CAPITA

IFRS 15 teach–in

7 September 2017

Agenda

Introduction	Nick Greatorex
Application to Capita	David Manuel
Break	
2016 under IFRS 15	Nick Greatorex
Key implications	Nick Greatorex
Q&A	Nick Greatorex, David Manuel Simon Mayall, Tory Rogers & Chris Clements

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Introduction

- **IFRS 15 is a significant, complex and far reaching accounting standard**
  - Impacts long-term contracts and software licences
  - Closer alignment of our commercial performance with the accounting description
- **Our objectives today**
  - Provide you with an understanding of the requirements of the standard
  - Provide an explanation of their application to the Group
  - Provide you with half year and full year 2016 results after application of IFRS 15
  - Ongoing implications from the adoption of the standard
- **Timeline**
  - **7 September**: IFRS 15 adoption presentation and release of 2016 financials under IFRS 15
  - **21 September**: 2017 half year results under IFRS 15
  - **Early December**: pre-close trading statement under IFRS 15, initial views on KPIs
  - **1 March**: 2017 full year results under IFRS 15

Early adoption of IFRS 15

- Impact due to long-term output based contracts
- More closely aligns our revenue recognition with commercial substance of contracts
- Will drive even greater focus on performance across Capita
- Immediately provides a consistent basis for investors to evaluate our business going forwards
- In line with our strategy of simplifying the business and improving transparency
- Consulted widely with advisors, supported by EY and KPMG and their technical teams
- IFRS 15 adopted in a consistent, prudent and sustainable way

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Key judgements

- Presents a number of judgements on adoption
- Transformation packaged with the service as an integrated solution - Capita's clients value the 'what' we do for them (the delivery of outcomes) rather than the 'how' we do it
- Software products require regular updates, making them a service over time
- 70% of the Group's revenue re-profiled
- Majority of transactional businesses unaffected
- IFRS 15 realises revenues as outcomes are delivered for clients and therefore increases focus on achieving early cost efficiencies in contracts to drive profit

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Other important points to note

- No impact on Capita’s cash flow
- Changes the way revenue is recognised – a matter of timing
- Does not change lifetime revenue or profits of contracts
- New contracts may give rise to losses in early years
- Profitable long-term contract portfolio continues to drive value for the Group - disclosure of order book
- Fully retrospective approach - three years of comparative results under IFRS 15 by end 2018
- Balance sheet will look very different under IFRS 15 - contract fulfilment assets and significant deferred income
- We are reviewing remuneration and incentives across the Group and our KPIs
- Capita Asset Services (CAS) will be treated as a discontinued operation

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IFRS 15 – key points

No impact on:

- Lifetime profitability of contracts
- Cash flow of contracts
- Majority of transactional businesses

Key impacts:

- Revenue more evenly distributed over the life of contracts and active software licences – timing of profits re-profiled
- Potentially lower profits or losses in early years on contracts where there are significant upfront restructuring costs or higher operating costs prior to transformation – compensating increase in profits in later years
- Balance sheet includes
  - New contract fulfilment assets created in the process of transforming services
  - Deferred income in relation to contracts where payments have been received from clients to undertake transformation in advance of delivering planned outcomes

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IFRS 15 – key points (cont.)

Full year 2016 under IFRS 15

- Revenue and operating profit decreased
- Net assets moved to net liabilities
- Operating cash unchanged

Underlying continuing*

	£m Pre-IFRS 15	£m IFRS 15
Revenue	4,582	4,357
Operating profit	481	335
Net assets/(liabilities)	483	(553)
Operating cash	750	750

*Restated to exclude CAS as we will treat it as a discontinued operation at 30 June 2017

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Application to Capita

David Manuel

Director, Group Finance

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Overview

- Commercial model
- Previous accounting policy
- Example outsourcing contract pre-IFRS 15
- The IFRS 15 five step revenue model and application to Capita
  - main impacts
  - areas of no impact
- Example outsourcing contract post-IFRS 15
- Software licence revenue
- Working capital
- Presentation and disclosure changes
- Re-cap of main impacts

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Commercial model – key points

Large contracts:

- We take an inefficient process being run by our client, and transform this into a more efficient and effective solution
- The outcome we strive for is a high quality, efficient solution that addresses our client’s needs, delivered consistently over the life of the contract
- We will often incur greater costs during the transformation stage, particularly if we incur redundancy costs, with costs then diminishing over time as we implement more efficient processes
- We normally seek to ensure that the cash we receive from our clients reflects the costs we have to incur to transform, restructure and run the service
- Typically on these contracts the client values the delivery of the transformed service rather than the discrete steps: transform, restructure, and deliver

Software:

- Typically specialist software
- Regular updates and maintenance critical for customer continued usage
- Customer values the ongoing support and maintenance as much as initial licence

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Previous accounting policy

- Matching revenue and costs
- Recognise revenue separately for restructure, transformation and BAU
- Percentage of completion, common across the sector
- Higher profits in early years

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Illustrative example - Capita's outsourcing proposition

Throughout this section we will use an example of an outsourcing contract (**Contract Saturn**) to illustrate the differences between pre-IFRS 15 and post-IFRS 15.

Background:

- Saturn's in-house function cost = **£65m** p.a.
- Post-transformation, Capita's Target Operating Model (TOM) cost = **£40m** p.a.
- Cost to reach TOM = **£100m**:
  - **£10m** - restructuring
  - **£40m** - transformation/technology/transition (including **£10m** capital expenditure)
  - **£50m** - operating costs above the TOM prior to the TOM being reached

Capita's offer to Saturn - 10 year deal:

- Saturn's cost to keep function in house = **£650m**
- Capita's cost £400m + £10m + £40m + £50m = **£500m**
- Capita will run the function if Saturn pays Capita **£550m**
- Saturn saving = **£100m** Capita profit = **£50m**

Cash:

- The profile of the cash received from Saturn matches the profile of Capita's spend

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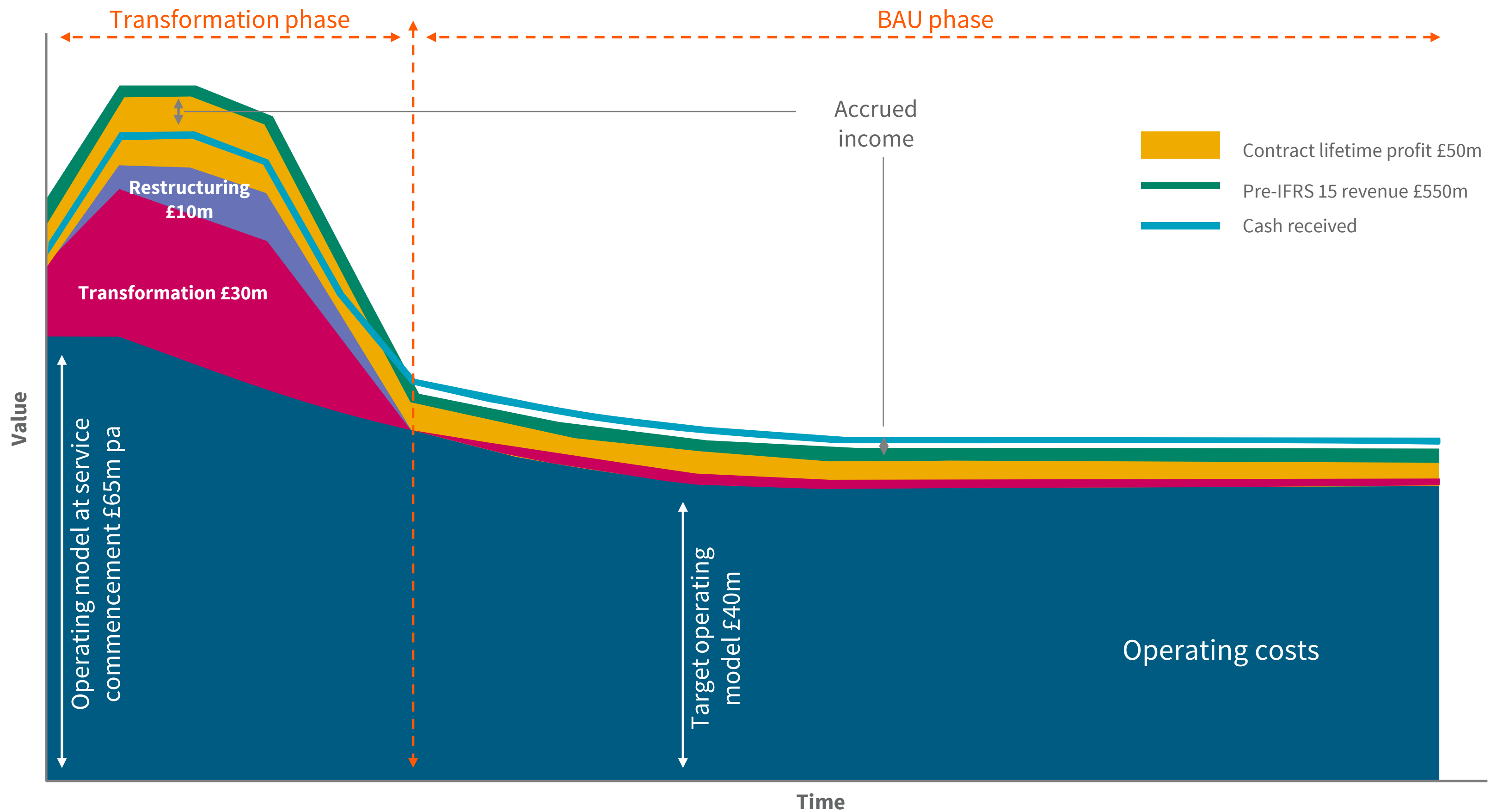
Contract Saturn - pre-IFRS 15



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Contract Saturn - pre-IFRS 15 (cont.)

