

Strategy and Portfolio Planning Breakfast Briefing

Don't Forget the Financials - Maximise the return on your assets

Wednesday 10 July 2013

The UK Chapter is grateful to its Annual Sponsors:



Upcoming UK Events

25 th July	Annual Summer Walk, London
September TBC	Young Leaders Charity Event, London
9 th – 11 th September	CoreNet Global Summit, Amsterdam
10 th October	Scottish event at Gogarburn, Edinburgh
17 th October	Energy & Sustainability Event, London
3 rd December	Annual Awards Christmas Breakfast, London

The UK Chapter is grateful to its Annual Sponsors:



Programme

- 08.30 Introductions
- 08.35 Mark Burgess, DLA Piper
- 09.15 Q&A
- 09.30 Tea / coffee break
- 09.45 Shantanu Sonde, KPMG
- 10.30 Q&A
- 10.45 Feedback and concluding remarks
- 11.00 Close

The UK Chapter is grateful to its Annual Sponsors:



Introductions

The UK Chapter is grateful to its Annual Sponsors:



The Conference Board CEO Challenge® 2013

- More than 720 business leaders identified their most critical challenges in this study
- Some of the key strategies highlighted by the survey respondents to meet key challenges:
 - Make most of existing staff by retaining talents and raising engagement
 - Improve operational performance through better alignment between organisation and strategy
 - Foster more innovation
 - Develop existing customer relationships

Watch out for Global political/economic risk and Government regulation

Human Capital and Operational Excellence are the Top Global Challenges for 2013		
Global Rank	CHALLENGES 2013*	Score
N=729		
1	Human Capital	2.44
2	Operational excellence	2.10
3	Innovation	1.99
4	Customer relationships	1.72
5	Global political/economic risk	1.68
6	Government Regulation	1.55
7	Global Expansion	1.31
8	Corporate brand and reputation	0.92
9	Sustainability	0.82
10	Trust in business	0.46

N=Number of overall responses. The response rate varies for each challenge. Each score represents the mean of the ranks given the challenge. For information about how the scores were created, see "About the 2013 Survey" on page 24 of the CEO Challenge® 2013 Summary Report.

*Operational Excellence was added to the list of challenges in 2013 replacing Cost Optimization. Trust in business was also added in 2013 replacing Investor relations.

The UK Chapter is grateful to its Annual Sponsors:



Mark Burgess DLA Piper

The UK Chapter is grateful to its Annual Sponsors:





EVERYTHING MATTERS

Tax for property occupiers

UK tax issues relating to leases

Mark Burgess, DLA Piper

July 2013

- UK's senior accounting officer rules:
 - applicable to 'large' UK companies (UK companies within a UK group having £2bn balance sheet and/or £200m turnover)
 - duty to have appropriate tax accounting arrangements and to ensure awareness of tax
 - annual certificate of compliance
 - personal liabilities can apply

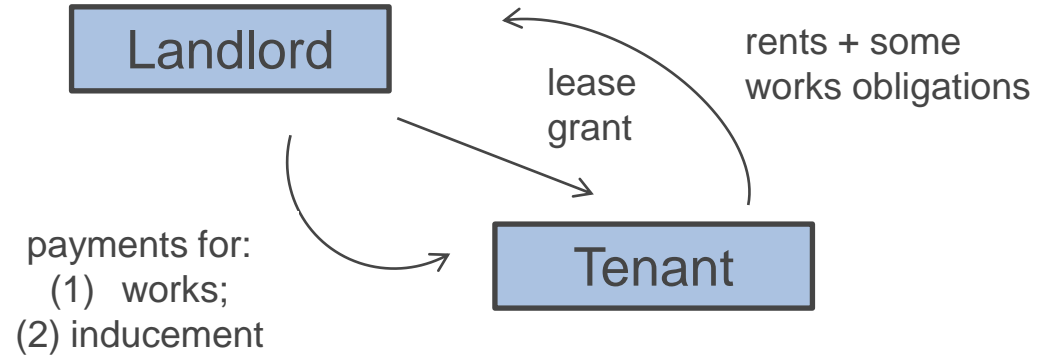
- The 'immediate' tax treatment of a property deal may be well established:
 - VAT charge calculated on the rents and/or purchase price
 - SDLT charge arising on completion and/or substantial performance
- But what about:
 - corporation tax treatment of receipts
 - tax deductibility of payments
 - VAT on inducements and other receipts
 - CIS on receipts and payments for works
 - SDLT liabilities 'inherited' with leases
 - capital allowances issues



