent of the Group's profit before tax excluding items noted below. For these accounts, we performed other procedures, including analytical review, testing of consolidation journals and intercompany eliminations to respond to any potential risks of material misstatement to the Group financial statements.

Involvement with component teams

In establishing our overall approach to the Group audit, we determined the type of work needed to be undertaken at each of the components by us, as the primary audit engagement team, or by component auditors from other EY network firms operating under our instruction. Of the full scope components, audit procedures were performed on the head office company, J Sainsbury plc, Sainsbury's and Argos trading entities and consolidation of the Group by the primary team. The work at the specific scope locations was performed by EY components in Hong Kong, the Isle of Man and the primary team.

For the Sainsbury's Bank full scope component, where the work was performed by auditors from another audit firm, we instructed the component auditor to perform specified procedures in response to our risk assessment. During the current period's audit cycle, the Senior Statutory Auditor visited Sainsbury's Bank and held discussions with management. The team discussed the audit approach with the component team and significant issues arising from their work, reviewing key audit working papers on risk areas. The closing discussion was attended by the primary team. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £34 million, which is 5.1 per cent of profit before tax excluding the items described below. We believe that this materiality basis provides us with the best assessment of the requirements of the users of the financial statements. This is consistent with the approach taken in the prior period.

| | | |
|-----------------------|--|--------|
| Starting basis | Profit before tax | £503m |
| Adjustments | Net impairment and onerous contract charge | £37m |
| | Argos transaction and integration costs | £53m |
| | Sainsbury's Bank transition costs | £60m |
| | Business rationalisation | (£72m) |
| | IT write-offs | £57m |
| | Restructuring costs | £33m |
| Materiality | Profit before tax excluding adjustments | £671m |
| | Materiality (5.1% of materiality basis) | £34m |

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was approximately 75 per cent (2015/16: 50 per cent) of our planning materiality, namely £25 million (2015/16: £15 million). The reason for the change is that we have assessed the risk of material misstatement to be lower now this is no longer our first audit.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current period, the range of performance materiality allocated to components was £5 million to £19 million (2015/16: £3 million to £11 million).

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £1.7 million (2015/16: £1.5 million), which is set at 5 per cent of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

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 and 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 to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Respective responsibilities of Directors and auditor

As explained more fully in the Statement of Directors' responsibilities set out on page 100, the Directors are responsible for the preparation of the 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 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 is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

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 based on the work undertaken in the course of the audit:
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements;

Matters on which we are required to report by exception

| | | |
|--|---|----------------------------------|
| ISAs (UK and Ireland) reporting | <p>We are required to report to you if, in our opinion, financial and non-financial information in the Annual Report is:</p> <ul style="list-style-type: none"> — materially inconsistent with the information in the audited financial statements; or — apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or — otherwise misleading. <p>In particular, we are required to report whether we have identified any inconsistencies between our knowledge acquired in the course of performing the audit and the Directors' statement that they consider the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy; and whether the Annual Report appropriately addresses those matters that we communicated to the Audit Committee that we consider should have been disclosed.</p> | We have no exceptions to report. |
| Companies Act 2006 reporting | <p>In light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report or Directors' Report.</p> <p>We are required to report to you if, in our opinion:</p> <ul style="list-style-type: none"> — 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. | We have no exceptions to report. |
| Listing Rules review | <p>We are required to review:</p> <ul style="list-style-type: none"> — the Directors' statement in relation to going concern, set out on page 45, and longer-term viability, set out on page 45; and — the part of the Corporate Governance Statement relating to the Company's compliance with the provisions of the UK Corporate Governance Code specified for our review. | We have no exceptions to report. |

Statement on the Directors' assessment of the principal risks that would threaten the solvency or liquidity of the entity

| | | |
|--|--|--|
| ISAs (UK and Ireland) reporting | <p>We are required to give a statement as to whether we have anything material to add or to draw attention to in relation to:</p> <ul style="list-style-type: none"> — the Directors' confirmation in the Annual Report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity; — the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated; — the Directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements; and — the Directors' explanation in the Annual Report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions. | We have nothing material to add or to draw attention to. |
|--|--|--|

Nigel Jones

(Senior statutory auditor)

for and on behalf of Ernst & Young LLP,
Statutory Auditor London
2 May 2017

- 1 The maintenance and integrity of the J Sainsbury plc website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- 2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement

for the 52 weeks to 11 March 2017

| | Note | 2017 £m | 2016 £m |
|---|------|-----------------|------------|
| Revenue | 4 | 26,224 | 23,506 |
| Cost of sales | | (24,590) | (22,050) |
| Gross profit | | 1,634 | 1,456 |
| Administrative expenses | 5 | (1,207) | (850) |
| Other income | 5 | 215 | 101 |
| Operating profit | | 642 | 707 |
| Finance income | 6 | 34 | 19 |
| Finance costs | 6 | (136) | (167) |
| Share of post-tax loss from joint ventures and associates | 12 | (37) | (11) |
| Profit before tax | | 503 | 548 |
| Analysed as: | | | |
| Underlying profit before tax | 3 | 581 | 587 |
| Non-underlying items | 3 | (78) | (39) |
| | | 503 | 548 |
| Income tax expense | 7 | (126) | (77) |
| Profit for the financial year | | 377 | 471 |
| Earnings per share | 8 | pence | pence |
| Basic | | 17.5 | 23.9 |
| Diluted | | 16.5 | 22.5 |
| Underlying basic | | 21.8 | 24.2 |
| Underlying diluted | | 20.4 | 22.8 |

The notes on pages 111 to 177 form an integral part of these financial statements.

Consolidated statement of comprehensive income

for the 52 weeks to 11 March 2017

| | Note | 2017 £m | 2016 £m |
|---|------|--------------|------------|
| Profit for the financial year | | 377 | 471 |
| Items that will not be reclassified subsequently to the income statement | | | |
| Remeasurement on defined benefit pension schemes | 29 | (407) | 121 |
| Current tax relating to items not reclassified | 7 | 41 | – |
| Deferred tax relating to items not reclassified | 7 | 28 | (36) |
| | | (338) | 85 |
| Items that may be reclassified subsequently to the income statement | | | |
| Currency translation differences | 20 | 5 | 2 |
| Available-for-sale financial assets fair value movements | | | |
| Attributable to Group | | 10 | (1) |
| Items reclassified from available-for-sale assets reserve | 20 | (1) | – |
| Cash flow hedges effective portion of fair value movements | | | |
| Attributable to Group | 20 | 115 | 4 |
| Attributable to joint ventures and associates | 20 | – | 1 |
| Items reclassified from cash flow hedge reserve | 20 | (87) | 7 |
| Current tax relating to items that may be reclassified | 7 | (1) | – |
| Deferred tax relating to items that may be reclassified | 7 | 5 | 3 |
| | | 46 | 16 |
| Total other comprehensive (expense)/income for the year (net of tax) | | (292) | 101 |
| Total comprehensive income for the year | | 85 | 572 |

The notes on pages 111 to 177 form an integral part of these financial statements.

Consolidated balance sheet

At 11 March 2017 and 12 March 2016

| | Note | 2017 £m | 2016 £m |
|--|------|----------------|------------|
| Non-current assets | | | |
| Property, plant and equipment | 10 | 10,006 | 9,764 |
| Intangible assets | 11 | 742 | 329 |
| Investments in joint ventures and associates | 12 | 237 | 327 |
| Available-for-sale financial assets | 13 | 435 | 340 |
| Other receivables | 15a | 69 | 103 |
| Amounts due from Financial Services customers | 15b | 1,916 | 1,649 |
| Derivative financial instruments | 24 | 10 | 17 |
| | | 13,415 | 12,529 |
| Current assets | | | |
| Inventories | 14 | 1,775 | 968 |
| Trade and other receivables | 15a | 574 | 508 |
| Amounts due from Financial Services customers | 15b | 2,686 | 1,695 |
| Available-for-sale financial assets | 13 | 100 | 48 |
| Derivative financial instruments | 24 | 94 | 51 |
| Cash and cash equivalents | 25b | 1,083 | 1,143 |
| | | 6,312 | 4,413 |
| Assets held for sale | 16 | 10 | 31 |
| | | 6,322 | 4,444 |
| Total assets | | 19,737 | 16,973 |
| Current liabilities | | | |
| Trade and other payables | 17a | (3,741) | (3,077) |
| Amounts due to Financial Services customers and other deposits | 17b | (4,284) | (3,173) |
| Borrowings | 27 | (172) | (223) |
| Derivative financial instruments | 24 | (22) | (43) |
| Taxes payable | | (219) | (158) |
| Provisions | 18 | (135) | (46) |
| | | (8,573) | (6,720) |
| Liabilities held for sale | 16 | – | (4) |
| | | (8,573) | (6,724) |
| Net current liabilities | | (2,251) | (2,280) |
| Non-current liabilities | | | |
| Other payables | 17a | (304) | (269) |
| Amounts due to Financial Services customers and other deposits | 17b | (637) | (582) |
| Borrowings | 27 | (2,039) | (2,190) |
| Derivative financial instruments | 24 | (38) | (69) |
| Deferred income tax liability | 7 | (172) | (237) |
| Provisions | 18 | (128) | (129) |
| Retirement benefit obligations | 29 | (974) | (408) |
| | | (4,292) | (3,884) |
| Net assets | | 6,872 | 6,365 |
| Equity | | | |
| Called up share capital | 19 | 625 | 550 |
| Share premium account | 19 | 1,120 | 1,114 |
| Capital redemption reserve | 20 | 680 | 680 |
| Merger reserve | 19 | 568 | – |
| Other reserves | 20 | 193 | 155 |
| Retained earnings | 22 | 3,190 | 3,370 |
| Total equity before perpetual securities | | 6,376 | 5,869 |
| Perpetual capital securities | 21 | 248 | 248 |
| Perpetual convertible bonds | 21 | 248 | 248 |
| Total equity | | 6,872 | 6,365 |

The notes on pages 111 to 177 form an integral part of these financial statements.

The financial statements on pages 106 to 177 were approved by the Board of Directors on 2 May 2017, and are signed on its behalf by:

Mike Coupe Chief Executive
Kevin O'Byrne Chief Financial Officer

Consolidated cash flow statement

for the 52 weeks to 11 March 2017

| | Note | 2017 £m | 2016 £m |
|--|------|--------------|------------|
| Cash flows from operating activities | | | |
| Cash generated from operations | 25a | 1,323 | 624 |
| Interest paid | | (95) | (108) |
| Corporation tax paid | | (75) | (124) |
| Net cash generated from operating activities | | 1,153 | 392 |
| Cash flows from investing activities | | | |
| Purchase of property, plant and equipment | | (634) | (646) |
| Purchase of intangible assets | | (110) | (34) |
| Proceeds from disposal of property, plant and equipment | | 55 | 109 |
| Receipt of advance disposal proceeds | | – | 125 |
| Acquisition of subsidiaries, net of cash acquired | 31 | 101 | – |
| Capital return to Home Retail Group plc shareholders | 31 | (226) | – |
| Share issuance costs on acquisition of Home Retail Group plc | 31 | (3) | – |
| Investment in joint ventures | 12 | (16) | (18) |
| Disposal of subsidiaries | | – | (1) |
| Interest received | 12 | 18 | 19 |
| Dividends and distributions received | | 65 | 46 |
| Net cash used in investing activities | | (750) | (400) |
| Cash flows from financing activities | | | |
| Proceeds from issuance of ordinary shares | | 6 | 8 |
| Drawdown of short-term borrowings | | 448 | – |
| Repayment of short-term borrowings | | (492) | (95) |
| Repayment of long-term borrowings | | (130) | (238) |
| Proceeds from the issue of perpetual capital securities | 21 | – | 247 |
| Proceeds from the issue of perpetual convertible bonds | 21 | – | 247 |
| Purchase of own shares | | – | (20) |
| Repayment of capital element of obligations under finance lease payments | | (37) | (30) |
| Interest elements of obligations under finance lease payments | | (8) | (9) |
| Dividends paid on ordinary shares | 9 | (230) | (234) |
| Dividends paid on perpetual securities | 21 | (23) | (4) |
| Net cash used in financing activities | | (466) | (128) |
| Net decrease in cash and cash equivalents | | (63) | (136) |
| Opening cash and cash equivalents | | 1,140 | 1,276 |
| Effects of foreign exchange rates | | – | – |
| Closing cash and cash equivalents | 25b | 1,077 | 1,140 |

The notes on pages 111 to 177 form an integral part of these financial statements.

Consolidated statement of changes in equity

for the 52 weeks to 11 March 2017

| | Note | Called up share capital £m | Share premium account £m | Capital redemption and other reserves £m | Merger reserve £m | Retained earnings £m | Total equity before perpetual securities £m | Perpetual capital securities £m | Perpetual convertible bonds £m | Total equity £m |
|--|--------|-------------------------------|-----------------------------|---|----------------------|-------------------------|--|------------------------------------|-----------------------------------|--------------------|
| At 13 March 2016 | | 550 | 1,114 | 835 | — | 3,370 | 5,869 | 248 | 248 | 6,365 |
| Profit for the year | 21, 22 | — | — | — | — | 359 | 359 | 12 | 6 | 377 |
| Other comprehensive income/(expense) | 20, 22 | — | — | 46 | — | (338) | (292) | — | — | (292) |
| Total comprehensive income for the year ended 11 March 2017 | | — | — | 46 | — | 21 | 67 | 12 | 6 | 85 |
| Transactions with owners: | | | | | | | | | | |
| Dividends | 9, 22 | — | — | — | — | (232) | (232) | — | — | (232) |
| Acquisition of subsidiaries | 19, 22 | 75 | — | — | 568 | (3) | 640 | — | — | 640 |
| Adjustment to consideration in respect of share options (note 31) | 31 | — | — | — | — | 3 | 3 | — | — | 3 |
| Distribution to holders of perpetual securities (net of tax) | 21 | — | — | — | — | — | — | (12) | (6) | (18) |
| Amortisation of convertible bond equity component | 20, 22 | — | — | (8) | — | 8 | — | — | — | — |
| Share-based payment (net of tax) | 30 | — | — | — | — | 32 | 32 | — | — | 32 |
| Purchase of own shares | 22 | — | — | — | — | (9) | (9) | — | — | (9) |
| Allotted in respect of share option schemes | 19, 22 | — | 6 | — | — | — | 6 | — | — | 6 |
| At 11 March 2017 | | 625 | 1,120 | 873 | 568 | 3,190 | 6,376 | 248 | 248 | 6,872 |
| At 15 March 2015 | | | | | | | | | | |
| | | 548 | 1,108 | 826 | — | 3,057 | 5,539 | — | — | 5,539 |
| Profit for the year | 21, 22 | — | — | — | — | 452 | 452 | 13 | 6 | 471 |
| Other comprehensive income | 22 | — | — | 16 | — | 85 | 101 | — | — | 101 |
| Total comprehensive income for the year ended 12 March 2016 | | — | — | 16 | — | 537 | 553 | 13 | 6 | 572 |
| Transactions with owners: | | | | | | | | | | |
| Dividends | 9, 22 | — | — | — | — | (234) | (234) | — | — | (234) |
| Issue of perpetual subordinated capital securities and perpetual subordinated convertible bonds (net of tax) | 21 | — | — | — | — | — | — | 248 | 248 | 496 |
| Distributions to holders of perpetual subordinated convertible bonds (net of tax) | 21 | — | — | — | — | — | — | (13) | (6) | (19) |
| Amortisation of convertible bond equity component | 20, 22 | — | — | (7) | — | 7 | — | — | — | — |
| Share-based payment (net of tax) | 30 | — | — | — | — | 23 | 23 | — | — | 23 |
| Purchase of own shares | 22 | — | — | — | — | (20) | (20) | — | — | (20) |
| Allotted in respect of share option schemes | 19, 22 | 2 | 6 | — | — | — | 8 | — | — | 8 |
| At 12 March 2016 | | 550 | 1,114 | 835 | — | 3,370 | 5,869 | 248 | 248 | 6,365 |

The notes on pages 111 to 177 form an integral part of these financial statements.

Notes to the consolidated financial statements

1 Basis of preparation

J Sainsbury plc is a public limited company (the 'Company') incorporated in the United Kingdom, whose shares are publicly traded on the London Stock Exchange. The Company is domiciled in the United Kingdom and its registered address is 33 Holborn, London EC1N 2HT, United Kingdom.

The financial year represents the 52 weeks to 11 March 2017 (prior financial year 52 weeks to 12 March 2016). The consolidated financial statements for the 52 weeks to 11 March 2017 comprise the financial statements of the Company and its subsidiaries (the 'Group') and the Group's share of the post-tax results of its joint ventures and associates.

The Group's principal activities are Food, General Merchandise & Clothing retailing and Financial Services.

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and International Financial Reporting Interpretations Committee (IFRIC) and with those parts of the Companies Act 2006 applicable to companies reporting under IFRSs.

The financial statements are presented in sterling, rounded to the nearest million (£m) unless otherwise stated. They have been prepared on a going concern basis under the historical cost convention, except for derivative financial instruments, defined benefit scheme assets, investment properties and available-for-sale financial assets that have been measured at fair value.

Significant accounting policies have been included in the relevant notes to which the policies relate, and those relating to the financial statements as a whole can be read further below. Significant accounting policies have been applied consistently to all periods presented in the financial statements. As part of the acquisition of Home Retail Group plc an exercise has been performed to ensure that the accounting policies within both businesses are aligned. Based on this review, there have been no material changes to existing accounting policies from those disclosed in this Annual Report.

Basis of consolidation

The consolidated financial statements of the Group consist of the financial statements of the ultimate parent company J Sainsbury plc, all entities controlled by the Company and the Group's share of its interests in joint ventures and associates.

a) Subsidiaries

Subsidiaries are all entities (including structured entities) over which the Group has control. This is when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The results of subsidiaries are included in the income statement from the date of acquisition or, in the case of disposals, up to the effective date of disposal. Intercompany transactions and balances between Group companies are eliminated upon consolidation.

Sainsbury's Property Scottish Partnership and Sainsbury's Property Scottish Limited Partnership are two partnerships the Group has an interest in, which are fully consolidated into these Group accounts. The Group has taken advantage of the exemption conferred by Regulation 7 of the Partnerships ('Accounts') Regulations 2008 and has therefore not appended the accounts of these qualifying partnerships to these accounts. Separate accounts for these partnerships are not required to be, and have not been, filed at Companies House.

b) Joint ventures and associates

The Group applies IFRS 11 to all joint arrangements. Under IFRS 11, investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor. The Group has assessed the nature of its joint arrangements and determined them to be joint ventures. The Group's share of the post-tax results of its joint ventures and associates is included in the income

statement using the equity method of accounting. Where the Group transacts with a joint venture or associate, profits and losses are eliminated to the extent of the Group's interest in the joint venture or associate.

Investments in joint ventures and associates are carried in the Group balance sheet at historical cost plus post-acquisition changes in the Group's share of net assets of the entity, less any provision for impairment.

Associates are entities over which the Group has significant influence but not control.

Investment properties held by the Group are those contained within its joint ventures with Land Securities Group PLC and The British Land Company PLC. These are properties held for capital appreciation and/or to earn rental income. They are initially measured at cost, including related transaction costs. After initial recognition at cost, they are carried at their fair values based on market value determined by professional valuers at each reporting date. The difference between the fair value of an investment property at the reporting date and its carrying amount prior to re-measurement is included within the income statement but is excluded from underlying profit in order to provide a clear and consistent presentation of the underlying performance of the Group's ongoing business for shareholders.

Foreign currencies

The consolidated financial statements are presented in sterling, which is the ultimate parent company's functional currency.

a) Foreign operations

On consolidation, assets and liabilities of foreign operations are translated into sterling at year-end exchange rates. The results of foreign operations are translated into sterling at average rates of exchange for the year.

b) Foreign currency transactions

Transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

Amendments to published standards

Effective for the Group and Company in these financial statements:

The Group has considered the following amendments to published standards that are effective for the Group for the financial year beginning 13 March 2016 and concluded that they are either not relevant to the Group or that they do not have a significant impact on the Group's financial statements. These standards and interpretations have been endorsed by the European Union.

- Annual Improvements to IFRSs 2012–2014 Cycle
- Amendments to IAS 16, 'Property, plant and equipment' and IAS 38, 'Intangible assets' which clarifies acceptable methods of depreciation and amortisation
- Amendments to IFRS 11, 'Joint arrangements' on the accounting for acquisitions of interests in joint operations
- Amendments to IAS 16 and IAS 41, 'Bearer Plants'
- Amendments to IAS 1, 'Presentation of financial statements' which clarifies existing IAS 1 requirements
- Amendments to IAS 27, 'Consolidated and separate financial statements' which allow an entity to use the equity method as described in IAS 28 to account for its investments in subsidiaries
- Amendments to IFRS 10, 'Consolidated financial statements', IFRS 12, 'Disclosure of interests in other entities' and IAS 28, 'Investments in associates and joint ventures' on applying the consolidation exception

1 Basis of preparation continued

Standards and revisions effective for future periods:

The following standards and revisions will be effective for future periods:

- IFRS 9, 'Financial instruments'
- IFRS 15, 'Revenue from contracts with customers'
- IFRS 16, 'Leases'
- Amendments to IAS 7 'Statement of cash flows' on the disclosures in financial statements

IAS 7 is expected to impact disclosures only. The remaining standards have been considered in turn below:

IFRS 9 'Financial Instruments'

IFRS 9 will supersede IAS 39 in its entirety, and is effective for accounting periods commencing on or after 1 January 2018. For Sainsbury's, the effective date is the financial year commencing 11 March 2018. Any changes to recognition and measurement will be applied retrospectively by adjusting the opening balance sheet at that time. There is no requirement to restate comparative amounts.

The core areas addressed within IFRS 9 are as follows:

- Classification and measurement of financial assets and liabilities
- Impairment of financial assets
- Hedge accounting

The Group does not expect any material changes in relation to the classification and measurement of financial assets and liabilities, nor for hedge accounting other than additional disclosure requirements. The most significant impact on the Group is likely to be in relation to impairment of financial assets as outlined below.

Impairment of financial assets

Financial assets which are measured at amortised cost or fair value through other comprehensive income under IFRS 9 will be subject to the new impairment provisioning requirements of the standard, and it is this area which has the most impact on the Group in relation to loans and advances to customers within Financial Services.

Financial Services' current impairment policy under IAS 39 is to recognise losses only when an impairment event has been observed, and where an impairment event has arisen but has not yet been identified through observation of a specific impairment trigger. As a result, losses are generally not recognised when credit risk deteriorates, and only materialise when the deterioration results in an impairment event.

IFRS 9 introduces a three stage 'expected credit loss (ECL)' model which is forward looking and which generally will result in earlier recognition of credit losses. It is no longer necessary for an impairment event to have occurred before credit losses are recognised.

| | |
|----------------|---|
| Stage 1 | As soon as a financial instrument is originated or purchased, 12-month expected credit losses must be recognised in profit and loss and an impairment allowance will be established |
| Stage 2 | If the credit risk increases significantly (and the resulting credit quality is not considered to be low credit risk) full lifetime expected credit losses will be provided for |
| Stage 3 | Financial assets will move into Stage 3 when they are considered to be credit impaired, i.e. when one or more events have occurred that have a detrimental impact on the estimated future cash flows of the asset |

Implementation approach

The Group's implementation project has been in place since early 2015 (and has been expanded to incorporate subsidiaries acquired as part of the J Sainsbury's acquisition of Home Retail Group). The primary objectives of the project are to: define accounting policies in compliance with the standard; deliver the necessary data, system and operational changes; and update the credit provisioning models and overall governance framework. The project is being jointly led by Sainsbury's Bank's Finance and Credit Risk functions, with support from external professional advisers. The project has a steering committee in place to provide appropriate oversight and governance; and a Technical Working Group to ensure that policy decisions and approaches are appropriate and in line with industry practice.

The Bank has defined its approach and methodology for ECL provisioning under IFRS 9, and has been developing models to comply with the new requirements.

Key judgemental areas still to be concluded on include the determination of 'significant increase in credit risk' (which is the key concept for moving from 12-month ECL to lifetime ECL), and the approach to modelling future economic scenarios.

Until the ECL models are fully developed, the Group is unable to quantify the impact of transition to IFRS 9. Furthermore, the mapping of the three IFRS 9 impairment stages to regulatory treatment (specific versus general credit risk adjustments) is not clear at this time, pending further guidance from regulators. The Basel Committee for Banking Supervision (BCBS) has proposed a transitional approach to the impact of IFRS 9 on regulatory capital, whereby the Day 1 impact on CET1 capital may be spread over several years. The decision on whether or not to apply such an approach has been delegated to individual regulatory jurisdictions. The Group will fully consider the impact of IFRS 9 on the Bank's regulatory capital once these proposals have been finalised within the European Union.

IFRS 15 'Revenue from Contracts with Customers'

IFRS 15 'Revenue' will replace IAS 18 'Revenue' and IAS 11 'Construction Contracts' for accounting periods commencing on or after 1 January 2018. For Sainsbury's, the effective date is the financial year commencing 11 March 2018. Any changes to recognition and measurement will be applied retrospectively by adjusting the opening balance sheet at that time. There is no requirement to restate comparative amounts.

The core principle of the standard is that an entity will recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring promised goods or services to a customer.

To apply this principle, entities must follow the five-step model below:

- 1 Identify the contract(s) with a customer – written, oral or implied by an entity's customary business practices.
- 2 Identify the performance obligations in the contract(s) – evaluate the terms in the contract to identify all the promised goods or services and then determine which of these will be treated as separate performance obligations. They are separate if the customer can benefit from the good or service on its own (i.e. it is distinct).
- 3 Determine the transaction price – the amount that an entity expects to be entitled to in exchange for transferring goods or services to a customer, excluding amounts collected on behalf of third parties.
- 4 Allocate the transaction price to the performance obligations – generally in proportion to their stand-alone selling prices.
- 5 Recognise revenue when (or as) the entity satisfies each performance – when control of a promised good or service transfers to the customer.

The Group has performed a detailed impact assessment during the year, identifying all current sources of revenue and analysing the accounting requirements for each under IFRS 15. Currently the Group does not expect any material changes to either revenue or profit as a result of adopting IFRS 15.

1 Basis of preparation continued

IFRS 16 'Leases'

IFRS 16 'Leases' will replace IAS 17 'Leases' for accounting periods commencing on or after 1 January 2019. For Sainsbury's, the effective date is the financial year commencing 10 March 2019. The core principal of the standard is to provide a single lessee accounting model, requiring lessees to recognise a right-of-use asset and lease liability for all leases unless the term is less than 12 months or the underlying asset has a low value. IFRS 16's approach to lessor accounting is mostly unchanged from IAS 17.

The transition to IFRS 16 will have a material impact on the balance sheet as all operating leases will need to be recognised on the balance sheet. Furthermore, rental expense in the income statement will be replaced with depreciation and interest expense.

The Group's implementation project commenced in 2016 to ensure all leases acquired as part of the Home Retail Group transaction were also captured. The primary objectives of the project are to: define accounting policies in compliance with the standard; identify all leases within the Group; capture the necessary data for each lease, including discount rates; determine a transition approach; understand and implement necessary system and operational changes; and update the Group's leasing strategy and overall governance framework. The project is being led by Group Finance with support from external professional advisers. The project has a steering committee in place to provide appropriate oversight and governance; and a Technical Working Group to ensure that policy decisions and approaches are appropriate and in line with industry practice.

The Group is currently in the process of developing updated accounting policies (including the application of practical expedients) and is assessing the information requirements for each lease.

A key area still to be concluded on is the transition approach. Whilst the impact of transition is likely to be material, the Group is unable to quantify the effect of transition at this time.

2 Significant accounting judgements, estimates and assumptions

The preparation of financial statements in conformity with IFRSs requires the use of judgements, estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Those which are significant to the Group are discussed separately below:

Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, which have the most significant effect on the amounts recognised in the consolidated financial statements:

a) Non-current assets and liabilities held for sale

At each balance sheet date management assesses whether any assets, whose carrying amount will be recovered through a sale transaction rather than continued use, meet the definition of held for sale. Where there is an active plan in place to locate a buyer, management consider such assets to meet the criteria to be classified as held for sale if they are available for immediate sale and the sale is highly probable.

For more information on the assets and liabilities held for sale, refer to note 16.

b) Operating lease commitments

The Group is party to commercial property leases on a number of its stores. At inception of each lease, the terms and conditions of the arrangements are evaluated to assess whether the lease terms constitute a major part of the economic life of the assets and whether the present value of the minimum lease payments amount to substantially all of the fair value of the commercial property. Where there is no evidence of this, management concludes that all the significant risks and rewards of ownership do not transfer to the Group and these leases are accounted for as operating leases. Further information about committed operating lease payments is included in note 32.

c) Consolidation of structured entities

A structured entity is one in which Sainsbury's does not hold the majority interest but for which management has concluded that voting rights are not the dominant factor in deciding who controls the entity. In making such an assessment, management considers the terms of the arrangement to assess who has responsibility for the management of the entity and its assets. Where Sainsbury's has this responsibility, it is deemed that the Group controls the entity and it is fully consolidated into the Group accounts. The structured entities applicable to the Group are Sainsbury's Property Scottish Partnership and Sainsbury's Property Scottish Limited Partnership.

d) Aggregation of operating segments

Management has determined the operating segments based on the information provided to the Operating Board (the Chief Operating Decision Maker for the Group) to make operational decisions on the management of the Group. Following the acquisition of Home Retail Group plc in September 2016, four operating segments were identified as follows:

- Retail – Food
- Retail – General Merchandise & Clothing
- Financial Services
- Property Investment

Management has considered the economic characteristics, similarity of products, production processes, customers, sales methods and regulatory environment of its two Retail segments. In doing so it has been concluded that they should be aggregated into one 'Retail' segment in the financial statements. This aggregated information provides users the financial information needed to evaluate the business and the environment in which it operates.

Estimates and assumptions

The areas where estimates and assumptions are significant to the financial statements are as described below. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

a) Business combinations

As part of the acquisition of Home Retail Group, the identifiable assets and liabilities acquired, including intangible assets and contingent liabilities, were recognised at their fair value in accordance with IFRS 3 'Business combinations'. The determination of the fair values on acquired assets and liabilities is based to a considerable extent, on management's judgement. In particular, the valuation of £179 million for the acquired Argos brand was sensitive to management's assessment of useful economic life (UEL), which was estimated to be ten years. A movement of plus or minus one year on the UEL would have resulted in a brand asset movement of £25 million/£(28) million.

b) Impairment of assets

The Group is required to assess whether goodwill has suffered any impairment loss, based on the recoverable amount of the cash-generating unit (CGU) or group of CGUs to which it is allocated. The recoverable amounts of the CGUs have been determined based on value in use calculations and these calculations require the use of estimates in relation to future cash flows and suitable discount rates, as disclosed in note 11. Actual outcomes could vary from these estimates.

Financial and non-financial assets are subject to impairment reviews based on whether current or future events and circumstances suggest that their recoverable amount may be less than their carrying value. Recoverable amount is based on the higher of the value in use and fair value less costs to dispose. Value in use is calculated from expected future cash flows using suitable discount rates and includes management assumptions and estimates of future performance.

2 Significant accounting judgements, estimates and assumptions continued

Impairment loss calculations on loans and advances within Financial Services (note 15(b)) involve the estimation of future cash flows of financial assets, based on observable data at the balance sheet date and historical loss experience for assets with similar credit risk characteristics. This will typically take into account the level of arrears, security, past loss experience and default levels. These calculations are undertaken on a portfolio basis using various statistical modelling techniques.

Impairment models are continually reviewed to ensure data and assumptions are appropriate, with the most material assumption being around expected loss rates. The accuracy of any such impairment calculation will be affected by unexpected changes to the economic situation, and assumptions which differ from actual outcomes. As such, judgement is applied when determining the levels of provisioning.

c) Post-employment benefits

The Group operates two defined benefit schemes for its employees – the Sainsbury's Defined Benefit Scheme and the Home Retail Group Defined Benefit Scheme. The present value of the schemes' liabilities recognised at the balance sheet date and the net financing charge recognised in the income statement are dependent on interest rates of high quality corporate bonds. Other key assumptions within this calculation are based on market conditions or estimates of future events, including mortality rates, as set out in note 29. The carrying value of the retirement benefit obligations will be impacted by changes to any of the assumptions used, however is most sensitive to changes in the discount rate. Sensitivities to movements in the discount rate are included in note 29.

d) Provisions

Provisions have been made for onerous leases, onerous contracts, dilapidations, restructuring, insurance and long service awards. These provisions are estimates and the actual costs and timing of future cash flows are dependent on future events and market conditions. Any difference between expectations and the actual future liability will be accounted for in the period when such determination is made. The carrying amount of provisions will be impacted by changes in the discount rate. Details of provisions are set out in note 18.

e) Income taxes

The Group recognises expected liabilities for tax based on an estimation of the likely taxes due, which requires significant judgement as to the ultimate tax determination of certain items. Where the actual liability arising from these items differs from these estimates, such differences will have an impact on income tax and deferred tax provisions in the period when such determination is made. Detail of the tax charge and deferred tax are set out in note 7.

f) Determining fair values

The fair values of financial assets and liabilities are based on prices available from the market on which the instruments are traded. Where market values are not available, the fair values of financial assets and liabilities have been calculated by discounting expected future cash flows at prevailing interest rates. The fair values of short-term deposits, trade receivables, overdrafts and payables are assumed to approximate to their book values.

g) Supplier arrangements

Supplier incentives, rebates and discounts, collectively known as 'supplier arrangements', represent a material deduction to cost of sales and administrative expenses and directly affect the Group's reported margin. The arrangements can be complex, with amounts spanning multiple products over different time periods, and there can be multiple triggers and discounts. The accrued value at the reporting date is included in trade receivables or trade payables, depending on the right of offset. The four key types are as follows:

- Discounts and supplier incentives – these represent the majority of all supplier arrangements and are linked to individual unit sales. The incentive is typically based on an agreed sum per item sold on promotion for a period and therefore is considered part of the purchase price of that product.
- Fixed amounts – these are agreed with suppliers primarily to support

in-store activity including promotions, such as utilising specific space. These involve a degree of judgement and estimation in ensuring the appropriate cut-off of arrangements for fixed amounts which span period-end. These require judgement to determine when the terms of the arrangement are satisfied and that amounts are recognised in the correct period.