- Prior revenue recognition policy matched costs and revenue – percentage of completion
- The revenue in the chart matched the cost profile
- Yellow area represented profit
- The Group earned higher profits during the complex transformation phase
- Followed by normalised margins in the Business As Usual (BAU) phase
- Accrued and deferred income was the difference between cash receipts and revenue recognition

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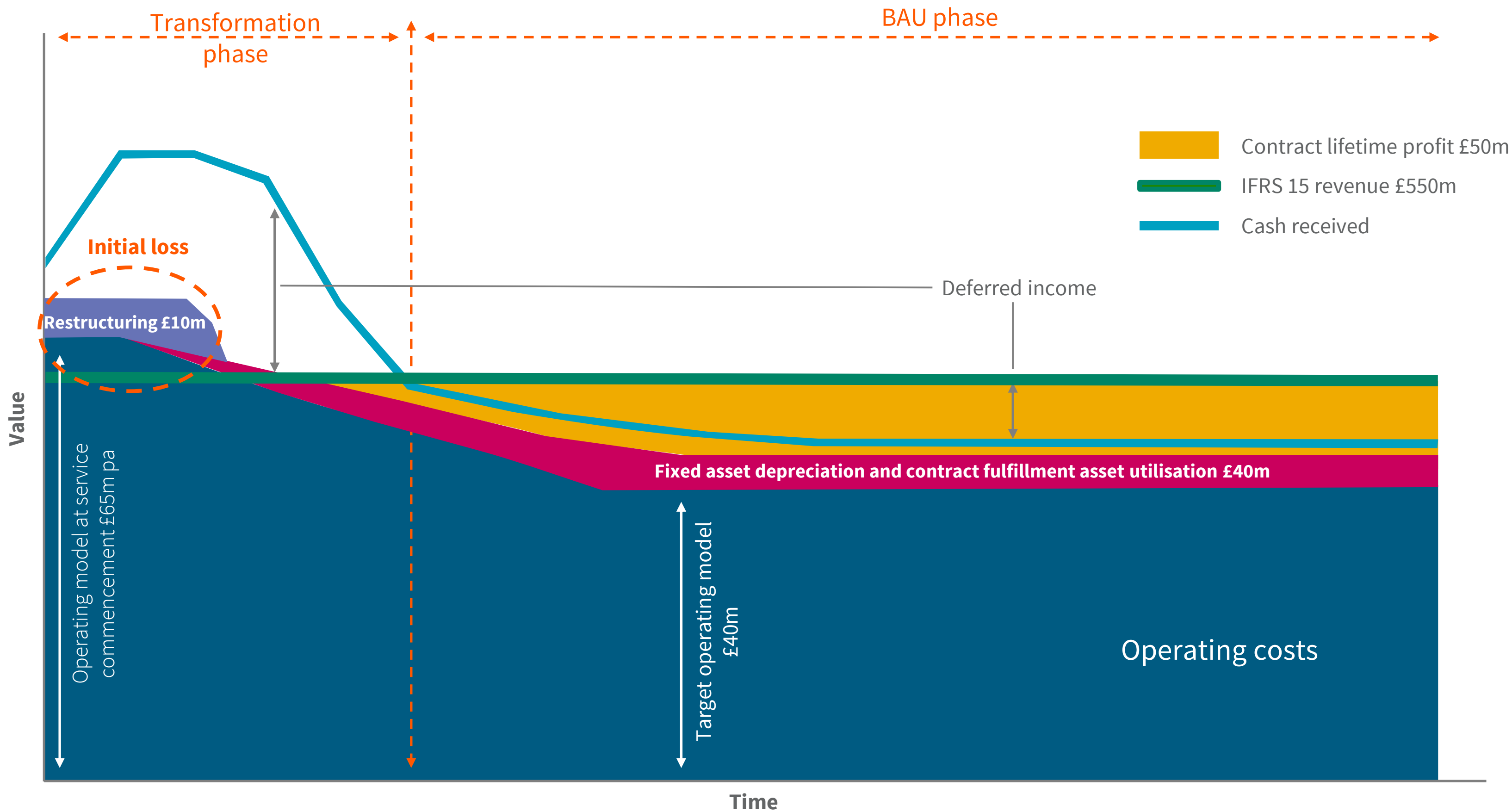
Contract Saturn - IFRS 15



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IFRS 15 - main impacts for Capita

- **Revenue:** recognition of revenue over the life of major contracts and active software licences spread more evenly
- **Costs:** certain transformation spend, previously expensed, now capitalised as contract fulfilment assets and released over the contract life. Redundancies expensed upfront. Increased focus on cost reduction
- **Profit:** phasing of profits on major contracts may be shaped differently, with potentially lower profits or losses in the early years on contracts – but overall contract profitability unchanged – just the timing
- **Balance sheet:** net liabilities reflects increase in deferred income on contracts where we have been paid to undertake transformation prior to delivering planned outcomes for clients
- **Presentation:** underlying result further analysed to separately disclose results of significant new contract wins and restructuring
- **Cash:** no change

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IFRS 15 – a five step revenue model

- IFRS 15 provides a framework that replaces existing revenue guidance in US GAAP and IFRS
- The five step model is to be used for all revenue in all industries
- The five step model will determine when to recognise revenue, and at what amount, once an entity transfers control of goods or services to a customer
- Steps 2 and 5 have the biggest impact for Capita
- New qualitative and quantitative disclosure requirements aim to enable investors increased clarity

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Step 1 – Identify the "IFRS 15 contract"

Step 1 Identify the "IFRS 15 contract" > **Step 2** Identify Performance Obligations > **Step 3** Determine the transaction price > **Step 4** Allocate the transaction price > **Step 5** Recognise revenue

An "IFRS 15 contract" broader than just legal agreements such as frameworks, contracts and side letters so that the combined agreement meets the following criteria:

1. Parties approved the contract, and are committed to perform the obligations
2. Rights of parties identified
3. Payment terms established
4. Contract has commercial substance
5. Collection of consideration is probable

Application to Capita:

Trading businesses – no difference as each standalone transaction meets the five step criteria

Software businesses – can result in separate licence and maintenance agreements being bundled into a single "IFRS 15 contract"

Frameworks – some framework agreements will not meet the definition of a single "IFRS 15 contract" and instead individual calls-offs treated as separate contracts

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Step 2 – Identify performance obligations

Step 1 Identify the "IFRS 15 contract" > **Step 2** Identify Performance Obligations > **Step 3** Determine the transaction price > **Step 4** Allocate the transaction price > **Step 5** Recognise revenue

Identify the promises
A promise is an implicit or explicit commitment made by you to your customer within the "IFRS 15 contract" identified in Step 1

Identify the Performance Obligations
The individual promises are grouped together until they combine to make a **distinct** good or service. IFRS 15 calls these groupings of promises performance obligations

To be distinct the performance obligations must be both:

- Capable of being distinct
- Distinct within the context of the contract

Application to Capita:
Requirement to consider what the distinct performance obligations are for each contract

The core service: Distinct
Core service provides functions previously provided an in-house department

Transformation: Not distinct, combined with core service
Transformation is a significant element in meeting the core performance obligations of delivering an efficient service for the customer

Restructuring – Not distinct, combined with core service
The benefit to the customer of Capita's restructuring spend is the more efficient service Capita delivers post-transformation

Step 2 – Identify performance obligations (cont.)

Contract fulfilment asset

Costs of fulfilling a contract that cannot be capitalised under another standard are capitalised if they:

1. Relate directly to a contract;
2. Generate or enhance resources that will be used to satisfy performance obligations in the future; and
3. Are expected to be recovered

The release of contract fulfilment assets occur once the enhanced resource is being used

The release is spread over the useful economic life of the enhanced resource

Application to Capita:

The Group will capitalise investment in the IP of the business solution that achieves the target operating model and generates value in terms of the expertise used to deliver an efficient high quality service in the future

This is separate, and in addition to, the traditional tangible and intangible assets that may be created on the set-up of a contract. Consistent with any other assets, the CFA are subject to impairment testing

Examples

Refer to appendix for specific contract fulfilment asset examples

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Step 3 & 4 – Determine and allocate the transaction price

Step 1 Identify the "IFRS 15 contract" > Step 2 Identify Performance Obligations > **Step 3 Determine the transaction price** > **Step 4 Allocate the transaction price** > Step 5 Recognise revenue

Determine transaction price

IFRS 15 introduces the concept of transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer

An entity estimates the transaction price at contract inception and updates the estimate each reporting period for any changes in circumstances

Application to Capita

Disclosures

The disclosure requirements include reporting the currently contracted future revenues

Revenue to date must be highly probably not to reverse

On a contract basis IFRS 15 insists that at all times the total revenue recognised to date is highly probably not to reverse, this leads to the Group to restrict revenue recognition on some gain-share arrangements as compared to previous accounting

Allocation of the transaction price

This step has two goals:

1. ensure appropriate revenue allocation between performance obligations
2. allow revenue to be allocated to unpriced performance obligations

IFRS 15 requires allocation of the total transaction price between the performance obligations based on relative Standalone Selling Price (SSP)

SSP is IFRS 15's definition of a fair price for each performance obligation and is based on an arms length selling price for that performance obligation assuming none of the other obligations existed

Application to Capita

Most performance obligations in the Group's contracts do not meet the definition of being distinct, and so there are few performance obligations to allocate the transaction price

Where price step downs are included in the life of a contract, but with no change to the underlying scope of services delivered, these step downs are included in the transaction price and allocated to the relevant performance obligation

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Step 5 – Recognise revenue

Step 1 Identify the "IFRS 15 contract" > **Step 2** Identify Performance Obligations > **Step 3** Determine the transaction price > **Step 4** Allocate the transaction price > **Step 5** Recognise revenue

Over time vs point in time

To be over time a service must meet **one** of the following conditions:

- Entity creates or enhances an asset that the customer controls as it is created or enhanced
- Entity's performance does not create an asset with alternative use and the entity has an enforceable right to payment for performance completed to date
- **Client simultaneously receives and consumes the benefits of the entity's performance as the entity performs** and another entity would not have to re-perform work completed to date

Input vs Output

For an over time service you have to decide what is the most appropriate measure of progress:

- Input – value is transferred to the client based on how we do the service
- **Output – value is transferred to the client based on what we do for them**

A series of over time services

When considering application of the series provision within IFRS 15, the FASB and IASB's Joint Transition Resource Group specifically use the example of an outsourcing arrangement for reference.

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Step 5 – Recognise revenue (cont.)