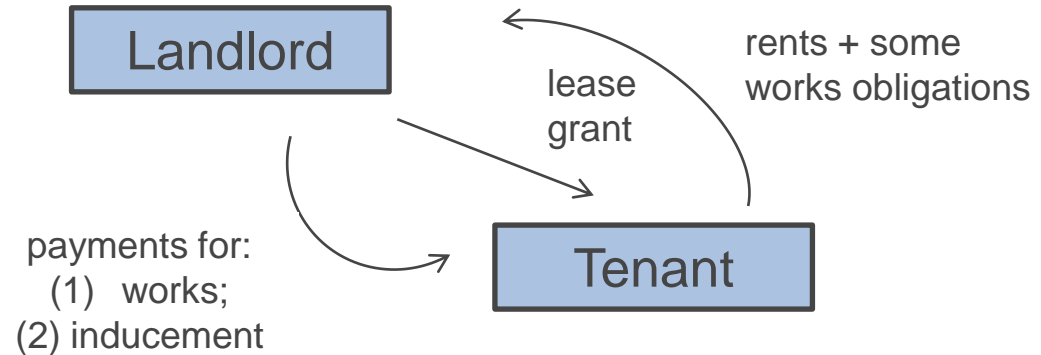
EVERYTHING MATTERS

New lease acquisition

Leasehold acquisition

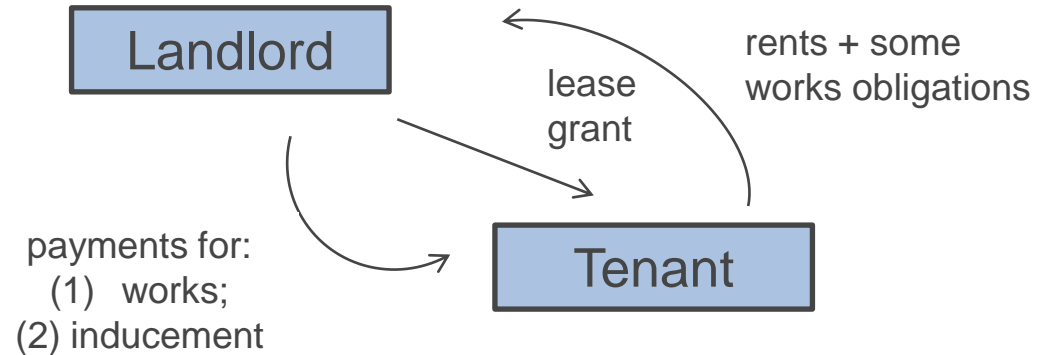


- New lease grant
- Payment for works to be carried out by the tenant
- Payment as an inducement to the tenant
- Rent payment obligations



- Works payment:
 - VAT chargeable if monies for 'landlord works' but not if monies for 'tenant works'
 - tenant taxable if payment is to 'induce' /'benefit' the tenant
 - CIS may apply if the tenant obliged to carry out works
 - landlord likely to benefit from capital allowances (but this blocks potential tax charge on tenant)
- Inducement payment:
 - may not be VATable unless paid to an 'anchor tenant'
 - tenant taxable unless linked to relevant works and/or possibly rent payable
 - landlord unlikely to get tax relief unless linked to cost of works

Leasehold acquisition (continued)



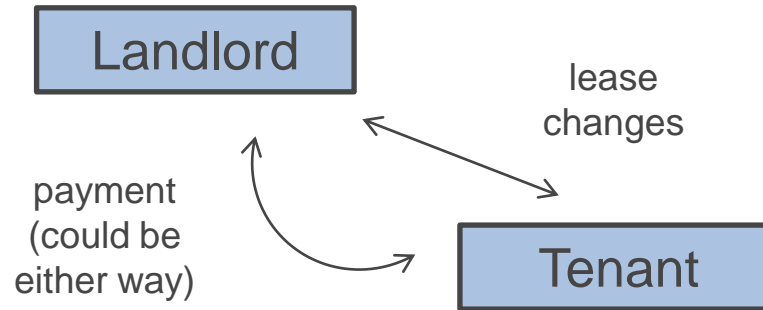
Other issues:

