

**Commercial income**

Commercial income represents part of our overall economic relationship with suppliers. Consistent with standard grocery market practice, we negotiate a very wide range of payments to and from our suppliers including fees, contributions, discounts, multiple offers and volume rebates. Whilst we have embarked on a fundamental review which will significantly simplify our approach, in total we currently use over 20 different categories of variation in payment terms. Many of these relate to adjustments to a cost price and can be considered (and are in practice) a part of the standard unit price variations that can be expected under normal, competitive market conditions. As such these amounts are recognised in the income statement as a deduction to the cost of goods sold.

A number of commercial income categories can be conditional on the satisfaction of certain actions or performance conditions by either Tesco or the supplier in question, including the achievement of agreed sales volume targets, the provision of certain benefits such as marketing materials or promotional product positioning, and costs incurred for unplanned variations in product specification. In most instances, the arrangements that set out these terms cover periods that are within or end at the same point as our financial year.

Where agreements are in place across a period end, judgement can be required to assess if the conditions will be met, and therefore to estimate the period end amounts payable and receivable. For example, where there are volume-related allowances spanning different account periods, the Group assesses the probability that targeted volumes will be achieved based on historical and forecast performance, recognising the appropriate amounts in the period end balance sheet and income statement.

Commercial income is reflected in a number of balance sheet categories – principally due to differences in timing between recognition of income, receipt of cash and sale of goods. In order to provide greater clarity on the accounting for commercial income – including those instances where judgement and estimates are used – we are increasing our disclosure to show the effects of commercial income on the following balance sheet accounts:



$CGS = Beg + Pur - End$

- **Inventories:** The carrying value of inventories is reduced by the value of commercial income which will be earned when the associated stock is sold.
- **Trade and other receivables:** Amounts that have been invoiced to suppliers but not yet received are included within trade and other receivables.
- **Accrued income:** Any amounts earned but not yet invoiced to suppliers are included in accrued income. The majority relates to amounts outstanding under large supplier agreements or promotional allowances that run up to the period end. The balance

primarily reflects amounts due under long-term agreements for volume rebates.

• **Trade payables:** Most agreements with suppliers enable income earned to be offset against amounts owed. These balances are included as a deduction within trade payables.

• **Accruals and deferred income:** Any amounts received in advance of income being earned are included in accruals and deferred income.

The impact of commercial income on each of these accounts for the years to 28 February 2015 and 22 February 2014 is shown below:

|                               | 2015<br>Group<br>£m | UK<br>£m | 2014<br>Group<br>£m | UK<br>£m |
|-------------------------------|---------------------|----------|---------------------|----------|
| <b>Current Assets</b>         |                     |          |                     |          |
| Inventories                   | (93)                | (67)     | (82)                | (52)     |
| Trade and other receivables   |                     |          |                     |          |
| –Other receivables            | 97                  | 54       | 89                  | 22       |
| –Accrued income               | 158                 | 117      | 230                 | 173      |
| <b>Current Liabilities</b>    |                     |          |                     |          |
| Trade and other payables      |                     |          |                     |          |
| –Trade payables               | 347                 | 173      | 547                 | 368      |
| –Accruals and deferred income | (63)                | (53)     | –                   | –        |