

Contract accounting adjustments under IFRS 15

Under current accounting, the stage of completion of long-term service contracts is assessed based on flying hours. As set out on page 55, this means that the percentage of completion will usually be lower under IFRS 15 than under current accounting. For linked OE and service contracts, the stage of completion takes into account both OE and flying hour revenue. The consequence of this linkage with the services contract means that the difference

between the completion percentage under IFRS 15 and current accounting will be greater. This is because the linked OE revenue is no longer included in assessing the stage of completion. This change in the way the percentage of completion is calculated will impact the level of contract accounting benefit recognised under current accounting in respect of beneficial lifecycle cost margin adjustments by £(96)m from £113m under current accounting to £17m under IFRS 15.

On the other hand, the contract margin adjustment associated with technical costs will be £50m lower under IFRS 15.

The benefit from other operational changes totalled £17m in 2017 under current accounting. This included a £77m benefit arising from a change to a customer credit rating risk assessment on a linked contract where under IFRS 15, with no linkage, there is no benefit in the year.

Contract accounting adjustments under IFRS 15

| 2017 £m | Current accounting | IFRS 15 | Difference |
|--|-----------------------|--------------|--------------|
| Lifecycle cost improvements | 113 | 17 | (96) |
| Technical costs | (148) | (98) | 50 |
| Operational changes | 17 | (68) | (85) |
| Total contract accounting adjustments | (18) | (149) | (131) |

Balance sheet adjustments under IFRS 15

The impact of adopting IFRS 15 on the Civil Aerospace balance sheet is summarised below.

£(5.1)bn of the £(5.2)bn impact to the Group's opening reserves from the adoption of IFRS 15 is driven by Civil Aerospace.

The transition to IFRS 15 requires de-recognition of the contractual aftermarket rights recorded as intangible assets under current accounting. As this cost will now be recorded at the point of sale of OE the amortisation previously recorded will cease benefiting the gross profit reported on underlying services revenue.

Under IFRS 15 we regard participation fees as payments to customers that are offset against future revenue from those customers. Therefore, they are recognised as contract assets rather than as intangible assets under current accounting.

In assessing the accounting for the participation fee payments we make to our OE customers, we have also assessed the accounting for up-front payments we sometimes receive from the Group's suppliers under RRSAs to allow them to participate in an engine programme. We have concluded that, consistent with changes to how we will account for participation fees noted above, these receipts should be deferred and recognised against cost of sales over the period of supply. This will also require judgement

as to the number of units over which the receipts will be allocated.

The most significant change is to the net contract balance. Other than the reclassification of participation fees and the transition from revenue recognition on an engine flying hours to a cost input basis, the adjustment also represents £(3.2)bn of reversal of profit from contract linkage. The majority of service contracts are on monthly payment terms based on engine flying hours. As a result, in many cases we will receive cash in advance of incurring costs to support the contract including for overhauls. Under IFRS 15 we will recognise the revenue as costs are incurred, changing the net contract debtor under current GAAP to a net deferred revenue creditor under IFRS 15.

Balance sheet adjustments under IFRS 15

| 2017 £bn | Current accounting | IFRS 15 | Difference |
|---|-----------------------|--------------|--------------|
| Contractual aftermarket rights | 0.8 | - | (0.8) |
| Participation fees - intangible | 0.4 | - | (0.4) |
| Participation fees - contract asset | - | 0.4 | 0.4 |
| Net contract debtor/(creditor) | 2.5 | (2.7) | (5.2) |
| Other | (0.6) | (0.3) | 0.3 |
| Risk and revenue sharing agreements (RRSAs) | (0.3) | (0.8) | (0.5) |
| Civil Aerospace net assets (pre-tax) | 2.8 | (3.4) | (6.2) |
| Tax | | | 1.1 |
| Civil Aerospace reserves impact (post-tax) | | | (5.1) |