Application to Capita:

As the client benefits from the more efficient Capita service **throughout** the contract Capita's revenue will be recognised **over time**

The value to Capita's clients is not based on how Capita delivers the service, but on **what** service Capita delivers

In applying IFRS 15 Capita has therefore adopted the **output** method, and applied the series guidance, as the underlying principle

The dynamics of an output driven revenue stream

- Revenue varies by output volume
- The same output item has the same revenue value throughout the contract
- As revenue per output item is fixed, in year profitability improves as we become more efficient and lower the cost to deliver

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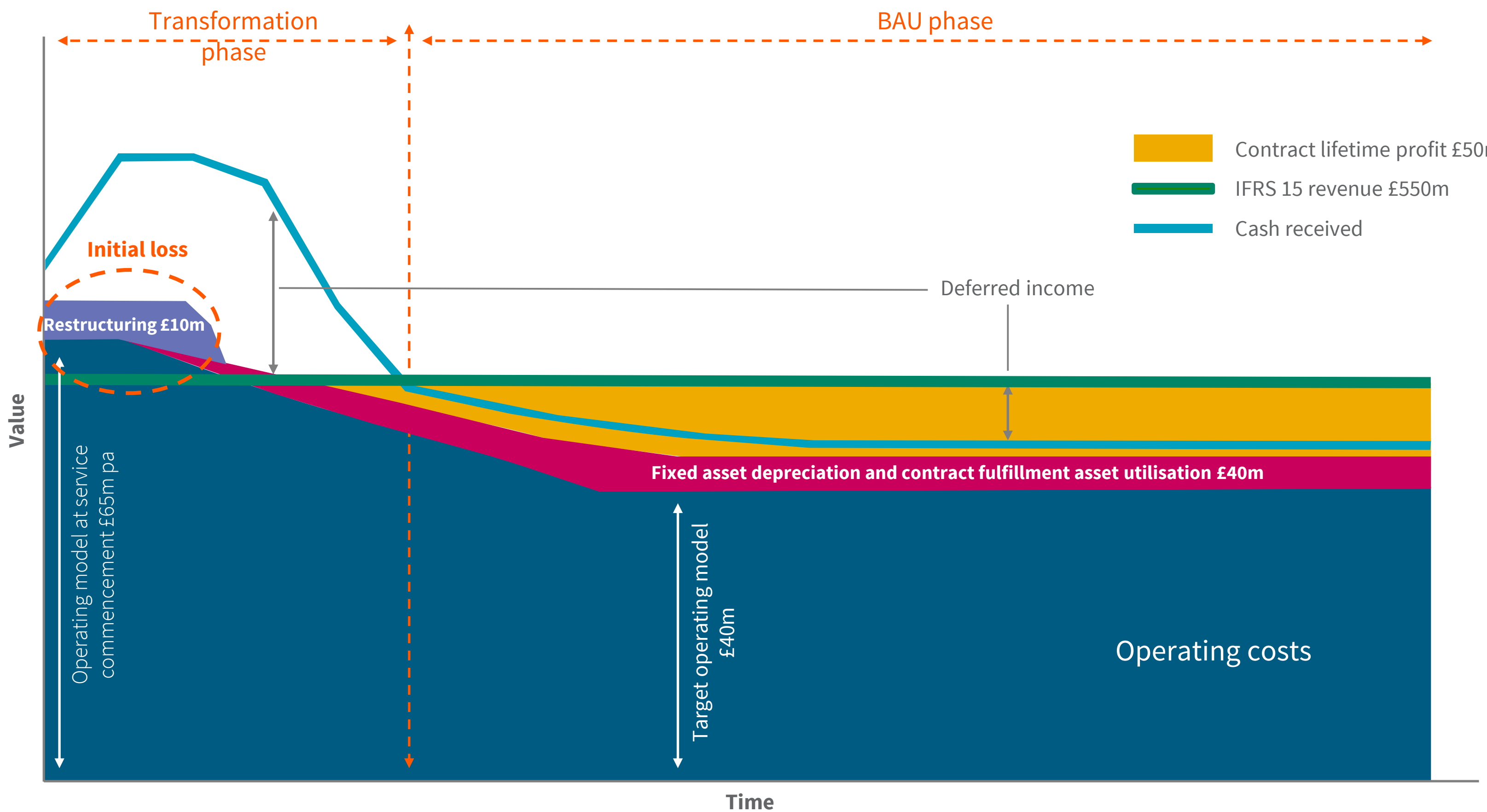
Contract Saturn - IFRS 15



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Contract Saturn - IFRS 15 (cont.)

- IFRS 15 revenue more evenly spread following the IFRS 15 series guidance and output method of recognition with a single performance obligation (**green line**)
- Operating costs unchanged (**dark blue**)
- Fixed asset depreciation and contract fulfilment cost utilisation spread over the contract lifetime (**red**)
- Restructuring costs expensed with no related revenues (**light purple**)
- Total profit unchanged, but profile over the contract lifetime different (**yellow**)
- Results in lower profits or losses (**orange**) in early stage of long term contracts
- Cash received unchanged (**blue line**)
- Increased deferred income as cumulative cash receipts greater than cumulative revenue recognised

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Software licences

Pre IFRS 15:

Perpetual licences: the revenue is recognised as a point in time when the licence legally transfers to the customer; or

Term licences: the revenue is spread over the term of the licence.

IFRS 15:

Active licences – a right to access: licences which require continuous upgrade and updates for the software to remain useful, and the revenue is recognised over the life of the licence; or

Passive licences – a right to use: all other licences are treated as passive licences

Software as a service (SaaS)

Pre IFRS 15: The revenue is recognised over the service.

IFRS 15: Accounting for SaaS is unchanged

Application to Capita:

The Group has concluded that most of its software licences are "active" and as such are spread over the life of the contract

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Illustrative example - Capita's software proposition

Throughout this section we will use an example of a software licence (**Neptune**) to illustrate the differences between pre-IFRS 15 and post-IFRS 15.

Background:

- Neptune is a B2B sale of a perpetual software licence for operationally critical systems
- Price breakdown = **£25m**:
    - **£10m** – perpetual licence
    - **£10m** – implementation and adaptation
    - **£5m** - £1m per annum maintenance revenue over a 5 year maintenance term
- Cost breakdown = **£12m**:
    - No incremental costs – perpetual licence in a sunk cost as it is a copy of an existing software product
    - **£8m** – implementation and adaptation
    - **£4m** – allocation of maintenance team costs

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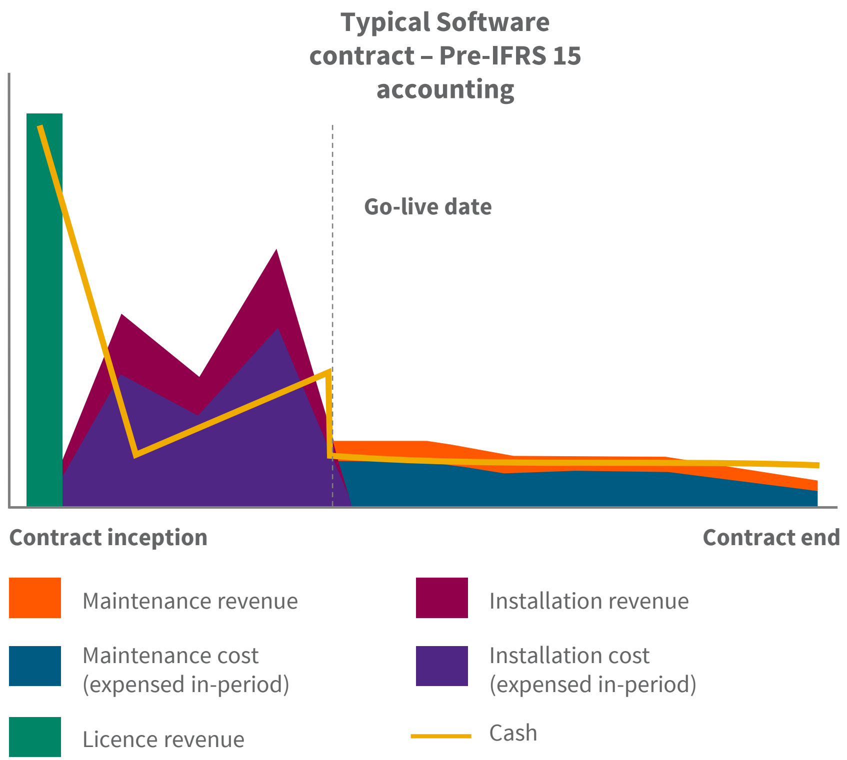
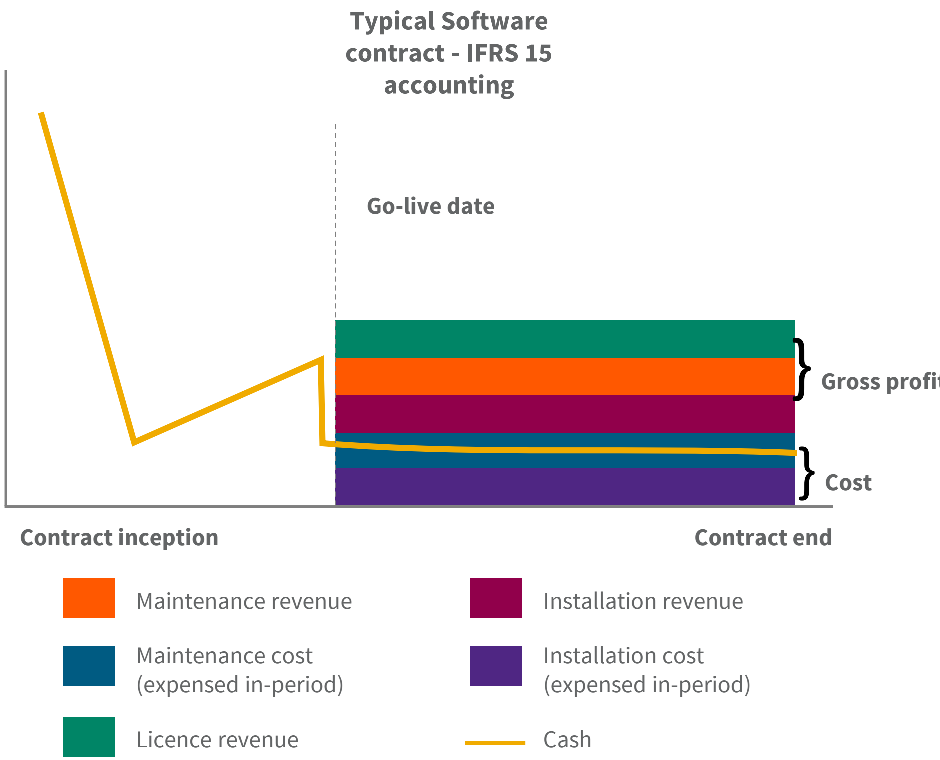
Software - contract level analysis