- Supplier rebates – these are typically agreed on an annual basis, aligned with the Group's financial year. The rebate amount is linked to pre-agreed targets such as sales volumes and requires estimates of the amount earned up to the balance sheet date, for each relevant supplier contract. Where agreements span a financial period-end, estimations are required of projected turnover and judgement may also need to be applied to determine the rebate level earned as agreements may involve multiple tiers. In order to minimise any risk arising from estimation, supplier confirmations are obtained to agree the value to be recognised at year-end, prior to it being invoiced. Rebates represent the smallest element of the Group's supplier arrangements and by aligning the agreements to the Group's financial year, where possible, the judgements required are minimised.
- Marketing and advertising income – income which is directly linked to the cost of producing the Argos catalogue is recognised once agreed with the supplier and when the catalogue is made available to the Group which is the point at which the catalogue costs are recognised.

Of the above categories, fixed amounts, supplier rebates and marketing and advertising income involve a level of judgement and estimation. The amounts recognised in the income statement for these three categories in the financial year are as follows:

| | 2017 £m | 2016 £m |
|--|------------|------------|
| Fixed amounts (within cost of sales) | 204 | 302 |
| Supplier rebates (within cost of sales) | 87 | 69 |
| Marketing and advertising income (included within operating expenses) | 52 | – |
| Total supplier arrangements | 343 | 371 |

Of the above amounts, the following was outstanding and held on the balance sheet at year-end:

| | 2017 £m | 2016 £m |
|---|------------|------------|
| Within current trade receivables | | |
| Supplier arrangements due | 29 | 6 |
| Within current trade payables | | |
| Supplier arrangements due | 25 | 39 |
| Accrued supplier arrangements | 13 | 25 |

3 Non-GAAP performance measures

In order to provide shareholders with additional insight in to the underlying performance of the business, items recognised in reported profit or loss before tax which, by virtue of their size and or nature, do not reflect the Group's underlying performance are excluded from the Group's underlying results.

These adjusted items are as follows:

| | 2017 £m | 2016 £m |
|--|-------------|------------|
| Underlying profit before tax | 581 | 587 |
| Property related | | |
| Profit on disposal of properties | 98 | 101 |
| Investment property fair value movements | (25) | (18) |
| Net impairment and onerous contract charge | (37) | (1) |
| Argos | | |
| Transaction costs relating to the acquisition of Home Retail Group | (22) | (12) |
| Argos integration costs | (27) | — |
| Homebase separation | (4) | — |
| Sainsbury's Bank transition | (60) | (59) |
| Focus | | |
| Business rationalisation | 72 | (3) |
| IT write-offs | (57) | — |
| Restructuring costs | (33) | (15) |
| Other | | |
| Perpetual securities coupons | 23 | 15 |
| Non-underlying finance movements | 10 | (22) |
| Acquisition adjustments | 8 | 3 |
| Defined benefit scheme financing charge and scheme expenses | (24) | (28) |
| Total adjustments | (78) | (39) |
| Profit before tax | 503 | 548 |

Property related

- Profit on disposal of properties for the financial year comprised £101 million for the Group (2016: £100 million) and £(3) million for the property joint ventures (2016: £1 million) included within other income.
- Net impairment and onerous contract charge comprises £19 million within property, plant and equipment (note 10) and onerous lease provisions of £18 million.

Argos

- Argos integration costs for the year of £(27) million were part of the previously announced £(130) million required over the three years in order to achieve the synergies of £160 million.
- The Homebase separation and restructuring costs for the year of £(4) million were part of the previously announced £(75) million upon the sale of Homebase.

Sainsbury's Bank transition

- Sainsbury's Bank transition costs of £(60) million (2016: £(59) million) were part of the previously announced costs incurred in transitioning to a new, more flexible banking platform as part of the previously announced New Bank Programme.

Focus

- Business rationalisation includes £98 million profit on disposals of the Pharmacy business (included within other income) offset by £(26) million of costs incurred closing non-core businesses to enable the Group to focus on its strategy. This included the closure of Netto, Sainsbury's Entertainment and Phoneshops.
- The Group incurred £(57) million in relation to the cessation of non-core IT projects. This includes £(36) million in property, plant and equipment (note 10), £(19) million in intangibles (note 11) and £(2) million other directly attributable costs.

Restructuring costs

- Internal restructuring costs of £(33) million relate to changes in store colleague structures and working practices.

Other

- The coupons on the perpetual subordinated capital securities and the perpetual subordinated convertible bonds are accounted for as equity in line with IAS 32 'Financial Instruments: Presentation', however are accrued on a straight-line basis and included as an expense within underlying profit before tax.
- Non-underlying finance movements for the financial year comprised £12 million for the Group (2016: £(20) million) and £(2) million for the joint ventures (2016: £(2) million).
- Acquisition adjustments of £8 million (2016: £3 million) reflect the unwind of fair value adjustments arising from the Sainsbury's Bank and Home Retail Group acquisitions.
- Comprises pension financing charge of £(16) million (2016: £(22) million) and defined benefit scheme expenses of £(8) million (2016: £(6) million).

The tax impact of adjusted items is included within note 7.

3 Non-GAAP performance measures continued

Cash flow statement

The table below shows the impact of non-underlying items on the Group cash flow statement:

| | 2017 £m | 2016 £m |
|--|--------------|-------------|
| Cash flows from operating activities | | |
| Defined benefit scheme financing charge and scheme expenses | (8) | (6) |
| Sainsbury's Bank transition | (47) | (53) |
| Business rationalisation | (5) | – |
| Argos integration costs | (12) | – |
| Transaction costs relating to acquisition of Home Retail Group | (22) | (12) |
| Homebase separation | (2) | – |
| Restructuring costs | (19) | (19) |
| Cash used in operating activities | (115) | (90) |
| Cash flows from investing activities | | |
| Profit on disposal of properties | 55 | 109 |
| Business rationalisation (sale of Pharmacy business) | (4) | 125 |
| Cash generated from investing activities | 51 | 234 |
| Net cash flows | (64) | 144 |

4 Segment reporting

Background

The Group's businesses are organised into four operating segments:

- Retail – Food;
- Retail – General Merchandising & Clothing;
- Financial Services (Sainsbury's Bank plc and Argos Financial Services entities); and
- Property Investments (The British Land Company PLC joint venture and Land Securities Group PLC joint venture).

As discussed in note 2, the Food and General Merchandise & Clothing segments have been aggregated into a Retail segment in the financial statements. The Operating Board assesses the performance of all segments on the basis of underlying profit before tax. All material operations and assets are in the UK. The year ended 11 March 2017 includes 27 weeks of Home Retail Group results.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Segment capital expenditure is the total cost incurred during the period to acquire segment assets that are expected to be used for more than one period.

| | Retail £m | Financial Services £m | Property Investment £m | Group £m |
|---|--------------|-----------------------------|------------------------------|-------------|
| 52 weeks to 11 March 2017 | | | | |
| Segment revenue | | | | |
| Retail sales to external customers | 25,824 | – | – | 25,824 |
| Financial Services to external customers | – | 407 | – | 407 |
| Underlying revenue | 25,824 | 407 | – | 26,231 |
| Acquisition adjustment fair value unwind ¹ | – | (7) | – | (7) |
| Revenue | 25,824 | 400 | – | 26,224 |
| Underlying operating profit | 626 | 62 | – | 688 |
| Underlying finance income | 18 | – | – | 18 |
| Underlying finance costs ² | (137) | – | – | (137) |
| Underlying share of post-tax loss from joint ventures | – | – | 12 | 12 |
| Underlying profit before tax | 507 | 62 | 12 | 581 |
| Non-underlying expense (note 3) | | | | (78) |
| Profit before tax | | | | 503 |
| Income tax expense (note 7) | | | | (126) |
| Profit for the financial period | | | | 377 |
| Assets | 13,650 | 5,850 | – | 19,500 |
| Investment in joint ventures | 4 | – | 233 | 237 |
| Segment assets | 13,654 | 5,850 | 233 | 19,737 |
| Segment liabilities | (7,762) | (5,103) | – | (12,865) |
| Other segment items | | | | |
| Capital expenditure ³ | 741 | 58 | – | 799 |
| Depreciation expense ⁴ | 593 | 7 | – | 600 |
| Amortisation expense ⁵ | 18 | 10 | – | 28 |
| Net impairment and onerous contract charge | 37 | – | – | 37 |
| Share-based payments | 30 | 2 | – | 32 |

1 Represents fair value unwind on loans and advances to customers resulting from the Sainsbury's Bank and Home Retail Group Financial Services acquisitions.

2 The coupons on the perpetual capital securities and the perpetual convertible bonds are accounted for as equity in line with IAS 32 'Financial Instruments: Presentation', however are accrued on a straight-line basis and included as an expense within underlying finance costs, as detailed in note 3.

3 Retail capital expenditure consists of property, plant and equipment additions of £683 million and intangible asset additions of £58 million. Financial Services capital expenditure consists of property, plant and equipment additions of £12 million and intangible asset additions of £46 million.

4 Depreciation within the Retail segment includes a £6 million charge in relation to the unwind of fair value adjustments recognised on acquisition of HRG.

5 Amortisation expense within the Retail segment includes £32 million income in relation to the unwind of fair value adjustments recognised on acquisition of HRG. Amortisation expense within the Financial Services segment includes £6 million charge in relation to the unwind of fair value adjustments recognised on acquisition of Sainsbury's Bank.

4 Segment reporting continued

52 weeks to 12 March 2016

| | Retail £m | Financial Services £m | Property Investment £m | Group £m |
|--|--------------|-----------------------------|------------------------------|-------------|
| Segment revenue | | | | |
| Retail sales to external customers | 23,168 | — | — | 23,168 |
| Financial Services to external customers | — | 327 | — | 327 |
| Underlying revenue | 23,168 | 327 | — | 23,495 |
| Acquisition adjustment fair value unwind ¹ | — | 11 | — | 11 |
| Revenue | 23,168 | 338 | — | 23,506 |
| Underlying operating profit | 635 | 65 | — | 700 |
| Underlying finance income | 19 | — | — | 19 |
| Underlying finance costs ² | (140) | — | — | (140) |
| Underlying share of post-tax (loss)/profit from joint ventures | (7) | — | 15 | 8 |
| Underlying profit before tax | 507 | 65 | 15 | 587 |
| Non-underlying expense (note 3) | | | | (39) |
| Profit before tax | | | | 548 |
| Income tax expense (note 7) | | | | (77) |
| Profit for the financial period | | | | 471 |
| Assets | 12,115 | 4,531 | — | 16,646 |
| Investment in joint ventures | 16 | — | 311 | 327 |
| Segment assets | 12,131 | 4,531 | 311 | 16,973 |
| Segment liabilities | (6,727) | (3,881) | — | (10,608) |
| Other segment items | | | | |
| Capital expenditure ³ | 654 | 35 | — | 689 |
| Depreciation expense | 552 | 7 | — | 559 |
| Amortisation expense ⁴ | 14 | 11 | — | 25 |
| Net impairment and onerous contract charges ⁵ | (1) | — | — | (1) |
| Share-based payments | 22 | 1 | — | 23 |

1 Represents fair value unwind on loans and advances to customers resulting from the Sainsbury's Bank acquisition.

2 The coupons on the perpetual capital securities and the perpetual convertible bonds are accounted for as equity in line with IAS 32 'Financial Instruments: Presentation', however are accrued on a straight-line basis and included as an expense within underlying finance costs, as detailed in note 3.

3 Retail capital expenditure consists of property, plant and equipment additions of £635 million and intangible asset additions of £19 million. Financial Services capital expenditure consists of property, plant and equipment additions of £20 million and intangible asset additions of £15 million.

4 Amortisation expense within the Financial Services segment includes £10 million of intangible asset amortisation arising from Sainsbury's Bank acquisition fair value adjustments.

5 Net impairment and onerous contract charge includes a £9 million impairment reversal recognised against property, plant and equipment as detailed in note 10.

4 Segment reporting continued

Cash flow

| | APM reference | 2017 Retail £m | 2017 Financial Services £m | 2017 Group £m | 2016 Retail £m | 2016 Financial Services £m | 2016 Group £m |
|---|------------------|----------------------|-------------------------------------|---------------------|----------------------|-------------------------------------|---------------------|
| Cash flows from operating activities | | | | | | | |
| Cash generated from/(used in) operations (note 25a) | | 929 | 394 | 1,323 | 1,024 | (400) | 624 |
| Interest paid | A | (95) | – | (95) | (108) | – | (108) |
| Corporation tax (paid)/received | | (87) | 12 | (75) | (124) | – | (124) |
| Net cash generated from/(used in) operating activities | | 747 | 406 | 1,153 | 792 | (400) | 392 |
| Cash flows from investing activities | | | | | | | |
| Purchase of property, plant and equipment excluding strategic capital expenditure | | (530) | (12) | (542) | (593) | (53) | (646) |
| Purchase of strategic capital expenditure | B | (92) | – | (92) | – | – | – |
| Purchase of property, plant and equipment | | (622) | (12) | (634) | (593) | (53) | (646) |
| Purchase of intangible assets | | (58) | (52) | (110) | (34) | – | (34) |
| Proceeds from disposal of property, plant and equipment | B | 55 | – | 55 | 109 | – | 109 |
| Receipt of advance disposal proceeds | | – | – | – | 125 | – | 125 |
| Acquisition of subsidiaries | C | (447) | – | (447) | – | – | – |
| Cash acquired upon acquisition of subsidiaries | C | 548 | – | 548 | – | – | – |
| Capital return to Home Retail Group plc shareholders | C | (226) | – | (226) | – | – | – |
| Share issuance costs on acquisition of Home Retail Group plc | C | (3) | – | (3) | – | – | – |
| Investment in joint ventures | E | (16) | – | (16) | (18) | – | (18) |
| Disposal of subsidiaries | E | – | – | – | (1) | – | (1) |
| Interest received | A | 18 | – | 18 | 19 | – | 19 |
| Dividends and distributions received ¹ | B | 65 | – | 65 | 46 | – | 46 |
| Net cash used in investing activities | | (686) | (64) | (750) | (347) | (53) | (400) |
| Cash flows from financing activities | | | | | | | |
| Proceeds from issuance of ordinary shares | E | 6 | – | 6 | 8 | – | 8 |
| Drawdown of short-term borrowings | D | 448 | – | 448 | – | – | – |
| Repayment of short-term borrowings | D | (492) | – | (492) | (95) | – | (95) |
| Repayment of long-term borrowings | D | (130) | – | (130) | (238) | – | (238) |
| Proceeds from the issue of perpetual capital securities and bonds | | – | – | – | 494 | – | 494 |
| Purchase of own shares | E | – | – | – | (20) | – | (20) |
| Repayment of capital element of obligations under finance lease payments | D | (37) | – | (37) | (30) | – | (30) |
| Interest elements of obligations under finance lease payments | A | (8) | – | (8) | (9) | – | (9) |
| Dividends paid on ordinary shares | | (230) | – | (230) | (234) | – | (234) |
| Dividends paid on perpetual securities | A | (23) | – | (23) | (4) | – | (4) |
| Net cash used in financing activities | | (466) | – | (466) | (128) | – | (128) |
| Intra group funding | | | | | | | |
| Bank capital injections | | (130) | 130 | – | (137) | 137 | – |
| HRG acquisition and AFS loan book refinancing | C | 585 | (585) | – | – | – | – |
| Net cash generated from/(used in) intra group funding | | 455 | (455) | – | (137) | 137 | – |
| Net increase/(decrease) in cash and cash equivalents | | 50 | (113) | (63) | 180 | (316) | (136) |
| Elimination of net decrease in Sainsbury's Bank cash and cash equivalents | | | | 113 | | | 316 |
| Decrease in debt | | | | 211 | | | 363 |
| Fair value and other non-cash movements | | | | 88 | | | (26) |
| Movement in net debt | | | | 349 | | | 517 |
| Opening net debt | | | | (1,826) | | | (2,343) |
| Closing net debt | | | | (1,477) | | | (1,826) |

1 Included within dividends and distributions received of £65 million is £55 million of dividends received from property investment joint ventures.

4 Segment reporting continued

Cash flows from operating activities are reconciled as follows:

| | 2017 Retail £m | 2017 Financial Services £m | 2017 Group £m | 2016 Retail £m | 2016 Financial Services £m | 2016 Group £m |
|---|----------------------|-------------------------------------|---------------------|----------------------|-------------------------------------|---------------------|
| Profit/(loss) before tax ¹ | 516 | (13) | 503 | 539 | 9 | 548 |
| Net finance costs | 102 | – | 102 | 148 | – | 148 |
| Share of post-tax loss from joint ventures (note 12) ¹ | 37 | – | 37 | 11 | – | 11 |
| Operating profit/(loss) | 655 | (13) | 642 | 698 | 9 | 707 |
| Adjusted for: | | | | | | |
| Depreciation/amortisation expense | 611 | 17 | 628 | 566 | 18 | 584 |
| Non-cash adjustments arising from acquisitions (note 3) | 5 | 7 | 12 | – | (13) | (13) |
| Financial Services impairment losses on loans and advances | – | 33 | 33 | – | 15 | 15 |
| Profit on disposal of properties | (101) | – | (101) | (100) | – | (100) |
| Loss on disposal of intangibles | 22 | 14 | 36 | – | – | – |
| Profit on disposal of Pharmacy business | (98) | – | (98) | – | – | – |
| Impairment charge/(reversal) of property, plant & equipment | 55 | – | 55 | (9) | – | (9) |
| Foreign exchange differences | (7) | – | (7) | 24 | – | 24 |
| Share-based payments expense | 30 | 2 | 32 | 23 | – | 23 |
| Retirement benefit obligations | (112) | – | (112) | (76) | – | (76) |
| Exceptional pension contributions | (199) | – | (199) | (125) | – | (125) |
| Operating cash flows before changes in working capital | 861 | 60 | 921 | 1,001 | 29 | 1,030 |
| Decrease/(increase) in working capital | 68 | 334 | 402 | 23 | (429) | (406) |
| Cash generated from/(used in) operations | 929 | 394 | 1,323 | 1,024 | (400) | 624 |

1 Includes £(18) million relating to the Property Investment segment.

5 Operating profit

Accounting policies

Revenue

Revenue consists of sales through retail outlets and online and, in the case of Financial Services, interest receivable, fees and commissions and excludes Value Added Tax. Revenue is recognised when the significant risks and rewards of goods and services have been passed to the buyer and it can be measured reliably.

a) Retail – sale of goods

Sales through retail outlets are shown net of returns, the cost of Nectar reward points issued and redeemed, colleague discounts, vouchers and sales made on an agency basis. Commission income is recognised in revenue based on the terms of the contract.

Sales of in-store goods are generally recognised at the point of cash receipt. Where Nectar credits such as vouchers or loyalty points are provided as part of the sales transaction, the amount allocated to the credits is deferred and recognised when the credits are redeemed and the Group fulfils its obligations to supply the credit. For delivered goods, sales are recognised when the goods have been delivered.

b) Other income

Other income generally consists of profits and losses on disposal of assets. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

c) Financial Services interest receivable

Interest income is recognised in the income statement for all instruments measured at amortised cost using the effective interest method. This calculation takes into account all amounts that are integral to the yield as well as incremental transaction costs. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument to the net carrying amount of the financial asset or liability at initial recognition.

d) Financial Services fees and commissions

Fees and commissions that are not integral to the effective interest rate calculation relate primarily to certain credit card and storecard fees, ATM interchange fees, insurance introduction commission and warranty commission receivable. These are recognised in the income statement on an accruals basis as services are provided. Where in the case of insurance commissions the income comprises an initial commission and profit share, both are recognised on completion of the service to the extent reliably measurable. Where there is a risk of potential claw back, an appropriate element of the commission receivable is deferred and amortised over the clawback period. Where the relevant contract requires Financial Services to perform future services in respect of the income receivable, initial commission is recognised on completion of the service provided, with an element deferred to reflect services yet to be performed in future periods.

e) Financial Services other operating income

Margin from the sale of travel money, representing the difference between the cost price and the selling price, is recognised when the sale to the customer takes place within other operating income.

Cost of sales

Cost of sales consists of all costs that are directly attributable to the point of sale including warehouse, transportation costs and all the costs of operating retail outlets. In the case of Financial Services, cost of sales includes interest expense on operating activities, calculated using the effective interest method.

5 Operating profit continued

Operating profit is stated after charging/(crediting) the following items:

| | 2017 £m | 2016 £m |
|---|--------------|------------|
| Employee costs (note 28) | 2,878 | 2,541 |
| Depreciation expense (note 10) ¹ | 600 | 559 |
| Amortisation expense (note 11) ² | 28 | 25 |
| Profit on disposal of properties (note 3) ³ | (101) | (100) |
| Operating lease rentals | | |
| – land and buildings | 625 | 532 |
| – other leases | 80 | 73 |
| – sublease payments receivable | (53) | (49) |
| Foreign exchange (gains)/losses | (7) | 24 |
| Impairment losses on loans and advances | 33 | 15 |
| Impairment and onerous contract charges (note 3) ⁴ | (37) | (1) |
| IT write-offs (note 3) | (57) | – |

1 Depreciation expense includes £6 million (2016: £nil) in relation to the unwind of acquisition adjustments.

2 Amortisation expense includes £32 million income (2016: £nil) in relation to the unwind of fair value adjustments recognised on acquisition of HRG, and a £6 million charge (2016: £10 million charge) in relation to the unwind of fair value adjustments recognised on acquisition of Sainsbury's Bank.

3 Included within other income of £215 million, along with gain on sale of Pharmacy business of £98 million (note 3).

4 Includes an impairment reversal of £19 million (2016: £9 million reversal) recognised against property, plant and equipment as detailed in note 10.

| | 2017 £m | 2016 £m |
|--|------------|------------|
| Auditors' remuneration | | |
| Fees payable to the Company's auditors for the audit of the parent company and consolidated financial statements | 0.8 | 0.3 |
| Fees payable to the Company's auditors for other services: | | |
| The audit of the Company's subsidiaries | 0.9 | 0.4 |
| Audit related assurance services | 0.1 | 0.1 |
| Tax advisory, tax compliance and other non-audit fees | 0.1 | 0.0 |
| Total fees | 1.9 | 0.8 |

The increase in auditors' remuneration is as a result of the acquisition of Home Retail Group during the year.

6 Finance income and finance costs

Accounting policies

Finance income and costs, excluding those arising from Financial Services, are recognised in the income statement for financial assets and liabilities measured at amortised cost using the effective interest method. For Financial Services, finance income and finance costs are recognised in revenue and cost of sales.

Interest paid and interest received for the purpose of the cash flow statement relates to retail only, with Financial Services interest paid and interest received included in the net operating cash flow.

The coupons on the perpetual capital securities and perpetual convertible bonds are accounted for as dividends in accordance with IAS 32 'Financial Instruments: Presentation' and hence are not a finance cost.

| | 2017 £m | 2016 £m |
|--|--------------|------------|
| Interest on bank deposits and other financial assets | 18 | 19 |
| Finance fair value movements ¹ | 16 | — |
| Finance income | 34 | 19 |
| Borrowing costs: | | |
| Secured borrowings | (81) | (88) |
| Unsecured borrowings | (30) | (30) |
| Obligations under finance leases | (8) | (9) |
| Provisions – amortisation of discount (note 18) | (6) | (5) |
| | (125) | (132) |
| Other finance costs: | | |
| Interest capitalised – qualifying assets (note 10) | 7 | 7 |
| Finance fair value movements ¹ | — | (20) |
| IAS 19 pension financing charge (note 29) | (16) | (22) |
| Interest expense on Pharmacy sale advance proceeds | (2) | — |
| | (11) | (35) |
| Finance costs | (136) | (167) |

1 Finance fair value movements relate to net fair value movements on derivative financial instruments not designated in a hedging relationship.

7 Taxation

Accounting policies

Current tax

Current tax is accounted for on the basis of tax laws enacted or substantively enacted at the balance sheet date. Current tax is charged or credited to the income statement, except when it relates to items charged to equity or other comprehensive income.

Deferred tax

Deferred tax is accounted for on the basis of temporary differences arising from differences between the tax base and accounting base of assets and liabilities.

Deferred tax is recognised for all temporary differences, except to the extent where it arises from the initial recognition of an asset or a liability in a transaction that is not a business combination and, at the time of transaction, affects neither accounting profit nor taxable profit. It is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity or other comprehensive income.

Deferred tax is provided on temporary differences associated with investments in subsidiaries, branches and joint ventures except where the Group is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Income tax expense

| | 2017 £m | 2016 £m |
|---|------------|-------------|
| Current tax expense: | | |
| Current year UK tax | 124 | 105 |
| Over-provision in prior years | (11) | (17) |
| Total current tax expense | 113 | 88 |
| Deferred tax charge/(credit): | | |
| Origination and reversal of temporary differences | 17 | 17 |
| Under-provision in prior years | 14 | 7 |
| Revaluation of deferred tax balances | (18) | (35) |
| Total deferred tax charge/(credit) | 13 | (11) |
| Total income tax expense in income statement | 126 | 77 |
| Analysed as: | | |
| Underlying tax | 135 | 122 |
| Non-underlying tax | (9) | (45) |
| Total income tax expense in income statement | 126 | 77 |
| Underlying tax rate | 23.2% | 20.8% |
| Effective tax rate | 25.0% | 14.1% |

7 Taxation continued

The effective tax rate of 25.0 per cent (2016: 14.1 per cent) is higher than (2016: lower than) the standard rate of corporation tax in the UK. The differences are explained below:

| | 2017 £m | 2016 £m |
|--|------------|------------|
| Profit before tax | 503 | 548 |
| Income tax at UK corporation tax rate of 20.0% (2016: 20.05%) | 101 | 110 |
| Effects of underlying items: | | |
| Disallowed depreciation on UK properties | 27 | 26 |
| Over-provision in prior years | (1) | (1) |
| Revaluation of deferred tax balances | (9) | (20) |
| Other | 2 | (1) |
| Effects of non-underlying items: ¹ | | |
| Profit on disposal of properties | (8) | (21) |
| Investment property fair value movements | 5 | 4 |
| Net impairment and onerous contract charge | 6 | — |
| Transaction costs relating to the acquisition of Home Retail Group | 4 | 3 |
| Argos integration costs | 1 | — |
| Homebase separation | 1 | — |
| Business rationalisation | — | 1 |
| IT write-offs | 1 | — |
| Non-underlying finance movements | 1 | — |
| Under/(over) provision in prior years | 4 | (9) |
| Revaluation of deferred tax balances | (9) | (15) |
| Total income tax expense in income statement | 126 | 77 |

1 Disclosed where the tax on non-underlying items differs from the statutory rate.

The main rate of UK corporation tax is reducing from 20 per cent to 19 per cent effective from 1 April 2017. A further reduction in the corporation tax rate to 17 per cent, rather than 18 per cent, effective from 1 April 2020 was substantively enacted in the year, so its effect is reflected in these financial statements. Deferred tax on temporary differences and tax losses as at the balance sheet date is calculated at the substantively enacted rates at which the temporary differences and tax losses are expected to reverse.

Income tax charged or (credited) to equity and/or other comprehensive income during the year is as follows:

| | Retirement benefit obligations ¹ £m | Fair value movements ¹ £m | Perpetual security coupons ² £m | Total £m |
|---|---|--|---|-------------|
| 52 weeks to 11 March 2017 | | | | |
| Current tax recognised in equity or other comprehensive income | (41) | 1 | (5) | (45) |
| Deferred tax recognised in equity or other comprehensive income | (28) | (5) | — | (33) |
| Income tax charged/(credited) | (69) | (4) | (5) | (78) |
| 52 weeks to 12 March 2016 | | | | |
| Current tax recognised in equity or other comprehensive income | — | — | (6) | (6) |
| Deferred tax recognised in equity or other comprehensive income | 36 | (3) | — | 33 |
| Income tax charged/(credited) | 36 | (3) | (6) | 27 |

1 Recognised in other comprehensive income.

2 Recognised in equity.

The current and deferred tax in relation to the Group's defined benefit pension scheme's remeasurements, available-for-sale fair value movements and perpetual securities coupons have been charged or credited through other comprehensive income where appropriate.

7 Taxation continued

Deferred tax

The movements in deferred income tax assets and liabilities during the financial year, prior to the offsetting of the balances within the same tax jurisdiction, are shown below.

| | Accelerated capital allowances £m | Capital losses £m | Fair value movements £m | Rolled over capital gains £m | Retirement benefit obligations £m | Share-based payments £m | Other £m | Total £m |
|--|--|----------------------|-------------------------------|------------------------------------|--|-------------------------------|--------------------|--------------------|
| At 13 March 2016 | (159) | 51 | (25) | (95) | 19 | 7 | (35) | (237) |
| Acquisition of subsidiaries | (19) | – | (28) | – | 82 | 1 | 9 | 45 |
| Prior year adjustment to income statement | (16) | (12) | – | 15 | – | – | (1) | (14) |
| Prior year adjustment to equity or other comprehensive income | – | – | 9 | – | – | – | – | 9 |
| Credit/(charge) to income statement | 21 | (7) | (2) | (10) | (6) | – | (13) | (17) |
| (Charge)/credit to equity or other comprehensive income | – | – | (6) | – | 40 | – | – | 34 |
| Rate change adjustment to income statement | 7 | (1) | 2 | 6 | 1 | – | 3 | 18 |
| Rate change adjustment to equity or other comprehensive income | – | – | 2 | – | (12) | – | – | (10) |
| At 11 March 2017 | (166) | 31 | (48) | (84) | 124 | 8 | (37) | (172) |
| At 15 March 2015 | (162) | 52 | (29) | (97) | 57 | 6 | (42) | (215) |
| Prior year adjustment to income statement | (10) | 1 | 1 | – | – | – | 1 | (7) |
| (Charge)/credit to income statement | (5) | 4 | – | (8) | (12) | 2 | 2 | (17) |
| Charge to equity or other comprehensive income | – | – | – | – | (24) | – | – | (24) |
| Rate change adjustment to income statement | 18 | (6) | – | 10 | 10 | (1) | 4 | 35 |
| Rate change adjustment to equity or other comprehensive income | – | – | 3 | – | (12) | – | – | (9) |
| At 12 March 2016 | (159) | 51 | (25) | (95) | 19 | 7 | (35) | (237) |
| | | | | | | | 2017 £m | 2016 £m |
| Total deferred income tax liabilities | | | | | | | (335) | (314) |
| Total deferred income tax assets | | | | | | | 163 | 77 |
| Net deferred income tax liability recognised in non-current liabilities | | | | | | | (172) | (237) |

Deferred income tax assets have been recognised in respect of all temporary differences and tax losses giving rise to deferred income tax assets because it is probable that these assets will be recovered. Deferred income tax assets and liabilities are only offset where there is a legally enforceable right of offset and the deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority.

8 Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding those held by the Employee Share Ownership Plan trusts (note 22), which are treated as cancelled. For diluted earnings per share, the earnings attributable to the ordinary shareholders are adjusted by the interest on the senior convertible bonds (net of tax) and by the coupons on the perpetual subordinated convertible bonds (net of tax).

The weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares. These represent share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the year and the number of shares that would be issued if all senior convertible bonds and perpetual subordinated convertible bonds are assumed to be converted.

Underlying earnings per share is provided by excluding the effect of any non-underlying items as defined in note 3. This alternative measure of earnings per share is presented to reflect the Group's underlying trading performance.