- amount of payment required if tenant cannot recover VAT
- is a rent free better? Probably for the landlord but not for the tenant
- SDLT on rents – timing where there is early occupation for fit out
- SDLT on rents – timing and amounts of payment where the rent is uncertain
- SDLT – scheduling later payments/reviews
- tenant obligation to carry out works may result in taxable income for the landlord and a tax deduction for the tenant



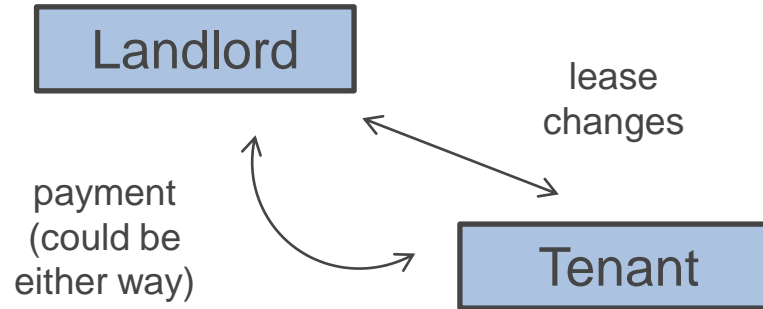
EVERYTHING MATTERS

Lease change/variation



- Parties decide to change lease terms:
 - term (i.e. duration) of lease to increase
 - rent payments to increase
 - landlord to fund works to be carried out by the tenant at the premises
 - tenant to get the benefit of additional floor area

Lease changes (continued)



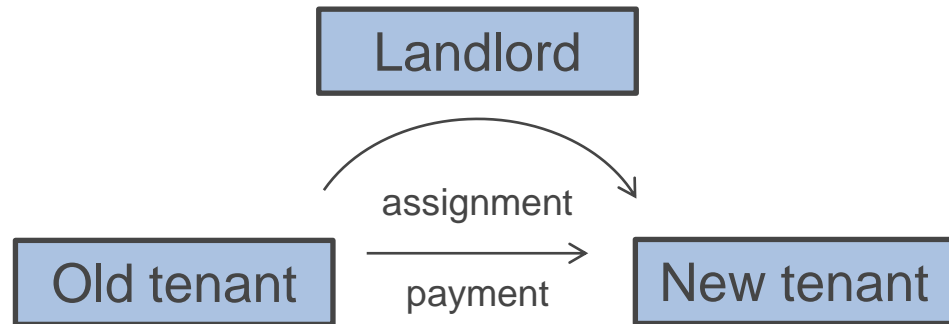
- The legal bit: variations involving extension of demise or term involves an automatic surrender and re-grant (unless the property is in Scotland!)
- SDLT:
 - full SDLT charge on deemed re-grant unless "overlap relief" applies
 - may be better to have a co-terminous lease of the extra part and an option to renew
- Landlord payment for works – tax treatment may depend on the nature of the works. Tenant may not be taxable on receipt if the 'deemed' new lease can be avoided or if the payment is linked to the rent increase
- Tenant may be able to get the payment treated as capital if consideration for the surrender of the existing lease
- CIS rules may apply if the payment is for 'landlord works'



EVERYTHING MATTERS

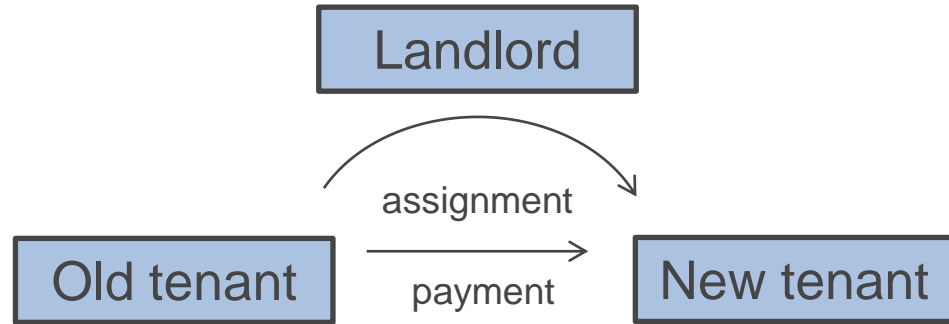
'Second hand' leases

Acquiring an existing lease



- Old tenant assigns its lease to new tenant
- Old tenant pays monies to new tenant being a mix of:
 - a sum to represent dilapidated state of the building
 - a 'simple' inducement
 - an agreement to pay 'rent support' sums over the next 24 months (equal to the difference between market rent and actual rent)