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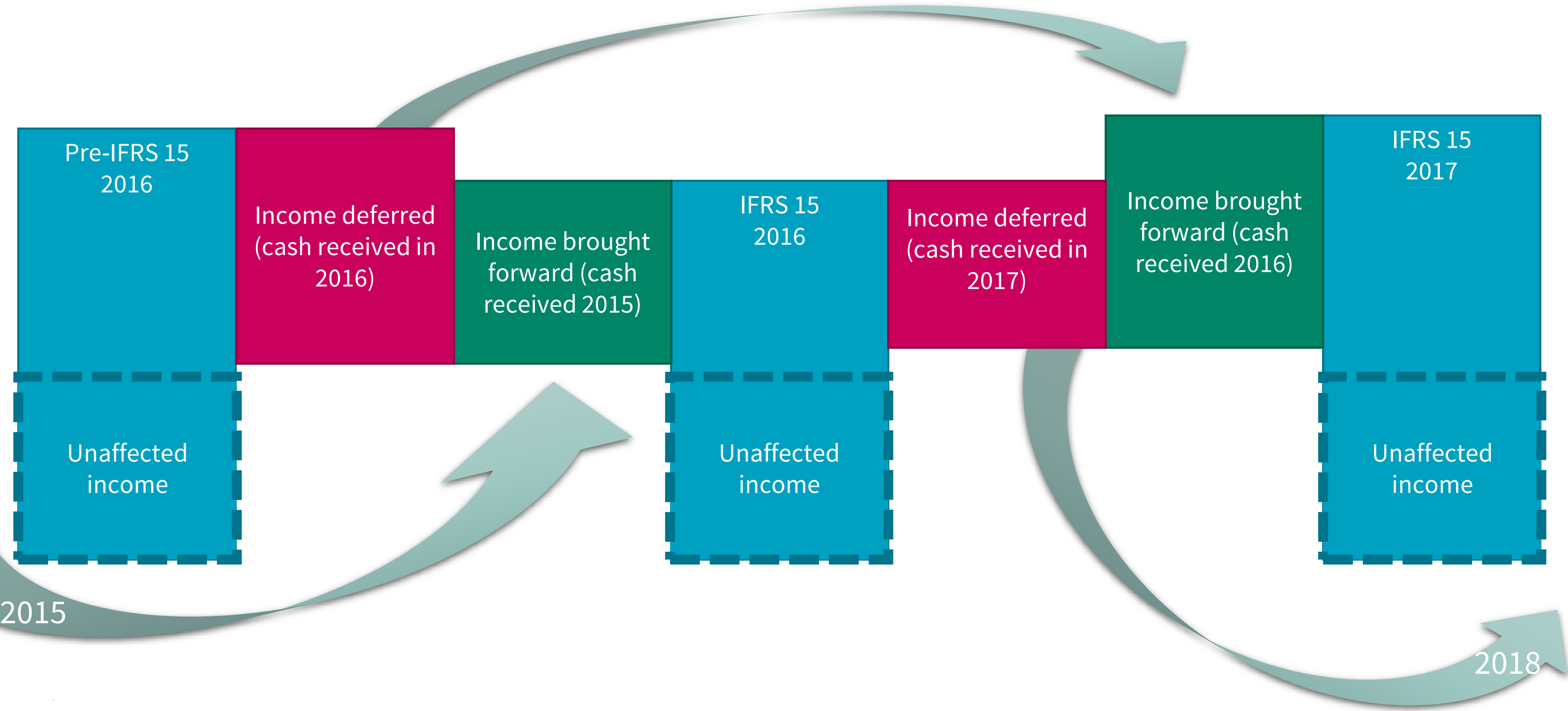
Illustrative working capital cycle



Presentation of underlying operating profit

- New presentation of the in year profits/losses from significant new contract wins and related, or significant, restructuring. Provides greater transparency of performance

- Underlying operating profit reported at the half year and full year to be analysed into "*Underlying before significant new contracts and restructuring*" and "*Significant new contracts and restructuring*"

- Future guidance to be provided based on "*Underlying before significant new contracts and restructuring*"

- Announcement of significant new contract wins will include the forecast: profits/losses in that year, restructuring costs, and inflection point. In year impact will be reported in "*Significant new contracts and restructuring*"

- Presented as a new note to the financial statements

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IFRS 15 – re-cap of main impacts for Capita

- **Revenue:** recognition of revenue over the life of major contracts and active software licences spread more evenly
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- **Cash:** no change

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2016 Results under IFRS 15

Nick Greatorex

Group Finance Director

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Underlying results excluding discontinued operations

	As reported in 2016			Capita Asset Services (discontinued operations)			Pre-IFRS 15 continuing operations		
	£m Six months ended June 2016*	£m Six months ended December 2016*	£m Year ended December 2016*	£m Six months ended June 2016*	£m Six months ended December 2016*	£m Year ended December 2016*	£m Six months ended June 2016*	£m Six months ended December 2016*	£m Year ended December 2016*
Revenue	2,405	2,493	4,898	147	169	316	2,258	2,324	4,582
Operating profit	318	223	541	28	32	60	290	191	481
Interest	(32)	(34)	(66)	-	-	-	(32)	(34)	(66)
Profit before tax	285	190	475	28	32	60	257	158	415
Profit attributable to shareholders	227	150	377	23	28	51	204	122	326
Basic eps (pence)	34.24	22.43	56.67	3.54	4.07	7.61	30.70	18.36	49.06

All following slides <u>have</u> been restated under IFRS 15 for the impact of discontinued operations

*Excludes specific items which include: intangible amortisation, impairments, net contingent consideration movements, other non-recurring items, non-cash mark to market finance costs

Underlying income statement

	Pre-IFRS 15			IFRS 15		
	£m Six months ended June 2016*	£m Six months ended December 2016*	£m Year ended December 2016*	£m Six months ended June 2016*	£m Six months ended December 2016*	£m Year ended December 2016*
Revenue	2,258	2,324	4,582	2,131	2,226	4,357
Operating profit	290	191	481	166	169	335
Interest	(32)	(34)	(66)	(32)	(34)	(66)
Profit before tax	257	158	415	134	135	269
Profit attributable to shareholders	204	122	326	107	104	211
Basic eps (pence)	30.70	18.36	49.06	16.12	15.56	31.68

*Excludes specific items which include: intangible amortisation, impairments, net contingent consideration movements, other non-recurring items, non-cash mark to market finance costs
All Pre-IFRS 15 are based on discontinued operations

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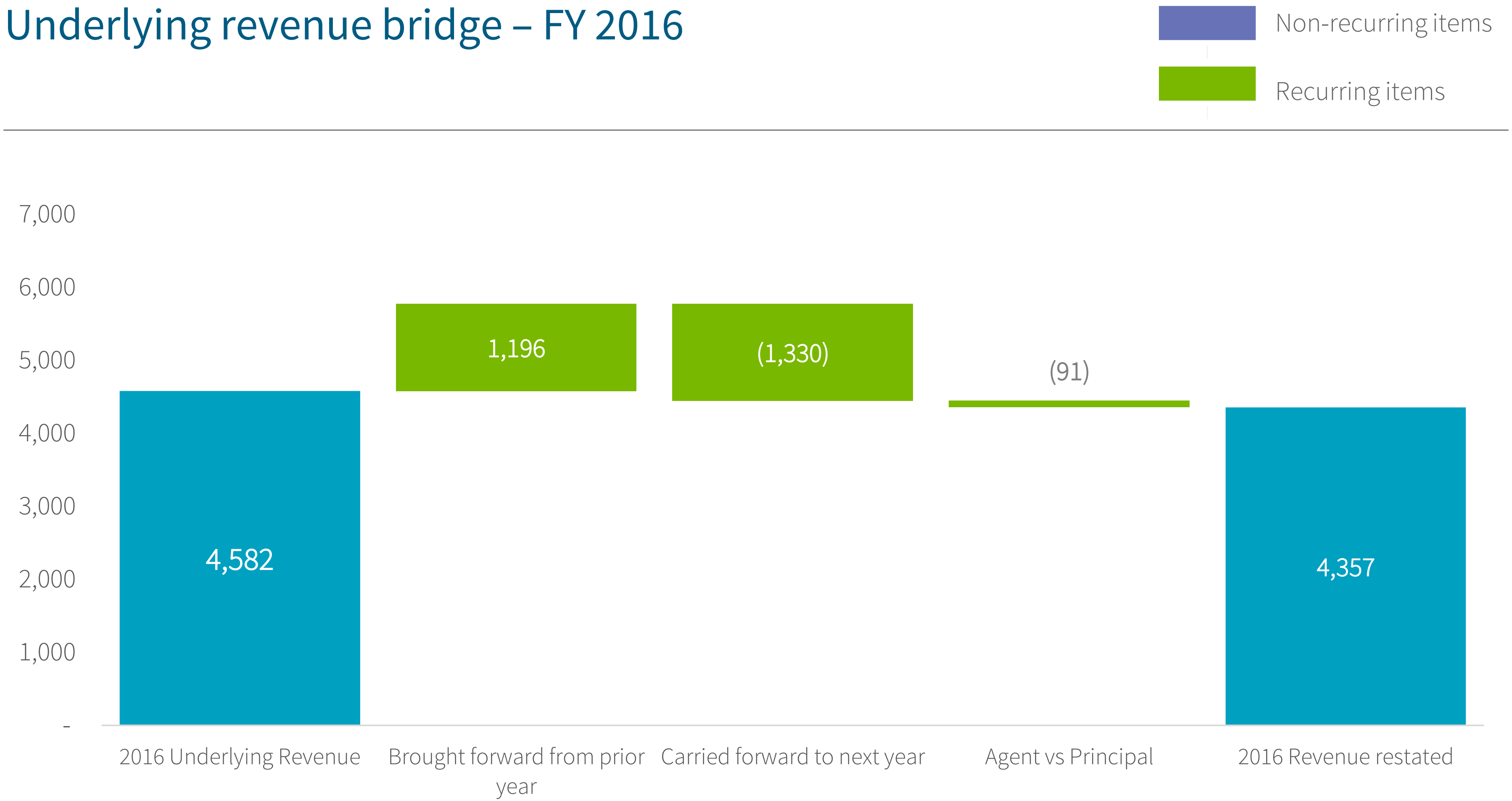
Underlying revenue

	Pre-IFRS 15			IFRS 15		
	£m Six months ended June 2016*	£m Six months ended December 2016*	£m Year ended December 2016*	£m Six months ended June 2016*	£m Six months ended December 2016*	£m Year ended December 2016*
Total reported revenue	2,282	2,311	4,593	2,155	2,213	4,368
Available for sale in 2015, disposed in 2016	(3)	-	(3)	(3)	-	(3)
2016 disposals	(21)	13	(8)	(21)	13	(8)
Revenue from continuing activities	2,258	2,324	4,582	2,131	2,226	4,357
2015 acquisitions	(67)	(9)	(76)	(67)	(9)	(76)
2016 acquisitions	(17)	(65)	(82)	(12)	(36)	(48)
Organic revenue on continuing basis	2,174	2,250	4,424	2,052	2,181	4,233

*Like-for-like revenue growth includes a justice business which was previously held for sale in 2015, on which the disposal process ceased and was moved back into underlying reported revenue in 2016