8 Earnings per share continued

All operations are continuing for the periods presented.

| | 2017 million | 2016 million |
|---|-----------------------|-----------------------|
| Weighted average number of shares in issue | 2,049.0 | 1,920.8 |
| Weighted average number of dilutive share options | 18.2 | 14.6 |
| Weighted average number of dilutive senior convertible bonds | 137.7 | 131.4 |
| Weighted average number of dilutive subordinated perpetual convertible bonds | 75.1 | 41.4 |
| Total number of shares for calculating diluted earnings per share | 2,280.0 | 2,108.2 |
| | £m | £m |
| Profit for the financial period (net of tax) | 377 | 471 |
| Less profit attributable to: | | |
| Holders of perpetual capital securities | (12) | (8) |
| Holders of perpetual convertible bonds | (6) | (4) |
| Profit for the financial year attributable to ordinary shareholders | 359 | 459 |
| | £m | £m |
| Profit for the financial period attributable to ordinary shareholders | 359 | 459 |
| Add interest on senior convertible bonds (net of tax) | 12 | 11 |
| Add coupon on subordinated perpetual convertible bonds (net of tax) | 6 | 4 |
| Diluted earnings for calculating diluted earnings per share | 377 | 474 |
| | £m | £m |
| Profit for the financial year attributable to ordinary shareholders of the parent | 359 | 459 |
| Adjusted for non-underlying items (note 3) | 78 | 39 |
| Tax on non-underlying items | (9) | (45) |
| Add back coupons on perpetual securities (net of tax) ¹ | 18 | 12 |
| Underlying profit after tax attributable to ordinary shareholders of the parent | 446 | 465 |
| Add interest on convertible bonds (net of tax) | 12 | 11 |
| Add coupon on subordinated perpetual convertible bonds (net of tax) | 6 | 4 |
| Diluted underlying profit after tax attributable to ordinary shareholders of the parent | 464 | 480 |
| | Pence per share | Pence per share |
| Basic earnings | 17.5 | 23.9 |
| Diluted earnings | 16.5 | 22.5 |
| Underlying basic earnings | 21.8 | 24.2 |
| Underlying diluted earnings | 20.4 | 22.8 |

¹ Underlying earnings per share calculation is based on underlying profit after tax attributable to ordinary shareholders. Therefore the coupons on the perpetual securities (note 21) are added back.

9 Dividends

| | 2017 Pence per share | 2016 Pence per share | 2017 £m | 2016 £m |
|---|----------------------------|----------------------------|------------|------------|
| Amounts recognised as distributions to ordinary shareholders in the year: | | | | |
| Final dividend of prior financial year | 8.1 | 8.2 | 155 | 157 |
| Interim dividend of current financial year | 3.6 | 4.0 | 77 | 77 |
| | 11.7 | 12.2 | 232 | 234 |

After the balance sheet date on 2 May 2017, a final dividend of 6.6 pence per share (2016: 8.1 pence per share) was proposed by the Directors in respect of the 52 weeks to 11 March 2017. This results in a total final proposed dividend of £144 million (2016: £155 million), a decrease of 7.1 per cent on the previous year. Subject to shareholders' approval at the Annual General Meeting, the dividend will be paid on 7 July 2017 to the shareholders on the register at 12 May 2017. The proposed final dividend has not been included as a liability at 11 March 2017.

Of the above dividend of £232 million, £2 million remained unpaid at the year-end.

10 Property, plant and equipment

Accounting policies

a) Land and buildings

Land and buildings are held at historical cost less accumulated depreciation and any recognised provision for impairment. Capital work in progress is held at cost less any recognised provision for impairment. Cost includes the original purchase price of the asset and the costs to bringing the asset to its working condition for intended use. This includes capitalised borrowing costs.

b) Fixtures and equipment

Fixtures, equipment and vehicles are held at cost less accumulated depreciation and any recognised provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition and its intended use.

c) Depreciation

Depreciation is calculated to write down the cost of the assets to their residual values, on a straight-line basis, using the following rates:

- Freehold buildings and leasehold properties – 50 years, or the lease term if shorter
- Fixtures, equipment and vehicles – three to 15 years
- Freehold land is not depreciated

Capital work in progress is not depreciated.

Gains and losses on disposal are determined by comparing proceeds less any associated costs of disposal with the asset's carrying amount and are recognised within operating profit.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Impairment of non-financial assets

At each reporting date, the Group reviews the carrying amounts of its property, plant and equipment to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset, being the higher of its fair value less costs to dispose and its value in use, is estimated in order to determine the extent of the impairment loss.

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 (CGU) to which the asset belongs. For Retail property, plant and equipment, the CGU is deemed to be each trading store or store pipeline development site. Non-store assets, including depots and IT assets, are reviewed separately, whilst Financial Services is deemed a separate CGU.

Any impairment loss is recognised in the income statement in the year in which it occurs. Where an impairment loss subsequently reverses due to a change in the original estimate, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, or its original carrying value less notional accumulated depreciation if lower.

Capitalisation of interest

Borrowing costs that are directly attributable to the acquisition or construction of qualifying assets are capitalised to the cost of the asset, gross of tax relief.

Leased assets

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. All other leases are classified as operating leases. For property leases, the land and building elements are treated separately to determine the appropriate lease classification.

a) Finance leases

Assets funded through finance leases are capitalised as property, plant and equipment and depreciated over the shorter of their estimated useful lives or the lease term. The amount capitalised is the lower of the fair value of the asset or the present value of the minimum lease payments during the lease term. The resulting lease obligations are included in liabilities net of finance charges. Finance costs on finance leases are charged directly to the income statement.

b) Lease incentives

Lease incentives primarily include up-front cash payments or rent-free periods. Lease incentives are capitalised and spread over the period of the lease term.

c) Leases with predetermined fixed rental increases

The Group has a number of leases with predetermined fixed rental increases. These rental increases are accounted for on a straight-line basis over the term of the lease.

10 Property, plant and equipment continued

| | Land and buildings £m | Fixtures and equipment £m | Total £m |
|--|-----------------------------|---------------------------------|---------------|
| Cost | | | |
| At 13 March 2016 | 10,114 | 5,145 | 15,259 |
| Acquisition of subsidiaries (note 31) | 111 | 151 | 262 |
| Additions | 301 | 394 | 695 |
| Disposals | (71) | (607) | (678) |
| Transfer to assets held for resale | (11) | – | (11) |
| Exchange differences | 1 | 1 | 2 |
| At 11 March 2017 | 10,445 | 5,084 | 15,529 |
| Accumulated depreciation and impairment | | | |
| At 13 March 2016 | 2,313 | 3,182 | 5,495 |
| Depreciation expense for the year | 193 | 407 | 600 |
| Impairment loss for the year ¹ | 17 | 38 | 55 |
| Disposals | (28) | (599) | (627) |
| Transfer to assets held for resale | (1) | – | (1) |
| Exchange differences | – | 1 | 1 |
| At 11 March 2017 | 2,494 | 3,029 | 5,523 |
| Net book value at 11 March 2017 | 7,951 | 2,055 | 10,006 |
| Capital work-in-progress included above | 213 | 86 | 299 |
| Cost | | | |
| At 15 March 2015 | 9,932 | 4,922 | 14,854 |
| Additions | 259 | 396 | 655 |
| Disposals | (152) | (173) | (325) |
| Transfer to assets held for resale | 75 | – | 75 |
| At 12 March 2016 | 10,114 | 5,145 | 15,259 |
| Accumulated depreciation and impairment | | | |
| At 15 March 2015 | 2,249 | 2,957 | 5,206 |
| Depreciation expense for the year | 166 | 393 | 559 |
| Impairment reversal for the year | (9) | – | (9) |
| Disposals | (97) | (168) | (265) |
| Transfer to assets held for resale | 4 | – | 4 |
| At 12 March 2016 | 2,313 | 3,182 | 5,495 |
| Net book value at 12 March 2016 | 7,801 | 1,963 | 9,764 |
| Capital work-in-progress included above | 259 | 83 | 342 |

¹ Comprises an impairment reversal of £17 million which was recognised on land where there has been an increase in the market value during the year, and an impairment charge of £72 million recognised on assets where impairment indicators existed. Net charge of £55 million comprises £36 million of non-core IT assets, and £19 million of other fixed asset impairments, both as detailed in note 3.

10 Property, plant and equipment continued

Interest capitalised

Interest capitalised included in additions amounted to £7 million (2016: £7 million) for the Group. Accumulated interest capitalised included in the cost of property, plant and equipment net of disposals amounted to £352 million (2016: £348 million) for the Group. The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation is 4.0 per cent (2016: 4.0 per cent).

Security

Property, plant and equipment pledged as security is as follows:

| | 2017 Number of properties | 2017 Net book value £bn | 2016 Number of properties | 2016 Net book value £bn |
|---|---------------------------------|----------------------------------|---------------------------------|----------------------------------|
| Loan due 2018 and loan due 2031 | 125 | 2.6 | 125 | 2.6 |
| Revolving credit facility | 60 | 1.3 | 60 | 1.4 |
| Sainsbury's Property Scottish partnership | 24 | 0.6 | 24 | 0.6 |
| Other | 16 | 0.3 | 16 | 0.3 |
| | 225 | 4.8 | 225 | 4.9 |

Analysis of assets held under finance leases

| | 2017 Land and buildings £m | 2017 Fixtures and equipment £m | 2017 Total £m | 2016 Land and buildings £m | 2016 Fixtures and equipment £m | 2016 Total £m |
|---|-------------------------------------|---|---------------------|-------------------------------------|---|---------------------|
| Cost | 82 | 1 | 83 | 82 | — | 82 |
| Accumulated depreciation and impairment | (33) | — | (33) | (30) | — | (30) |
| Net book value | 49 | 1 | 50 | 52 | — | 52 |

11 Intangible assets

Accounting policies

a) Goodwill

Goodwill represents the excess of the fair value of the consideration of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is considered to have an indefinite useful life. Goodwill is tested for impairment annually and again whenever indicators of impairment are detected and is carried at cost less any provision for impairment.

b) Computer software

Computer software is carried at cost less accumulated amortisation and any provision for impairment. Externally acquired computer software and software licences are amortised on a straight-line basis over their useful economic lives of five to ten years. Costs relating to development of computer software for internal use are capitalised once the recognition criteria of IAS 38, 'Intangible Assets' are met. Other development expenditures that do not meet these criteria are expensed as incurred. When the software is available for its intended use, these costs are amortised on a straight-line basis over their useful economic lives of five to ten years within administrative expenses.

c) Acquired intangible assets

Intangible assets acquired in a business combination are recognised at fair value at the acquisition date. Intangible assets with finite useful economic lives are carried at cost less accumulated amortisation and any provision for impairment and are amortised on a straight-line basis over their estimated useful economic lives, ranging from three to ten years, within administrative expenses.

Impairment of non-financial assets

At each reporting date, the Group reviews the carrying amounts of its intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset, being the higher of its fair value less costs to dispose and its value in use, is estimated in order to determine the extent of the impairment loss.

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 (CGU) to which the asset belongs. For retail goodwill, the CGU is deemed to be each retail chain of stores acquired. Non-store assets, including IT assets, are reviewed separately, whilst Financial Services is deemed a separate CGU.

Any impairment loss is recognised in the income statement in the year in which it occurs. Where an impairment loss, other than an impairment loss on goodwill, subsequently reverses due to a change in the original estimate, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, or its original carrying value less notional accumulated depreciation if lower.

11 Intangible assets continued

| | Goodwill £m | Computer software £m | Acquired intangibles £m | Other £m | Total £m |
|--|----------------|----------------------------|-------------------------------|-------------|-------------|
| Cost | | | | | |
| At 13 March 2016 | 142 | 231 | 39 | 10 | 422 |
| Reclassification | – | 10 | – | (10) | – |
| Acquisition of subsidiaries (note 31) | 58 | 143 | 179 | – | 380 |
| Additions | – | 104 | – | – | 104 |
| Disposals | (7) | (59) | – | – | (66) |
| At 11 March 2017 | 193 | 429 | 218 | – | 840 |
| Accumulated amortisation and impairment | | | | | |
| At 13 March 2016 | 4 | 59 | 29 | 1 | 93 |
| Reclassification | – | 1 | – | (1) | – |
| Amortisation expense for the year | – | 13 | 15 | – | 28 |
| Disposals | – | (23) | – | – | (23) |
| At 11 March 2017 | 4 | 50 | 44 | – | 98 |
| Net book value at 11 March 2017 | 189 | 379 | 174 | – | 742 |
| Cost | | | | | |
| At 15 March 2015 | 143 | 197 | 39 | 49 | 428 |
| Additions | – | 34 | – | – | 34 |
| Disposals | (1) | – | – | – | (1) |
| Transfer to assets held for resale | – | – | – | (39) | (39) |
| At 12 March 2016 | 142 | 231 | 39 | 10 | 422 |
| Accumulated amortisation and impairment | | | | | |
| At 15 March 2015 | 4 | 44 | 19 | 36 | 103 |
| Amortisation expense for the year | – | 15 | 10 | – | 25 |
| Transfer to assets held for resale | – | – | – | (35) | (35) |
| At 12 March 2016 | 4 | 59 | 29 | 1 | 93 |
| Net book value at 12 March 2016 | 138 | 172 | 10 | 9 | 329 |

Goodwill comprises the following:

| | 2017 £m | 2016 £m |
|-------------------------|------------|------------|
| Jacksons Stores Limited | 47 | 53 |
| Home Retail Group plc | 58 | – |
| Sainsbury's Bank plc | 45 | 45 |
| Bells Stores Limited | 16 | 17 |
| Other | 23 | 23 |
| | 189 | 138 |

The goodwill balances above are allocated to the respective cash-generating units (CGUs) or group of CGUs within the Retail or Financial Services segment. The CGUs to which goodwill has been allocated and the level at which it is monitored in the retailing segment are deemed to be the respective acquired retail chains of stores, whilst Financial Services is a separate CGU.

The value of the goodwill was tested for impairment during the current financial year by means of comparing the recoverable amount of each CGU or group of CGUs with the carrying value of its goodwill. The calculation of the Retail CGU's value in use is calculated on the cash flows expected to be generated by the stores using the latest budget and forecast data. Board approved cash flow projections for five years are used and then extrapolated out assuming flat cash flows and discounted at a pre-tax rate of nine per cent (2016: nine per cent) over the earlier of a 25 year period (being the estimated average remaining useful life of a freehold store) or lease length for leasehold stores. Financial Services CGU's value in use is calculated using Board approved cash flows discounted at a pre-tax rate of nine per cent (2016: nine per cent) over a five year period with a terminal value.

Based on the operating performance of the CGUs, an impairment of goodwill of £nil million was identified in the current financial year (2016: £nil million). The valuations indicate sufficient headroom such that a reasonably possible change to key assumptions would not result in any impairment of goodwill.

Additions to acquired intangibles arose from the acquisition of HRG and relates to the Argos brand. This is being amortised over ten years.

12 Investments in joint ventures and associates

Accounting policies

The Group applies IFRS 11 to all joint arrangements. Under IFRS 11, investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor. The Group has assessed the nature of its joint arrangements and determined them to be joint ventures. The Group's share of the post-tax results of its joint ventures and associates is included in the income statement using the equity method of accounting. Where the Group transacts with a joint venture or associate, profits and losses are eliminated to the extent of the Group's interest in the joint venture or associate.

Investments in joint ventures and associates are carried in the Group balance sheet at historical cost plus post-acquisition changes in the Group's share of net assets of the entity, less any provision for impairment.

Associates are entities over which the Group has significant influence but not control.

The Group's principal joint venture is:

| | Statutory year-end | Share of ordinary allotted capital | Country of registration or incorporation |
|---|-----------------------|---|--|
| BL Sainsbury Superstores Limited (British Land property investment) | 31 March | 50% | England |

A full list of the Group's joint ventures is included in note 37. Joint ventures with a different year-end date to the Group are reported to include the results up to 28 February 2017, the nearest month-end to the Group's year-end. Adjustments are made for the effects of significant transactions or events that occurred between 28 February and the Group's balance sheet date.

| | British Land £m | Other joint ventures £m | Total £m |
|--|-----------------------|-------------------------------|-------------|
| At 13 March 2016 | 275 | 52 | 327 |
| Additions ¹ | – | 18 | 18 |
| Dividends and distributions received ² | (54) | (11) | (65) |
| Share of retained loss: | | | |
| Underlying profit after tax | 12 | – | 12 |
| Investment property fair value movements | (23) | (2) | (25) |
| Finance fair value movements | (2) | – | (2) |
| Share of loss on disposal of properties ³ | (5) | – | (5) |
| Other non-underlying joint venture items | – | (19) | (19) |
| Share of retained loss | (18) | (21) | (39) |
| Disposals to the Group ³ | 2 | – | 2 |
| Share of joint venture loss after tax | (16) | (21) | (37) |
| Disposals from the Group | – | (6) | (6) |
| At 11 March 2017 | 205 | 32 | 237 |
| At 15 March 2015 | 288 | 71 | 359 |
| Additions | – | 18 | 18 |
| Dividends and distributions received ² | (9) | (37) | (46) |
| Share of retained profit: ⁴ | | | |
| Underlying profit after tax | 13 | (3) | 10 |
| Investment property fair value movements | (18) | – | (18) |
| Finance fair value movements | (2) | – | (2) |
| Share of profit on sale of properties | 2 | (1) | 1 |
| Share of joint venture loss after tax | (5) | (4) | (9) |
| Disposals from the Group | – | 4 | 4 |
| | 274 | 52 | 326 |
| Movements in other comprehensive income (note 20) | 1 | – | 1 |
| At 12 March 2016 | 275 | 52 | 327 |

1 Additions of £18 million include a non-cash element of £2 million.

2 The dividends and distributions received in cash include £nil million (2016: £13 million) return of partner capital.

3 Total joint venture property losses of £(3) million as per note 3.

4 In addition to the above, in the prior year a £(2) million share of joint venture losses was recognised in relation to joint ventures with a carrying value of £nil.

12 Investments in joint ventures and associates continued

The total assets, liabilities, income and expenses of the Group's principal joint venture BL Sainsbury Superstores Limited are detailed below:

| | 2017 £m | 2016 £m |
|--|--------------|------------|
| Non-current assets | 769 | 946 |
| Current assets (excluding cash and cash equivalents) | – | 2 |
| Cash and cash equivalents | 3 | 65 |
| Current liabilities | (24) | (28) |
| Non-current liabilities | (324) | (417) |
| Joint venture net assets | 424 | 568 |
| Group share of joint venture net assets | 212 | 284 |
| Goodwill | 5 | 5 |
| Unrealised profit on disposal of properties as above | (12) | – |
| Group share of joint venture net assets as disclosed above | 205 | 289 |
| Revenue | 48 | 55 |
| Other expenses | (61) | (41) |
| Other income | – | 3 |
| Interest expenses | (20) | (24) |
| Joint venture loss before tax | (33) | (7) |
| Analysed as: | | |
| Underlying profit before tax | 27 | 30 |
| Investment property fair value movements | (45) | (36) |
| Finance fair value movements | (3) | 3 |
| Loss on disposals of properties | (12) | (4) |
| | (33) | (7) |
| Income tax expense | (3) | (3) |
| Joint venture loss after tax | (36) | (10) |
| Other comprehensive income | – | 1 |
| Total comprehensive expense | (36) | (9) |

The joint venture had no other contingent liabilities nor capital commitments other than those disclosed in notes 33 and 35.

13 Available-for-sale financial assets

Accounting policies

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories (fair value through profit or loss and loans and receivables). They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Subsequent to initial recognition at fair value plus transaction costs, these assets are recorded at fair value at each period end with the movements recognised in other comprehensive income until derecognition or impaired at which time the cumulative gain or loss previously recognised in other comprehensive income reserves is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the entity's right to receive payment is established. Interest on available-for-sale debt instruments is recognised using the effective interest method.

| | 2017 £m | 2016 £m |
|--|------------|------------|
| Non-current | | |
| Equity: | | |
| Unlisted equity investment | 2 | 3 |
| Other financial assets | 161 | 146 |
| Debt: | | |
| Interest bearing financial assets | 39 | 35 |
| Financial Services related investment securities | 233 | 156 |
| | 435 | 340 |
| Current | | |
| Debt: | | |
| Financial Services related investment securities | 100 | 48 |
| | 535 | 388 |

The other financial asset predominantly represents the Group's beneficial interest in a commercial property investment pool. The fair value of the other financial asset is based on discounted cash flows assuming a property rental growth rate of 0.5 per cent (2016: 0.6 per cent) and a weighted average cost of capital of nine per cent (2016: nine per cent). There were no disposals or impairment provisions on available-for-sale financial assets in either the current or the previous financial year.

14 Inventories

Accounting policies

Inventories comprise goods held for resale and properties held for resale or in the course of development and are valued on a weighted average cost basis and carried at the lower of cost and net realisable value. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution. Cost includes all direct expenditure and other appropriate attributable costs incurred in bringing inventories to their present location and condition.

| | 2017 £m | 2016 £m |
|------------------------|------------|------------|
| Goods held for resale | 1,774 | 967 |
| Development properties | 1 | 1 |
| | 1,775 | 968 |

The amount of inventories recognised as an expense and charged to cost of sales for the 52 weeks to 11 March 2017 was £19,483 million (2016: £17,210 million).

15 Receivables

(a) Trade and other receivables

Accounting policies

Trade receivables are non-interest bearing and are on commercial terms. Other receivables have both non-interest and interest bearing receivables. Trade and other receivables are stated at their carrying amounts and are written off when management deems them uncollectable or forgiven.

| | 2017 £m | 2016 £m |
|--------------------------------|------------|------------|
| Non-current | | |
| Other receivables | 59 | 92 |
| Prepayments and accrued income | 10 | 11 |
| | 69 | 103 |
| Current | | |
| Trade receivables | 106 | 96 |
| Other receivables | 312 | 305 |
| | 418 | 401 |
| Prepayments and accrued income | 156 | 107 |
| | 574 | 508 |

Current other receivables of £312 million (2016: £305 million), which include £165 million (2016: £170 million) of bank funds in the course of settlement, are generally non-interest bearing. The carrying amounts of trade and other receivables are denominated in sterling.

The Group's exposure to credit risk arising from its retail operations is minimal given that the customer base is large and unrelated and that the overwhelming majority of customer transactions are settled through cash or secure electronic means. New parties wishing to obtain credit terms with the Group are credit checked prior to invoices being raised and credit limits are determined on an individual basis.

(b) Amounts due from Financial Services customers

Accounting policies

Loans and advances are initially recognised at fair value and subsequently held at amortised cost, using the effective interest method, less provision for impairment and recognised on the balance sheet when cash is advanced. For the Financial Services portfolios of loans, such as credit card lending and personal loans, impairment provisions are calculated for groups of assets, otherwise impairment is identified at a counterparty specific level following objective evidence that a financial asset is impaired. Such evidence may include a missed interest or principal payment or the breach of a banking covenant. Provisioning on unsecured balances identified as being in arrears is calculated based on past experience, with regularly updated assumptions. The present value of estimated cash flows recoverable is determined after taking into account any security held. The amount of impairment is calculated by comparing the present value of the cash flows discounted at the loan's original effective interest rate with the balance sheet carrying value. If impaired, the carrying value is adjusted and the difference charged to the income statement and a provision recognised in the balance sheet.

The written down value of the impaired loan is compounded back to the net realisable balance over time using an effective interest rate. This is reported through interest receivable within the income statement and represents the unwinding of the discount.

A write-off is made when all or part of a loan or advance is deemed uncollectable or forgiven. Write-offs are charged against previously established provisions for impairment or directly to the income statement. Subsequent recoveries of amounts written off decrease the charge for loan impairment in the income statement.

15 Receivables continued

An allowance for impairment losses is also maintained in respect of assets which are impaired at the balance sheet date but which have not been identified as such, based on historical loss experience and other relevant factors. This includes analysis of the likelihood of a particular balance to move into an arrears status within a defined period of time and application of an appropriate loss rate. The emergence period into an arrears state represents the average time elapsed between the loss trigger event and default. The methodology and assumptions used are regularly reviewed to reduce any differences between estimates and actual results.

| | 2017 £m | 2016 £m |
|----------------------------------|--------------|------------|
| Non-current | | |
| Loans and advances to customers | 1,948 | 1,680 |
| Impairment of loans and advances | (32) | (31) |
| | 1,916 | 1,649 |
| Current | | |
| Loans and advances to customers | 2,743 | 1,743 |
| Impairment of loans and advances | (57) | (48) |
| | 2,686 | 1,695 |

Loans and advances to customers accrue interest at the effective interest rate. Financial Services has pledged the rights to £678 million (2016: £468 million) of its personal loans book with the Bank of England for £260 million (2016: £240 million) of Treasury Bills under the Funding for Lending Scheme and £155 million of funding (2016: £nil) under the Indexed Long-Term Repo Facility. Funding for Lending Treasury Bills can then be converted to cash as a source of future funding to the Bank. As at 11 March 2017, there was £nil (2016: £nil) borrowings drawn down.

Financial Services has assigned the beneficial interest in £378 million (2016: £379 million) of its personal loans book to a Special Purpose Entity for use as collateral in securitisation transactions, facilitating £311 million (2016: £300 million) of drawings.

Refer to note 23 for details on Financial Services credit risk.

(c) Provision for impairment of loans and advances

| | 2017 £m | 2016 £m |
|--------------------------|-------------|------------|
| Opening provision | (79) | (87) |
| Additional provisions | (33) | (15) |
| Utilisation of provision | 24 | 22 |
| Amortisation of discount | (1) | 1 |
| Closing provision | (89) | (79) |

The Group acquired Home Retail Group plc during the year. The loan book fair value acquired was £615 million net of provisions. Gross provisions at the date of acquisition were £66 million which are not shown in the table above in line with IFRS 3 'Business Combinations'.

(d) Major counterparties

The Group has two major counterparties totalling £55 million (2016: two major counterparties totalling £43 million). No major counterparty balances are considered overdue or impaired.

16 Assets and liabilities held for sale

Accounting policies

Assets and liabilities are classified as held for sale if their carrying amount is to be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable within one year from the date of classification and the assets and liabilities are available-for-sale in their present condition. Assets held for sale are stated at the lower of the carrying amount and fair value less costs to dispose.

| | 2017 £m | 2016 £m |
|--|------------|------------|
| Assets held for sale | | |
| Retail segment properties | 10 | 9 |
| Assets related to Pharmacy business: | | |
| Fixed assets | – | 3 |
| Intangible assets | – | 4 |
| Inventory | – | 15 |
| | 10 | 31 |
| Liabilities held for sale | | |
| Liabilities relating to Pharmacy business: | | |
| Creditors | – | 4 |
| | – | 4 |

All of the Company's assets and liabilities held for sale at 12 March 2016 were sold during the current financial year.

17 Payables

(a) Trade and other payables

Accounting policies

The Group's policy on payment of creditors is to agree terms of payment prior to commencing trade with a supplier and to abide by those terms on the timely submission of satisfactory invoices.

Accruals and deferred income/gains includes accounting for leases with fixed rental increases and lease incentives on a straight-line basis over the term of the lease.

| | 2017 £m | 2016 £m |
|------------------------------------|--------------|------------|
| Current | | |
| Trade payables | 2,685 | 2,082 |
| Other payables | 571 | 590 |
| Accruals and deferred income/gains | 485 | 405 |
| | 3,741 | 3,077 |
| Non-current | | |
| Other payables | 19 | 6 |
| Accruals and deferred income/gains | 285 | 263 |
| | 304 | 269 |

Foreign currency risk

The Group has net euro denominated trade payables of £17 million (2016: £11 million) and US dollar denominated trade payables of £64 million (2016: £49 million).

(b) Amounts due to Financial Services customers and banks

Accounting policies

With the exception of fixed rate bonds, amounts due to Financial Services customers are generally repayable on demand and accrue interest at retail deposit rates.

| | 2017 £m | 2016 £m |
|---------------------------|--------------|------------|
| Current | | |
| Customer accounts | 3,885 | 3,026 |
| Other deposits | 278 | 29 |
| Senior secured loan notes | 121 | 118 |
| | 4,284 | 3,173 |
| Non-current | | |
| Customer accounts | 216 | 182 |
| Other deposits | 231 | 219 |
| Senior secured loan notes | 190 | 181 |
| | 637 | 582 |

Financial Services, via its subsidiary undertakings, has entered a £400 million asset backed commercial paper securitisation of consumer loans. Of this facility, £311 million had been drawn as at 11 March 2017 (12 March 2016: £300 million). Interest on the notes is repayable at a floating rate linked to three-month LIBOR and their contractual repayment is determined by cash flows on the relevant personal loans included in the collateral pool.

Other deposits of £509 million (2016: £248 million) relate to deposits from wholesale counterparties.

18 Provisions

Accounting policies

Provisions are recognised when there is a present legal or constructive obligation as a result of a past event, for which it is probable that an outflow of economic benefit will be required to settle the obligation and where the amount can be reliably estimated. 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.

The need for provisions for onerous leases, measured net of expected rental income, is assessed when the leased property becomes vacant and is no longer used in the operations of the business or when the leased property relates to an unprofitable trading store. Provisions for dilapidation costs are recognised on a lease-by-lease basis.

Provisions for onerous contracts are recognised where expected cash outflows exceed the anticipated future benefits. The amounts provided are based on the Group's best estimate of the likely committed outflow net of anticipated future benefits and after any impairment of pipeline development site assets where applicable.

The costs of long service awards are accrued over the period the service is provided by the employee when it is probable that settlement will be required and they are capable of being measured reliably. Liabilities recognised in respect of long-term employee benefits are measured at the present value of the estimated future cash outflows to be made by the Group in respect of services provided by employees up to the reporting date.

A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring.

18 Provisions continued

| | Onerous leases and onerous contracts £m | Long service awards £m | Restructuring £m | Other provisions £m | Total £m |
|--------------------------------|---|------------------------------|---------------------|---------------------------|--------------|
| At 13 March 2016 | 96 | 4 | 2 | 73 | 175 |
| Acquisition of subsidiaries | – | – | 18 | 86 | 104 |
| Additional provisions | 32 | – | 33 | 26 | 91 |
| Unused amounts reversed | (5) | – | – | (5) | (10) |
| Utilisation of provision | (29) | – | (16) | (58) | (103) |
| Amortisation of discount | 6 | – | – | – | 6 |
| At 11 March 2017 | 100 | 4 | 37 | 122 | 263 |
| At 15 March 2015 | 88 | 7 | 10 | 16 | 121 |
| Reclassification from accruals | – | – | – | 68 | 68 |
| Additional provisions | 23 | – | 11 | 14 | 48 |
| Unused amounts reversed | (2) | (2) | (3) | (1) | (8) |
| Utilisation of provision | (18) | (1) | (16) | (24) | (59) |
| Amortisation of discount | 5 | – | – | – | 5 |
| At 12 March 2016 | 96 | 4 | 2 | 73 | 175 |

| | 2017 £m | 2016 £m |
|---------------|------------|------------|
| Disclosed as: | | |
| Current | 135 | 46 |
| Non-current | 128 | 129 |
| | 263 | 175 |

The onerous lease provision covers residual lease commitments of up to an average of 32 years (2016: 28 years), after allowance for existing or anticipated sublet rental income.

Long service awards are accrued over the period the service is provided by the employee.

Insurance provisions of £80 million (2016: £57 million) are included within other provisions.

19 Called up share capital, share premium and merger reserve

Accounting policies

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

| | 2017 million | 2016 million | 2017 £m | 2016 £m |
|--|-----------------|-----------------|------------|------------|
| Called up share capital | | | | |
| Allotted and fully paid ordinary shares 28 ⁴ /p | 2,188 | 1,924 | 625 | 550 |

Share premium account

| | | |
|---------------|--------------|-------|
| Share premium | 1,120 | 1,114 |
|---------------|--------------|-------|

The movements in the called up share capital, share premium and merger reserve are set out below:

| | Number of ordinary shares million | Ordinary shares £m | Share premium account £m | Merger reserve £m |
|---|--|--------------------------|-----------------------------------|-------------------------|
| At 13 March 2016 | 1,924 | 550 | 1,114 | – |
| Acquisition of subsidiaries ¹ | 261 | 75 | – | 568 |
| Allotted in respect of share option schemes | 3 | – | 6 | – |
| At 11 March 2017 | 2,188 | 625 | 1,120 | 568 |
| At 15 March 2015 | 1,919 | 548 | 1,108 | – |
| Allotted in respect of share option schemes | 5 | 2 | 6 | – |
| At 12 March 2016 | 1,924 | 550 | 1,114 | – |

¹ 261 million new J Sainsbury plc shares of 28⁴/p nominal value each were issued (being 0.321 new J Sainsbury plc shares per existing Home Retail Group plc share); fair value of the consideration is based on a J Sainsbury plc share price of £2.4610 as of 2 September 2016. This is accounted for as £75 million in share capital, plus the premium arising from the consideration in excess of the nominal amount of shares issued of £568 million, which is recognised in merger reserve as the transaction qualified for merger relief.