Acquiring an existing lease (continued)

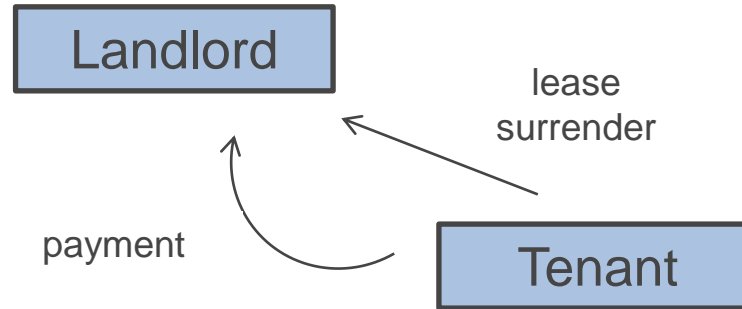


- SDLT: may be nothing. However, an unexpected charge can arise if the original lease grant was SDLT exempt
- VAT:
 - generally chargeable by new tenant on the payment
 - VAT on the rent support payments generally triggered in full at completion
 - chargeable even in relation to the 'dilapidations' payment
 - consider how much should be paid if new tenant not in a VAT recovery position
- Corporation tax:
 - new tenant may not be subject to tax on receipt
 - old tenant may not get any tax relief unless sufficiently linked to relevant works



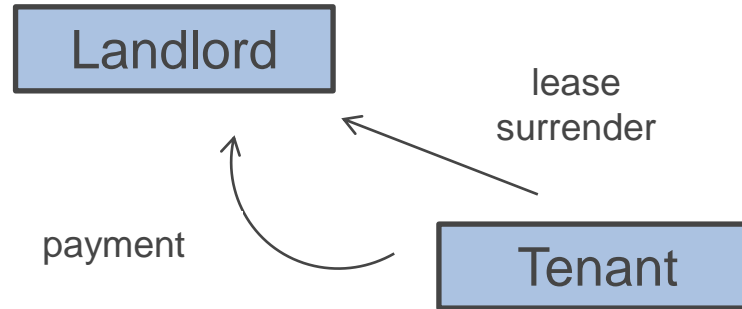
EVERYTHING MATTERS

Disposal



- Tenant surrenders lease to landlord
- Payment made by tenant to reflect:
 - dilapidations
 - release from obligations

Leasehold surrender (continued)



■ VAT:

- not payable on dilapidations, but should the landlord factor VAT into the amount of the dilapidations?
- payable on other payments if landlord has opted to tax

■ Corporation tax:

- potentially taxable for landlord
- possible tax relief for tenant on dilapidations if relevant dilapidations works are of an 'income' nature



EVERYTHING MATTERS

Summary

- Some tax mitigation would require structuring and carry risk
- Some tax issues are an inevitable result of a transaction. However, tax compliance needs to occur. This requires information flows within a business
- Some tax issues are dependent upon the terms agreed between the parties – tax benefits may arise simply from agreeing and documenting the deal in an appropriate form but within the existing commercial and economic 'framework'
- Some tax issues arise immediately. Others will not 'come out' for some time. This requires retention of information



EVERYTHING MATTERS

Tax for property occupiers

UK tax issues relating to leases

Mark Burgess, DLA Piper

July 2013

Q&A

The UK Chapter is grateful to its Annual Sponsors:



Shantanu Sonde KPMG

The UK Chapter is grateful to its Annual Sponsors:





cutting through complexity™

Proposed Lease Accounting Standard

July 10, 2013



Deliberations, deliberations, deliberations..... and a new exposure draft



International
Accounting Standards
Board®



The International Accounting Standards Board (“IASB”) and the U.S. Financial Accounting Standards Board (“FASB”) or collectively the Boards have been deliberating a new lease accounting model for an eternity. So what can we read into this:

- The proposed changes are both significant and unpopular;
- The concepts challenge the way people have always thought about leases;
- The complexities of the detail are difficult to work through; and
- The consequences are significant and will be a challenge to explain

First exposed in 2010, the Boards recently concluded deliberations relating to the comments received in response to the earlier draft and have issued a second exposure draft in May 2013.

The comment deadline for this exposure draft is 13 September 2013. The Boards plan to undertake further outreach and to hold public round-table meetings.