Underlying revenue bridge – FY 2016



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Underlying operating profit

	Six months ended 30 June 2016			Year ended 31 December 2016		
	Underlying before significant new contracts and restructuring	Significant new contracts and restructuring	£m Total underlying*	Underlying before significant new contracts and restructuring	Significant new contracts and restructuring	£m Total underlying*
Revenue	**2,131**	-	**2,131**	**4,357**	-	**4,357**
Cost of sales	**(1,656)**	-	**(1,656)**	**(3,418)**	-	**(3,418)**
Gross profit	**475**	-	**475**	**939**	-	**939**
Administrative expenses	**(309)**	-	**(309)**	**(545)**	**(59)**	**(604)**
Operating profit	**166**	-	**166**	**394**	**(59)**	**335**

As part of the transition to IFRS 15 we have included the 2016 £59m restructuring provision in underlying profit

*Excludes specific items which include: intangible amortisation, impairments, net contingent consideration movements, other non-recurring items, non-cash mark to market finance costs

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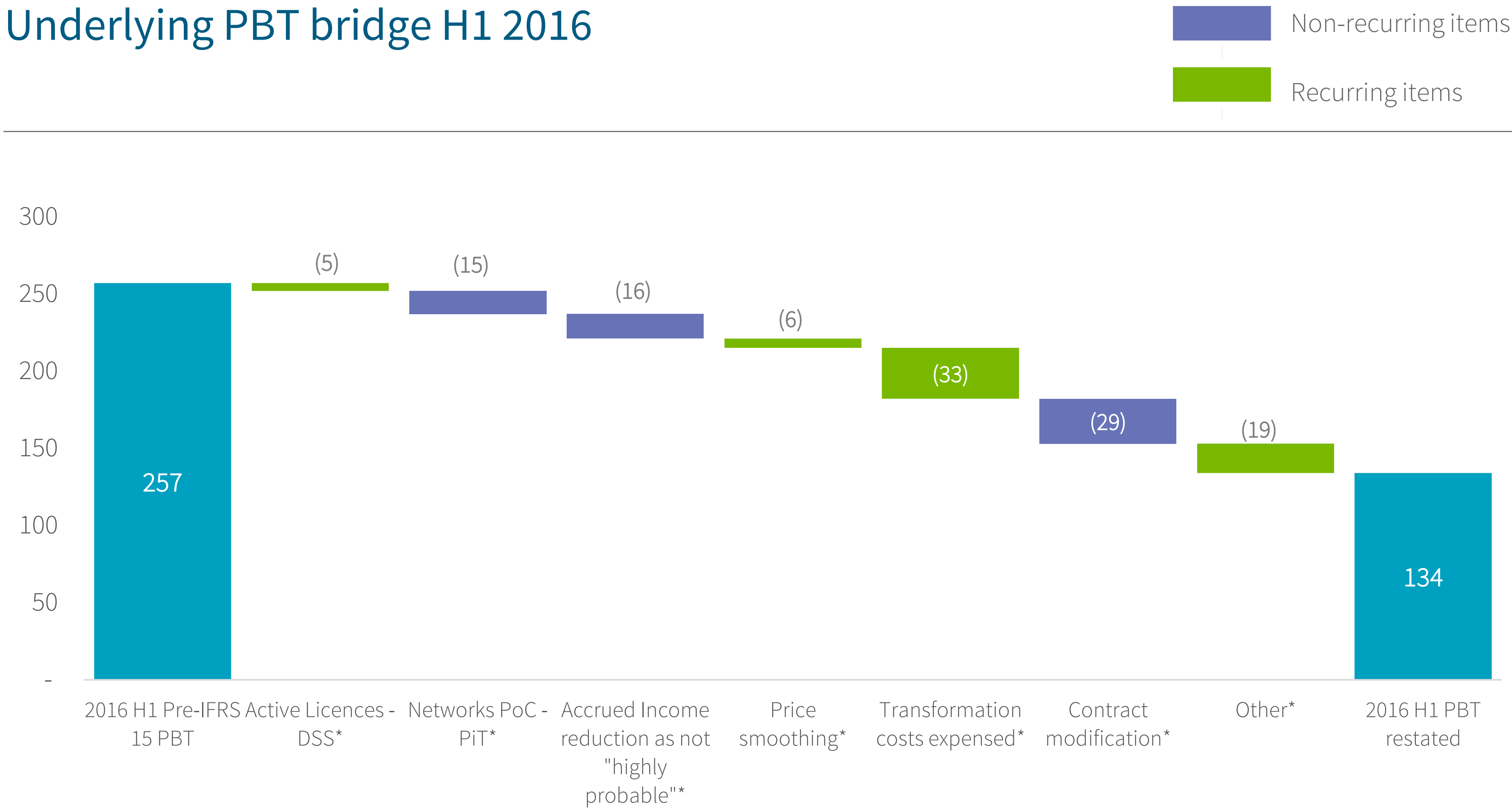
Underlying PBT bridge H1 2016



*These movements taken together are as a result of the impact on revenue of the application of IFRS 15

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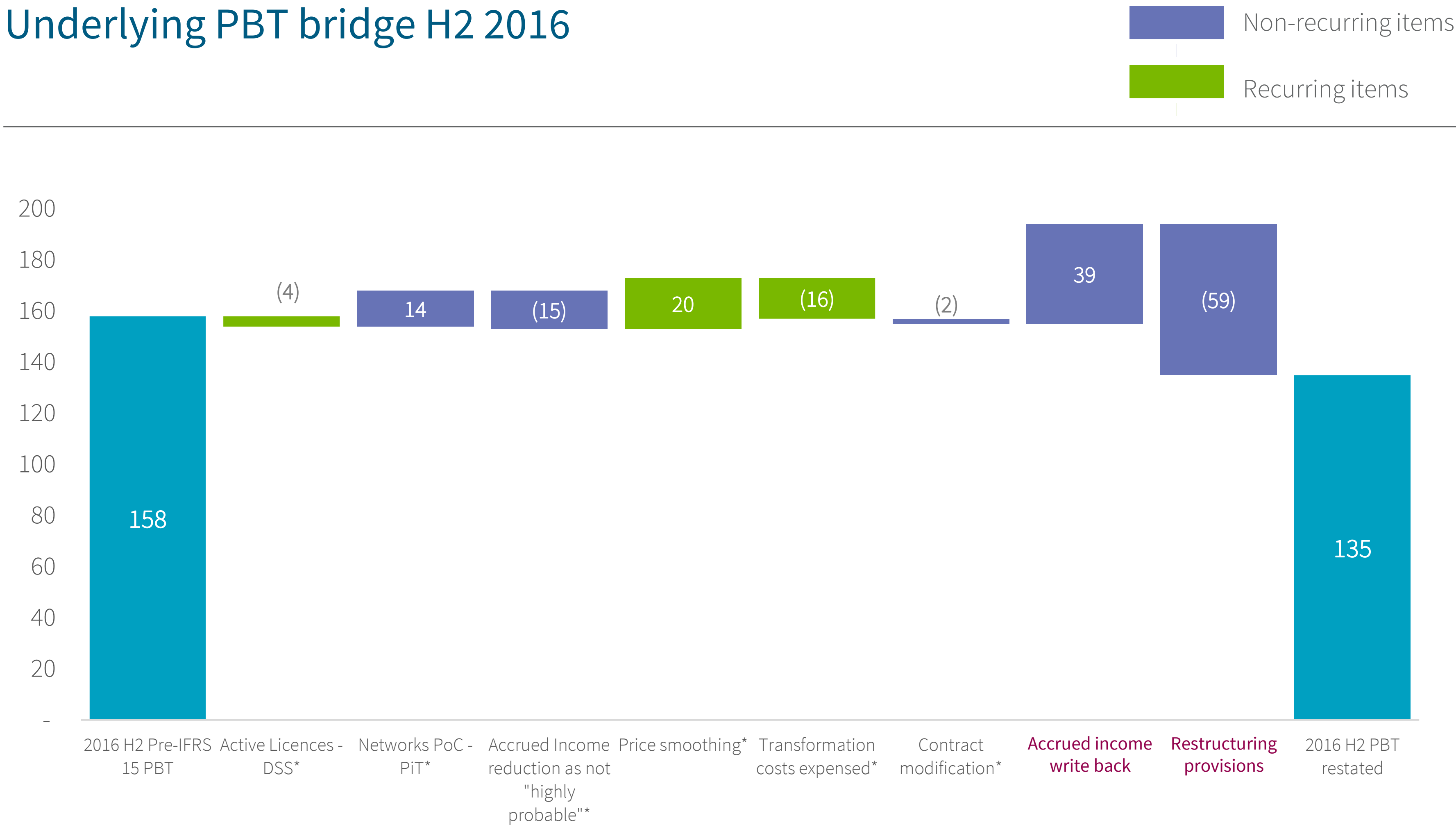
Underlying PBT bridge H2 2016



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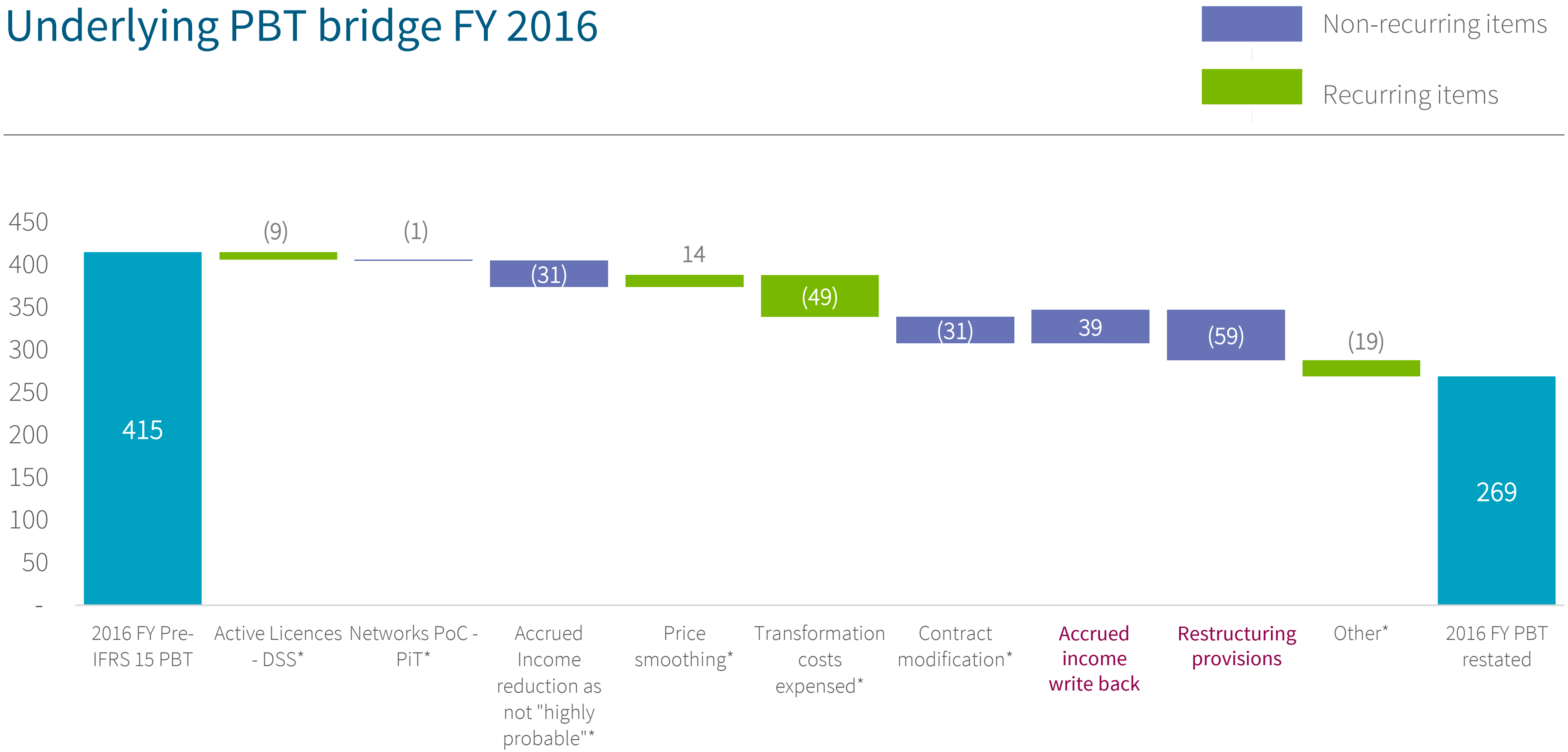
Underlying PBT bridge FY 2016