20 Capital redemption and other reserves

| | Currency translation reserve £m | Available-for-sale assets £m | Cash flow hedge £m | Convertible bond reserve £m | Total other reserves £m | Capital redemption reserve £m |
|--|------------------------------------|---------------------------------|-----------------------|--------------------------------|----------------------------|----------------------------------|
| At 13 March 2016 | 3 | 126 | (3) | 29 | 155 | 680 |
| Currency translation differences | 5 | – | – | – | 5 | – |
| Available-for-sale financial assets fair value movements (net of tax) | – | 18 | – | – | 18 | – |
| Items reclassified from available-for-sale asset reserve | – | (1) | – | – | (1) | – |
| Cash flow hedges effective portion of fair value movements (net of tax): | | | | | | |
| Attributable to Group | – | – | 111 | – | 111 | – |
| Items reclassified from cash flow hedge reserve | – | – | (87) | – | (87) | – |
| Amortisation of convertible bond – equity component | – | – | – | (8) | (8) | – |
| At 11 March 2017 | 8 | 143 | 21 | 21 | 193 | 680 |
| At 15 March 2015 | 1 | 124 | (15) | 36 | 146 | 680 |
| Currency translation differences | 2 | – | – | – | 2 | – |
| Available-for-sale financial assets fair value movements (net of tax) | – | 2 | – | – | 2 | – |
| Cash flow hedges effective portion of fair value movements (net of tax): | | | | | | |
| Attributable to Group | – | – | 4 | – | 4 | – |
| Attributable to joint ventures (note 12) | – | – | 1 | – | 1 | – |
| Items reclassified from cash flow hedge reserve | – | – | 7 | – | 7 | – |
| Amortisation of convertible bond – equity component | – | – | – | (7) | (7) | – |
| At 12 March 2016 | 3 | 126 | (3) | 29 | 155 | 680 |

The currency translation reserve represents the cumulative foreign exchange differences on the translation of the net assets of the Group's foreign operations from their functional currency to the presentation currency of the parent.

The available-for-sale assets reserve represents the fair value gains and losses on the available-for-sale financial assets held by the Group. The cash flow hedge reserve represents the cumulative effective fair value gains and losses on cash flow hedges in the Group.

The convertible bond reserve represents the equity component of the £450 million convertible bond issued in November 2014.

The capital redemption reserve arose on the redemption of B shares. Shareholders approved a £680 million return of share capital, by way of a B share scheme, at the Company's Extraordinary General Meeting on 12 July 2004. The final redemption date for B shares was 18 July 2007 and all transactions relating to the B shares have now been completed.

21 Perpetual securities

Accounting policies and key information

Perpetual securities (perpetual capital securities and perpetual convertible bonds) are issued securities that qualify for recognition as equity. Accordingly any periodic returns are accounted for as dividends and recognised directly in equity and as a liability at the time it becomes obligated to pay the periodic return. Any associated tax impacts are recognised directly in equity.

On 30 July 2015 the Group issued £250 million of perpetual subordinated capital securities and £250 million of perpetual subordinated convertible bonds, collectively known as perpetual securities. Costs directly associated with the issue of £6 million were offset against the value of the proceeds. The securities are perpetual with no fixed redemption date. Holders of the perpetual securities do not benefit from any put option rights however the Group does have the right to call the perpetual subordinated capital securities at their principal amount on 30 July 2020, and the perpetual subordinated convertible bonds on 30 July 2021. The perpetual subordinated convertible bonds may be converted into ordinary shares of the Company at the option of the holders at any time up to 23 July 2021 at a conversion price of 327.4615 pence.

The Group has the right to defer coupons on the perpetual securities on any coupon payment date where the Company has not either paid a dividend on its ordinary shares or bought back ordinary shares (excluding shares bought to satisfy employee share schemes) within the previous 12 month period. The coupon rate on the perpetual subordinated capital securities increases after the fifth anniversary and for the perpetual subordinated convertible bonds after the sixth anniversary.

The next coupon date on the perpetual securities is 30 July 2017. As the Company paid a dividend to ordinary shareholders in the 12 months prior to this date (in January 2017), the periodic distributions of £7 million for the perpetual subordinated capital securities and £16 million for the perpetual subordinated convertible bonds have been recognised in the financial year.

21 Perpetual securities continued

| | Perpetual capital securities £m | Perpetual convertible bonds £m |
|--|------------------------------------|-----------------------------------|
| At 13 March 2016 | 248 | 248 |
| Distributions to holders of perpetual securities | (16) | (7) |
| Current tax relief on distributions to holders of perpetual securities | 4 | 1 |
| Profit for the year attributable to holders of perpetual securities | 12 | 6 |
| At 11 March 2017 | 248 | 248 |
| At 15 March 2015 | | |
| Issue of £250 million 2.875% perpetual subordinated convertible bonds (net of issue costs) | – | 247 |
| Issue of £250 million 6.5% perpetual subordinated capital securities (net of issue costs) | 247 | – |
| Current tax relief on issue costs | 1 | 1 |
| Distributions to holders of perpetual securities | (16) | (7) |
| Current tax relief on distributions to holders of perpetual securities | 3 | 1 |
| Profit for the year attributable to holders of perpetual securities | 13 | 6 |
| At 12 March 2016 | 248 | 248 |

22 Retained earnings

| | Own shares £m | Profit and loss account £m | Total retained earnings £m |
|---|------------------|-------------------------------|-------------------------------|
| At 13 March 2016 | (21) | 3,391 | 3,370 |
| Profit for the year | – | 359 | 359 |
| Remeasurements on defined benefit pension schemes (net of tax) | – | (338) | (338) |
| Dividends paid | – | (232) | (232) |
| Acquisition of subsidiaries | – | (3) | (3) |
| Adjustment to consideration in respect of share options (note 31) | – | 3 | 3 |
| Amortisation of convertible bond-equity component | – | 8 | 8 |
| Share-based payment (net of tax) | – | 32 | 32 |
| Purchase of own shares | (9) | – | (9) |
| Allotted in respect of share option schemes | 19 | (19) | – |
| At 11 March 2017 | (11) | 3,201 | 3,190 |
| At 15 March 2015 | (18) | 3,075 | 3,057 |
| Profit for the year | – | 452 | 452 |
| Remeasurements on defined benefit pension schemes (net of tax) | – | 85 | 85 |
| Dividends paid | – | (234) | (234) |
| Share-based payment (net of tax) | – | 23 | 23 |
| Purchase of own shares | (20) | – | (20) |
| Allotted in respect of share option schemes | 17 | (17) | – |
| Amortisation of convertible bond – equity component | – | 7 | 7 |
| At 12 March 2016 | (21) | 3,391 | 3,370 |

Own shares held by Employee Share Ownership Plan (ESOP) trusts

The Group owns 4,303,928 (2016: 7,857,148) of its ordinary shares of 28½ pence nominal value each. At 12 March 2016, the total nominal value of the own shares was £1.2 million (2016: £2.2 million).

All shares (2016: all shares) are held by Group trusts for the Executive Share Plans. All Group trusts waive the rights to the dividends receivable in respect of the shareholder under the above schemes.

The cost of the own shares is deducted from equity in the Group financial statements. The market value of the own shares at 11 March 2017 was £11 million (2016: £21 million).

23 Financial risk management

The principal financial risks faced by the Group relate to liquidity risk, counterparty credit risk, foreign currency risk, interest rate risk, commodity risk and capital risk.

Financial risk management is managed by a central treasury department in accordance with policies and guidelines which are reviewed and approved by the Board of Directors. The risk management policies are designed to minimise potential adverse effects on the Group's financial performance by identifying financial exposures and setting appropriate risk limits and controls. The risk management policies also ensure sufficient liquidity is available to the Group to meet foreseeable financial obligations and that cash assets are invested safely.

Financial risk management with respect to Financial Services is separately managed within the Financial Services' governance structure. The risks are more fully described in the Financial Services section below.

The Group uses forward contracts to hedge foreign exchange and commodity exposures, and cross currency swap contracts and interest rate swap contracts to hedge interest rate exposures. The use of financial derivatives is governed by Board approved policies which prohibits the use of derivative financial instruments for speculative purposes.

Liquidity risk

Liquidity risk is the risk that the Group could be unable to meet its financial obligations as they fall due.

The principal operational cash flow of the Group is largely stable and predictable reflecting the low business risk profile of the food retail sector and the cyclical profile of the non-food retail sector. Cash flow forecasts are produced to assist management in identifying future liquidity requirements. The Group's liquidity policy sets a minimum funding headroom of £400 million in excess of forecast net debt over a rolling 12 month time horizon. The Group manages its liquidity risk by maintaining a core of long-dated borrowings, pre-funding future cash flow commitments and holding contingent committed credit facilities.

The Group maintains a contingent committed revolving credit facility of £1,150 million. The £1,150 million facility is split into two tranches, a £500 million Facility (A) maturing in May 2019 and a £650 million Facility (B) maturing in May 2020. As at 11 March 2017, £nil had been drawn (2016: £nil).

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows or an estimate of cash flows in respect of floating interest rate liabilities.

| Group | Less than one year £m | One to two years £m | Two to five years £m | More than five years £m |
|--|-----------------------------|---------------------------|----------------------------|-------------------------------|
| At 11 March 2017 | | | | |
| Non-derivative financial liabilities | | | | |
| Secured loans: | | | | |
| Loan due 2018 | (137) | (575) | – | – |
| Loan due 2031 ¹ | (66) | (68) | (219) | (777) |
| Unsecured loans: | | | | |
| Bank overdraft | (6) | – | – | – |
| Bank loans due 2019 ² | (4) | (4) | (202) | – |
| Convertible bond due 2019 | (6) | (6) | (453) | – |
| Finance lease obligations ² | (31) | (34) | (32) | (206) |
| Trade and other payables | (3,741) | – | – | – |
| Amounts due to Financial Services customers and banks ⁵ | (4,365) | (364) | (293) | – |
| Derivative contracts – net settled | | | | |
| Commodity contracts | 3 | – | – | – |
| Interest rate swaps in hedging relationships ^{1,4} | (5) | (4) | (9) | (5) |
| Other interest rate swaps ⁴ | (1) | – | – | – |
| Derivative contracts – gross settled | | | | |
| Foreign exchange forwards – outflow ³ | (1,327) | (92) | – | – |
| Foreign exchange forwards – inflow ³ | 1,405 | 97 | – | – |
| Commodity contracts – outflow | (15) | (15) | (37) | (29) |
| Commodity contracts – inflow | 12 | 12 | 27 | 29 |

Assumptions:

- Cash flows relating to debt and swaps linked to inflation rates have been calculated using a RPI of 1.3 per cent for the year ended 11 March 2017, 2.6 per cent for the year ending 10 March 2018 and 3.6 per cent for future years (2016: RPI of 1.1 per cent for the year ended 12 March 2016, 1.3 per cent for the year ended 11 March 2017, and 3.0 per cent for future years).
- Cash flows relating to debt bearing a floating interest rate have been calculated using prevailing interest rates as at 11 March 2017 and 12 March 2016.
- Cash flows in foreign currencies have been translated using spot rates as at 11 March 2017 and 12 March 2016.
- The swap rate that matches the remaining term of the interest rate swap as at 11 March 2017 has been used to calculate the floating rate cash flows over the life of the interest rate swaps shown above (2016: 12 March 2016).
- Cash flows relating to amounts due to Sainsbury's Bank customers and banks are calculated using contractual terms and interest rates for fixed rate instruments. Where balances are contractually repayable on demand, behavioural assumptions are applied to estimate the interest payable on those balances. These are shown as due within one year.

23 Financial risk management continued

| | Less than one year £m | One to two years £m | Two to five years £m | More than five years £m |
|---|-----------------------------|---------------------------|----------------------------|-------------------------------|
| At 12 March 2016 | | | | |
| Non-derivative financial liabilities | | | | |
| Secured loans: | | | | |
| Loan due 2018 | (134) | (137) | (575) | — |
| Loan due 2031 | (64) | (66) | (210) | (817) |
| Unsecured loans: | | | | |
| Bank overdraft | (3) | — | — | — |
| Bank loans due 2016 | (39) | — | — | — |
| Bank loans due 2019 | (4) | (4) | (207) | — |
| Convertible bond due 2019 | (6) | (6) | (458) | — |
| Finance lease obligations | (46) | (30) | (56) | (209) |
| Trade and other payables | (2,939) | (6) | — | — |
| Amounts due to Sainsbury's Bank customers and banks | (3,223) | (232) | (375) | — |
| Derivative contracts – net settled | | | | |
| Commodity contracts | (5) | — | — | — |
| Interest rate swaps in hedging relationships | (8) | (10) | (5) | — |
| Other interest rate swaps | (1) | (1) | — | — |
| Derivative contracts – gross settled | | | | |
| Foreign exchange forwards – outflow | (562) | (74) | — | — |
| Foreign exchange forwards – inflow | 585 | 74 | — | — |
| Commodity contracts – outflow | (15) | (15) | (43) | (37) |
| Commodity contracts – inflow | 9 | 9 | 26 | 29 |
| Cross currency swaps – outflow | 45 | — | — | — |
| Cross currency swaps – inflow | (40) | — | — | — |

23 Financial risk management continued

The year-on-year increase in foreign exchange projected cash outflows and inflows is largely as a result of the acquisition of Home Retail Group.

Further information relating to liquidity risk in Financial Services is more fully described in the separate section on Financial Services financial risk factors below.

Counterparty credit risk

Counterparty credit risk is the risk of a financial loss arising from counterparty default or non-performance in respect of the Group's holdings of cash and cash equivalents, derivative financial assets, deposits with banks, investments in marketable securities, trade and other receivables and loans and advances to customers. The Group considers its maximum credit risk to be £6,967 million (2016: £5,554 million), equivalent to the Group's total financial assets, and of this amount £5,620 million relates to Financial Services (2016: £4,326 million).

The Group (excluding Financial Services) sets counterparty limits for each of its banking and investment counterparties based on their credit ratings, the minimum unsecured long-term credit rating accepted by the Group is BBB+ (Standard & Poor's and Fitch) or Baa1 (Moody's) or, in the case of sterling liquidity funds, AAA or Aaa/MR1+ from Moody's. In the event of a split credit rating, the lower rating applies.

The table below analyses the Group's cash and cash equivalents by credit exposure excluding bank balances, store cash, cash in transit and cash at ATMs:

| Counterparty | Long-term rating | Group 2017 £m | Group 2016 £m |
|--|------------------|---------------------|---------------------|
| Financial institutions – Money market funds | AAAm/Aaa | 294 | 330 |
| Financial institutions – Money market deposits | AAAm/Aaa | 9 | 50 |
| Financial institutions – Money market deposits | AA+/Aa1 to A/A2 | 100 | 100 |
| UK Government Treasury Bills | AA+/Aa1 to A/A2 | – | 20 |
| Deposits at central banks | AA+/Aa1 | 241 | 269 |

Management does not expect any losses arising from non-performance of deposit counterparties.

Interest rate swaps, forward contracts and commodity contracts for difference are used by the Group to hedge interest rate, foreign currency and fuel exposures. The table below analyses the fair value of the Group's derivative financial assets by credit exposure, excluding any collateral held.

| Counterparty | Long-term rating | Group 2017 £m | Group 2016 £m |
|-----------------------------|--------------------|---------------------|---------------------|
| Interest rate swaps | AA+/Aa1 to A/A2 | 25 | 48 |
| FX forward contracts | AA+/Aa1 to A/A2 | 65 | 17 |
| FX forward contracts | A/A3- to BBB+/Baa1 | 11 | 3 |
| FX forward contracts | BBB- | 1 | – |
| Commodity forward contracts | AA+/Aa1 to A/A2 | 2 | – |

The foreign currency forward contracts entered into with a BBB- counterparty relate to historic operating practices within Home Retail Group plc. This exposure will be reduced through natural hedging in 2017.

Further information relating to counterparty credit risk in Financial Services is more fully described in the section on Financial Services financial risk factors below.

Offsetting of financial assets and liabilities

The following table sets out the Group's financial assets and financial liabilities that are subject to counterparty offsetting or a master netting agreement. The master netting agreements regulate settlement amounts in the event either party defaults on their obligations.

| | Gross amounts of recognised financial assets and liabilities £m | Amounts offset in the balance sheet £m | Net amounts recognised in the balance sheet £m | Balances subject to a contractual right of offset £m | Cash collateral pledged £m | Net amounts £m |
|----------------------------------|---|---|---|---|-------------------------------------|-------------------|
| At 11 March 2017 | | | | | | |
| Derivative financial assets | 104 | – | 104 | (2) | – | 102 |
| Derivative financial liabilities | (60) | – | (60) | 2 | 19 | (39) |
| Cash and cash equivalents | 1,083 | – | 1,083 | – | – | 1,083 |
| Bank overdrafts | (6) | – | (6) | – | – | (6) |
| Trade and other payables | (1,705) | 60 | (1,645) | – | – | (1,645) |
| | (584) | 60 | (524) | – | 19 | (505) |
| At 12 March 2016 | | | | | | |
| Derivative financial assets | 68 | – | 68 | (7) | – | 61 |
| Derivative financial liabilities | (112) | – | (112) | 7 | 13 | (92) |
| Cash and cash equivalents | 1,143 | – | 1,143 | – | – | 1,143 |
| Bank overdrafts | (3) | – | (3) | – | – | (3) |
| Trade and other payables | (1,785) | 114 | (1,671) | – | – | (1,671) |
| | (689) | 114 | (575) | – | 13 | (562) |

23 Financial risk management continued

The Group holds certain financial derivatives which are subject to credit support agreements. Under these agreements cash collateral is posted by one party to the other party should the fair value of the financial derivative exceed a pre-agreed level. As at 11 March 2017, the Group held no collateral against financial derivative assets (2016: nil).

Financial Services has derivatives that are governed by the International Swaps and Derivatives Association and their associated credit support annex bilateral agreements whereby if the fair value exceeds a pre-agreed level, cash collateral is exchanged. As at 11 March 2017, Financial Services and its subsidiary undertakings had provided collateral of £19 million (2016: £13 million) against the derivatives.

The Group also operates a cash pooling arrangement and collective net overdraft facility with its main clearing bank. As at 11 March 2017, the Group had £6 million (2016: £3 million) under this facility.

Foreign currency risk

Currency risk is the risk of increased costs arising from unexpected movements in exchange rates impacting the Group's foreign currency denominated supply contracts.

The Group's currency risk policy seeks to limit the impact of fluctuating exchange rates on the Group's income statement by requiring highly probable foreign currency cash flows to be hedged. Highly probable future cash flows, which may be either contracted or un-contracted, are hedged on a layered basis using foreign currency forward contracts.

The Group has exposure to currency risk on balances held in foreign currency denominated bank accounts, which may arise due to short-term timing differences on maturing hedges and underlying supplier payments.

The Group considers that a ten per cent movement in exchange rates against sterling is a reasonable measure of volatility. The impact of a ten per cent movement in the exchange rate of US dollar and euro versus sterling as at the balance sheet date, with all other variables held constant, is summarised in the table below:

| | 2017 Change in exchange rate impact on post-tax profit +/-10% £m | 2017 Change in exchange rate impact on cash flow hedge reserve +/-10% £m | 2016 Change in exchange rate impact on post-tax profit +/-10% £m | 2016 Change in exchange rate impact on cash flow hedge reserve +/-10% £m |
|--------------|---|--|---|--|
| Group | | | | |
| USD/GBP | 12/(15) | (114)/139 | 3/(4) | (48)/59 |
| EUR/GBP | (2)/2 | (10)/13 | 3/(4) | (9)/11 |

The year-on-year increase in foreign exchange related sensitivities is largely as a result of the acquisition of Home Retail Group.

Interest rate risk

Interest rate risk is the risk of increased costs or lower income arising from unexpected movements in interest rates and inflation rates impacting on the Group's borrowing and investment portfolios. The Group's interest rate policy seeks to limit the impact of fluctuating interest and inflation rates by maintaining a diversified mix of fixed rate, floating rate and variable capped rate liabilities.

Interest on financial instruments is classified as fixed rate if interest re-sets on the borrowings are less frequent than once every 12 months. Interest on financial instruments is classified as floating rate if interest re-sets on the borrowings occur every 12 months or more frequently. Floating rate instruments are considered variable capped rate if the nominal interest rate is subject to a cap.

23 Financial risk management continued

The mix of the Group's financial assets and liabilities at the balance sheet date was as follows:

| Group | Fixed £m | Floating £m | Variable capped £m | Total £m |
|---|----------------|----------------|--------------------------|----------------|
| At 11 March 2017 | | | | |
| Interest bearing available-for-sale financial assets | 334 | 39 | – | 373 |
| Amounts due from Financial Services customers | 2,862 | 1,740 | – | 4,602 |
| Cash and cash equivalents | 423 | 660 | – | 1,083 |
| Borrowings | (1,108) | (205) | (761) | (2,074) |
| Finance lease obligations | (88) | (50) | – | (138) |
| Amounts due to Financial Services customers and banks | (770) | (4,151) | – | (4,921) |
| Derivative effect: | | | | |
| Interest rate swaps | (2,437) | 2,437 | – | – |
| Inflation linked swaps | (400) | – | 400 | – |
| Total | (1,184) | 470 | (361) | (1,075) |
| At 12 March 2016 | | | | |
| Interest bearing available-for-sale financial assets | – | 35 | – | 35 |
| Amounts due from Financial Services customers | 2,507 | 837 | – | 3,344 |
| Cash and cash equivalents | 475 | 668 | – | 1,143 |
| Borrowings | (1,202) | (238) | (798) | (2,238) |
| Finance lease obligations | (114) | (61) | – | (175) |
| Amounts due to Financial Services customers and banks | (410) | (3,345) | – | (3,755) |
| Derivative effect: | | | | |
| Interest rate swaps | (2,160) | 2,160 | – | – |
| Inflation linked swaps | (400) | – | 400 | – |
| Total | (1,304) | 56 | (398) | (1,646) |

Further information relating to interest rate risk in Financial Services is more fully described in the section on Financial Services financial risk factors below.

(i) Cash flow sensitivity for floating rate instruments

The Group considers that a 100 basis point movement in interest rates is a reasonable measure of volatility. The sensitivity of floating rate balances to a change of 100 basis points in the interest rate (or such lesser amount as would result in a zero rate of interest) at the balance sheet date is shown below:

| | 2017 Impact on post-tax loss £m | 2017 Impact on cash flow hedge reserve £m | 2016 Impact on post-tax profit £m | 2016 Impact on cash flow hedge reserve £m |
|-----------------------------------|---|--|---|--|
| Change in floating rate +/-100bps | (10)/5 | 2/(2) | (7)/5 | 3/(3) |

(ii) Cash flow sensitivity for variable capped rate liabilities

The Group holds £761 million of capped inflation-linked borrowings (2016: £798 million) of which £400 million (2016: £400 million) have been swapped into fixed rate borrowings using inflation rate swaps maturing April 2017 to April 2019.

The Group considers that a 100 basis point movement in the RPI rate is a reasonable measure of volatility. The sensitivity of variable capped balances to a change of 100 basis points in the RPI rate at the balance sheet date is shown below:

| | 2017 Impact on post-tax loss £m | 2017 Impact on cash flow hedge reserve £m | 2016 Impact on post-tax profit £m | 2016 Impact on cash flow hedge reserve £m |
|-----------------------------------|---|--|---|--|
| Change in floating rate +/-100bps | (3)/3 | 2/(2) | (3)/3 | 6/(6) |

Commodity risk

Commodity risk is the risk of increased costs arising from unexpected movements in commodity prices impacting the Group's own use consumption of electricity, gas and diesel.

The Group hedges own use consumption of electricity and gas with forward purchases under flexible purchasing arrangements with its suppliers. The Group uses a combination of purchasing agreements and financial derivatives to hedge fuel exposures on a layered basis using contracts for difference.

The Group considers a ten per cent movement in commodity prices a reasonable measure of volatility.

23 Financial risk management continued

| | 2017 Impact on cash flow hedge reserve £m | 2017 Impact on cash flow hedge reserve £m |
|--|--|--|
| Change in the fair value of electricity, diesel and gas price +/-10% | 2/(2) | 1/(1) |

Capital risk management

The Group defines capital as total equity plus net debt.

The Board's capital objective is to maintain a strong and efficient capital base to support the Group's strategic objectives, provide optimal returns for shareholders and safeguard the Group's status as a going concern. There has been no change to capital risk management policies during the year.

The Board monitors a broad range of financial metrics including return on capital employed, balance sheet gearing and fixed charge cover.

The Board can manage the Group's capital structure by diversifying the debt portfolio, adjusting the size and timing of dividends paid to shareholders, recycling capital through sale and leaseback transactions, issuing new shares or repurchasing shares in the open market and flexing capital expenditure.

From time-to-time the Company purchases its own shares in the market for the purpose of issuing shares under the Group's share option programmes; however the Group does not operate a defined share buy-back plan.

Part of the Group's capital risk management is to ensure compliance with the general covenants included in the Group's various borrowing facilities. There have been no breaches of general covenants in the financial year ended 11 March 2017.

23 Financial risk management continued

Information relating to Financial Services capital risk management is detailed below.

Financial Services

Sainsbury's Bank (including Argos Financial Services) has identified a set of primary risk types (see table) that are overseen by a dedicated second line function. These risks are actively managed through primary risk policies and supporting policy standards that clearly articulate the rules, boundaries and measures by which the risks are controlled and help each colleague to understand their individual responsibilities. Our risk reporting processes provide a detailed and aggregated view of these risks to facilitate an active review and management process within defined risk appetite.

| Financial Primary Risk | Primary Risk | Approach and mitigating actions |
|------------------------|---|--|
| | Liquidity and Funding Risk Holding insufficient resources to meet obligations as they fall due or only being able to access them at an excessive cost. <i>Example:</i> A sudden and significant withdrawal of savings balances due to market uncertainty. | <ul style="list-style-type: none"> — Liquidity and Funding policy aligned to risk appetite, with targets for key ratios and coverage of stress outflows. — Key liquidity and funding ratios are monitored and reported on a daily basis with triggers in place for escalation. — Regular reviews of the Internal Liquidity Adequacy Assessment Process (ILAAP), funding plan and Liquidity Contingency Plan to support resilience. |
| | Market Risk The risk that the Bank's earnings and value would be reduced as result of adverse change to market parameters. <i>Example:</i> Changes in the level and volatility of movement in interest rates and foreign exchange rates. | <ul style="list-style-type: none"> — The Bank has a detailed market risk policy, which sets out its market risk limit structure. Earnings and market value sensitivity is reported on a regular basis to ALCO. — All new banking products or amendments to the terms of existing products are reviewed from an interest rate risk perspective to ensure compliance with existing risk appetite. |
| | Retail Credit Risk Losses arising from a retail customer failing to meet their capital or interest repayment obligations as they fall due. <i>Example:</i> Adverse changes in UK macro-economic factors impacting on the credit quality of the Bank's assets. | <ul style="list-style-type: none"> — Credit Risk policy aligned with risk appetite limits. — Robust credit decisioning tools use multiple sources of credit reference agency data in decisions and monitoring. — Effective credit risk governance and committee framework. — Regular reporting framework in place, including reference to external benchmarking. — Stress testing applied, early warning triggers in place. |
| | Wholesale Credit Risk Losses arising from institutional counterparties failing to meet their contractual cash flow obligations. <i>Example:</i> Downgrades in the credit rating of counterparties. | <ul style="list-style-type: none"> — Counterparty limits are in place to control exposure levels. — Key ratios are monitored and reported on a daily basis with triggers in place for escalation. — Regular monitoring of credit ratings migration and CDS pricing of the Bank's key counterparties. |
| | Capital Adequacy Risk Holding an insufficient level or quality of capital for normal or stress requirements, or an inefficient deployment of capital. <i>Example:</i> Adverse changes in the economy could deplete capital resources and/or increase capital requirements. | <ul style="list-style-type: none"> — Capital policy aligned to risk appetite, with a range set for normal conditions along with stress minimums. — Capital adequacy is monitored and reported on a daily basis with triggers in place for escalation. — The annual Internal Capital Adequacy Assessment Process (ICAAP) determines the adequacy of capital resources as well as mitigating actions. |

Further detail on each of these risks is shown below:

Liquidity and funding risk

Liquidity risk is the risk that the Bank cannot meet its payment obligations as they fall due, or can only do so at extreme cost. We seek to ensure that we can meet our financial obligations at all times, even under liquidity stress conditions.

The annual Internal Liquidity Adequacy Assessment Process (ILAAP) enables the Bank to:

- (1) demonstrate that it understands the liquidity risks it is running
- (2) assess its liquidity needs under various stress scenarios and
- (3) put in place appropriate controls to mitigate liquidity risks.

In meeting its internal limits as well as PRA requirements, the Bank maintains a stock of high quality liquid assets that can be readily monetised by outright sale or repurchase agreement to meet the Bank's obligations to depositors and other creditors.

The Bank's Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are regularly monitored and forecast alongside cash flow and funding ratios. We prepare long-term and short-term forecasts to assess liquidity requirements, taking into account factors such as ATM cash management, contractual maturities and customer deposit patterns (stable or less stable deposits) as well as outflows regarding pipelines and commitments. These reports support daily liquidity management, with early warning indicators reviewed on a daily basis and appropriate triggers for escalation and action in line with the risk appetite, Liquidity and Funding Policy and Liquidity Contingency Plan. Asset encumbrance ratios and risk indicators for wholesale funding concentrations by type (total/secured/unsecured), maturity, sector, geography and counterparty are also regularly monitored and reported to ALCO.

23 Financial risk management continued

Market risk

Market risk is the risk that the value of the Bank's assets, liabilities, capital and earnings are exposed to the adverse change of the market risk drivers. The Bank's market risks include Interest Rate Risk in the Banking Book (IRRBB) and Foreign Exchange (FX) Risk. The Bank does not have a trading book.

Interest rate risk

IRRBB arises from interest rates movements which impact present value and timing of future cash flows resulting in changes to the underlying value of a bank's assets, liabilities and off-balance sheet instruments and hence its economic value. Interest rates movements also affect a bank's earnings by altering interest-sensitive income and expenses, affecting its net interest income.

The main types of interest rate risk faced by the Bank are:

- a) Re-pricing gap risk: the risk arising from timing differences in the interest rate changes of bank assets and liabilities (e.g. fixed rate personal loans and instant access savings accounts).
- b) Yield curve risk: the risk arising from changes in the slope and shape of the yield curve.
- c) Basis risk: risk arising from imperfect correlation between different interest rate indices (e.g. administered rate on savings products and treasury assets linked to LIBOR).
- d) Prepayment risk: the risk arising from the timing of customer prepayments which differ from planning and hedging assumptions.
- e) Pipeline risk: the risk of a customer drawing down, or not, a product at a rate which is unfavourable for the Bank.

Interest risk exposure is actively managed within limits that are aligned with the Bank's risk appetite by using financial instruments such as interest rate swaps and by taking into account natural hedges between assets and liabilities. The hedging strategies are implemented to ensure the Bank remains within its limits and that it takes advantage of natural hedging opportunities between fixed rate assets and liabilities with similar re-pricing characteristics.

In order to measure the exposure to interest rate risk under various interest rates shock scenarios, the Bank uses both economic value and earnings-based metrics: Market Value Sensitivity and Earnings at Risk. These metrics are monthly monitored and reported to ALCO.

For interest rate risk measurement, products are allocated within re-pricing gap analysis based on their nearest re-pricing date (all non-maturing deposits are assumed to re-price in month one) and personal loans are allocated according to behavioural repayment profile.

Foreign exchange risk

The Bank is exposed to FX risk through its holding of cash denominated in foreign currencies, primarily euro and US dollar, within its Travel Money bureaux in J Sainsbury's stores. Starting February 2017 the FX positions are hedged on a daily basis.

Credit risk

Credit risk is the risk of financial loss arising from the failure of customers or other counterparties to settle their financial obligations to the Bank.

Retail credit risk

Management of credit risk in respect of retail customers makes use of automated credit decisioning techniques (both scorecards and policy rules) for new applications. In addition, behavioural scoring is used to assess the conduct of customers' accounts on an on-going basis, for example granting extensions to limits. Underwriting is undertaken by specialist teams in operational areas to complement these processes. The Retail Credit Risk Committee ensures that appropriate policies are established and adhered to and this is subject to further oversight from the Board Risk Committee. Internal Audit teams carry out regular reviews of credit risk processes and policies are reviewed and re-approved on an annual basis.

Wholesale and derivative credit risk

The Bank invests its liquidity resources in eligible investment securities that qualify for the regulatory Liquidity Coverage Ratio (LCR) and internal Operational Liquidity Pool (OLP). These investments include the Bank of England's (BoE) reserve account, UK government securities (gilts or Treasury bills), multilateral development bank securities, government guaranteed agency securities UK regulated covered bond programmes and asset backed securities.

Limits are established for all counterparty and asset class exposures based on their respective credit quality and market liquidity. Consideration is also given to geographical region and the strength of relevant sovereign credit ratings. Derivatives are subject to the same credit risk control procedures as are applied to other wholesale market instruments and the credit risk arising from mark to market derivative valuations is mitigated by daily margin calls, posting cash collateral to cover exposures. Daily monitoring is undertaken by the Bank's Treasury department, including early warning indicators with appropriate triggers for escalation.

