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IFRS Seminar
25 February 2005

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Introduction
Andrew Higginson, Finance & Strategy Director

Agenda

• Introduction	AH
• Review of key standards	LD
• Year end convergence	AH
• What next?	AH
• Q & A	

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Progress

- Based on our current view
- All numbers are estimates only
- Looking at transition, not ongoing impacts
- Subject to industry interpretation
- Focus on statutory profit

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Key messages

- Tesco is the same business under IFRS as before
- No change to underlying business performance
- Accounting, not operational change
- Small impact to reported 04/05 profit
- No impact to group pre-tax cash flow
- IFRS may lead to increased volatility going forward
- **Profit after tax changes by between zero and £30 million**

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37 new standards

- IFRS 1 First-time adoption of IFRS
- IFRS 2 Share Based Payments
- IFRS 3 Business Combinations
- IFRS 4 Insurance contracts
- IFRS 5 Non-current assets held for sale
- IFRS 6 Exploration & evaluation of mineral resources
- IAS 1 Presentation of Financial Statements
- IAS 2 Inventories
- IAS 7 Cash flow statements
- IAS 8 Accounting policies, changes in accounting estimates and errors
- IAS 10 Events after the balance sheet date
- IAS 11 Construction Contracts
- IAS 12 Income Taxes
- IAS 14 Segmental Reporting
- IAS 16 Property, plant and equipment
- IAS 17 Leasing
- IAS 18 Revenue
- IAS 19 Employee Benefits
- IAS 20 Accounting for Government grants
- IAS 21 The effects of changes in foreign exchange rates
- IAS 23 Borrowing costs
- IAS 24 Related party Disclosures
- IAS 26 Accounting and reporting by Retirement Benefit Plans
- IAS 27 Consolidated financial statements
- IAS 28 Investments in associates
- IAS 29 Financial reporting in hyperinflationary economies
- IAS 30 Disclosures in the financial statement of banks and similar financial institutions
- IAS 31 Interests in Joint Ventures
- IAS 32 Financial Instruments: Disclosure and Presentation
- IAS 33 Earnings per share
- IAS 34 Interim financial reporting
- IAS 36 Impairment of assets
- IAS 37 Provisions, contingent liabilities and contingent assets
- IAS 38 Intangible assets
- IAS 39 Financial Instruments: Recognition and Measurement
- IAS 40 Investment property
- IAS 41 Agriculture

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17 with little or no impact

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9 are disclosure only

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Financial impact: 11 standards

- IFRS 2 Share Based Payments
- IFRS 3 Business Combinations
- IAS 10 Events after the balance sheet date
- IAS 12 Income Taxes
- IAS 17 Leasing
- IAS 19 Employee Benefits
- IAS 28 Investments in associates
- IAS 31 Interests in Joint Ventures
- IAS 36 Impairment of assets
- IAS 32 Financial Instruments: Disclosure and Presentation
- IAS 39 Financial Instruments: Recognition and Measurement

IAS 32 & 39: One year exemption

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9 standards affect 04/05 results

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Review of standards

Liz Doherty, Group International FD

04/05 financial impact: 9 standards

	04/05 Profit before tax	Feb 04 Net assets
• IFRS 2 Share Based Payments	✓	✓
• IFRS 3 Business Combinations	✓	
• IAS 10 Events after the balance sheet date		✓
• IAS 12 Income Taxes		✓
• IAS 17 Leasing		✓
• IAS 19 Employee Benefits	✓	✓
• IAS 28 Investments in associates	✓	
• IAS 31 Interests in Joint Ventures	✓	
• IAS 36 Impairment of assets		✓

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Review of standards - structure

- What's the issue?
- What's the impact?
- What choices have we made?
- What else do you need to know?

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IFRS 2: Share based payments

What's the issue?

- Share schemes are important for Tesco - in the UK alone, we have over 250,000 employees and share schemes are a key way of retaining and rewarding all of our staff:
  - every member of staff with over one year's service is eligible for Shares in Success (over 160,000 last year)
  - over 70,000 of our people take part in SAYE each year
  - over 3,000 managers are rewarded with options and bonuses

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IFRS 2: Share based payments

What's the impact?

Bonuses

- Insignificant impact on P & L
- There will be a one-off increase of c.£40m in Feb 04 net assets, primarily due to the change from profit share to Shares in Success

Options

- Employee share options expensed to P & L for the first time
  - ⇨ **04/05 profit will decrease by c.£45-55m**
  - ⇨ **no impact on Feb 04 net assets**
  - ⇨ **no impact on pre-tax cashflow**

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IFRS 2: Share based payments

What choices have we made?