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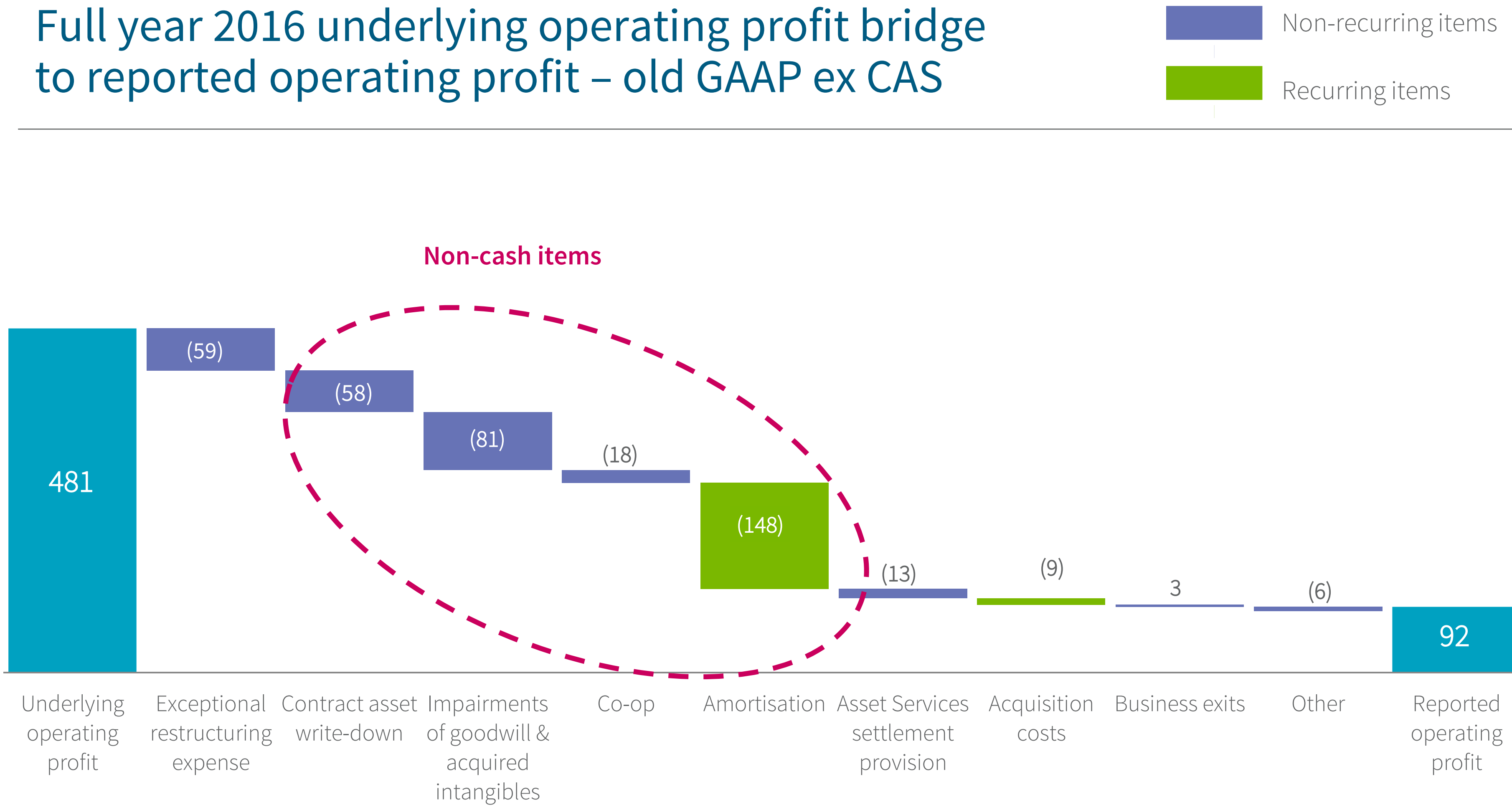
Full year 2016 underlying operating profit bridge to reported operating profit – old GAAP ex CAS



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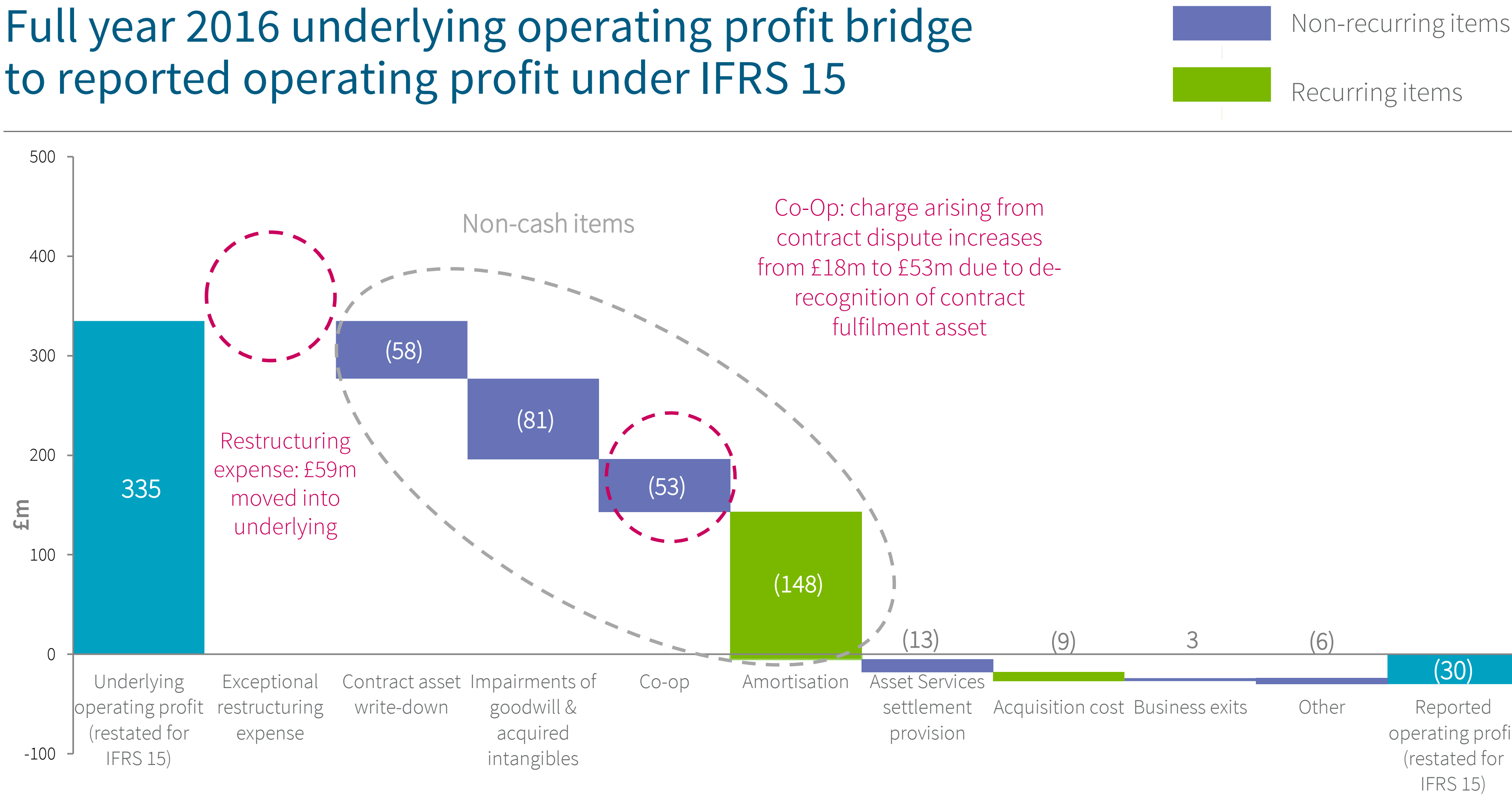
Full year 2016 underlying operating profit bridge to reported operating profit under IFRS 15



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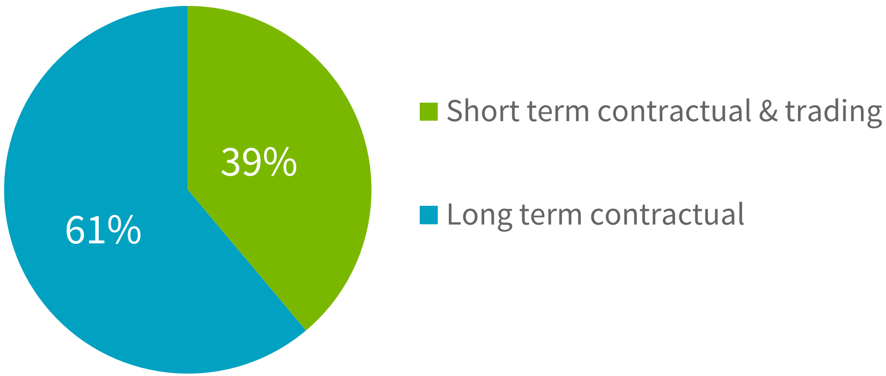
Overall Group revenue split 2016