23 Financial risk management continued

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of collateral agreements.

| | 2017 £m | 2016 £m |
|--|--------------|------------|
| Credit risk exposures relating to on balance sheet items | | |
| Loans and advances to customers | | |
| Unsecured | 4,564 | 3,301 |
| Secured | 38 | 43 |
| Cash and balances with central banks | 420 | 423 |
| Loans and advances to banks | 33 | 25 |
| Derivative financial instruments | 1 | – |
| Investment securities | 333 | 317 |
| Other assets | 231 | 206 |
| Credit risk exposures relating to off balance sheet items | | |
| Loans commitment and other related liabilities | 98 | 77 |
| Treasury bills drawn under FLS | 260 | 240 |
| Total credit risk exposures | 5,978 | 4,632 |

Credit quality per class of financial asset

Loans and advances to customers are summarised as follows:

| | 2017 £m | 2016 £m |
|-------------------------------------|--------------|------------|
| Impaired | 146 | 106 |
| Past due but not impaired | 50 | 13 |
| Neither past due nor impaired | 4,485 | 3,291 |
| Gross | 4,681 | 3,410 |
| Less: allowance for impairment | (89) | (79) |
| Less: hedging fair value adjustment | 10 | 13 |
| Net book value | 4,602 | 3,344 |

23 Financial risk management continued

Credit quality analysis

| | Unsecured lending £m | Secured lending £m | Total £m |
|--|----------------------------|--------------------------|-------------|
| 11 March 2017 | | | |
| Past due and impaired | | | |
| Less than three months, but impaired | 2 | – | 2 |
| Past due three to six months | 16 | 2 | 18 |
| Past due six to 12 months | – | – | – |
| Past due over 12 months | – | – | – |
| Recoveries | 126 | – | 126 |
| Possession | – | – | – |
| Total gross impaired loans | 144 | 2 | 146 |
| Past due but not impaired | | | |
| Past due less than three months but not impaired | 49 | 1 | 50 |
| Total gross past due but not impaired | 49 | 1 | 50 |
| Neither past due nor impaired | | | |
| Not impaired | 4,450 | 35 | 4,485 |
| Total gross neither past due nor impaired | 4,450 | 35 | 4,485 |
| Total gross amount due | 4,643 | 38 | 4,681 |

12 March 2016

| | | | |
|--|-------|----|-------|
| Past due and impaired | | | |
| Less than three months, but impaired | 2 | – | 2 |
| Past due three to six months | 8 | – | 8 |
| Past due six to 12 months | – | 1 | 1 |
| Past due over 12 months | – | – | – |
| Recoveries | 95 | – | 95 |
| Total gross impaired loans | 105 | 1 | 106 |
| Past due but not impaired | | | |
| Past due less than three months but not impaired | 12 | 1 | 13 |
| Total gross past due but not impaired | 12 | 1 | 13 |
| Neither past due nor impaired | | | |
| Not impaired | 3,251 | 40 | 3,291 |
| Total gross neither past due nor impaired | 3,251 | 40 | 3,291 |
| Total gross amount due | 3,368 | 42 | 3,410 |

Mortgages held over residential properties represent the only collateral held by the Bank for retail exposures. The market value of collateral held for impaired loans and loans past due but not impaired was £7 million (2016: £7 million). The fair value of collateral held against possession cases was £nil (2016: £nil).

Financial Services capital resources (unaudited)

The following table analyses the regulatory capital resources under both transitional and end point measures of CRD IV (for which there is no difference in the case of the Bank). CRD IV regulations are being phased in over a five year period from 2013 – 2018. From a prudential perspective, the Bank is monitored and supervised on a consolidated basis with its subsidiary, Home Retail Group Card Services Limited, from the point of acquisition of Argos Financial Services onwards. The Bank has obtained an individual consolidation waiver from the PRA, which allows the Bank to monitor its capital position on a consolidated basis only. Therefore, the 28 February 2017 capital position shown below is on a regulatory consolidated basis, but the comparative shows the Bank standalone position.

| | 2017 £m | 2016 £m |
|--|------------|------------|
| Common Equity Tier 1 (CET 1) capital: | | |
| Ordinary share capital | 566 | 436 |
| Allowable reserves | 148 | 167 |
| Regulatory adjustments | (147) | (118) |
| Total Common Equity Tier 1 (CET 1) capital | 567 | 485 |
| Tier 1 capital | 567 | 485 |

Regulatory capital is calculated under the Capital Requirements Regulations and Capital Requirements Directive (collectively known as CRD IV) as enacted in the UK. Common Equity Tier 1 (CET 1) capital includes ordinary share capital, other reserves, losses and regulatory deductions. The Bank does not currently hold any Tier 2 capital.

23 Financial risk management continued

The movement of CET 1 capital during the financial year is analysed as follows:

| | 2017 £m | 2016 £m |
|--|-------------|------------|
| At 1 March 2017/1 March 2016 | 485 | 354 |
| Share capital issued | 130 | 137 |
| Verified profit attributable to shareholders | (4) | 6 |
| Verified losses of subsidiary undertakings | (17) | – |
| Other reserve movements | 2 | 2 |
| Increase in intangible assets | (29) | (14) |
| At 28 February 2017/29 February 2016 | 567 | 485 |

Leverage ratio (unaudited)

The leverage ratio is defined as the ratio of Tier 1 capital to adjusted assets, which is measured below on a regulatory consolidated basis. The denominator represents the total non-risk weighted assets of the regulatory group (Bank and Home Retail Group Card Services Limited) adjusted for certain off balance sheet exposures, assets and regulatory deductions and provides a non-risk-weighted 'backstop' capital measure. The leverage ratio is planned to become a Pillar 1 measure from 1 January 2018. The leverage ratio is calculated below as at 28 February 2017 – this represents both transitional and end point CRD IV measures. The Bank's leverage ratio of 8.6 per cent exceeds the minimum Basel leverage ratio of 3 per cent.

| | 2017 £m | 2016 £m |
|--|--------------|------------|
| Components of the leverage ratio | | |
| Total assets as per published financial statements | 5,794 | 4,499 |
| Uplift on consolidation of subsidiary undertakings | 42 | – |
| Exposure value for derivatives and securities financing transactions | 269 | 6 |
| Off balance sheet exposures: unconditionally cancellable (10%) | 633 | 336 |
| Off balance sheet: other (100%) | 20 | 260 |
| Other adjustments | (168) | (136) |
| | 6,590 | 4,965 |
| Tier 1 capital | 567 | 485 |
| Leverage ratio | 8.6% | 9.8% |

Capital management

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. During the period to 28 February 2017, the Bank received planned injections of £130 million of ordinary share capital to support the increased capital requirements resulting from: the acquisition of Argos Financial Services and forecast costs and deductible intangible assets generated through the development of flexible banking platforms. Capital adequacy is monitored on an on-going basis by senior management, the ALCO, the Executive Risk Committee and the Board Risk Committee. Our submissions to the PRA in the year have shown that the Bank has complied with all externally imposed capital requirements. The Bank's capital ratio of 13.3 per cent exceeds internal and regulatory thresholds.

Sainsbury's Bank plc, as the principal regulated entity within Financial Services, will disclose Pillar 3 information as required by the Capital Requirements Regulations and PRA prudential sourcebook on the J Sainsbury plc external website.

24 Financial instruments

Accounting policies

a) Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss (FVTPL), loans and receivables, and available-for-sale (AFS). AFS investments are initially measured at fair value including transaction costs and are recognised at the trade date. Financial assets held at FVTPL are initially recognised at fair value and transaction costs are expensed.

'Financial assets at FVTPL' include financial assets held for trading and those designated at FVTPL at inception. FVTPL are derivatives classified as held for trading unless they are accounted for as an effective hedging instrument. 'Financial assets at FVTPL' are recorded at fair value, with any fair value gains or losses recognised in the income statement in the period in which they arise.

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Subsequent to initial recognition at fair value plus transaction costs, these assets are recorded at fair value at each period end with the movements recognised in other comprehensive income until derecognition or impaired at which time the cumulative gain or loss previously recognised in other comprehensive income reserves are recycled is recognised in the income statement. Dividends on AFS equity instruments are recognised in the income statement when the entity's right to receive payment is established. Interest on AFS debt instruments is recognised using the effective interest method.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group has no intention of trading these loans and receivables and include amounts due from Financial Services customers and amounts due from other banks. Subsequent to initial recognition at fair value plus transaction costs, these assets are carried at amortised cost less impairment using the effective interest method. Income from these financial assets is calculated on an effective yield basis and is recognised in the income statement.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Within Financial Services, securities sold subject to standard sale and repurchase agreements ('repos') are not derecognised where the Bank retains substantially all the risks and rewards of ownership by virtue of the predetermined repurchase price. The counterparty liability is included in other deposits.

b) Impairment of financial assets

An assessment of whether there is objective evidence of impairment is carried out for all financial assets or groups of financial assets at the balance sheet date. An assessment of impairment may be of individual assets ('individual impairment') or of a portfolio of assets ('collective impairment') where indicators arise. A financial asset or a group of financial assets is considered to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

For individual impairment, the principal loss event is one or more missed payments, although other loss events can also be taken into account, including arrangements in place to pay less than the contractual payments, fraud and bankruptcy or other financial difficulty indicators. An assessment of collective impairment will be made of financial assets with similar risk characteristics. For these assets, portfolio loss experience is used to provide objective evidence of impairment.

Where there is objective evidence that an impairment loss exists on loans and receivables, impairment provisions are made to reduce the carrying value of financial assets to the present value of estimated future cash flows discounted at the financial asset's original effective interest rate.

For financial assets carried at amortised cost, the charge to the income statement reflects the movement in the level of provisions made, together with amounts written off net of recoveries in the year.

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the asset below its cost is considered in determining whether the asset is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss is removed from equity and recognised in the income statement.

Impairment losses recognised in the income statement on equity instruments are not reversed. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.

Interest will continue to accrue on all financial assets, based on the written down carrying value based on the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. To the extent that a provision may be increased or decreased in subsequent periods, the recognition of interest will be based on the latest balance net of provision.

c) Financial Services loans and advances including impairment

For Financial Services portfolios of loans, such as credit card lending, storecard lending and personal loans, impairment provisions are calculated for groups of assets, otherwise impairment is identified at a counterparty specific level following objective evidence that a financial asset is impaired. Such evidence may include a missed interest or principal payment or the breach of a banking covenant. Provisioning on unsecured balances identified as being in arrears is calculated based on past experience, with regularly updated assumptions. The present value of estimated cash flows recoverable is determined after taking into account any security held. The amount of impairment is calculated by comparing the present value of the cash flows discounted at the loan's original effective interest rate with the balance sheet carrying value. If impaired, the carrying value is adjusted and the difference charged to the income statement and a provision recognised in the balance sheet.

The written down value of the impaired loan is compounded back to its net realisable balance over time using an effective interest rate. This is reported through interest receivable within the income statement and represents the unwinding of the discount.

A write-off is made when all or part of a claim is deemed uncollectable or forgiven. Write-offs are charged against previously established provisions for impairment or directly to the income statement. Subsequent recoveries of amounts written off decrease the charge for loan impairment in the income statement.

24 Financial instruments continued

An allowance for impairment losses is also maintained in respect of assets which are impaired at the balance sheet date but which have not been identified as such, based on historical loss experience and other relevant factors. This includes analysis of the likelihood of a particular balance to move into an arrears status within a defined period of time and application of an appropriate loss rate. The emergence period into an arrears state represents the average time elapsed between the loss trigger event and default. The methodology and assumptions used are regularly reviewed to reduce any differences between estimates and actual results.

Interest-bearing bank loans, overdrafts, other deposits and amounts due to Sainsbury's Bank customers are recorded initially at fair value, which is generally the proceeds received, net of direct issue costs. Subsequently, these liabilities are held at amortised cost using the effective interest method.

d) Financial liabilities

Financial liabilities charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis in the income statement using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

The fair value of the liability component of a convertible bond is determined using the market interest rate for an equivalent non-convertible bond. This amount is recorded as a liability on an amortised cost basis until extinguished on conversion or maturity of the bonds. The remainder of the proceeds are allocated to the conversion option which is recognised in shareholders' equity, net of income tax effects and is not subsequently remeasured.

Issue costs are apportioned between the liability and the equity components of the convertible bonds based on their carrying amounts at the date of issue.

Financial liabilities are derecognised when the obligation under the liability is discharged, cancelled or expires.

e) Fair value estimation

The methods and assumptions applied in determining the fair values of financial assets and financial liabilities are disclosed below in the financial disclosure section.

f) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the company or the counterparty.

Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments to hedge its exposure to foreign exchange, interest rate and commodity risks. All derivative financial instruments are initially measured at fair value on the contract date and are also measured at fair value at subsequent reporting dates. Where derivatives do not qualify for hedge accounting, any changes in the fair value of the derivative financial instrument are recognised in the income statement as finance income or costs as they arise.

To qualify for hedge accounting, the Group documents, at the inception of the hedge, the hedging risk management strategy, the relationship between the hedging instrument and the hedged item or transaction, the nature of the risks being hedged and an assessment of the effectiveness of the hedging relationship to ensure it is highly effective on an ongoing basis.

Where a derivative does qualify for hedge accounting, any changes in fair value are recognised depending on the nature of the hedge relationship and the item being hedged as follows:

a) Cash flow hedges

Hedge relationships are classified as cash flow hedges where the derivative financial instruments hedge the Group's exposure to variability in cash flows resulting from a highly probable forecasted transaction. These include the exchange rate risk of inventory purchases denominated in foreign currency, as well as the commodity risk on purchases of power and fuel. Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in other comprehensive income and the ineffective portion is recognised immediately in the income statement.

If the cash flow hedge of a firm commitment or forecast transaction results in the recognition of a non-financial asset or liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in other comprehensive income are included in the initial measurement of the asset or liability.

b) Fair value hedges

Hedge relationships are classified as fair value hedges where the derivative financial instruments hedge the change in the fair value of a financial asset or liability due to movements in interest rates. The changes in fair value of the hedging instrument are recognised in the income statement. The hedged item is also adjusted for changes in fair value attributable to the hedged risk, with the corresponding adjustment made in the income statement.

c) Portfolio fair value hedging

During the period Sainsbury's Bank used portfolio fair value hedging as a risk management tool for hedging interest rate risk on the personal loans portfolio. Portfolio fair value hedging allows the designation of the whole or part of a portfolio of assets or liabilities with similar risk exposures. The hedged item can be designated based on expected maturities to match the hedging derivative maturity.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in other comprehensive income is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in other comprehensive income is transferred to the income statement for the period.

24 Financial instruments continued

The fair value of derivative financial instruments has been disclosed in the balance sheet as follows:

| | 2017 | Group 2017 | 2016 | 2016 |
|--------------|-------------|-----------------|-------------|-----------------|
| | Asset £m | Liability £m | Asset £m | Liability £m |
| Non-current | 10 | (38) | 17 | (69) |
| Current | 94 | (22) | 51 | (43) |
| Total | 104 | (60) | 68 | (112) |

The fair value and notional amount of derivatives analysed by hedge type are as follows:

| | 2017 | | | | 2016 | | | |
|---|------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|
| | 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 | 8 | 774 | (22) | 2,386 | 18 | 620 | (22) | 2,291 |
| Cash flow hedges | | | | | | | | |
| Interest rate swaps | – | – | (4) | 100 | – | – | (4) | 100 |
| Inflation rate swaps | – | – | (2) | 400 | – | – | (10) | 400 |
| Foreign exchange forward contracts | 77 | 1,301 | (2) | 119 | 20 | 453 | (2) | 156 |
| Commodity contracts | 3 | 21 | – | – | – | – | (6) | 21 |
| Derivatives not in a formal hedging relationship | | | | | | | | |
| Interest rate swaps | 16 | 341 | (15) | 295 | 30 | 386 | (27) | 327 |
| Cross currency and foreign exchange swaps | – | – | – | – | – | – | (7) | 71 |
| Commodity contracts | – | – | (15) | 15 | – | – | (34) | 15 |
| Total | 104 | 2,437 | (60) | 3,315 | 68 | 1,459 | (112) | 3,381 |

The notional and fair value of foreign exchange forward contracts has increased on consolidation of the Home Retail Group plc.

Fair value hedges

Interest rate swaps

The Group holds a £160 million portfolio of interest rate swaps (2016: £206 million) to hedge a portion of fixed rate borrowings maturing in April 2018. Under the terms of the swaps, the Group receives fixed rate interest and pays floating rate interest.

Financial Services holds a £3,000 million portfolio of interest rate swaps accounted for as fair value hedges (2016: £2,705 million). Interest rate swaps are transacted to hedge Financial Services customer assets, fixed interest treasury instruments and non-interest bearing items (including reserves) through a combination of pay and receive fixed swaps (£2,354 million and £646 million respectively (2016: £2,350 million and £355 million respectively)). All derivatives are designated into effective fair value hedge accounting relationships.

For the year to 11 March 2017, the fair value movement in the Group's interest rate swaps resulted in a charge to the income statement of £7 million (2016: £6 million). The fair value movement in the underlying fixed rate borrowings and Sainsbury's Bank loans and advances to customers resulted in a credit to the income statement of £6 million (2016: £6 million).

Cash flow hedges

Interest rate swaps

The Group holds a £400 million (2016: £400 million) portfolio of inflation rate swaps to hedge a portion of the inflation linked secured loan due 2031. Under the terms of the swaps, the Group receives annual RPI inflation (subject to a cap at five per cent and floor at nil per cent) and pays fixed rate interest.

The Group holds a £100 million (2016: £100 million) portfolio of interest rate swaps to hedge £100 million of a £200 million floating rate bank loan due 2019. Under the terms of the swaps, the Group receives floating rate interest and pays fixed rate interest.

As at 11 March 2017, an unrealised loss of £4 million (2016: loss of £13 million) is included in other comprehensive income in respect of the swaps designated as cash flow hedges. This loss will be transferred to the income statement over the next 24 months.

Foreign exchange forward contracts

The Group holds a portfolio of foreign exchange forward contracts to hedge its future foreign currency trading liabilities. As at 11 March 2017 the Group had forward purchased a net €135 million (2016: €127 million) and sold sterling with maturities from March 2017 to July 2018 (2016: March 2016 to February 2017) and forward purchased US\$1,521 million (2016: US\$763 million) and sold sterling with maturities from March 2017 to June 2018 (2016: March 2016 to June 2017).

As at 11 March 2017, an unrealised profit of £28 million (2016: £16 million) is included in other comprehensive income in respect of the forward contracts. This profit will be transferred to the income statement over the next 15 months. During the year a credit to the income statement of £83 million was transferred from the cash flow hedge equity reserve and included in cost of sales (2016: £12 million credit).

24 Financial instruments continued

Commodity forward contracts

The Group holds a portfolio of commodity forward contracts to hedge its own use fuel consumption over the next 24 months.

At 11 March 2017, an unrealised gain of £3 million (2016: loss of £5 million) is included in other comprehensive income in respect of the commodity contracts. This gain will be transferred to the income statement over the next 24 months.

Derivatives not in a hedge relationship

Some of the Group's derivative contracts do not qualify for hedge accounting and are therefore not designated in a hedging relationship. In addition, where gains or losses on a derivative contract economically offset the losses or gains on an underlying transaction, the derivative is not designated as being in a hedging relationship.

Interest rate and foreign exchange swaps

The Group holds a £295 million (2016: £327 million) portfolio of interest rate swaps at fair value through profit or loss to convert floating rate obligations into fixed rates. Under the terms of the swaps the Group receives floating rate interest and pays fixed rate interest. Offsetting these swaps the Group holds a £341 million (2016: £386 million) portfolio of interest rate swaps at fair value through profit or loss, to convert fixed rate obligations into floating rate interest. Under the terms of the swaps the Group receives fixed rate interest and pays floating rate interest.

Commodity forward contracts

Commodity forward contracts at fair value through profit and loss relate to the Group's long-term fixed price power purchase agreements with independent producers.

Fair value

Set out below is a comparison of the carrying amount and the fair value of financial instruments that are carried in the financial statements at a value other than fair value. The fair values of financial assets and liabilities are based on prices available from the market on which the instruments are traded. Where market values are not available, the fair values of financial assets and liabilities have been calculated by discounting expected future cash flows at prevailing interest rates. The fair values of short-term deposits, trade receivables, other receivables, overdrafts and payables are assumed to approximate to their book values.

| | Group Carrying amount £m | Group Fair value £m |
|---|-----------------------------------|---------------------------|
| At 11 March 2017 | | |
| Financial assets | | |
| Amounts due from Financial Services customers ¹ | 4,602 | 4,640 |
| Financial liabilities | | |
| Loans due 2018 ² | (680) | (706) |
| Loans due 2031 | (761) | (1,062) |
| Bank overdrafts | (6) | (6) |
| Bank loans due 2019 | (199) | (199) |
| Convertible bond due 2019 | (427) | (473) |
| Obligations under finance leases | (138) | (138) |
| Amounts due to Financial Services customers and other banks | (4,921) | (4,924) |
| At 12 March 2016 | | |
| Financial assets | | |
| Amounts due from Financial Services customers ¹ | 3,344 | 3,337 |
| Financial liabilities | | |
| Amounts due to Group entities | — | — |
| Loans due 2018 ² | (780) | (824) |
| Loans due 2031 | (799) | (896) |
| Bank overdrafts | (3) | (3) |
| Bank loans due 2016 | (39) | (39) |
| Bank loans due 2019 | (199) | (199) |
| Convertible bond due 2019 | (418) | (473) |
| Obligations under finance leases | (175) | (175) |
| Amounts due to Financial Services customers and other banks | (3,755) | (3,757) |

¹ Included within a portfolio fair value hedging relationship with £3,000 million (2016: £2,705 million) of interest rate swaps.

² Includes £160 million accounted for as a fair value hedge (2016: £206 million).

24 Financial instruments continued

The fair value of financial assets as disclosed in the table above as at 11 March 2017 was £4,640 million (2016: £3,337 million). The fair value of the financial assets has been calculated by discounting cash flows at prevailing interest rates and is within Level 2 of the fair value hierarchy. The fair value of financial liabilities was £7,508 million (2016: £6,366 million) of which £473 million (2016: £473 million) has been determined using market values and is within Level 1 of the fair value hierarchy. The remaining £7,035 million (2016: £5,893 million) has been calculated by discounting cash flows at prevailing interest rates and is within Level 2 of the fair value hierarchy.

Fair value measurements recognised in the balance sheet

The following table provides an analysis of financial instruments that are recognised at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are derived from quoted market prices (unadjusted) in active markets for identical assets or liabilities at the balance sheet date. This level includes listed equity securities and debt instrument on public exchanges;
- Level 2 fair value measurements are derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). The fair value of financial instruments is determined by discounting expected cash flows at prevailing interest rates; and
- Level 3 fair value measurements are derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

| Group | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|--|---------------|---------------|---------------|-------------|
| At 11 March 2017 | | | | |
| Available-for-sale financial assets | | | | |
| Interest bearing financial assets | – | 39 | – | 39 |
| Other financial assets | – | 13 | 148 | 161 |
| Investment securities | 333 | – | – | 333 |
| Financial assets | | | | |
| Derivative financial assets | – | 104 | – | 104 |
| Financial liabilities | | | | |
| Derivative financial liabilities | – | (45) | (15) | (60) |

At 12 March 2016

| | | | | |
|--|-----|------|------|-------|
| Available-for-sale financial assets | | | | |
| Interest bearing financial assets | – | 35 | – | 35 |
| Other financial assets | – | – | 146 | 146 |
| Investment securities | 203 | – | 1 | 204 |
| Financial assets | | | | |
| Derivative financial assets | – | 68 | – | 68 |
| Financial liabilities | | | | |
| Derivative financial liabilities | – | (78) | (34) | (112) |

The increase in derivative financial assets and liabilities is as a result of the consolidation of Home Retail Group plc.

Reconciliation of Level 3 fair value measurements of financial assets and liabilities:

| | Available-for-sale financial assets £m | Commodity derivatives £m | Investment securities £m | Total £m |
|---|---|-----------------------------|-----------------------------|-------------|
| 52 weeks to 11 March 2017 | | | | |
| At 12 March 2016 | 146 | (34) | 1 | 113 |
| In finance cost in the Group income statement | – | 19 | (1) | 18 |
| In other comprehensive income | 2 | – | – | 2 |
| At 11 March 2017 | 148 | (15) | – | 133 |

| | Available-for-sale financial assets £m | Commodity derivatives £m | Investment securities £m | Total £m |
|---|---|-----------------------------|-----------------------------|-------------|
| 52 weeks to 12 March 2016 | | | | |
| At 14 March 2015 | 145 | (14) | – | 131 |
| In finance cost in the Group income statement | – | (20) | – | (20) |
| In other comprehensive income | 1 | – | 1 | 2 |
| At 12 March 2016 | 146 | (34) | 1 | 113 |

24 Financial instruments continued

The available-for-sale financial assets relate to the Group's beneficial interest in a property investment pool. The net present value of the Group's interest in the various freehold reversions owned by the property investment pool has been derived by assuming a property growth rate of 0.5 per cent per annum (2016: 0.6 per cent) and a discount rate of nine per cent (2016: nine per cent), (see note 13). The sensitivity of this balance to changes of one per cent in the assumed rate of property rental growth and one per cent in the discount rate holding other assumptions constant is shown below:

| | 2017 Change in growth rate +/-1.0% £m | 2017 Change in discount rate +/-1.0% £m | 2016 Change in growth rate +/-1.0% £m | 2016 Change in discount rate +/-1.0% £m |
|---------------------------|---|---|---|---|
| Available-for-sale assets | 13/(13) | (8)/9 | 15/(14) | (9)/10 |

The Group has entered into several long-term fixed price Power Purchase agreements with independent producers. Included within derivative financial liabilities is £15 million (2016: £34 million) relating to these agreements. The Group values its Power Purchase agreements as the net present value of the estimated future usage at the contracted fixed price less the market implied forward energy price discounted at the prevailing swap rate. The Group also makes an assumption regarding expected energy output based on the historical performance and the producer's estimate of expected electricity output. The sensitivity of this balance to changes of 20 per cent in the assumed rate of energy output and 20 per cent in the implied forward energy prices holding other assumptions constant is shown below:

| | 2017 Change in volume +/-20.0% £m | 2017 Change in electricity forward price +/- 20.0% £m | 2016 Change in volume +/- 20.0% £m | 2016 Change in electricity forward price +/- - 20.0% £m |
|----------------------------------|---|---|--|--|
| Derivative financial instruments | (3)/3 | 12/(13) | (7)/7 | 13/(14) |

Financial assets and liabilities by category

Set out below are the accounting classification of each class of financial assets and liabilities as at 11 March 2017 and 12 March 2016.

| Group | Loans and receivables £m | Available- for-sale £m | Fair value through profit or loss £m | Derivatives used for hedging £m | Other financial liabilities £m | Total £m |
|---|--------------------------------|------------------------------|--|--|---|-------------|
| At 11 March 2017 | | | | | | |
| Cash and cash equivalents | 1,083 | — | — | — | — | 1,083 |
| Trade and other receivables | 477 | — | — | — | — | 477 |
| Amounts due from Financial Services customers | 4,602 | — | — | — | — | 4,602 |
| Available-for-sale financial assets | — | 535 | — | — | — | 535 |
| Trade and other payables | — | — | — | — | (3,741) | (3,741) |
| Current borrowings | — | — | — | — | (172) | (172) |
| Non-current borrowings | — | — | — | — | (2,039) | (2,039) |
| Amounts due to Financial Services customers and banks | — | — | — | — | (4,921) | (4,921) |
| Derivative financial instruments | — | — | (14) | 58 | — | 44 |
| | 6,162 | 535 | (14) | 58 | (10,873) | (4,132) |

| Group | Loans and receivables £m | Available- for-sale £m | Fair value through profit or loss £m | Derivatives used for hedging £m | Other financial liabilities £m | Total £m |
|---|--------------------------------|------------------------------|---|--|---|-------------|
| At 12 March 2016 | | | | | | |
| Cash and cash equivalents | 1,143 | — | — | — | — | 1,143 |
| Trade and other receivables | 493 | — | — | — | — | 493 |
| Amounts due from Financial Services customers | 3,344 | — | — | — | — | 3,344 |
| Available-for-sale financial assets | — | 388 | — | — | — | 388 |
| Trade and other payables | — | — | — | — | (2,945) | (2,945) |
| Current borrowings | — | — | — | — | (223) | (223) |
| Non-current borrowings | — | — | — | — | (2,190) | (2,190) |
| Amounts due to Financial Services customers and banks | — | — | — | — | (3,755) | (3,755) |
| Derivative financial instruments | — | — | (38) | (6) | — | (44) |
| | 4,980 | 388 | (38) | (6) | (9,113) | (3,789) |

25 Notes to the cash flow statements

Accounting policies

Cash and cash equivalents

Cash and bank balances comprise cash in hand and at bank, deposits at central banks, investments in money market funds and deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purposes of the cash flow statement.

(a) Reconciliation of operating profit to cash generated from operations

| | 2017 £m | 2016 £m |
|--|--------------|------------|
| Profit before tax | 503 | 548 |
| Net finance costs | 102 | 148 |
| Share of post-tax loss from joint ventures (note 12) | 37 | 11 |
| Operating profit | 642 | 707 |
| Adjustments for: | | |
| Depreciation expense | 600 | 559 |
| Amortisation expense | 28 | 25 |
| Non-cash adjustments arising from acquisitions (note 3) ¹ | 12 | (13) |
| Financial Services impairment losses on loans and advances | 33 | 15 |
| Profit on disposal of properties | (101) | (100) |
| Loss on disposal of intangibles | 36 | – |
| Profit on disposal of Pharmacy business | (98) | – |
| Impairment charge/(release) of property, plant and equipment | 55 | (9) |
| Foreign exchange differences | (7) | 24 |
| Share-based payments expense | 32 | 23 |
| Retirement benefit obligations ² | (311) | (201) |
| Operating cash flows before changes in working capital | 921 | 1,030 |
| Changes in working capital: | | |
| (Increase)/decrease in inventories | (6) | 12 |
| Increase in current available-for-sale financial assets | (126) | (202) |
| Decrease/(increase) in trade and other receivables | 37 | (25) |
| Increase in amounts due from Financial Services customers and other deposits | (681) | (318) |
| Increase/(decrease) in trade and other payables | 36 | (16) |
| Increase in amounts due to Financial Services customers and other deposits | 1,166 | 95 |
| (Decrease)/increase in provisions and other liabilities | (24) | 48 |
| Cash generated from operations | 1,323 | 624 |

1 This excludes £26 million income (2016: £10 million charge) relating to acquisition adjustment unwinds included with amortisation in this note, and a £6 million charge for acquisition adjustment unwinds included in depreciation (2016: £nil).

2 The adjustment for retirement benefit obligations reflects the difference between the defined benefit pension scheme expenses of £8 million (2016: £6 million), and the cash contributions of £319 million made by the Group to the defined benefit scheme (2016: £207 million).

(b) Cash and cash equivalents

For the purposes of the cash flow statements, cash and cash equivalents comprise the following:

| | 2017 £m | 2016 £m |
|--------------------------------------|--------------|--------------|
| Cash in hand and bank balances | 439 | 374 |
| Money market funds and deposits | 403 | 480 |
| Treasury bills | – | 20 |
| Deposits at central banks | 241 | 269 |
| Cash and bank balances | 1,083 | 1,143 |
| Bank overdrafts (note 27) | (6) | (3) |
| Net cash and cash equivalents | 1,077 | 1,140 |

26 Analysis of net debt

| | Retail | Financial Services | Group ¹ | Retail | Financial Services | Group ¹ |
|--|----------------|--------------------|--------------------|----------------|--------------------|--------------------|
| | 2017 £m | 2017 £m | 2017 £m | 2016 £m | 2016 £m | 2016 £m |
| Non-current assets | | | | | | |
| Interest bearing available-for-sale financial assets | 39 | – | 39 | 35 | – | 35 |
| Available-for-sale investment securities | – | 233 | 233 | – | 156 | 156 |
| Derivative financial instruments | 9 | 1 | 10 | 13 | 4 | 17 |
| | 48 | 234 | 282 | 48 | 160 | 208 |
| Current assets | | | | | | |
| Cash and cash equivalents | 630 | 453 | 1,083 | 577 | 566 | 1,143 |
| Available-for-sale investment securities | – | 100 | 100 | – | 48 | 48 |
| Derivative financial instruments | 94 | – | 94 | 51 | – | 51 |
| | 724 | 553 | 1,277 | 628 | 614 | 1,242 |
| Current liabilities | | | | | | |
| Bank overdrafts | (6) | – | (6) | (3) | – | (3) |
| Borrowings | (143) | – | (143) | (182) | – | (182) |
| Finance leases | (23) | – | (23) | (38) | – | (38) |
| Derivative financial instruments | (19) | (3) | (22) | (41) | (2) | (43) |
| | (191) | (3) | (194) | (264) | (2) | (266) |
| Non-current liabilities | | | | | | |
| Borrowings | (1,924) | – | (1,924) | (2,053) | – | (2,053) |
| Finance leases | (115) | – | (115) | (137) | – | (137) |
| Derivative financial instruments | (19) | (19) | (38) | (48) | (21) | (69) |
| | (2,058) | (19) | (2,077) | (2,238) | (21) | (2,259) |
| Total net debt | (1,477) | 765 | (712) | (1,826) | 751 | (1,075) |

1 The perpetual capital securities and perpetual convertible bonds are accounted for as equity in accordance with IAS 32 'Financial Instruments: Presentation' and therefore are not included within net debt.