- We have decided to include schemes before November 2002 - this results in a higher charge in 04/05, but avoids a misleading increase in future years

What else do you need to know?

- The future P & L charge is driven by option pricing - this is influenced by a number of factors, including the share price, so can be volatile

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IFRS 3: Business Combinations

What's the issue?

- For us, this means goodwill
- We have made a number of acquisitions in recent years and have a balance of £965m goodwill as at Feb 04

What's the impact?

- Goodwill will no longer be amortised on a straight line basis, but will instead be subject to annual impairment testing
  - ⇨ **04/05 statutory profit before tax will increase by c.£60-65m**
  - ⇨ **no change to pre-tax cashflow**

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IFRS 3: Business Combinations

What choices have we made?

- We are choosing to apply the standard from March 2004 onwards - this avoids the need to revisit the treatment of previous acquisitions

What else do you need to know?

- An equivalent increase in statutory profit before tax can be expected in future years, unless impairment is required

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IAS 10: Events after the balance sheet date

What's the issue?

- IAS 10 affects all companies which pay dividends and leads to a simple change to the timing of recognition

What's the impact?

- Dividends declared after the balance sheet date will no longer be recognised as a liability in the current financial year
  - ⇨ **no impact to pre or post tax profit**
  - ⇨ **no change to dividend policy or payment**
  - ⇨ **no impact to pre or post tax cashflow**
- There will be a one-off adjustment to defer the recognition of the 03/04 final dividend
  - ⇨ **net assets at Feb 04 will increase by £365m**

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IAS 17: Leasing

What's the issue?

- Tesco has a considerable property portfolio, with a proportion held as leasehold. Under certain conditions, leasehold properties are to be brought on balance sheet.

What's the impact?

- Only a very small number of leases are impacted
  - ⇨ **around £40m net fixed assets will be capitalised at Feb 04 (in context of around £12 billion book value)**
  - ⇨ **similar increase in net debt**
  - ⇨ **no material impact to 04/05 profit expected**

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IAS 19: Employee Benefits

What's the issue?

- Pensions - Tesco has a large, defined benefits scheme, with over 135,000 members

What's the impact?

- The surplus/deficit of the defined benefit pension scheme will now be brought on balance sheet
  - ⇨ **Feb 04 net assets will decrease by £677m**
- The P & L charge will be valued differently, based on market conditions at the opening balance sheet date
  - ⇨ **P & L charge for 04/05 will be c.£35-45m higher**
  - ⇨ **no impact on pre-tax cashflow**

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IAS 19: Employee Benefits

What choices have we made?

- We have opted for the the FRS 17 style approach of recognising all cumulative actuarial gains and losses as opposed to the 'corridor' approach, as it is simpler and less volatile for the P & L

What else do you need to know?

- The numbers aren't new - you've seen them before in our FRS17 note to the accounts
- IAS19 is inherently volatile: the valuation of our P & L charge and deficit is based on market conditions at a point in time, such as bond yields and inflation

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IAS 28: Investments in associates
IAS 31: Investments in joint ventures

What's the issue?

- We have a number of profitable JVs, for example, Tesco Personal Finance
- The JV and associate line in the P&L will decrease significantly but this is just a simple change in presentation

What's the impact?

- JVs and associate profit will appear to reduce, as it will be shown net of interest and tax
- No effect on group profit after tax

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IAS 28: Investments in associates
IAS 31: Investments in joint ventures

P & L extract

	£m
Share of JVs and associate profit	(60-70)
Group interest	30-35
Group profit before tax	(30-35)
Group tax	30-35
Group profit after tax	NIL

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IAS 28: Investments in associates
IAS 31: Investments in joint ventures

What choices have we made?

- For simplicity, we have chosen to continue to equity account for JVs as opposed to proportionately consolidate

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IAS 36: Impairment of assets

What's the issue?

- IAS 36 requires us to treat individual stores as cash generating units when we are looking at fixed asset impairment

What's the impact?

- Taking this strict interpretation, a small number of stores would be written down - there is no credit for stores which, under this methodology, would be undervalued
  - ⇨ **Feb 04 net assets will decrease by c.£95m**
  - ⇨ **no material impact expected to 04/05 profit**

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Tax

What's the issue?

- There are two areas of impact:
  1. IAS 12: Income tax
  2. Tax impact of other IFRS accounting changes

What's the impact?