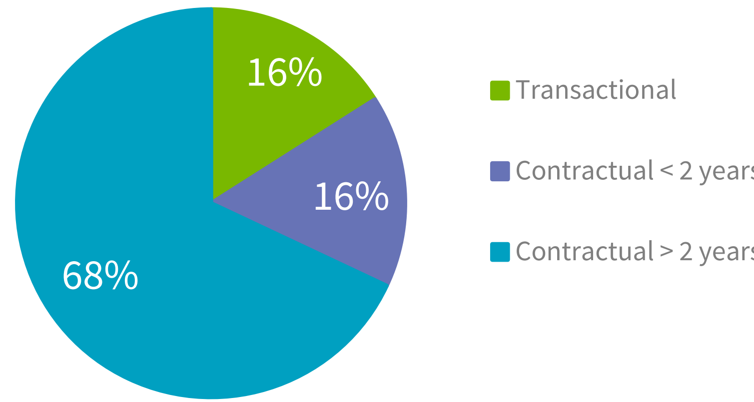
Revenue split - Pre-IFRS 15



- Pre-IFRS revenue split between '*short term contractual & trading*' and '*long term contractual*'

- Under IFRS 15, revenue split between '*contract length > 2 years*', '*contract length < 2 years*' and '*transactional (point in time)*'

Revenue split - IFRS 15



- On the following pages, allocation of corporate overheads to each division have been revised to be comparable to the 2017 results being reported on 21 September

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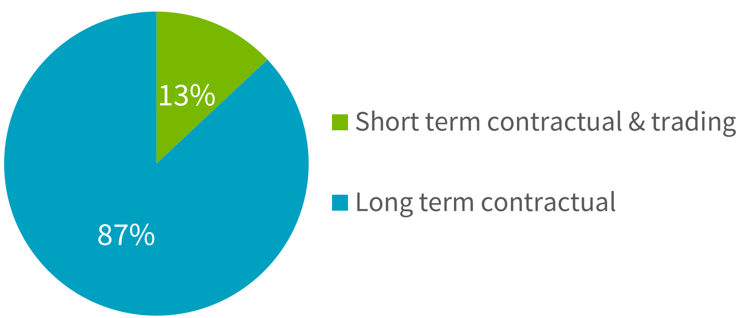
Private Sector Partnerships

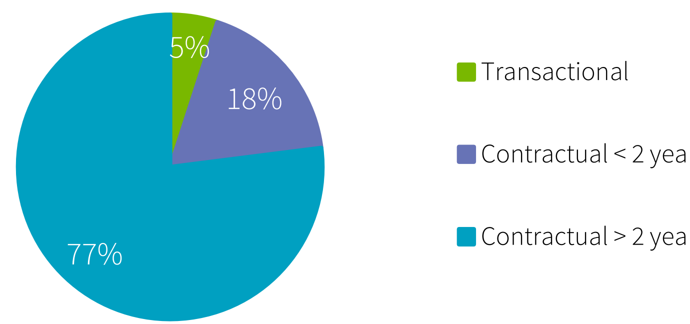
- Key movements:
  - The effect of price step downs being converted into an IFRS 15 blended revenue in CM and Insurance
  - 2016 accrued income impairment reversed
  - CFA write down

	FY16 Pre-IFRS 15	FY16 IFRS 15
Revenue	£1,568m	£1,544m
Profit	£108m	£122m
Margin	6.9%	7.9%

Revenue split - Pre-IFRS 15



Revenue split - IFRS 15



FY16 pre-IFRS 15 comparatives based on continuing activities before the write down of accrued income
Note: All figures prior to allocation of overheads

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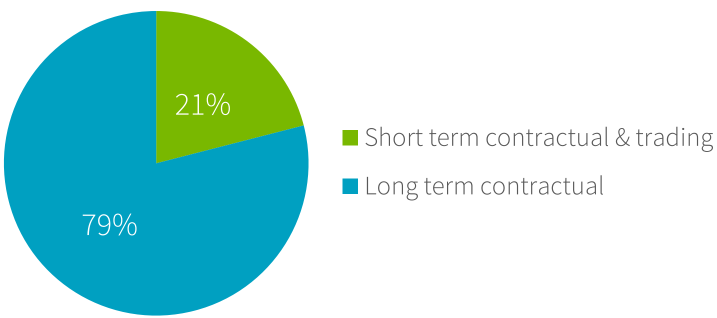
Public Services Partnerships

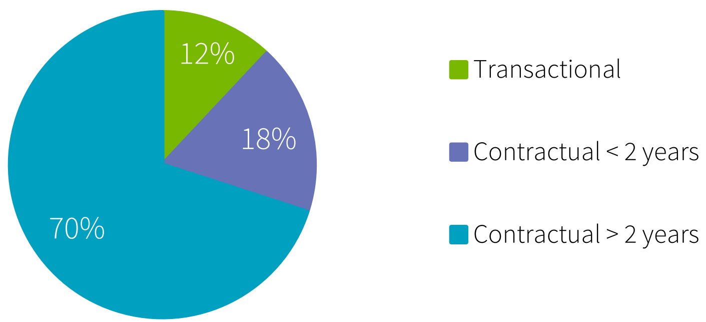
- Key movements:
  - Effect of change to highly probable recognition on gain-share
  - Transformation phase on PCSE
  - 2016 accrued income impairment reversed

	FY16 Pre-IFRS 15	FY16 IFRS 15
Revenue	£1,208m	£1,124m
Profit	£88m	£9m
Margin	7.3%	0.8%

Revenue split - Pre-IFRS 15



Revenue split - IFRS 15



FY16 pre-IFRS 15 comparatives based on continuing activities before the write down of accrued income
Note: All figures prior to allocation of overheads

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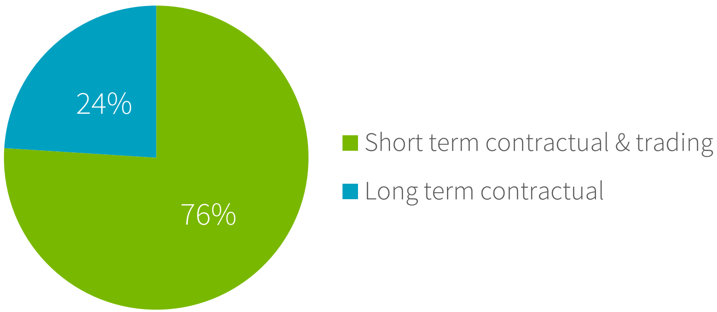
Professional Services

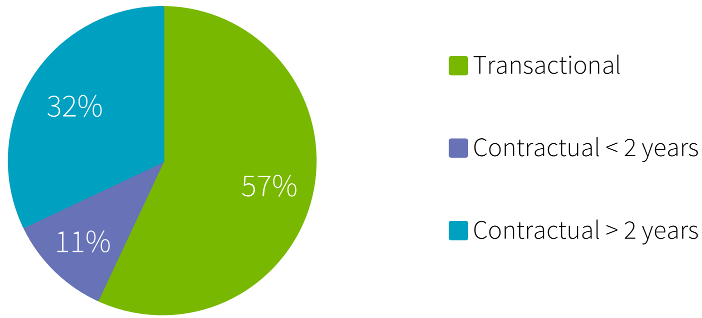
- Key movements:
  - The effect of moving from percentage on completion accounting to revenue which varies with output
  - Move from agency to principal accounting treatment in Learning Services

	FY16 Pre-IFRS 15	FY16 IFRS 15
Revenue	£676m	£717m
Profit	£127m	£115m
Margin	18.8%	16.0%

Revenue split - Pre-IFRS 15



Revenue split - IFRS 15



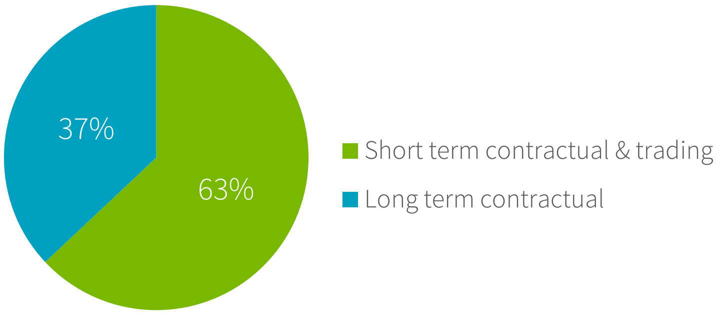
FY16 pre-IFRS 15 comparatives based on continuing activities before the write down of accrued income
Note: All figures prior to allocation of overheads

Digital & Software Solutions

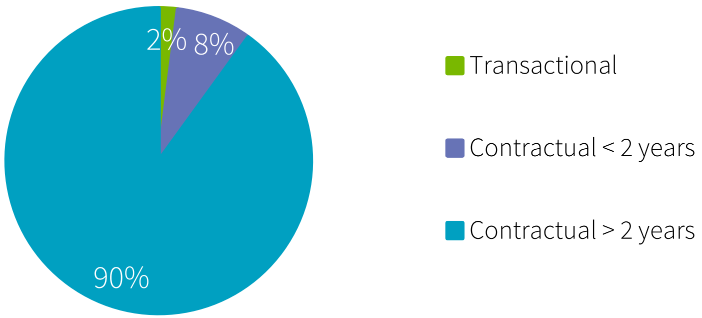
- Key movement:
  - Net impact of active licences being spread over time

	FY16 Pre-IFRS 15	FY16 IFRS 15
Revenue	£436m	£420m
Profit	£145m	£136m
Margin	33.3%	32.4%

Revenue split - Pre-IFRS 15



Revenue split - IFRS 15



FY16 pre-IFRS 15 comparatives based on continuing activities before the write down of accrued income

Note: All figures prior to allocation of overheads

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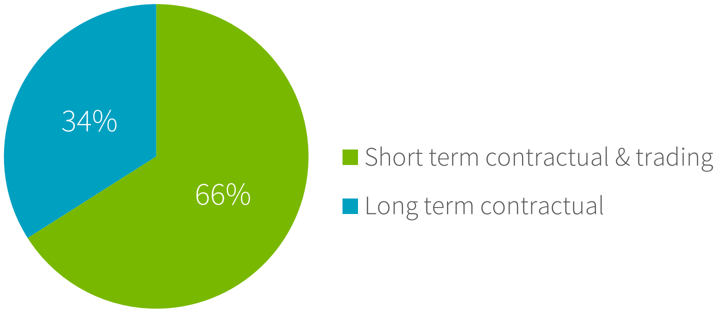
IT Services