27 Borrowings

| | 2017 Current £m | 2017 Non-current £m | 2017 Total £m | 2016 Current £m | 2016 Non-current £m | 2016 Total £m |
|---------------------------|-----------------------|---------------------------|---------------------|-----------------------|---------------------------|---------------------|
| Loan due 2018 | 108 | 572 | 680 | 101 | 679 | 780 |
| Loan due 2031 | 34 | 727 | 761 | 41 | 758 | 799 |
| Bank overdrafts | 6 | – | 6 | 3 | – | 3 |
| Bank loans due 2016 | – | – | – | 39 | – | 39 |
| Bank loans due 2019 | – | 199 | 199 | – | 199 | 199 |
| Convertible bond due 2019 | 1 | 426 | 427 | 1 | 417 | 418 |
| Finance lease obligations | 23 | 115 | 138 | 38 | 137 | 175 |
| Total borrowings | 172 | 2,039 | 2,211 | 223 | 2,190 | 2,413 |

a) Loan due 2018 and Loan due 2031

Secured loans are secured on 125 (2016: 125) supermarket properties (note 10) and comprise loans from two finance companies, Eddystone Finance plc and Longstone Finance plc:

- a fixed rate amortising loan from Eddystone Finance plc with an outstanding principal value of £670 million (2016: £764 million) at a weighted average rate of 4.54 per cent and carrying amount of £680 million (2016: £780 million) with a final repayment date of April 2018; and
- an inflation linked amortising loan from Longstone Finance plc with an outstanding principal value of £743 million (2016: £779 million) at a fixed real rate of 2.36 per cent where principal and interest are uplifted annually by RPI subject to a cap at five per cent and floor at nil per cent with a carrying amount of £761 million (2016: £798 million) with a final repayment date of April 2031.

27 Borrowings continued

The Group has entered into interest rate swaps to convert £160 million (2016: £206 million) of the £670 million (2016: £764 million) loan due 2018 from fixed to floating rates of interest. These transactions have been accounted for as fair value hedges (note 24). In previous years, £572 million of fixed to floating rate swaps accounted for as fair value hedges were de-designated from their fair value hedging relationship. The fair value adjustment of the debt previously hedged by these swaps will be amortised over the remaining life of the loans, resulting in an amortisation charge to the income statement in the current financial year of £1 million (2016: £1 million).

The Group has entered into inflation swaps to convert £400 million (2016: £400 million) of the £743 million (2016: £779 million) loan due 2031 from RPI linked interest to fixed rate interest for periods maturing April 2017 to April 2019. These transactions have been designated as cash flow hedges (note 24).

The principal activity of Eddystone Finance plc and Longstone Finance plc is the issuing of commercial mortgage backed securities and applying the proceeds towards the secured loans due 2018 and 2031 with the Group as summarised above.

SFM Corporate Services Limited holds all the issued share capital of Eddystone Finance Holdings Limited and Longstone Finance Holdings Limited on trust for charitable purposes. Eddystone Finance Holdings Limited beneficially owns all the issued share capital of Eddystone Finance plc and Longstone Finance Holdings Limited beneficially owns all the issued share capital of Longstone Finance plc. As the Group has no interest, power or bears any risk over these entities they are not included in the Group consolidation.

b) Bank overdrafts

Bank overdrafts are repayable on demand and bear interest at a spread above Bank of England base rate.

c) Revolving credit facility

The Group maintains a secured contingent committed revolving credit facility of £1,150 million. This facility is structured on a dual tranche basis with a £500 million Facility (A) due May 2019 and a £650 million Facility (B) due May 2020. As at 11 March 2017, £nil had been drawn (2016: £nil).

The revolving credit facility incurs commitment fees at market rates and drawdowns bear interest at a margin above LIBOR.

d) Bank loans due 2016

During September 2016, the Group repaid upon maturity a €50 million loan due September 2016 at floating rates of interest. The €50 million floating rate loan had been swapped into a £44 million floating rate loan using a cross currency swap.

e) Bank loans due 2019

On 5 May 2015, the Group amended its £200 million unsecured bank loan due August 2019 into a secured corporate £200 million bank loan due August 2019 at a floating rate of interest. £100 million of this has been swapped into a fixed rate liability. The £100 million portion of the loan and associated interest rate swap has been designated as a cash flow hedge.

f) Convertible bond due 2019

In November 2014, the Group issued £450 million of unsecured convertible bonds due November 2019. The bonds pay a coupon of 1.25 per cent payable semi-annually. Each bond is convertible into ordinary shares of J Sainsbury plc at any time up to 21 November 2019 at a conversion price of 321.47 pence.

The net proceeds of the convertible bond have been split as at 11 March 2017 into a liability component of £427 million and an equity component of £23 million. The equity component represents the fair value of the embedded option to convert the bond into ordinary shares of the Company.

| | 2017 £m | 2016 £m |
|---|------------|------------|
| Liability component brought forward | 418 | 410 |
| Interest expense | 13 | 13 |
| Interest paid | (6) | (6) |
| Other ¹ | 2 | 1 |
| Liability component as at the end of the year | 427 | 418 |

1 Other relates to fees.

27 Borrowings continued

g) Finance lease obligations

| | Minimum lease payments 2017 £m | Minimum lease payments 2016 £m | Present value of minimum lease payments 2017 £m | Present value of minimum lease payments 2016 £m |
|--|--|--|---|---|
| Obligations under finance leases: | | | | |
| Less than 1 year | 31 | 46 | 23 | 38 |
| Within 2 and 5 years inclusive | 66 | 87 | 41 | 63 |
| After 5 years | 207 | 209 | 74 | 74 |
| | 304 | 342 | 138 | 175 |
| Less: future finance charges | (166) | (167) | | |
| Present value of lease obligations | 138 | 175 | | |
| Disclosed as: | | | | |
| Current | 23 | 38 | | |
| Non-current | 115 | 137 | | |
| | 138 | 175 | | |

Finance leases have effective interest rates ranging from 4.3 per cent to 8.5 per cent (2016: 4.3 per cent to 8.5 per cent). The average remaining lease term is 72 years (2016: 66 years).

28 Employee costs

| | 2017 £m | 2016 £m |
|--|------------------------|------------------------|
| Employee costs for the Group during the year amounted to: | | |
| Wages and salaries, including bonus and termination benefits | 2,579 | 2,272 |
| Social security costs | 165 | 148 |
| Pension costs – defined contribution schemes | 102 | 98 |
| Share-based payments expense (note 30) | 32 | 23 |
| | 2,878 | 2,541 |
| | | |
| | 2017 Number 000s | 2016 Number 000s |
| The average number of employees, including Directors, during the year was: | | |
| Full-time | 51.9 | 48.0 |
| Part-time | 130.0 | 114.7 |
| | 181.9 | 162.7 |
| Full-time equivalent | 118.7 | 108.3 |

Details of key management compensation can be found in note 36 and within the Directors' Remuneration Report on pages 74 to 94.

29 Retirement benefit obligations

Accounting policies

In respect of defined benefit pension schemes, the surplus or deficit recognised in the balance sheet represents the difference between the fair value of the plan assets and the present value of the defined benefit obligation at the balance sheet date. The defined benefit obligation is actuarially calculated on an annual basis using the projected unit credit method. Plan assets are recorded at fair value.

Actuarial gains and losses are reported in the statement of other comprehensive income as incurred, and comprise both the effects of changes in actuarial assumptions and experience adjustments arising because of differences between the previous actuarial assumptions and what has actually occurred.

The income statement charge consists of a financing charge, which is the net of interest cost on pension scheme liabilities and interest income on plan assets and defined benefit pension scheme expenses.

The financing charge is determined by applying the discount rate used to measure the defined benefit obligation to the pension scheme liabilities and plan assets at the beginning of the financial year.

The Group contributions to defined contribution pension schemes are charged to the income statement as incurred. Any contributions unpaid at the balance sheet date are included as an accrual as at that date. The Group has no further payment obligations once the contributions have been paid.

Background

At 11 March 2017, retirement benefit obligations relate to two defined benefit schemes, the Sainsbury's Pension Scheme and from 2 September 2016, the Home Retail Group Pension Scheme (the 'Schemes') as well as two unfunded pension liabilities relating to senior former employees of Sainsbury's and Home Retail Group.

The retirement benefit obligations at the year-end have been calculated by KPMG, as actuarial advisers to the Group, using the projected unit credit method and based on adjusting the position at the date of the previous triennial valuations (see below) for known events and changes in market conditions as allowed under IAS 19, 'Employee benefits'.

Sainsbury's Pension Scheme

The Scheme is governed by a Trustee board, and the assets of the Scheme are held separately from the Group's assets. The Scheme is an HMRC Registered pension scheme, subject to UK legislation with oversight from the Pensions Regulator. The governance of the Scheme is the responsibility of the Trustee; the Trustee comprises 11 directors – five selected from members, five appointed by the Company and one Independent Chairman who is selected by the Company in consultation with the Trustee. In accordance with legislation, the Trustee consults with the Company regarding the Scheme's investment strategy and agrees an appropriate funding plan with the Company.

The Scheme has three different benefit categories: Final Salary, Career Average and Cash Balance. For Final Salary and Career Average members, benefits at retirement are determined by length of service and salary. For Cash Balance members, benefits are determined by the accrued retirement account credits.

The Scheme was closed to new employees on 31 January 2002 and closed to future benefit accrual on 28 September 2013. The Scheme is also used to pay life assurance benefits to current (including new) colleagues. The assets of the Scheme are valued at bid price and are held separately from the Group's assets.

The Scheme was subject to a triennial actuarial valuation, carried out by Willis Towers Watson for the Trustee, as at 14 March 2015 on the projected unit basis. On the basis of the assumptions agreed, the actuarial deficit at 14 March 2015 was £740 million, an increase of £148 million from the March 2012 deficit of £592 million.

A Recovery Plan was agreed in September 2016 which included:

- Two special contributions of £125 million paid in August 2015 and August 2016
- Deficit contributions increasing to £65 million a year until March 2021
- The interest in the property partnership to continue, of up to £600 million payable in 2030 if there is a deficit at that time.

The Scheme continues to receive annual coupons from the property partnership which are based on the average weighted discount rate used in the triennial valuation and so are effectively reset every three years. These coupons will reduce from 2017/18 to £19 million a year.

29 Retirement benefit obligations continued

Home Retail Group Pension Scheme

The Scheme is governed by a Trustee board, and the assets of the Scheme are held separately from the Group's assets. The Scheme is an HMRC Registered pension scheme, subject to UK legislation with oversight from the Pensions Regulator. The governance of the Scheme is the responsibility of the Trustee; the Trustee comprises six directors – two selected from members, four appointed by the Company including an Independent Chairman. In accordance with legislation, the Trustee consults with the Company regarding the Scheme's investment strategy and agrees an appropriate funding plan with the Company.

The Scheme was closed to new employees in 2009 and closed to future benefit accrual in January 2013. The Scheme is used to pay life assurance benefits only to current (including new) colleagues. Pension benefits were based on service and final salary. The assets of the Scheme are valued at bid price and are held separately from the Group's assets.

The Home Retail Group defined benefit pension scheme was subject to a Trustees' triennial valuation as at 31 March 2015. This was carried out by Willis Towers Watson for the Trustee. On the basis of the assumptions agreed, the actuarial deficit as at 31 March 2015 was £315 million, an increase of £157 million from the March 2012 deficit of £158 million.

A Recovery Plan was agreed and implemented on acquisition which included:

- An immediate payment on acquisition by Sainsbury's of £50 million
- Deficit contributions of £40 million a year, £10 million payable each quarter, until October 2021
- Security over £80 million of freehold property (to be completed in the year ending 10 March 2018)
- A parent guarantee of £470 million which reduces over time in line with deficit contributions paid and will be reset at following triennial valuations

As part of the sale of Homebase by Home Retail Group, it was agreed with the Trustee that a cash contribution of £50 million would be made to the Scheme. Of this total, £26 million was paid during Home Retail Group's year ending 28 February 2016. Following the capital return to shareholders associated with the Homebase sale, the final cash contribution of £24 million was made to the Scheme in September following the acquisition of Home Retail Group by Sainsbury's.

Unfunded pension liabilities

The unfunded pension liabilities are unwound when each employee reaches retirement and takes their pension from the Group payroll or is crystallised in the event of an employee leaving or retiring and choosing to take the provision as a one-off cash payment.

IFRIC 14

IFRIC 14 is the interpretation that details when a company can recognise any pension surplus that exists. Furthermore, if the company has a funding commitment in excess of the IAS 19 deficit, then IFRIC 14 requires recognition of this excess in those circumstances when the surplus that would result on fulfilling that commitment cannot be recognised. A surplus may be recognised either because of an unconditional right to a refund to the company, or on grounds of a future contribution reduction where schemes are still open to future accrual.

For the Sainsbury's pension scheme, management is of the view that it has an unconditional right to a refund of surplus under IFRIC 14. As such no adjustment has been made for potential additional liabilities.

Based on the net deficit of the Home Retail Group Pension Scheme as at 11 March 2017 and the committed payments under the Schedule of Contributions signed on 2 September 2016, there is no notional surplus and therefore no additional balance sheet liability in respect of a 'minimum funding requirement' to be recognised at 11 March 2017.

a) Income statement

The amounts recognised in the income statement are as follows:

| | 2017 £m | 2016 £m |
|---|------------|------------|
| Excluded from underlying profit before tax: | | |
| Interest cost on pension liabilities ¹ | (292) | (266) |
| Interest income on plan assets | 276 | 244 |
| Total included in finance costs (note 6) | (16) | (22) |
| Defined benefit pension scheme expenses | (8) | (6) |
| Total excluded from underlying profit before tax (note 3) | (24) | (28) |
| Total income statement expense | (24) | (28) |

1 Includes interest of £1 million for the unfunded pension scheme (2016: £1 million).

29 Retirement benefit obligations continued

b) Other comprehensive income

Re-measurement of the retirement benefit obligations have been recognised as follows:

| | 2017 £m | 2016 £m |
|---|----------------|------------|
| Return on plan assets, excluding amounts included in interest | 1,182 | (16) |
| Actuarial (losses)/gains arising from changes in: | | |
| Finance assumptions ¹ | (2,005) | 103 |
| Demographic assumptions ² | 320 | — |
| Experience | 96 | 34 |
| Total actuarial (losses)/gains | (1,589) | 137 |
| Total re-measurements | (407) | 121 |

1 Includes £3 million loss for the unfunded pension scheme (2016: £2 million loss).

2 Includes £1 million gain for the unfunded pension scheme (2016: £nil).

c) Balance sheet

The amounts recognised in the balance sheet are as follows:

| | Sainsbury's 2017 £m | Home Retail Group 2017 £m | Group 2017 £m | Group 2016 £m |
|---|---------------------------|------------------------------------|---------------------|---------------------|
| Present value of funded obligations | (9,441) | (1,413) | (10,854) | (7,625) |
| Fair value of plan assets | 8,708 | 1,212 | 9,920 | 7,235 |
| | (733) | (201) | (934) | (390) |
| Present value of unfunded obligations | (23) | (17) | (40) | (18) |
| Retirement benefit obligations | (756) | (218) | (974) | (408) |
| Deferred income tax asset (note 7) | 77 | 47 | 124 | 19 |
| Net retirement benefit obligations | (679) | (171) | (850) | (389) |

The retirement benefit obligation and the associated deferred income tax balance are shown within different line items on the face of the balance sheet.

The movements in the Group's net defined benefit obligation are as follows:

| | 2017 £m | 2016 £m |
|--|--------------|------------|
| As at the beginning of the year | (408) | (708) |
| Acquisition of Home Retail Group plc (note 31) | (454) | — |
| Interest cost | (16) | (22) |
| Remeasurement (losses)/gains | (407) | 121 |
| Pension scheme expenses | (8) | (6) |
| Contributions by employer | 319 | 207 |
| As at the end of the year | (974) | (408) |

The movements in the retirement benefit obligations (including unfunded obligations) are as follows:

| | 2017 £m | 2016 £m |
|--|-----------------|------------|
| As at the beginning of the year | (7,643) | (7,696) |
| Acquisition of Home Retail Group plc (note 31) | (1,587) | — |
| Interest cost | (292) | (267) |
| Remeasurement (losses)/gains | (1,589) | 138 |
| Benefits paid | 217 | 182 |
| As at the end of the year | (10,894) | (7,643) |

Analysed as:

| | | |
|--------------------------------|-----------------|---------|
| Retirement benefit obligations | (10,854) | (7,625) |
| Unfunded obligations | (40) | (18) |

29 Retirement benefit obligations continued

The movements in the fair value of plan assets are as follows:

| | 2017 £m | 2016 £m |
|--|--------------|--------------|
| As at the beginning of the year | 7,235 | 6,988 |
| Acquisition of Home Retail Group plc (note 31) | 1,133 | – |
| Interest income on plan assets | 276 | 244 |
| Pension scheme expenses | (8) | (6) |
| Remeasurement gains/(losses) | 1,182 | (16) |
| Contributions by employer | 319 | 207 |
| Benefits paid | (217) | (182) |
| As at the end of the year | 9,920 | 7,235 |

Risks associated with the Group's defined benefit pension schemes

The defined benefit schemes expose the Group to a number of risks as detailed below:

| Risk | Description | Mitigation |
|-------------------------------|---|---|
| Asset volatility | Returns on assets that vary from the discount rate create funding level volatility. Both schemes hold a significant proportion of growth assets such as equities and real estate. Whilst growth assets are expected to outperform corporate bond yields over the long term this might not always occur in the short term. | All equities are invested passively across global indices. All other assets are invested actively and are widely diversified to reduce returns risk and enhance returns. |
| Currency | The schemes' liabilities are sterling based whereas the majority of assets are denominated in foreign currencies. | Currency hedging programmes in both schemes help dampen returns volatility caused by the fluctuation of sterling against other leading currencies. |
| Changes in bond yields | A decrease in bond yields, which in turn drive the discount rate, will increase the present value of the schemes' liabilities for accounting purposes. | A significant proportion of assets are held in corporate bonds that provide a hedge against falling bond yields. Furthermore significant levels of interest rate hedging within the schemes' liability hedging portfolios through interest rate derivatives serve to protect against falling bond yields. A buy-in policy in the HRG scheme transfers a proportion of interest rate risk to an insurer. |
| Inflation | The majority of the schemes' liabilities are linked to UK price inflation indices (to a maximum of five per cent per year). | The Sainsbury's scheme's liability hedging portfolios hedge significant proportions of inflation liabilities by holding index linked bonds and inflation rate derivatives. The schemes' equities provide a natural hedge for inflation. A buy-in policy in the HRG scheme transfers a proportion of inflation risk to an insurer. |
| Longevity | Beneficiaries living longer than expected could increase the schemes' liabilities. | A buy-in policy in the HRG scheme transfers some longevity risk to an insurer. |
| Operational | Poor administration of benefits may result in an increased defined benefit obligation in future years. | The schemes' benefits administrators have agreed service level agreements and controls are carefully monitored. |

29 Retirement benefit obligations continued

The major categories of plan assets are as follows:

| | Quoted 2017 £m | Unquoted ¹ 2017 £m | Quoted 2016 £m | Unquoted 2016 £m |
|---------------------------------|----------------------|-------------------------------------|----------------------|------------------------|
| Equity | | | | |
| Public | 1,987 | – | 1,671 | – |
| Private | – | 267 | – | 206 |
| Bonds | | | | |
| Government bonds | 1,272 | – | 811 | – |
| Corporate bonds | 3,483 | (60) | 2,725 | (38) |
| Emerging market bonds | 419 | – | 268 | – |
| Derivatives² | – | 519 | – | 756 |
| Alternatives | | | | |
| Real estate | 58 | 524 | – | 309 |
| Private debt | – | 436 | – | 206 |
| Diversified growth | 185 | – | – | – |
| Insurance policies ³ | – | 357 | – | – |
| Other | 102 | 59 | – | 1 |
| Cash and cash equivalents | 390 | (78) | 343 | (23) |
| | 7,896 | 2,024 | 5,818 | 1,417 |

Notes

1 Certain unquoted fixed interest securities, private equity and debt investments, property investments and hedge funds are stated at fair value. These fair values may differ from their realisable values due to the absence of liquid markets in these investments.

2 Swap contract derivatives outstanding at the year-end are stated at the net present value of future discounted cash flows of each leg of the swap.

3 Insurance policies of £357 million refers to a buy-in policy held by the HRG scheme. The income from this policy exactly matches the amount and timing of all of the benefits payable for the insured pensioner members. Therefore the fair value of the insurance policy has been calculated to be the present value of the related obligations.

Of the above assets, £3,230 million are denominated in sterling and £6,690 million are denominated in overseas currencies.

d) Assumptions

The principal actuarial assumptions used at the balance sheet date are as follows:

| | 2017 % | 2016 % |
|--------------------------|--------------------|-------------|
| Discount rate | 2.70 | 3.65 |
| Inflation rate – RPI | 3.30 | 3.15 |
| Inflation rate – CPI | 2.30 | 2.15 |
| Future pension increases | 2.00 – 3.15 | 1.90 – 3.00 |

The discount rate is based on the yield on AA-rated sterling corporate bonds appropriate to the term of the Schemes' liabilities.

The life expectancy for members aged 65 years at the balance sheet date is as follows:

| | Sainsbury's (Main scheme) 2017 | Sainsbury's (Executive scheme) 2017 | HRG 2017 | Sainsbury's (Main scheme) 2016 | Sainsbury's (Executive scheme) 2016 |
|------------------|---|--|-------------|---|--|
| Male pensioner | 21.5 | 24.8 | 22.6 | 22.7 | 25.2 |
| Female pensioner | 24.3 | 26.0 | 25.0 | 25.5 | 26.4 |

The life expectancy at age 65 for members aged 45 years at the balance sheet date is as follows:

| | Sainsbury's (Main scheme) 2017 | Sainsbury's (Executive scheme) 2017 | HRG 2017 | Sainsbury's (Main scheme) 2016 | Sainsbury's (Executive scheme) 2016 |
|------------------|---|--|-------------|---|--|
| Male pensioner | 23.3 | 26.5 | 24.4 | 24.6 | 27.0 |
| Female pensioner | 26.3 | 27.9 | 26.9 | 27.4 | 28.3 |

The weighted average duration of the defined benefit obligation at the end of the reporting period is 22 years for Sainsbury's and 25 years for HRG (2016: 21 years for Sainsbury's).

29 Retirement benefit obligations continued

e) Sensitivities

An increase of 0.5 per cent in the discount rate would decrease the retirement benefit obligations by £1,095 million. A decrease of 0.5 per cent in the discount rate would increase the retirement benefit obligations by £1,270 million.

An increase of 0.5 per cent in the inflation rate would increase the retirement benefit obligations by £850 million. A decrease of 0.5 per cent in the inflation rate would decrease the retirement benefit obligations by £796 million. This sensitivity includes the effect of inflation on the Scheme's pension increases.

An increase of one year to the life expectancy would increase the retirement benefit obligations by £381 million.

The sensitivities are based on management's best estimate of a reasonably anticipated change. The sensitivities are calculated using the same methodology used to calculate the retirement benefit obligation, by considering the change in the retirement benefit obligation for a given change in assumption. The net retirement benefit obligation is the difference between the retirement benefit obligation and the fair value of plan assets. Changes in the assumptions may occur at the same time as changes in the fair value of plan assets. There has been no change in the calculation methodology since the prior period.

30 Share-based payments

Accounting policies

The Group provides benefits to employees (including Directors) of the Group in the form of equity-settled and cash-settled share-based payment transactions, whereby employees render services in exchange for shares, rights over shares or the value of those shares in cash terms.

For equity-settled share-based payments, the fair value of the employee services rendered is determined by reference to the fair value of the shares awarded or options granted, excluding the impact of any non-market vesting conditions. All share options are valued using an option-pricing model (Black-Scholes or Monte Carlo). This fair value is charged to the income statement over the vesting period of the share-based payment scheme.

For cash-settled share-based payments, the fair value of the employee services rendered is determined at each balance sheet date and the charge recognised through the income statement over the vesting period of the share-based payment scheme, with the corresponding increase in accruals.

The value of the charge is adjusted in the income statement over the remainder of the vesting period to reflect expected and actual levels of options vesting, with the corresponding adjustments made in equity and accruals.

The grant by the Company of options over its equity instruments to the employees of subsidiary undertakings in the Group is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity.

The Group recognised £32 million (2016: £23 million) of employee costs (note 28) related to share-based payment transactions made during the financial year. Of these, £nil (2016: £nil) were cash-settled.

The Group operates a number of share-based payment schemes as set out below:

a) Savings-Related Share Option Scheme (Sharesave)

The Group operates a Savings-Related Share Option Scheme, which is open to all UK employees with more than three months' continuous service. This is an approved HMRC scheme and was established in 1980. Under Sharesave, participants remaining in the Group's employment at the end of the three-year or five-year savings period are entitled to use their savings to purchase shares in the Company at a stated exercise price. Employees leaving for certain reasons are able to use their savings to purchase shares within six months of their leaving.

A reconciliation of Sharesave option movements is shown below:

| | 2017 Number of options million | 2017 Weighted average exercise price pence | 2016 Number of options million | 2016 Weighted average exercise price pence |
|---|---|---|---|--|
| Outstanding at the beginning of the year | 59.0 | 234 | 55.0 | 254 |
| Granted | 27.1 | 184 | 20.0 | 195 |
| Forfeited | (16.7) | 249 | (13.0) | 253 |
| Exercised | (2.6) | 249 | (3.0) | 244 |
| Expired | (0.3) | 208 | — | 218 |
| Outstanding at the end of the year | 66.5 | 210 | 59.0 | 234 |
| Exercisable at the end of the year | 5.7 | 301 | 7.6 | 277 |
| Exercisable price range | 185 to 332 | | 195 to 332 | |

The weighted average share price for options exercised over the year was 269 pence (2016: 266 pence). The weighted average remaining contractual life of options outstanding at 11 March 2017 was 2.4 years (2016: 2.3 years).

30 Share-based payments continued

Options granted during the year were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted during the year and the assumptions used in the calculation are as follows:

| | | 2017 | 2016 |
|--|-------------------------|-------------|------|
| Share price at grant date (pence) | | 231 | 243 |
| Exercise price (pence) | | 185 | 195 |
| Expected volatility | – 3 year period (%) | 29.9 | 26.6 |
| | – 5 year period (%) | 25.5 | 24.1 |
| Option life | – 3 year period (years) | 3.2 | 3.2 |
| | – 5 year period (years) | 5.2 | 5.2 |
| Expected dividends (expressed as dividend yield %) | | 4.9 | 5.1 |
| Risk-free interest rate | – 3 year period (%) | 0.8 | 1.6 |
| | – 5 year period (%) | 1.6 | 2.1 |
| Fair value per option | – 3 year period (pence) | 49 | 48 |
| | – 5 year period (pence) | 45 | 45 |

The expected volatility is based on the standard deviation of the Group's share price for the period immediately prior to the date of grant of award, over the period identical to the vesting period of the award, adjusted for management's view of future volatility of the share price.

As part of the acquisition of Home Retail Group plc (HRG) colleagues had the option to roll over their HRG Save As You Earn (SAYE) options to J Sainsbury plc SAYE option or let their HRG options vest. Therefore the above outstanding SAYE options include the rollover options. The calculation of the fair value per option rolled over has not been included within the table above.

b) Long-Term Incentive Plan

Under the Long-Term Incentive Plan, shares are conditionally awarded to the senior managers in the Company. The core awards are calculated as a percentage of the participants' salaries and scaled according to grades.

Performance is measured at the end of the three-year performance period. If the required performance conditions have been met, the awards vest and 50 per cent of the award will be released. Subject to participants remaining in employment for a further year, the balance will then be released one year after the vesting date. Options granted to acquire the award of shares will expire two years from the vesting date. Dividends will accrue on the shares that vest in the form of additional shares.

The core award can grow by up to four times, dependent on the level of performance. Straight-line vesting will apply if performance falls between two points. Awards are structured as nil cost options.

A reconciliation of the number of shares conditionally allocated is shown below:

| | 2017 million | 2016 million |
|---|-----------------|-----------------|
| Outstanding at the beginning of the year | 5.4 | 6.1 |
| Conditionally allocated | 2.5 | 2.2 |
| Forfeited | (1.7) | (2.2) |
| Released to participants | (0.4) | (0.7) |
| Outstanding at the end of the year | 5.8 | 5.4 |

The weighted average remaining contractual life of share options outstanding at 11 March 2017 was 1.8 years (2016: 1.7 years).

Details of shares conditionally allocated at 11 March 2017 are set out below:

| Date of conditional award | 2017 million | 2016 million |
|-----------------------------------|-----------------|-----------------|
| 19 May 2011 (2011 Value Builder) | – | 0.2 |
| 16 May 2013 (2013 Future Builder) | – | 1.4 |
| 15 May 2014 (2014 Future Builder) | 1.6 | 1.7 |
| 14 May 2015 (2015 Future Builder) | 1.9 | 2.1 |
| 12 May 2016 (2016 Future Builder) | 2.3 | – |
| | 5.8 | 5.4 |

30 Share-based payments continued

Options to acquire the award of shares were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted during the year and the assumptions used in the calculation are as follows:

| | 2017 | 2016 |
|-----------------------------------|------------|------|
| Share price at grant date (pence) | 265 | 276 |
| Option life (years) | 4.2 | 4.2 |
| Fair value per option (pence) | 265 | 276 |

During the year, a total number of 0.4 million shares were exercised (2016: 1.4 million shares). The weighted average share price during the year for options exercised was 272 pence (2016: 238 pence).

c) Deferred Share Award

The Deferred Share Award targets a diverse range of financial and strategic scorecard measures. These are intended to reward the top managers in the Company, including Executive Directors, for driving the short-term objectives that will directly lead to building the sustainable, long-term growth of the Company. Awards are structured as nil cost options.

Share-based awards are made to participants subject to performance against a basket of measures. At least 50 per cent of the awards are based on the delivery of financial performance and returns to shareholders. The balance is based on measures which will assess the Company's performance relative to its competitors as well as key strategic goals.

Performance against the target is measured over one financial year. Any shares awarded are deferred for a further two years to ensure that management's interests continue to be aligned with those of shareholders. The shares are subject to forfeiture if the participant resigns or is dismissed. Dividends accrue on the shares that vest in the form of additional shares.

A reconciliation of the number of shares granted over the year is shown below:

| | 2017 million | 2016 million |
|---|-----------------|-----------------|
| Outstanding at the beginning of the year | 2.2 | 2.5 |
| Granted | 2.2 | 1.2 |
| Lapsed | (0.1) | (0.3) |
| Exercised | (1.3) | (1.2) |
| Outstanding at the end of the year | 3.0 | 2.2 |

The number of shares allocated at the end of the year is set out below:

| | 2017 million | 2016 million |
|-------------|-----------------|-----------------|
| 16 May 2013 | – | 0.1 |
| 15 May 2014 | – | 1.2 |
| 14 May 2015 | 0.9 | 0.9 |
| 13 May 2016 | 2.1 | – |
| | 3.0 | 2.2 |

The weighted average remaining contractual life of share options outstanding at 11 March 2017 was 1.7 years (2016: 1.4 years). The weighted average share price during the year for options exercised was 269 pence (2016: 268 pence).

30 Share-based payments continued

d) Bonus Share Award

The bonus arrangements for our senior managers and supermarket store managers include corporate and personal performance targets. A profit gateway is in place where a certain level of underlying profit before tax must be achieved before any bonus related to the corporate element of the bonus is released.

60 per cent of the bonus is paid in cash and 40 per cent awarded in shares. They are automatically released after three financial years. Shares are subject to forfeiture if the participant resigns or is dismissed.

Dividends accrue on these shares and are released at the end of the three-year retention period.

A reconciliation of the number of shares granted over the year is shown below:

| | 2017 million | 2016 million |
|---|-----------------|-----------------|
| Outstanding at the beginning of the year | 8.9 | 10.2 |
| Granted | 6.3 | 3.7 |
| Exercised | (3.8) | (4.0) |
| Lapsed | (0.5) | (1.0) |
| Outstanding at the end of the year | 10.9 | 8.9 |

The number of shares allocated at the end of the year is set out below:

| | 2017 million | 2016 million |
|-------------|-----------------|-----------------|
| 16 May 2013 | – | 3.1 |
| 15 May 2014 | 2.7 | 3.0 |
| 14 May 2015 | 2.5 | 2.8 |
| 13 May 2016 | 5.7 | – |
| | 10.9 | 8.9 |

The weighted average remaining contractual life of share options outstanding at 11 March 2017 was 1.5 years (2016: 1.1 years). The weighted average share price during the year for options exercised was 277 pence (2016: 269 pence).

31 Acquisition of Home Retail Group plc

Accounting policies for business combinations

The Group applies the acquisition method of accounting for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair value of identifiable assets transferred, the liabilities incurred and the equity interests issued by the Group at the acquisition date. Acquisition-related costs are expensed as incurred.