- The tax impact is complex, but the net effect is:
  - ⇨ **Feb 04 net assets will increase by c.£150m**
  - ⇨ **04/05 tax charge will reduce by c.£50m**

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Expected IFRS impact on tax charge

Breakdown of tax impact

	Feb 04 Net Assets £m	04/05 P & L £m
Impact of IAS 12	(80)	(20)
Tax effect of accounting changes	230	35
JV / Assoc presentation change	-	30-35
Net impact on tax charge	**150**	**50**
add back: JV / Assoc presentation change		(30-35)
Net impact on profit after tax		**15-20**

(NB - all figures estimated)

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Disclosure

What will the accounts look like under IFRS?

- P & L and balance sheet will look very similar to UK GAAP
- Cashflow will be grouped in a different way
- Reporting segments won't change:
  - ⇨Primary segments will be geographical: UK, Europe and Asia
  - ⇨One secondary business segment, namely retail
- Notes to the accounts will include some new disclosures

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04/05 estimated profit impact

	Statutory profit £m
Share options	(50)
Pensions	(40)
Goodwill	60
Associates /JV's	(30)
Profit before tax	**(50) to (70)**
Tax impact	50
Profit after tax	**0 to (30)**

(NB - all figures estimated to nearest £10m)

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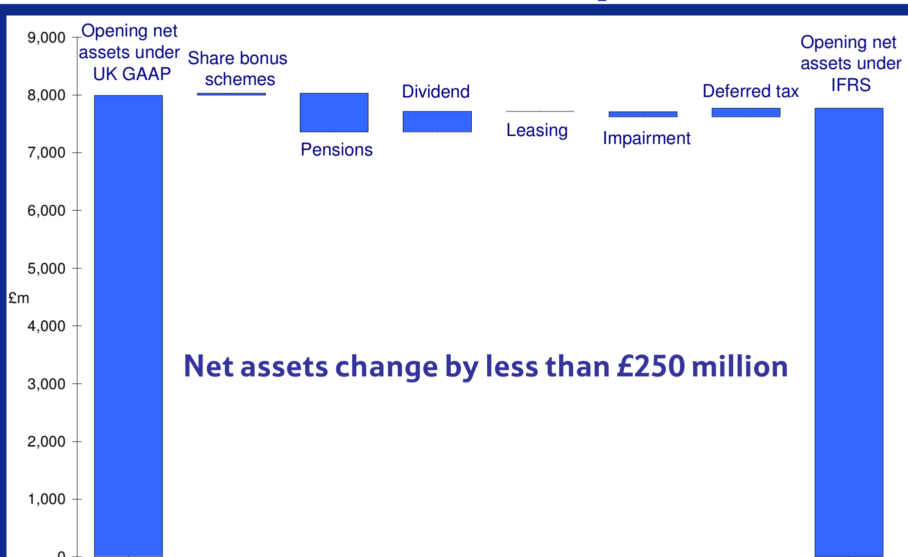
Feb 2004 net asset impact



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Key messages

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Year end convergence

Andrew Higginson, Finance & Strategy Director

Key messages

- Harmonising international and group year ends
- Making our reporting simpler
- Reflects growing importance of international business
- Changing now to minimise further accounting change later

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Year end convergence

UK & Group

Feb year-end

International

Dec year-end

05/06

Group

End of Q1

year-end

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Year end convergence

What are we doing?

- Moving to a common year end date for group and international
- Fixed quarterly trading statements - Q3 will include Christmas

Why?

- The international business is becoming a more and more significant part of the group
- We want to harmonise internal reporting and planning
- The current December 31st international year end leads to a very long closed period

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Dates and timings

2005/06 results

- Year end of 2nd April 2006
- Statutory accounts will show:
  - 2005/06: 57 weeks UK & ROI / 15 months international
  - 2004/05: 52 weeks UK & ROI / 12 months international

General principle going forward

- Half year: last Sunday in September / first Sunday in October
- Full year : first Sunday in April
- Quarterly sales: Q1, Q3

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What next?

Andrew Higginson, Finance & Strategy Director

What next?

<u>May 2005</u>

- Issue restated IFRS 04/05 numbers in press release format

<u>September 2005</u>

- Issue fully compliant IFRS 05/06 interim accounts (with restated 04/05 comparatives)

<u>May 2006</u>

- Issue fully compliant IFRS 05/06 full year accounts
  - 04/05 full year comparatives
  - reconciliation to UK GAAP

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Q & A

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IFRS Seminar

25 February 2005

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