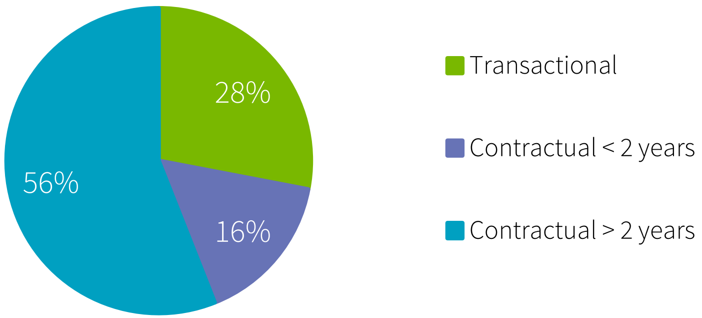
- Key movement:
  - Move from principal to agency accounting treatment in Trustmarque
  - Networks are now Point in Time
  - 2016 accrued income impairment reversed

	FY16 Pre-IFRS 15	FY16 IFRS 15
Revenue	£664m	£532m
Profit	£55m	£56m
Margin	8.3%	10.5%

Revenue split - Pre-IFRS 15



Revenue split - IFRS 15



FY16 pre-IFRS 15 comparatives based on continuing activities before the write down of accrued income
Note: All figures prior to allocation of overheads

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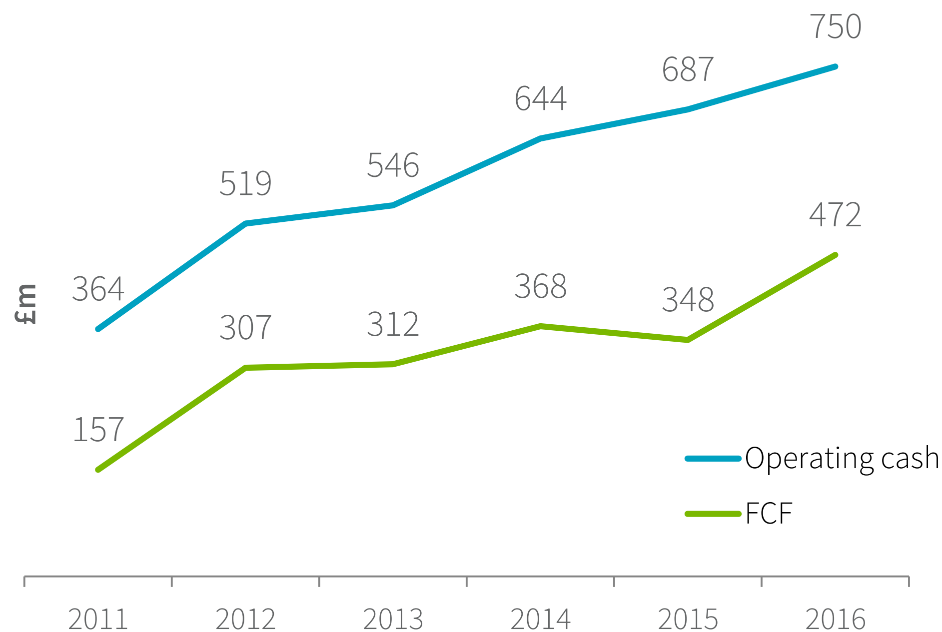
Underlying free funds from operations (FFO) and free cash flows (FCF)

- IFRS 15 has no effect on cash and debt
- Debt covenants for 2016 are not retested
- Covenants updated to include IFRS 15 from 1 January 2017
- Historically profit more aligned to recognition of cash, IFRS 15 will disconnect these, with profits lagging cash inflow
- Cash conversion will be less relevant
- Focus on free cash flow



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Balance sheet 2015

- Contract fulfilment assets created
- Deferred income significantly increased
- Deferred tax asset increase
- Net liabilities on the consolidated Group balance sheet
- Capita plc company balance sheet unchanged

	£m Year ended December 2015 Pre-IFRS 15	£m Year ended December 2015 IFRS 15
Contract fulfilment assets - Non-current	N/A	278
Contract fulfilment assets - Current	N/A	40
Accrued income – Current	451	167
Accrued income – Non current	42	-
Deferred income – Current	(271)	(1,157)
Deferred income – Non-current	(16)	(229)
Net deferred tax	-	165
Net assets/(liabilities)	753	(189)

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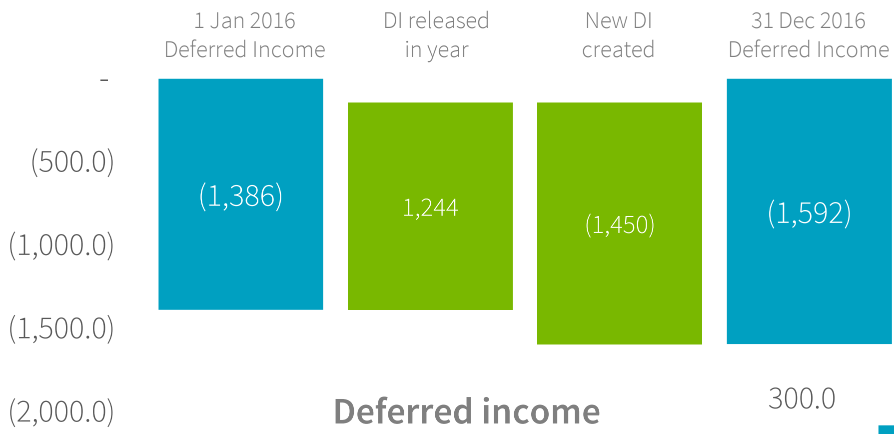
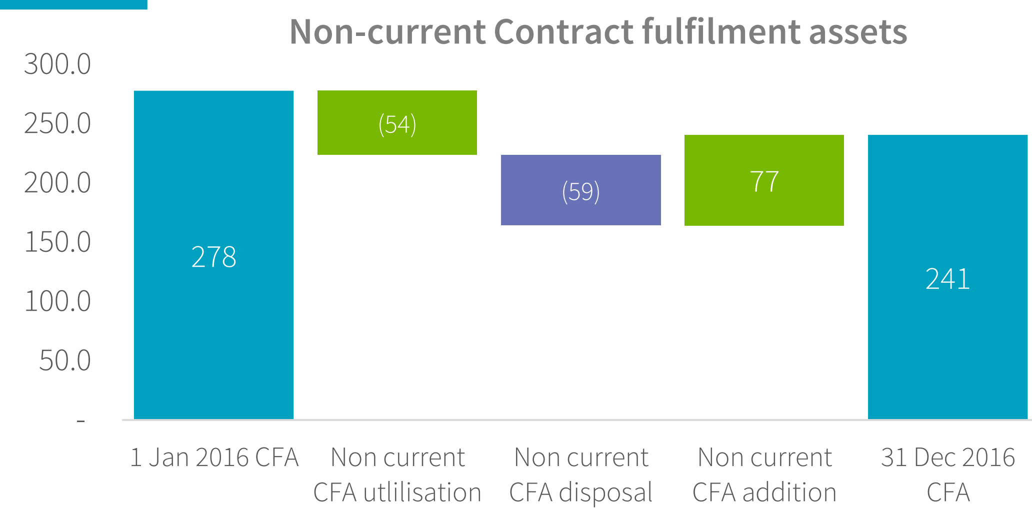
IFRS 15 balance sheet bridge 2015-2016 – significant items





CAPITA

Balance sheet 2016

- Contract fulfilment assets created
- Deferred income significantly increased
- Deferred tax asset increase
- Net liabilities on the consolidated Group balance sheet
- Capita plc company balance sheet unchanged

	£m Year ended December 2016 Pre-IFRS 15	**£m Year ended December 2016 IFRS 15**
Contract fulfilment assets non-current	**N/A**	**241**
Contract fulfilment assets current	**N/A**	**42**
Accrued income – Current	**364**	**189**
Accrued income – Non current	**80**	**-**
Deferred income – Current	**(321)**	**(1,375)**
Deferred income – Non-current	**(14)**	**(217)**
Net deferred tax	**10**	**193**
Net assets/(liabilities)	**483**	**(553)**

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Working capital

	December 2016 (£m) IFRS 15	Managements ability to effect
Trade receivables	444	Payment terms with clients
Accrued income	189	Timely billing of work completed
Trade payables Accruals Prepayments	(367) (373) 118	Commercial relationship with suppliers
Deferred income – Non current Deferred Income - Current	(217) (1,375)	Size of contract profile and associated contract payment terms
CFA – Non current CFA - Current	241 42	Ensure capital spend on service set up delivers future operating benefits

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Ongoing implications

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Commercial implications

- IFRS 15 better aligns the commercial substance of our contracts to the financial accounting – we are more profitable once we have transformed the service and are running it in an efficient way

- We are looking at how metrics and incentives need to change as part of this transition

- Able to recognise, in a contract fulfilment asset, the know-how we create in transforming a client’s service

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Change management

- Dedicated change management team
- Group and divisional expertise
- Staff training sessions and manual
- Sales teams continue to negotiate best possible commercial terms
- Bid models updated to align to IFRS 15
- Review of incentive schemes for management and business development teams underway

IFRS 15 – key points

No impact on:

- Lifetime profitability of contracts
- Cash flow of contracts
- Majority of transactional businesses

Key impacts:

- Revenue more evenly distributed over the life of contracts and active software licences – timing of profits re-profiled
- Potentially lower profits or losses in early years on contracts where there are significant upfront restructuring costs or higher operating costs prior to transformation – compensating increase in profits in later years
- Balance sheet includes
  - New contract fulfilment assets created in the process of transforming services
  - Deferred income in relation to contracts where payments have been received from clients to undertake transformation in advance of delivering planned outcomes

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Summary

- IFRS 15 is a significant, complex and far reaching accounting standard
- It will have a material impact on the way that long term contracts and software licences are accounted for
- We welcome the adoption of IFRS 15 as it better aligns our revenue recognition with the commercial substance of our contracts
- Our people and our investors will gain from the clearer view of the direct links between our commercial performance and our financial performance
- Greater forward visibility of performance from:
  - Transparency of smoother revenue profiles across long-term contracts and active software licences
  - An understanding of cost/profit inflection points
  - The additional disclosure of our order book will result in greater forward visibility of performance

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Notes:

Appendices

Contract fulfilment asset - examples

A contract fulfilment asset is a directly attributable cost for a contract that is not a fixed asset, not redundancies/training or recruitment but does create or enhance a resource that is used to deliver a service, such as:

- Designing a target operating model
- Creating operating manuals
- Designing training materials
- Solution design
- Creating templates for MI
- Designing/documenting workflows
- Creating an org structure
- Designing a governance structure

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