On 2 September 2016, the Group acquired 100 per cent of the issued share capital of Home Retail Group plc (HRG), a listed company based in the United Kingdom, by means of a Scheme of Arrangement under Part 26 of the Act for a consideration of £1,093 million. The full analysis of the consideration is shown below:

| | Consideration fair value at acquisition date £m |
|--|---|
| Form of consideration | |
| Cash of £447 million (being 55p per existing share); fair value is based on Home Retail Group plc's share capital of 813,445,001 shares in existence as at the acquisition date | 447 |
| £3 million in relation to the contractual requirement to settle certain existing HRG share scheme awards and options | 3 |
| 261 million new J Sainsbury plc shares of 28 $\frac{1}{2}$ p nominal value each were issued (being 0.321 new J Sainsbury plc shares per existing Home Retail Group plc share); fair value of the consideration is based on a J Sainsbury plc share price of £2.4610 as of 2 September 2016 | 643 |
| Total | 1,093 |

31 Acquisition of Home Retail Group plc continued

Home Retail Group's activities mainly comprise General Merchandise related retail. The acquisition is expected to accelerate Sainsbury's growth strategy in General Merchandise & Clothing retail as well as its online presence. The combination brings together two of the UK's leading retail businesses with complementary product offers through an integrated, multi-channel proposition.

None of the goodwill recognised of £58 million is expected to be deductible for income tax purposes. This was calculated as the difference between the fair value of consideration paid and the fair value of net assets acquired as set out in the following table.

The provisional assets and liabilities recognised as a result of the acquisition are as follows:

| Fair value of net assets acquired (provisional) | £m |
|---|----------------|
| Fixed assets | 262 |
| Intangible assets | 322 |
| Inventories | 810 |
| Trade and other receivables | 146 |
| Deferred tax assets | 45 |
| Amounts due from Financial Services customers (the 'loan book') | 615 |
| Other financial assets ¹ | 59 |
| Cash and cash equivalents ² | 548 |
| Total assets acquired | 2,807 |
| Trade and other payables ² | (1,214) |
| Provisions | (104) |
| Defined benefit obligation | (454) |
| Total liabilities acquired | (1,772) |
| Net identifiable assets acquired at fair value | 1,035 |
| Goodwill arising on acquisition | 58 |
| Purchase consideration transferred | 1,093 |

1 Other financial assets includes £9 million of J Sainsbury plc shares (converted from Home Retail Group plc own shares at the point of acquisition). On consolidation these become J Sainsbury plc own shares in the consolidated statement of changes in equity.

2 Cash and cash equivalents and trade and other payables acquired are both presented gross of the capital return of £226 million.

In accordance with IFRS 3 'Business Combinations', the acquisition accounting will be finalised within 12 months of the acquisition date of 2 September 2016.

a) Intangible assets

Intangible assets include a brand of £179 million relating to the Argos brand name. This reflects its fair value at the acquisition date and is estimated to have a useful economic life of ten years.

b) Trade and other receivables

Trade and other receivables include £40 million of trade receivables, against which a bad debt provision of £(1) million is held. Also included are prepayments and accrued income of £29 million, and other debtors of £78 million.

c) Amounts due from Financial Services customers (the 'loan book')

The loan book fair value of £615 million includes a fair value increase of £20 million and a provision for impairment of £(66) million.

d) Revenue and profit contribution

From the date of acquisition, Home Retail Group has contributed £2,661 million of revenue excluding VAT, £77 million of underlying profit before tax and a statutory profit before tax of £54 million to the Group. If the acquisition date had been on the first day of the financial year, Group revenues for the period would have been £28,013 million, Group underlying profit before tax would have been £563 million and Group profit before tax would have been £361 million. These amounts have been calculated using the Group's accounting policies. The information is provided for illustrative purposes only and is not indicative of the results of the combined Group that would have occurred had the purchase actually been made at the beginning of the year, or indicative of the future results of the combined Group.

e) Acquisition-related costs

Acquisition-related costs (included in administrative expenses and recognised outside of underlying profit) amount to £22 million in the current year (2016: £12 million) (see note 3). In addition £3 million of costs relating to the issuance of J Sainsbury plc shares have been recognised directly within equity.

f) Capital return

Prior to the acquisition of Home Retail Group plc, it was announced that Home Retail Group plc shareholders would be entitled to a £226 million capital return comprising the following:

- 25.0 pence per share, reflecting the £200 million return to shareholders in respect of the sale of Homebase by Home Retail Group plc on 29 February 2016; and
- 2.8 pence per share (totalling £26 million) in lieu of a final dividend in respect of Home Retail Group plc's financial year ended 27 February 2016.

This was recorded as a liability in the net assets acquired above within trade and other payables. The full amount was paid on 12 September 2016.

31 Acquisition of Home Retail Group plc continued

g) Cash impact of acquisition

| | £m |
|--|------------|
| Cash consideration | (447) |
| Cash acquired | 548 |
| Acquisition of subsidiaries, net of cash acquired (per cash flow statement) | 101 |

h) Hindsight adjustments

The provisional fair values acquired are different from those reported at the half-year due to hindsight adjustments as permitted under IFRS 3 'Business Combinations'. The goodwill arising as a result of the acquisition has therefore increased from £18 million, as reported at the half-year, to £58 million.

32 Operating lease commitments

Accounting policies

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. All other leases are classified as operating leases. For property leases, the land and building elements are treated separately to determine the appropriate lease classification.

a) Operating leases

Assets leased under operating leases are charged directly to the income statement on a straight-line basis over the lease term.

b) Sale and leaseback

A sale and leaseback transaction is one where a vendor sells an asset and immediately reacquires the use of that asset by entering into a lease with the buyer.

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

c) Leases with predetermined fixed rental increases

The Group has a number of leases with predetermined fixed rental increases. These rental increases are accounted for on a straight-line basis over the term of the lease.

d) Operating lease income

Operating lease income consists of rentals from sub-tenant agreements and is recognised as earned on a straight-line basis over the lease term.

The Group leases various retail stores, offices, depots and equipment under non-cancellable operating leases. The leases have varying terms, escalation clauses and renewal rights.

The Group's future minimum lease payments under operating leases are as follows:

| | 2017 £m | 2016 £m |
|--|---------------|---------------|
| Aggregate future minimum lease payments: | | |
| Within one year | 760 | 614 |
| In the second to fifth years inclusive | 2,615 | 2,245 |
| After five years | 7,117 | 7,209 |
| | 10,492 | 10,068 |

Further analysis of the Group's future minimum lease payments after five years is as follows:

| | 2017 £m | 2016 £m |
|---|--------------|--------------|
| Aggregate future minimum lease payments: | | |
| Greater than five years but less than ten years | 1,924 | 1,866 |
| Greater than ten years but less than 15 years | 1,253 | 1,281 |
| After 15 years | 3,940 | 4,062 |
| | 7,117 | 7,209 |

The commercial terms of the Group's operating leases vary, however they commonly include either a market rent review or an index linked rent review (with a cap and collar). The timing of when rent reviews take place differs for each lease. The Group has pre-emption rights over a minor number of properties, which provides the Group with the right of first refusal to purchase the property in the event the landlord chooses to sell. The option price payable for the asset in each instance is normally referenced to current market value prevailing at the point of pre-emption.

For the purposes of calculating adjusted net debt, the total value of the Group's capitalised operating lease commitments is £5,938 million (2016: £5,500 million).

32 Operating lease commitments continued

The Group sublets certain leased properties:

| | 2017 £m | 2016 £m |
|--|------------|------------|
| Aggregate future minimum lease receipts: | | |
| Within one year | 39 | 35 |
| In the second to fifth years inclusive | 119 | 119 |
| After five years | 116 | 124 |
| | 274 | 278 |

33 Capital commitments

The Group has entered into contracts totalling £107 million (2016: £173 million) for future capital expenditure in relation to property, plant and equipment and £11 million (2016: £6 million) for intangible assets not provided for in the financial statements.

34 Financial commitments

Sainsbury's Bank has off balance sheet commitments to extend credit to customers of £98 million (2016: £77 million).

35 Contingent liabilities

The Group has a contingent liability for indemnities arising from the disposal of subsidiaries. No provision has been recognised on the basis that any potential liability arising is not considered probable. It is not possible to quantify the impact of this liability with any certainty.

Along with other retailers, the Group is subject to claims in respect of pay rates across supermarket and distribution centre workers. There is also a potential obligation in respect of holiday pay on voluntary overtime. The Group is keeping these matters under close review but considers the likelihood of payout to be remote.

36 Related party transactions

a) Key management personnel

The key management personnel of the Group comprise members of the J Sainsbury plc Board of Directors and the Operating Board. The key management personnel compensation is as follows:

| | 2017 £m | 2016 £m |
|-----------------------------------|------------|------------|
| Short-term employee benefits | 10 | 7 |
| Post-employment employee benefits | 1 | 1 |
| Share-based payments | 6 | 4 |
| | 17 | 12 |

Nine key management personnel had credit card balances with Financial Services (2016: ten). These arose in the normal course of business and were immaterial to the Group and the individuals. Five key management personnel held saving deposit accounts with Financial Services (2016: five). These balances arose in the normal course of business and were immaterial to the Group and the individuals.

b) Joint ventures and associates

Transactions with joint ventures and associates

For the 52 weeks to 11 March 2017, the Group entered into various transactions with joint ventures and associates as set out below:

| | 2017 £m | 2016 £m |
|--|------------|------------|
| Management services received | – | (1) |
| Management services provided | 8 | 4 |
| Income share received from joint ventures | 29 | 33 |
| Dividends and distributions received | 65 | 46 |
| Proceeds from repayment of loan to joint venture | 2 | – |
| Investment in joint ventures and associates | (18) | (18) |
| Rental expenses paid | (57) | (65) |

Year-end balances arising from transactions with joint ventures and associates

| | 2017 £m | 2016 £m |
|-------------------------------|------------|------------|
| Receivables | | |
| Other receivables | 12 | 28 |
| Loans due from joint ventures | 3 | 3 |
| Payables | | |
| Other payables | – | (1) |
| Loans due to joint ventures | (5) | (5) |

Loans with joint ventures are non-interest bearing and repayable on demand.

c) Retirement benefit obligations

As discussed in note 29, the Group has entered into an arrangement with the Pension Scheme Trustee as part of the funding plan for the actuarial deficit in the Scheme. Full details of this arrangement are set out in note 29 to these financial statements.

37 Details of related undertakings

All companies listed below are owned by the Group and all interests are in the ordinary share capital, except where otherwise indicated. All subsidiaries have been consolidated.

a) Subsidiary undertakings

The Group holds a majority of the voting rights of the following undertakings:

| Entity | Country of Incorporation | Interest | Holding | Address* |
|--|--------------------------|----------|----------|-------------------------------|
| ARG Personal Loans Limited | UK | 100% | Indirect | Avebury |
| ARG Services Limited | UK | 100% | Indirect | 33 Holborn |
| Argos (Asia) Limited | Hong Kong | 100% | Indirect | Units C & D 5/F, D2 Place Two |
| Argos (Hong Kong) Limited | Hong Kong | 100% | Indirect | Units C & D 5/F, D2 Place Two |
| Argos Best Sellers Limited | UK | 100% | Indirect | 33 Holborn |
| Argos Business Solutions Limited | UK | 100% | Indirect | Avebury |
| Argos Card Transactions Limited | UK | 100% | Indirect | 33 Holborn |
| Argos Direct Limited | UK | 100% | Indirect | 33 Holborn |
| Argos Distributors (Ireland) Limited | Ireland | 100% | Indirect | Unit 7, Ashbourne Retail Park |
| Argos Extra Limited | UK | 100% | Indirect | 33 Holborn |
| Argos Holdings Limited | UK | 100% | Indirect | Avebury |
| Argos Limited | UK | 100% | Indirect | Avebury |
| Argos Retail Group (Asia) Limited | Hong Kong | 100% | Indirect | Units C & D 5/F, D2 Place Two |
| Argos Retail Group (Hong Kong) Limited | Hong Kong | 100% | Indirect | Units C & D 5/F, D2 Place Two |
| Argos Retail Group Limited | UK | 100% | Indirect | 33 Holborn |
| Argos Superstores Limited | UK | 100% | Indirect | 33 Holborn |
| Argos Surbs Investments Limited | UK | 100% | Indirect | Avebury |
| Avebury (Asia) Limited | Hong Kong | 100% | Indirect | Suite 1608-1613, Tower 6 |
| Barleygold Limited | UK | 100% | Indirect | 50 Bedford Street |
| Bed Store & More Limited | UK | 100% | Indirect | 33 Holborn |
| Bells Stores Limited | UK | 100% | Direct | 33 Holborn |
| BLSSP (PHC 7) Limited | UK | 100% | Direct | 33 Holborn |
| Braemar Castle Limited | UK | 100% | Direct | 33 Holborn |
| Brand Leaders Limited | UK | 100% | Indirect | 33 Holborn |
| Chad Valley Limited | UK | 100% | Indirect | 33 Holborn |
| Clearance Bargains Limited | UK | 100% | Indirect | 33 Holborn |
| Cliffrange Limited | UK | 100% | Indirect | 33 Holborn |
| Coolidge Investments Limited | UK | 100% | Indirect | 33 Holborn |
| Financial Recovery Services Limited | UK | 100% | Indirect | Avebury |
| First Stop Stores Limited | UK | 100% | Indirect | 33 Holborn |
| Flint Castle Limited | UK | 100% | Direct | 33 Holborn |
| Global (Guernsey) Limited | Guernsey | 100% | Indirect | Maison Trinity |
| Habitat Retail Limited | UK | 100% | Indirect | Avebury |
| Holborn UK Investments Limited | UK | 100% | Direct | 33 Holborn |
| Home Retail (Asia) Limited | Hong Kong | 100% | Indirect | Units C & D 5/F, D2 Place Two |
| Home Retail (Hong Kong) Limited | Hong Kong | 100% | Indirect | Units C & D 5/F, D2 Place Two |
| Home Retail Group (Asia) Limited | Hong Kong | 100% | Indirect | Units C & D 5/F, D2 Place Two |
| Home Retail Group (Cyprus) Limited | Cyprus | 100% | Indirect | Michalaki Karaoli, 8 |
| Home Retail Group (Finance) LLP | UK | 100% | Indirect | Avebury |
| Home Retail Group (Guernsey) LP | Guernsey | 100% | Indirect | Maison Trinity |
| Home Retail Group (Hong Kong) Limited | Hong Kong | 100% | Indirect | Units C & D 5/F, D2 Place Two |
| Home Retail Group (Jersey) Limited | Jersey | 100% | Indirect | 44 Esplanade |
| Home Retail Group (UK) Limited | UK | 100% | Indirect | Avebury |
| Home Retail Group Card Services Limited | UK | 100% | Indirect | Avebury |
| Home Retail Group Holdings (Overseas) Limited | UK | 100% | Indirect | 33 Holborn |
| Home Retail Group Insurance Services Limited | UK | 100% | Indirect | Avebury |
| Home Retail Group Limited | UK | 100% | Indirect | Avebury |
| Home Retail Group Nominees Limited | UK | 100% | Indirect | 33 Holborn |
| Home Retail Group Pension Scheme Nominees Limited | UK | 100% | Indirect | Avebury |
| Home Retail Group Procurement Consultancy (Shanghai) Limited | China | 100% | Indirect | Room 02-04, 12/F., Tower 1 |
| Home Retail Group UK Service Company Limited | UK | 100% | Indirect | 33 Holborn |
| Home Store & More Limited | UK | 100% | Indirect | 33 Holborn |
| J Sainsbury Common Investment Fund Limited | UK | 100% | Indirect | 33 Holborn |

*See full address on page 177.

37 Details of related undertakings continued

| Entity | Country of Incorporation | Interest | Holding | Address* |
|--|--------------------------|----------|----------|---|
| J Sainsbury Distribution Limited | UK | 100% | Direct | 33 Holborn |
| J Sainsbury Limited | Ireland | 100% | Direct | Riverside One |
| J Sainsbury Pension Scheme Trustees Limited | UK | 100% | Direct | 33 Holborn |
| J Sainsbury Trustees Limited | UK | 100% | Indirect | 33 Holborn |
| Jacksons Stores 2002 Limited | UK | 100% | Indirect | 33 Holborn |
| Jacksons Stores Limited | UK | 100% | Direct | 33 Holborn |
| JS Information Systems Limited | UK | 100% | Direct | 33 Holborn |
| JS Insurance Limited | Isle of Man | 100% | Direct | Third Floor, St George's Court |
| JSD (London) Limited | UK | 100% | Indirect | 33 Holborn |
| Jungle Online | UK | 100% | Indirect | 33 Holborn |
| Jungle.com Holdings Limited | UK | 100% | Indirect | 33 Holborn |
| Jungle.com Limited | UK | 100% | Indirect | 33 Holborn |
| Nash Court (Kenton) Limited | UK | 100% | Indirect | 33 Holborn |
| Premier Incentives Limited | UK | 100% | Indirect | 33 Holborn |
| Ramheath Properties Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury Bridgeco Holdco Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury Holdco A Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury Holdco B Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury Propco A Limited | UK | 100% | Indirect | 33 Holborn |
| Sainsbury Propco B Limited | UK | 100% | Indirect | 33 Holborn |
| Sainsbury Propco C Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury Propco D Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury Property Investments Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury's Asia (Shanghai) Limited | Hong Kong | 100% | Indirect | 27/F Standard Chartered Tower |
| Sainsbury's Asia Limited | Hong Kong | 100% | Indirect | 27/F Standard Chartered Tower |
| Sainsbury's Bank plc | UK | 100% | Direct | 33 Holborn |
| Sainsbury's Basingstoke Limited | UK | 100% | Indirect | 33 Holborn |
| Sainsbury's Commercial Consulting (Dongguan) Company Limited | China | 100% | Indirect | Room 302, Zhixing International Commerce Building |
| Sainsbury's Convenience Stores Limited | UK | 100% | Direct | 33 Holborn |
| Sainsburys Corporate Director Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury's Intermediate Holdings Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury's Limited | Ireland | 100% | Direct | Riverside One |
| Sainsbury's Limited | UK | 100% | Direct | No.2 Lochrin Square |
| Sainsbury's Manor GP Limited | UK | 100% | Direct | Hurlawcrook Road |
| Sainsbury's Manor II Property Limited | UK | 100% | Direct | Hurlawcrook Road |
| Sainsbury's Manor Property Limited | UK | 100% | Direct | Hurlawcrook Road |
| Sainsbury's Planet Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury's Supermarkets Ltd | UK | 100% | Direct | 33 Holborn |
| Software Warehouse Holdings Limited | UK | 100% | Indirect | 33 Holborn |
| Stamford House (Jersey) Limited | Jersey | 100% | Direct | Queensway House |
| Stamford House Investments Limited | UK | 100% | Indirect | 33 Holborn |
| Stamford Properties One Limited | UK | 100% | Direct | 33 Holborn |
| Stamford Properties Three Limited | UK | 100% | Direct | 33 Holborn |
| Stamford Properties Two Limited | UK | 100% | Direct | 33 Holborn |
| Stanhope Finance Limited | UK | 100% | Indirect | 33 Holborn |
| Tintagel Castle Limited | UK | 100% | Direct | 33 Holborn |
| Town Centre Retail (Bicester) Limited | UK | 100% | Indirect | 33 Holborn |

*See full address on page 177.

37 Details of related undertakings continued

b) Associated undertakings

The Group has a participating interest in the following undertakings:

| Entity | Country of Incorporation | Interest | Holding | Address* |
|---|--------------------------|---------------------------|----------|---------------------|
| Arcus FM Limited | UK | Preference Shares | Indirect | Enterprise House |
| Arcus Solutions Limited | UK | Preference Shares | Indirect | Enterprise House |
| PXS Limited | UK | 85,000 B Shares | | One New Change |
| Tamar Energy Limited | UK | 2,000,000 Investor shares | Indirect | 150 Waterloo Road |
| BL Sainsbury Superstores Limited | UK | 50% | Indirect | York House |
| Hedge End Park Limited | UK | 50% | Direct | 33 Holborn |
| Harvest 2 GP Limited | UK | 50% | Indirect | 100 Victoria Street |
| Insight 2 Communication LLP | UK | 50% | Indirect | 80 Strand |
| Harvest 2 Limited Partnership | UK | 50% | Indirect | 100 Victoria Street |
| Harvest Development Management Limited | UK | 50% | Indirect | 100 Victoria Street |
| Harvest GP Limited | UK | 50% | Indirect | 100 Victoria Street |
| Netto Limited | UK | 50% | Direct | 33 Holborn |
| Sainsbury's Property Scottish Partnership | UK | 33% | Indirect | Hurlawcrook Road |
| Sainsbury's Property Scottish Limited Partnership | UK | 10% | Indirect | Hurlawcrook Road |
| Manor II Property Scottish Partnership | UK | 0.01% | Indirect | Hurlawcrook Road |
| Manor Property Scottish Partnership | UK | 0.01% | Indirect | Hurlawcrook Road |
| Manor Scottish Limited Partnership | UK | 0.01% | Indirect | Hurlawcrook Road |

c) Undertakings other than subsidiaries and associated undertakings

The direct or indirect holder of 100 per cent of the voting interests in the following undertakings is an associate of the Group:

| Entity | Country of Incorporation | Interest | Holding | Address* |
|------------------------------------|--------------------------|----------|----------|--------------|
| B.L.C.T. (10775) Limited | Jersey | 50% | Indirect | 47 Esplanade |
| B.L.C.T. (11546) Limited | Jersey | 50% | Indirect | 47 Esplanade |
| B.L.C.T. (20720) Limited | Jersey | 50% | Indirect | 47 Esplanade |
| B.L.C.T. (27255) Limited | Jersey | 50% | Indirect | 47 Esplanade |
| B.L.C.T. (38775) Limited | Jersey | 50% | Indirect | 47 Esplanade |
| B.L.C.T. (39150) Limited | Jersey | 50% | Indirect | 47 Esplanade |
| B.L.C.T. (39214) Limited | Jersey | 50% | Indirect | 47 Esplanade |
| B.L.C.T. (39215) Limited | Jersey | 50% | Indirect | 47 Esplanade |
| BL Crawley | Jersey | 50% | Indirect | 47 Esplanade |
| BL Superstores Finance PLC | UK | 50% | Indirect | York House |
| BL Superstores (Funding) Limited | UK | 50% | Indirect | York House |
| BLS Non Securitised 2012 1 Limited | UK | 50% | Indirect | York House |
| BLS Non-Securitised 2012 2 Limited | UK | 50% | Indirect | York House |
| BLSSP (Cash Management) Limited | UK | 50% | Indirect | York House |
| BLSSP (Lending) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 1 2010) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 1 2012) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 1) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 10) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 11) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 12) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 14) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 16) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 17) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 18) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 19) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 2 2010) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 2) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 20) Limited | UK | 50% | Indirect | York House |

*See full address on page 177.

37 Details of related undertakings continued

| Entity | Country of Incorporation | Interest | Holding | Address* |
|------------------------------------|--------------------------|----------|----------|---------------------|
| BLSSP (PHC 21) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 22) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 23) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 24) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 25) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 26) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 28) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 3) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 32) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 33) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 34) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 35) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 4) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 5) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 6) Limited | UK | 50% | Indirect | York House |
| BLSSP (PHC 9) Limited | UK | 50% | Indirect | York House |
| British Land Superstores | UK | 50% | Indirect | York House |
| Clarendon Property Company | UK | 50% | Indirect | York House |
| Harvest 2 Selly Oak Limited | UK | 50% | Indirect | 100 Victoria Street |
| Harvest Nominee No. 1 Limited | UK | 50% | Indirect | 100 Victoria Street |
| Harvest Nominee No. 2 Limited | UK | 50% | Indirect | 100 Victoria Street |
| Pencilscreen Limited | UK | 50% | Indirect | York House |
| Selected Land and Property Company | UK | 50% | Indirect | York House |
| Ten Fleet Place | UK | 50% | Indirect | York House |
| Vyson | UK | 50% | Indirect | York House |

d) Overseas branches

The Group has the following branches overseas.

| Entity | Country | Holding | Address* |
|---|---------|----------|--|
| Sainsbury's Asia Limited – Bangladesh Liason Office | India | Indirect | Level 10, Simpletree Anarkali |
| Sainsbury's Asia Limited – India Branch Office | India | Indirect | Unit No. 1, 1st Floor, Ambience Corporate Tower II |
| Sainsbury's Commercial Consulting (Dongguan) Company Limited – Shanghai Branch Office | China | Indirect | Suite 2202-2205, 22F., Raffles City |

e) Companies in liquidation

| Entity | Country of Incorporation | Interest | Holding | Address* |
|---|--------------------------|----------|----------|-------------------|
| Global Media Vault Limited | UK | 100% | Indirect | 33 Holborn |
| Home Retail Group (India) Private Limited | India | 100% | Indirect | Paradigm Wing A |
| J Sainsbury (Overseas) Limited | UK | 100% | Direct | 33 Holborn |
| J Sainsbury Holdings | Ireland | 100% | Indirect | Riverside One |
| JS Finance Corporation | Ireland | 100% | Indirect | Riverside One |
| L&B (No 26) Limited | UK | 100% | Indirect | 50 Bedford Street |
| Mobile by Sainsbury's Limited | UK | 100% | Indirect | 33 Holborn |
| Portfolio Investments Ltd | UK | 100% | Indirect | 33 Holborn |
| RECO Property Limited | UK | 100% | Indirect | 33 Holborn |
| Romford Developments Limited | UK | 50% | Indirect | 33 Holborn |
| S. W. Dewsbury Limited | UK | 100% | Direct | 33 Holborn |
| Sainsbury's Entertainment Ltd | UK | 100% | Indirect | 33 Holborn |
| Sainsbury's Holborn Property | UK | 100% | Indirect | 33 Holborn |
| Savacentre Limited | UK | 100% | Direct | 33 Holborn |
| Stamford Properties (Dorking) Limited | UK | 100% | Indirect | 33 Holborn |
| Stamford Properties Four Limited | UK | 100% | Direct | 33 Holborn |
| Stockdale Land (Bicester) Limited | UK | 100% | Indirect | 33 Holborn |

*See full address on page 177.

37 Details of related undertakings continued

| Address | Full Address |
|--|--|
| 100 Victoria Street | 100 Victoria Street, London, SW1E 5JL, United Kingdom |
| 27/F Standard Chartered Tower | 27/F Standard Chartered Tower, Millennium City 1, 388 Kwun Tong Road, Kwun, Hong Kong |
| 33 Holborn | 33 Holborn, London, EC1N 2HT, United Kingdom |
| 150 Waterloo Road | 3rd Floor, 150 Waterloo Road, London, SE1 8SB, United Kingdom |
| 44 Esplanade | 44 Esplanade, St Helier, Jersey, JE4 9WG, Channel Islands |
| 47 Esplanade | 47 Esplanade, St Helier, Jersey, JE1 0BD, Channel Islands |
| 50 Bedford Street | 50 Bedford Street, Belfast, BT2 7FN, United Kingdom |
| 80 Strand | 80 Strand, 6th Floor, London, WC2R 0NN, United Kingdom |
| Avebury | Avebury, 489-499 Avebury Boulevard, Milton Keynes, MK9 2NW, United Kingdom |
| No.2 Lochrin Square | No.2 Lochrin Square, 96 Fountainbridge, Edinburgh, EH3 9QA, United Kingdom |
| Enterprise House | Enterprise House, 168-170 Upminster Road, Upminster, Essex, RM14 2RB, United Kingdom |
| Level 10, Simpletree Anarkali | Level 10, Simpletree Anarkali, 89 Gulshan Avenue Plet 03, Block – CWS(A), Dhaka – 1212 Bangladesh |
| Maison Trinity | Maison Trinity, Trinity Square, St Peter Port, GY1 4AT, Guernsey, Channel Islands |
| One New Change | One New Change, London, EC4M 9AF, United Kingdom |
| Michalaki Karaoli, 8 | Michalaki Karaoli, 8, Anemomylos Building, 4th Floor, Flat/Office 401, P.C. 1504, Nicosia, Cyprus |
| Paradigm Wing A | Paradigm Wing A, 1st Floor, Mindspace, Malad (West), Mumbai, 400 064, India |
| Room 02-04, 12/F., Tower 1 | Room 02-04, 12/F., Tower 1, Kerry Everybright City Phase III – Enterprise Centre, No 128 West Tian Mu Road, Ahzbei, Shanghai, 200070, Shanghai, People's Republic of China |
| Room 302, Zhixing International Commerce Building | Room 302, Zhixing International Commerce Building, Park Road, Changping Town, Dongguan City, Guangdong province, People's Republic of China. |
| Riverside One | Riverside One, Sir John Rogerson's Quay, Dublin 2, Republic of Ireland |
| Queensway House | Queensway House, Hilgrove Street, St. Helier, JE1 1ES, Jersey, Channel Islands |
| Hurlawcrook Road | Scottish Commercial Office, Hurlawcrook Road, Langlands Park Industrial Estate, East Kilbride, G75 0QH, United Kingdom |
| Units C & D 5/F, D2 Place Two | Units C & D 5/F, D2 Place Two, No 15 Cheung Shun Street, Cheung Sha Wan, Kowloon, Hong Kong, Hong Kong |
| Unit 7, Ashbourne Retail Park | Unit 7, Ashbourne Retail Park, Ballybin Road, Ashbourne, Republic of Ireland |
| Unit No. 1, 1st Floor, Ambiance Corporate Tower II | Unit No. 1, 1st Floor, Ambiance Corporate Tower II, Ambience Island, NH-8, Gurgaon – 122011, Haryana, India |
| Suite 1608-1613, Tower 6 | Suite 1608-1613, Tower 6, The Gateway, 9 Canton Road, Tsim Sha Tsui, Kowloon, Hong Kong |
| Suite 2202-2205, 22F., Raffles City | Suite 2202-2205, 22F., Raffles City, 268 Xi Zang Middle Road, Shanghai 200001, People's Republic of China |
| York House | York House, 45 Seymour Street, London, W1H 7LX, United Kingdom |
| Third Floor, St George's Court | Third Floor, St George's Court, Upper Church Street, Douglas, IM1 1EE, Isle of Man |

Five year financial record

Five year financial record

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---------------|--------|--------|--------|--------|
| Financial results (£m) | | | | | |
| Underlying sales (including VAT, including fuel, including Financial Services) | 29,112 | 25,829 | 26,122 | 26,353 | 25,632 |
| Underlying operating profit | | | | | |
| Retail | 626 | 635 | 720 | 873 | 831 |
| Financial Services | 62 | 65 | 62 | 6 | — |
| | 688 | 700 | 782 | 879 | 831 |
| Underlying net finance costs ¹ | (119) | (121) | (107) | (111) | (111) |
| Underlying share of post-tax profit from joint ventures | 12 | 8 | 6 | 30 | 38 |
| Underlying profit before tax^{1,2} | 581 | 587 | 681 | 798 | 758 |
| (Decrease)/increase on previous year (%) | (1.0) | (13.8) | (14.7) | 5.3 | 6.5 |
| Retail underlying operating margin (%)³ | 2.42 | 2.74 | 3.07 | 3.65 | 3.57 |
| Earnings per share | | | | | |
| Underlying (pence) | 21.8 | 24.2 | 26.4 | 32.8 | 30.8 |
| (Decrease)/increase on previous year (%) | (9.9) | (8.3) | (19.5) | 6.5 | 9.6 |
| Proposed dividend per share (pence) ⁴ | 10.2 | 12.1 | 13.2 | 17.3 | 16.7 |

1 Net finance costs before non-underlying finance movements, IAS 19 pension financing charge but after accrued coupons on the perpetual securities.

2 Profit/(loss) before tax from continuing operations before non-underlying items as described in note 3.

3 Retail operating profit margin based on retail sales excluding Value Added Tax, including fuel, excluding Financial Services.

4 Total proposed dividend to ordinary shareholders in relation to the financial year.

Company balance sheet

At 11 March 2017 and 12 March 2016

| | Note | 2017 £m | 2016 £m |
|---|------|----------------|------------|
| Non-current assets | | | |
| Investments in subsidiaries | 2 | 5,757 | 4,500 |
| Investments in joint ventures and associates | 3 | 10 | 33 |
| Available-for-sale financial assets | 4 | 39 | 35 |
| Other receivables | 5 | 1,716 | 1,531 |
| Derivative financial instruments | 12 | 6 | 22 |
| | | 7,528 | 6,121 |
| Current assets | | | |
| Trade and other receivables | 5 | 1,042 | 1,195 |
| Derivative financial instruments | 12 | 19 | 32 |
| Cash and cash equivalents | | 300 | 338 |
| | | 1,361 | 1,565 |
| Assets held for sale | | – | 1 |
| | | 1,361 | 1,566 |
| Total assets | | 8,889 | 7,687 |
| Current liabilities | | | |
| Trade and other payables | 6 | (375) | (157) |
| Borrowings | 7 | (1) | (40) |
| Derivative financial instruments | 12 | (17) | (35) |
| Taxes payable | | (31) | (21) |
| | | (424) | (253) |
| Net current assets | | 937 | 1,313 |
| Non-current liabilities | | | |
| Other payables | 6 | (587) | (692) |
| Borrowings | 7 | (625) | (616) |
| Derivative financial instruments | 12 | (4) | (13) |
| Deferred income tax liability | 9 | – | – |
| Provisions | 8 | (2) | (2) |
| | | (1,218) | (1,323) |
| Net assets | | 7,247 | 6,111 |
| Equity | | | |
| Called up share capital | 10 | 625 | 550 |
| Share premium account | 10 | 1,120 | 1,114 |
| Capital redemption reserve | 10 | 680 | 680 |
| Merger reserve | 10 | 568 | – |
| Other reserves | 10 | 28 | 31 |
| Retained earnings | 11 | 3,730 | 3,240 |
| Total equity before perpetual securities | | 6,751 | 5,615 |
| Perpetual capital securities | | 248 | 248 |
| Perpetual convertible bonds | | 248 | 248 |
| Total equity | | 7,247 | 6,111 |

The notes on pages 181 to 185 form an integral part of these financial statements.

The financial statements on pages 179 to 185 were approved by the Board of Directors on 2 May 2017, and are signed on its behalf by:

Mike Coupe Chief Executive

Kevin O'Byrne Chief Financial Officer

Company statement of changes in equity

for the 52 weeks to 11 March 2017

| | Note | Called up share capital £m | Share premium account £m | Capital redemption and other reserves £m | Merger reserve £m | Retained earnings £m | Total equity before perpetual securities £m | Perpetual capital securities £m | Perpetual convertible bonds £m | Total equity £m |
|--|---------|-------------------------------|-----------------------------|---|----------------------|-------------------------|--|------------------------------------|-----------------------------------|--------------------|
| At 13 March 2016 | | 550 | 1,114 | 711 | – | 3,240 | 5,615 | 248 | 248 | 6,111 |
| Profit for the period | 11 | – | – | – | – | 682 | 682 | 12 | 6 | 700 |
| Other comprehensive income | 10 | – | – | 5 | – | – | 5 | – | – | 5 |
| Total comprehensive income for the year ended 11 March 2017 | | – | – | 5 | – | 682 | 687 | 12 | 6 | 705 |
| Transactions with owners: | | | | | | | | | | |
| Dividends | 11 | – | – | – | – | (232) | (232) | – | – | (232) |
| Acquisition of subsidiaries | 10, 11 | 75 | – | – | 568 | (3) | 640 | – | – | 640 |
| Adjustment to consideration in respect of share options | 11 | – | – | – | – | 3 | 3 | – | – | 3 |
| Distribution to holders of perpetual securities (net of tax) | | – | – | – | – | – | – | (12) | (6) | (18) |
| Amortisation of convertible bond equity component | 10, 11 | – | – | (8) | – | 8 | – | – | – | – |
| Allotted in respect of share option schemes | 10, 11 | – | 6 | – | – | 32 | 38 | – | – | 38 |
| At 11 March 2017 | | 625 | 1,120 | 708 | 568 | 3,730 | 6,751 | 248 | 248 | 7,247 |
| At 15 March 2015 | | 548 | 1,108 | 720 | – | 2,085 | 4,461 | – | – | 4,461 |
| Profit for the period | 11 | – | – | – | – | 1,360 | 1,360 | 13 | 6 | 1,379 |
| Other comprehensive income | 10 | – | – | (2) | – | – | (2) | – | – | (2) |
| Total comprehensive income for the period ended 12 March 2016 | | – | – | (2) | – | 1,360 | 1,358 | 13 | 6 | 1,377 |
| Transactions with owners: | | | | | | | | | | |
| Dividends | 11 | – | – | – | – | (234) | (234) | – | – | (234) |
| Issue of perpetual subordinated capital securities and perpetual subordinated convertible bonds (net of tax) | | – | – | – | – | – | – | 248 | 248 | 496 |
| Distributions to holders of perpetual subordinated convertible bonds (net of tax) | | – | – | – | – | – | – | (13) | (6) | (19) |
| Amortisation of convertible bond equity component | 10, 11 | – | – | (7) | – | 7 | – | – | – | – |
| Allotted in respect of share option schemes | 10, x11 | 2 | 6 | – | – | 22 | 30 | – | – | 30 |
| At 12 March 2016 | | 550 | 1,114 | 711 | – | 3,240 | 5,615 | 248 | 248 | 6,111 |

The notes on pages 181 to 185 form an integral part of these financial statements.

Notes to the Company financial statements

1 Basis of preparation

The parent company's financial statements are prepared in accordance with United Kingdom Accounting Standards, in particular Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101) and the Companies Act 2006. FRS 101 sets out a reduced disclosure framework for a 'qualifying entity' as defined in the Standard, which addresses the financial reporting requirements and disclosure exemptions in the individual financial statements of qualifying entities that otherwise apply the recognition measurement and disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the European Union.

These are the first financial statements of the Company prepared in accordance with FRS 101. The Company's transition date to FRS 101 is 13 March 2016. FRS 101 sets out amendments to IFRS as adopted by the European Union that are necessary to achieve compliance with the Companies Act and related regulations. These amendments had no impact on the Statement of Comprehensive Income, Balance Sheet or Statement of Changes in Equity for the Company for the year ended 11 March 2017.

The financial year represents the 52 weeks to 11 March 2017 (prior financial year 52 weeks to 12 March 2016).

The disclosure exemptions adopted by the Company in accordance with FRS 101 are as follows:

- The requirements of IAS 7 to present a cash flow statement.
- The requirements of paragraph 17 of IAS 24, 'Related Party Transactions', to disclose information related to key management personnel, and the requirements of IAS 24 to disclose related party transactions between two or more members of a group for wholly owned subsidiaries.
- The requirements of paragraphs 30 and 31 of IAS 8 to disclose information assessing the possible impact of new standards issued but which are not yet effective.
- The requirements of IFRS 7 and IFRS 13 for disclosure of financial instruments and fair values.

The financial statements are presented in sterling, rounded to the nearest £million unless otherwise stated. They have been prepared on the going concern basis under the historical cost convention, except for derivative financial instruments and available-for-sale financial assets that have been measured at fair value.

The Directors have taken advantage of the exemption available under Section 408 of the Companies Act 2006 and not presented an Income Statement nor a Statement of Comprehensive Income for the Company alone. The profit after tax for the Company for the year was £682 million (2016: £1,360 million).

2 Investments in subsidiaries

Accounting policies

Investments in subsidiaries are carried at cost less any impairment loss in the financial statements of the Company.

| | 2017 £m | 2016 £m |
|---|--------------|------------|
| Shares in subsidiaries | | |
| At 13 March 2016 | 4,500 | 7,630 |
| Additions | 1,257 | 160 |
| Disposals | — | (3,294) |
| Release of provision for diminution of investment | — | 4 |
| At 11 March 2017 | 5,757 | 4,500 |

Additions in the year predominantly relate to the acquisition of Home Retail Group.

During the prior year a number of subsidiaries were liquidated as part of a corporate simplification project. This resulted in dividends received of £5,307 million and a subsequent disposal of subsidiaries of £3,294 million.

3 Investments in joint ventures and associates

Accounting policies

Investments in joint ventures and associates are carried at cost less any impairment loss in the financial statements of the Company.

| | Company shares at cost 2017 £m | Company shares at cost 2016 £m |
|---|--|---|
| At 13 March 2016 | 33 | 18 |
| Additions | 16 | 15 |
| Provision for diminution in value of investment | (39) | — |
| At 11 March 2017 | 10 | 33 |

A provision of £39 million (2016: £nil) was made against investments in joint ventures where the carrying amounts exceeded the recoverable amount.

4 Available-for-sale financial assets

Accounting policies

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories (of fair value through profit or loss, loans and receivables). They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Subsequent to initial recognition at fair value plus transaction costs, these assets are recorded at fair value at each period end with the movements recognised in other comprehensive income until derecognition or impaired, at which time the cumulative gain or loss previously recognised in other comprehensive income is recycled to the income statement. Dividends on AFS equity instruments are recognised in the income statement when the entity's right to receive payment is established. Interest on AFS debt instruments is recognised using the effective interest method.

| | 2017 £m | 2016 £m |
|-----------------------------------|------------|------------|
| Non-current | | |
| Interest bearing financial assets | 39 | 35 |

5 Other receivables

Accounting policies

Receivables are recognised initially at fair value, and subsequently at amortised cost using the effective interest rate method, less provision for impairment.

| | 2017 £m | 2016 £m |
|---------------------------------|--------------|------------|
| Non-current | | |
| Amounts owed by Group companies | 1,716 | 1,531 |
| Current | | |
| Amounts owed by Group companies | 1,038 | 1,189 |
| Prepayments and accrued income | 4 | 6 |
| | 1,042 | 1,195 |

6 Trade and other payables

Accounting policies

Payables are recognised initially at fair value, and subsequently at amortised cost using the effective interest rate method.

| | 2017 £m | 2016 £m |
|--------------------------------|------------|------------|
| Current | | |
| Amounts owed to Group entities | 346 | 125 |
| Other payables | 29 | 32 |
| | 375 | 157 |
| Non-current | | |
| Amounts owed to Group entities | 587 | 692 |

7 Borrowings

| | 2017 Current £m | 2017 Non-current £m | 2017 Total £m | 2016 Current £m | 2016 Non-current £m | 2016 Total £m |
|---------------------------|-----------------------|---------------------------|---------------------|-----------------------|---------------------------|---------------------|
| Bank loans due 2016 | – | – | – | 39 | – | 39 |
| Bank loans due 2019 | – | 199 | 199 | – | 199 | 199 |
| Convertible bond due 2019 | 1 | 426 | 427 | 1 | 417 | 418 |
| Total borrowings | 1 | 625 | 626 | 40 | 616 | 656 |

8 Provisions

Accounting policies

Provisions are recognised when there is a present legal or constructive obligation as a result of a past event, for which it is probable that an outflow of economic benefit will be required to settle the obligation, and where the amount of the obligation can be reliably estimated. 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.

| | Onerous leases and onerous contracts £m | Disposal provision £m | Total £m |
|------------------------------------|---|-----------------------------|--------------------|
| At 13 March 2016 and 12 March 2017 | 1 | 1 | 2 |
| At 15 March 2015 | 3 | 1 | 4 |
| Utilisation of provision | (2) | — | (2) |
| At 12 March 2016 | 1 | 1 | 2 |
| | | 2017 £m | 2016 £m |
| Disclosed as: | | | |
| Current | | — | — |
| Non-current | | 2 | 2 |
| | | 2 | 2 |

9 Taxation

Accounting policies

Deferred tax is accounted for on the basis of temporary differences arising from differences between the tax base and accounting base of assets and liabilities.

Deferred tax is recognised for all temporary differences, except to the extent where it arises from the initial recognition of an asset or a liability in a transaction that is not a business combination and, at the time of transaction, affects neither accounting profit nor taxable profit. It is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity or other comprehensive income.

Deferred tax is provided on temporary differences associated with investments in subsidiaries, branches and joint ventures except where the Company is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

| | Capital losses £m | Rolled over capital gains £m | Total £m |
|--|-------------------------|------------------------------------|--------------------|
| At 13 March 2016 | 22 | (22) | — |
| Rate change adjustment to income statement | (1) | 1 | — |
| At 11 March 2017 | 21 | (21) | — |
| At 15 March 2015 | 25 | (25) | — |
| Rate change adjustment to income statement | (3) | 3 | — |
| At 12 March 2016 | 22 | (22) | — |
| | | 2017 £m | 2016 £m |
| Total deferred income tax liabilities | | (21) | (22) |
| Total deferred income tax assets | | 21 | 22 |
| Net deferred income tax liability recognised in non-current liabilities | | — | — |

10 Share capital and reserves

Accounting policies

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

Share capital, share premium and merger reserve

| | 2017 million | 2016 million | 2017 £m | 2016 £m |
|--|-----------------|-----------------|--------------|------------|
| Called up share capital | | | | |
| Allotted and fully paid ordinary shares 28 $\frac{1}{2}$ p | 2,188 | 1,924 | 625 | 550 |
| Share premium account | | | | |
| Share premium | | | 1,120 | 1,114 |

The movements in the called up share capital, share premium and merger reserve accounts are set out below:

| | Number of ordinary shares million | Ordinary shares £m | Share premium account £m | Merger reserve £m |
|---|--|--------------------------|-----------------------------------|-------------------------|
| At 13 March 2016 | 1,924 | 550 | 1,114 | — |
| Acquisition of subsidiaries ¹ | 261 | 75 | — | 568 |
| Allotted in respect of share option schemes | 3 | — | 6 | — |
| At 11 March 2017 | 2,188 | 625 | 1,120 | 568 |
| At 15 March 2015 | 1,919 | 548 | 1,108 | — |
| Allotted in respect of share option schemes | 5 | 2 | 6 | — |
| At 12 March 2016 | 1,924 | 550 | 1,114 | — |

1 261 million new J Sainsbury plc shares of 28 $\frac{1}{2}$ p nominal value each were issued (being 0.321 new J Sainsbury plc shares per existing Home Retail Group plc share); fair value of the consideration is based on a J Sainsbury plc share price of £2.4610 as at 2 September 2016. This is accounted for as £75 million in share capital, plus the premium arising from the consideration in excess of the nominal amount of shares issued of £568 million, which is recognised in the merger reserve as the transaction qualified for merger relief.

Capital redemption and other reserves

| | Available- for-sale assets £m | Cash flow hedge reserve £m | Convertible bond reserve £m | Total other reserves £m | Capital redemption reserve £m | Merger reserve £m |
|---|-------------------------------------|----------------------------------|-----------------------------------|-------------------------------|--|-------------------------|
| At 13 March 2016 | 6 | (4) | 29 | 31 | 680 | — |
| Acquisition of subsidiaries | — | — | — | — | — | 568 |
| Available-for-sale financial assets fair value movements (net of tax) | 4 | — | — | 4 | — | — |
| Cash flow hedges effective portion of fair value movements (net of tax) | — | (1) | — | (1) | — | — |
| Items reclassified from cash flow hedge reserve | — | 2 | — | 2 | — | — |
| Amortisation of convertible bond – equity component | — | — | (8) | (8) | — | — |
| At 11 March 2017 | 10 | (3) | 21 | 28 | 680 | 568 |
| At 15 March 2015 | 8 | (4) | 36 | 40 | 680 | — |
| Available-for-sale financial assets fair value movements (net of tax) | (2) | — | — | (2) | — | — |
| Cash flow hedges effective portion of fair value movements (net of tax) | — | (2) | — | (2) | — | — |
| Items reclassified from cash flow hedge reserve | — | 2 | — | 2 | — | — |
| Amortisation of convertible bond – equity component | — | — | (7) | (7) | — | — |
| At 12 March 2016 | 6 | (4) | 29 | 31 | 680 | — |

The available-for-sale assets reserve represents the fair value gains and losses on the available-for-sale financial assets held by the Company. The cash flow hedge reserve represents the cumulative effective fair value gains and losses on cash flow hedges in the Company.

The convertible bond reserve represents the equity component of the £450 million convertible bond issued in November 2014.

The capital redemption reserve arose on the redemption of B shares. Shareholders approved a £680 million return of share capital, by way of a B share scheme, at the Company's Extraordinary General Meeting on 12 July 2004. The final redemption date for B shares was 18 July 2007 and all transactions relating to the B shares have now been completed.

11 Retained earnings

| | 2017 £m | 2016 £m |
|---|--------------|--------------|
| Beginning of the year | 3,240 | 2,085 |
| Acquisition of subsidiaries | (3) | – |
| Adjustment to consideration in respect of share options | 3 | – |
| Profit for the year | 682 | 1,360 |
| Dividends paid | (232) | (234) |
| Allotted in respect of share option schemes | 32 | 22 |
| Amortisation of convertible bond – equity component | 8 | 7 |
| End of the year | 3,730 | 3,240 |

12 Derivative financial instruments

The fair value of derivative financial instruments has been disclosed in the balance sheet as follows:

| | 2017 Asset £m | 2017 Liability £m | 2016 Asset £m | 2016 Liability £m |
|--------------|---------------------|-------------------------|---------------------|-------------------------|
| Non-current | 6 | (4) | 22 | (13) |
| Current | 19 | (17) | 32 | (35) |
| Total | 25 | (21) | 54 | (48) |

The fair value and notional amount of derivatives analysed by hedge type are as follows:

| | 2017 | | | | 2016 | | | |
|---|------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|
| | 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 | 6 | 160 | – | – | 14 | 206 | – | – |
| Cash flow hedges | | | | | | | | |
| Interest rate swaps | – | – | (4) | 100 | – | – | (4) | 100 |
| Derivatives not in a formal hedging relationship | | | | | | | | |
| Interest rate swaps | 17 | 341 | (15) | 295 | 30 | 386 | (27) | 327 |
| Inflation rate swaps | 2 | 400 | (2) | 400 | 10 | 400 | (10) | 400 |
| Cross currency and foreign exchange swaps | – | – | – | – | – | – | (7) | 71 |
| Total | 25 | 901 | (21) | 795 | 54 | 992 | (48) | 898 |

Additional shareholder information

Financial calendar

| | |
|---|------------------|
| Ex-dividend date | 11 May 2017 |
| Record date | 12 May 2017 |
| Last date for return of revocation of DRIP mandates | 16 June 2017 |
| Q1 Trading Statement | 4 July 2017 |
| Annual General Meeting | 5 July 2017 |
| Payment date and DRIP share purchase | 7 July 2017 |
| Interim results announced | 8 November 2017* |
| Q3 Trading Statement | 10 January 2018* |
| Preliminary Results announced | 2 May 2018* |
| Annual General Meeting | 11 July 2018* |

*provisional dates

The interim dividend was paid on 4 January 2017.

Shareholder profiles

End of year information as at 11 March 2017

| | 2017 | 2016 |
|---------------------------|----------------------|---------------|
| Number of shareholders | 133,332 | 113,101 |
| Number of shares in issue | 2,188,149,787 | 1,924,077,194 |

By size of holding

| | Shareholders % | | Shares % | |
|----------------------|----------------|-------|--------------|-------|
| | 2017 | 2016 | 2017 | 2016 |
| 500 and under | 69.13 | 63.58 | 0.47 | 0.42 |
| 501 to 1,000 | 11.23 | 11.94 | 0.51 | 0.53 |
| 1,001 to 10,000 | 17.98 | 22.35 | 3.01 | 3.69 |
| 10,001 to 100,000 | 1.24 | 1.63 | 1.85 | 2.33 |
| 100,001 to 1,000,000 | 0.29 | 0.35 | 6.12 | 7.20 |
| Over 1,000,000 | 0.13 | 0.15 | 88.04 | 85.83 |
| | 100 | 100 | 100 | 100 |

By category of shareholder

| | Shareholders % | | Shares % | |
|------------------------|----------------|-------|--------------|------|
| | 2017 | 2016 | 2017 | 2016 |
| Individuals | 96.47 | 92.82 | 5.26 | 5.67 |
| Insurance companies | 0.06 | 0.06 | 0.03 | 0.03 |
| Banks and Nominees | 3.18 | 6.85 | 93.59 | 92.1 |
| Investment Trusts | 0.03 | 0.03 | 0.01 | 0.04 |
| Pension Funds | 0.01 | 0.01 | 0.01 | 0 |
| Other Corporate Bodies | 0.25 | 0.23 | 1.1 | 2.16 |
| | 100 | 100 | 100 | 100 |

Annual General Meeting (AGM)

The AGM will be held at 11.00am on Wednesday, 5 July 2017 at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE. The Notice of the Meeting and the proxy card for the meeting are enclosed with this report.

Registrars

For information about the AGM, shareholdings, dividends and to report changes to personal details, shareholders should contact:

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
Telephone: 0370 702 0106

Please remember to tell Computershare if you move house or change bank details or if there is any other change to your account information.

You can view and manage your shareholding online at **www.investorcentre.co.uk**. You will require your 11 character Shareholder Reference Number (SRN) to log in. Your SRN starts with the letter C or G and is followed by ten numbers. It can be found on share certificates and dividend confirmations.

Dividends

Having your dividends paid directly into your bank or building society account is a more secure way than receiving your dividend by cheque. If you would prefer your dividends to be paid directly into your bank or building society account further information is available from Computershare Investor Services (address and telephone number above). You will still receive an annual dividend confirmation detailing each dividend to enable you to complete your tax return.

Dividend Reinvestment Plan (DRIP)

The Company has a DRIP, which allows shareholders to reinvest their cash dividends in the Company's shares bought in the market through a specially arranged share dealing service. No new shares are allotted under this DRIP and approximately 30,086 shareholders participate. Full details of the DRIP and its charges, together with mandate forms, are available from the Registrars. Alternatively, you can elect to join the DRIP by registering on **www.investorcentre.co.uk**.

Annual Dividend Confirmations

The Company sends out an Annual Dividend Confirmation (ADC) in relation to dividend payments. This means that those shareholders receiving their dividend direct into their bank account will receive an ADC once a year detailing all payments made throughout that year.

Shareholder communications Company website

J Sainsbury plc Interim and Annual Reports, and results announcements are available via the internet on our website at **www.j-sainsbury.co.uk**. As well as providing share price data and financial history, the site also provides background information about the Company, regulatory and news releases, and current issues.

Electronic shareholder communications

The Company encourages all shareholders to receive their shareholder communications electronically in order to reduce the impact on the environment. To do this go to **www.investorcentre.co.uk/etreeuk/jsainsbury**. For each email registration by a Sainsbury's shareholder, a donation will be made to the Woodland Trust, the UK's leading woodland conservation charity. By registering with the eTree programme you will be giving the Company permission to send all shareholder documents to you via email with a link to a secure website.

Alternatively, the Company has set up a facility for shareholders to take advantage of electronic communications. The service allows you to:

- view the Annual Report and Financial Statements on the day it is published;
- receive electronic notification of the availability of future shareholder information (you must register your email for this service);
- check the balance and current value of your shareholding and view your dividend history; and,
- submit your vote online prior to a general meeting.

To register visit **www.investorcentre.co.uk**. You will need your 11 character SRN which can be found on your share certificate or recent dividend confirmation – the number is often preceded by the letter C or G.

Shareholder security

Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company annual reports. If you receive any unsolicited investment advice, whether over the telephone, through the post or by email:

- make sure you get the name of the person and organisation;
- check that they are properly authorised by the FCA before getting involved by visiting **https://register.fca.org.uk/**; and,
- report the matter to the FCA either by calling 0800 111 6768 or by completing an online form at **www.fca.org.uk/consumers/report-scam-unauthorised-firm**

Details of any share dealing facilities that the Company endorses will be included in Company mailings.

More detailed information on this or similar activity can be found on the FCA website **www.scamsmart.fca.org.uk**

Share dealing services

To buy or sell your J Sainsbury plc ordinary shares, please visit your stockbroker or a high street bank who will usually be able to assist you. Alternatively, you may consider using:

- The Share Centre Ltd who offer a postal dealing service. They can be contacted at The Share Centre, PO Box 2000, Oxford Road, Aylesbury, Buckinghamshire HP21 8ZB. Telephone: 01296 414141 or Freephone 08000 282812 and quote Sainsbury's; or,
- Computershare who offer a telephone and internet facility which gives shareholders the opportunity to trade at a known price. The telephone service is available from 8.00am to 4.30pm, Monday to Friday, excluding bank holidays, on telephone number 0370 703 0084. The internet share dealing service gives shareholders the option to submit instructions to trade online. More information can be found by visiting www-uk.computershare.com/Investor/ShareDealing.

Further information and detailed terms and conditions are available on request by calling either provider.

American Depositary Receipts (ADRs)

The Company has a sponsored Level I ADR programme for which The Bank of New York Mellon acts as depositary. The ADRs are traded on the over-the-counter (OTC) market in the US under the symbol JSAIY, where one ADR is equal to four ordinary shares. All enquiries relating to ADRs should be addressed to:

BNY Mellon
Shareowner Services
PO Box 30170
College Station
TX 77842-3170

Toll Free Telephone # for domestic callers: 1-888-269-2377

International callers can call: +1-201-680-6825

Website: www.mybnymdr.com

Email: shrrelations@bnymellon.com

ShareGift

If you have only a small number of shares which would cost more for you to sell than they are worth, you may wish to consider donating them to the charity ShareGift (Registered Charity 1052686) which specialises in accepting such shares as donations. The relevant stock transfer form may be obtained from Computershare Investor Services PLC. There are no implications for Capital Gains Tax purposes (no gain or loss) on gifts of shares to charity. It is also possible to obtain income tax relief. Further information about ShareGift may be obtained on 020 7930 3737 or from www.sharegift.org.

Tax information – Capital Gains Tax (CGT)

For CGT purposes, the market value of J Sainsbury plc ordinary shares on 31 March 1982 adjusted for all capital adjustments was 91.99 pence and B shares 10.941 pence.

CGT information on historic Home Retail Group corporate actions can be found in the Investor Section on our website

www.j-sainsbury.co.uk/investor-centre.

Share capital consolidation

The original base cost of shares apportioned between ordinary shares of 28 ⁴/₇ pence and B shares is made by reference to the market value of each class of shares on the first day for which a market value is quoted after the new holding came into existence. The market value for CGT purposes of any share or security quoted on the Stock Exchange Daily Official List is generally the lower of the two quotations on any day plus one quarter of the difference between the values.

On Monday, 19 July 2004 the values were determined as follows:

New ordinary shares 257.5 pence

B shares 35 pence

Historic share capital consolidation information relating to Home Retail Group can be found in the Investor Section on our website www.j-sainsbury.co.uk/investor-centre.

Key contacts and advisers

General contact details

For general enquiries about Sainsbury's Bank call: 0808 540 5060

For any customer enquiries please contact, for Sainsbury's, our Sainsbury's Customer Careline by calling: 0800 636 262 and for Sainsbury's Argos, the Argos helpline by calling: 0345 640 2020

Registered office

J Sainsbury plc
33 Holborn
London EC1N 2HT
Registered number 185647

Investor relations

James Collins
Head of Investor Relations
J Sainsbury plc
Store Support Centre
33 Holborn
London EC1N 2HT
investorrelations2@sainsburys.co.uk

Registrar

Computershare Investor Services PLC
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Auditors

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1 More London Place
London SE1 2AF

Solicitors

Linklaters LLP
One Silk Street
London EC2Y 8HQ

Stockbrokers

UBS
5 Broadgate
London
EC2M 2QS

Morgan Stanley
25 Cabot Square
Canary Wharf
London E14 4QA

Cautionary statement

Certain statements included in this Annual Report are forward looking and are therefore subject to risks, assumptions and uncertainties that could cause actual results to differ materially from those expressed or implied because they relate to future events. These forward-looking statements include, but are not limited to, statements relating to the Company's expectations. Forward-looking statements can be identified by the use of relevant terminology including the words: 'believes', 'estimates', 'anticipates', 'expects', 'intends', 'plans', 'goal', 'target', 'aim', 'may', 'will', 'would', 'could' or 'should' or, in each case, their negative or other variations or comparable terminology and include all matters that are not historical facts. They appear in a number of places throughout this Annual Report and include statements regarding our intentions, beliefs or current expectations and those of our officers, Directors and employees concerning, amongst other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the businesses we operate. Consequently, our actual future financial condition, performance and results could differ materially from the plans, goals and expectations set out in our forward-looking statements. The Company undertakes no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise.

Alternative performance measures

In response to the Guidelines on Alternative Performance Measures (APMs) issued by the European Securities and Markets Authority (ESMA), we have provided additional information on the APMs used by the Group. The Directors use the below APMs as they are critical to understanding the financial performance and financial health of the Group. As they are not defined by International Financial Reporting Standards they may not be directly comparable with other companies who use similar measures. All APMs relate the current period's results and comparative periods where provided.

| APM | Definition | Reconciliation |
|--|--|----------------|
| Cash flows and net debt | | |
| Cash flow items in Financial Review | To help the reader understand cash flows of the business a summarised cash flow statement is included within the financial review. As part of this a number of line items have been combined. The cash flow in note 4 of the accounts includes a reference to show what has been combined in these line items. | |
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| Free cash flow | Net cash generated from retail operations, adjusted for exceptional pension contributions, after cash capital expenditure but before strategic capital expenditure. | |
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| | | |
| Operating cash flow | Cash generated from operations after changes in working capital. | |
| | | |
| Retail operating cash flow | Retail cash generated from operations after changes in working capital | |
| | | |
| Core retail capital expenditure | Capital expenditure excludes Sainsbury's Bank, Argos exceptional capital expenditure, proceeds from sale and leasebacks and strategic capital expenditure | |
| | | |
| Net debt | Net debt excludes the net debt of Financial Services and is calculated as: current available for sale assets + current net derivatives + net cash and cash equivalents + loans + non-current finance lease obligations + non-current net derivatives. | |
| | | |
| Gearing | Net debt divided by net assets. | |
| | | |

| APM | Definition | Reconciliation |
|--|--|--|
| Income statement | | |
| Like-for-like sales | Year-on-year growth in sales including VAT, excluding fuel, excluding Financial Services, for stores that have been open for more than one year. | A reconciliation of like-for-like sales is provided on page 47 of the Financial Review |
| Underlying profit before tax | Profit or loss before tax before any items recognised which, by virtue of their size and or nature, do not reflect the Group's underlying performance. | A reconciliation of underlying profit before tax is provided in note 3 to the accounts. |
| Retail underlying operating profit | Underlying earnings before interest, tax, Financial Services operating profit and Sainsbury's underlying share of post-tax profit from JVs. | A reconciliation of these measures can be found in note 4 of the accounts. |
| Underlying basic earnings per share | Earnings per share using underlying profit as described above. | A reconciliation of underlying earnings per share is included in note 8 to the accounts. |
| EBITDAR and underlying EBITDAR | Earnings before interest, tax, depreciation, amortisation and rent. Underlying EBITDAR uses underlying earnings. | A reconciliation is provided on page 48 of the Financial Review. |
| Other | | |
| Lease adjusted net debt/ underlying EBITDAR | Net debt plus capitalised lease obligations (5.5% discount rate) divided by Group underlying EBITDAR | A reconciliation of this is provided in the financial review on page 53. |
| Return on capital employed | Return on Capital Employed is calculated as Return divided by average Capital Employed. Return is defined as Underlying Profit before interest and tax. Capital Employed is defined as Net assets excluding Net debt. The average is calculated on a 14 point basis. | A calculation of this is provided on page 53 of the Financial Review. |

Glossary

Active Kids – Our nationwide scheme to help inspire school children to take more exercise and to eat more healthily. Launched in 2005, Active Kids is open to all nursery, primary and secondary schools as well as Scouts and Girl Guides in the UK. www.sainsburys.co.uk/activekids

Annual General Meeting (AGM) – This year the AGM will be held on Wednesday 5 July 2017 at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE at 11.00am.

Argos Financial Services – ARG Personal Loans Limited; Home Retail Group Card Services Limited; and Home Retail Group Insurance Services Limited.

basics – Sainsbury's entry level own-brand range of products.

bps – Basis points.

by Sainsbury's – Core own label brand.

Click & Collect – Service which allows customers to place general merchandise and grocery orders online for collection in-store.

CMBS – Commercial Mortgage Backed Securities.

Corporate Responsibility and Sustainability (CR&S) – The need to act responsibly in managing our impact on a range of stakeholders: customers, colleagues, investors, suppliers, the community and the environment.

CPI – Consumer Price Index.

Dividend cover – Underlying profit after tax from continuing operations attributable to ordinary shareholders divided by total value of dividends declared during the year.

Earnings Per Share (EPS) – Earnings attributable to ordinary shareholders of the parent divided by the weighted average number of ordinary shares in issue during the year, excluding those held by ESOP Trusts, which are treated as cancelled.

Fairtrade – The Fairtrade label is an independent consumer label that guarantees a fair deal for marginalised workers and small scale farmers in developing countries. Producers receive a minimum price that covers the cost of production and an extra premium that is invested in the local community. www.fairtrade.org.uk

Fair value – The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

FTSE4Good – The FTSE Group, an indexing company, runs the FTSE4Good index series to measure the performance of companies that meet corporate responsibility standards, and to facilitate investment in those companies. www.ftse.com/products/indices/FTSE4Good

FVTPL – Fair value through profit or loss. Method of valuing a financial instrument where changes in fair value are recognised directly in the income statement.

Group – The Company and its subsidiaries.

IFRIC – International Financial Reporting Interpretations Committee.

IFRSs – International Financial Reporting Standard(s).

Joint venture (JV) – A business jointly owned by two or more parties.

Kantar Worldpanel (Kantar) – An independent third party providing data on the UK Grocery Market.

Live Well for Less – Sainsbury's customer commitment to continue to help people live the life they want to live, with quality products at fair prices.

LTIP – Long-Term Incentive Plan.

MSC – Marine Stewardship Council.

Nectar – One of the most popular loyalty schemes in the UK, of which Sainsbury's is a partner.

Non-controlling interest – The equity in a subsidiary not attributable, directly or indirectly, to the Company.

OFT – Office of Fair Trading.

PRA – Prudential Regulation Authority.

Real discount rate – Discount rate less inflation rate.

RPI – Retail Price Index.

Taste the Difference – Sainsbury's premium own-brand range of products.

Total Shareholder Return (TSR) – The growth in value of a shareholding over a specified period, assuming that dividends are reinvested to purchase additional units of the stock.

Tu – Sainsbury's own label clothing range.