Agenda

Lease accounting model

Lease definition and scoping

Lease accounting concepts

Other relevant concepts

How it will impact you

Next steps



Current lease accounting – Operating vs. Finance Lease

Have substantially all risks and rewards of ownership of the leased asset been transferred to the lessee

No

Yes

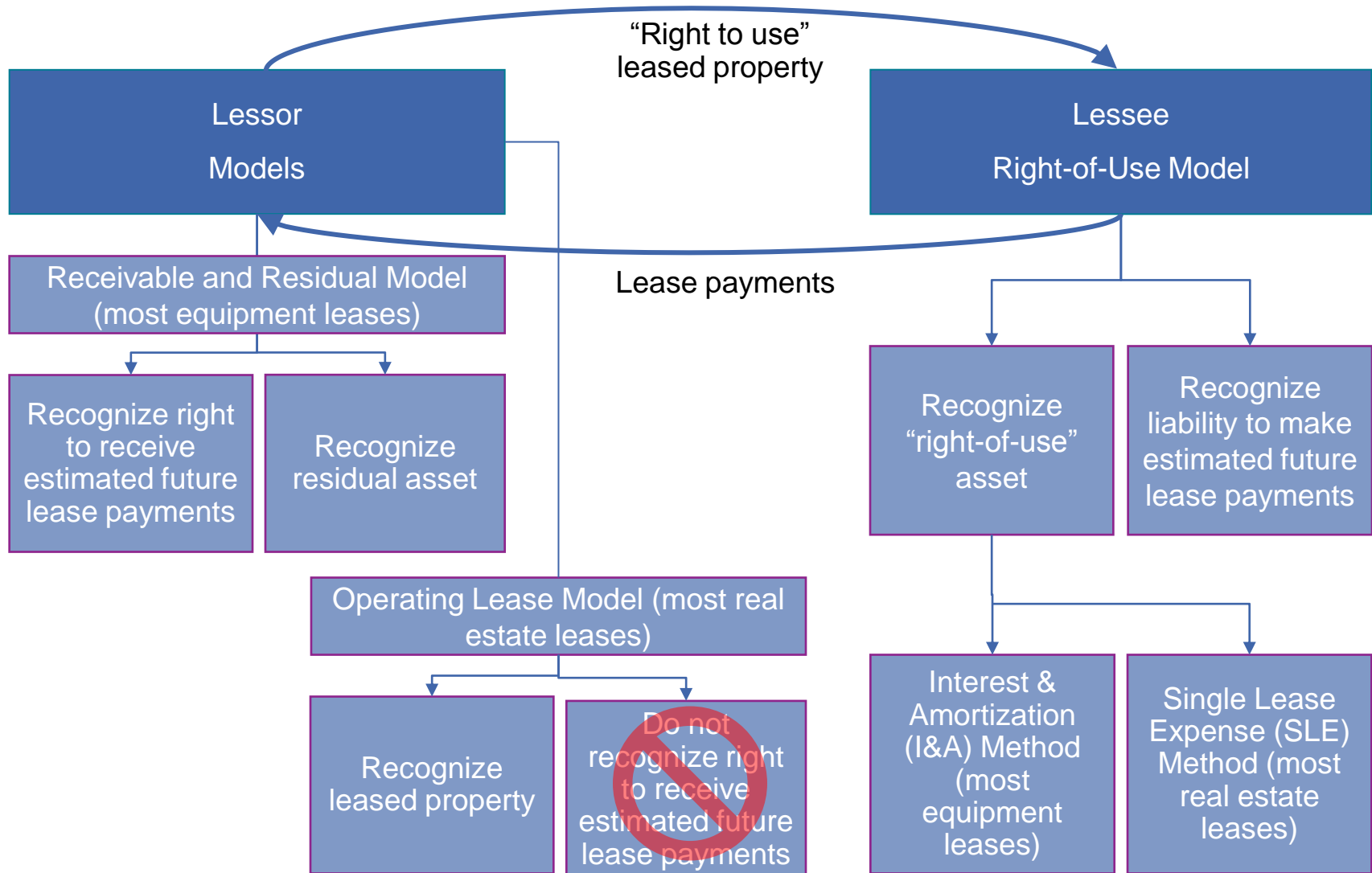
Operating lease

Lessee	Lessor
<ul style="list-style-type: none"> Balance sheet – asset not recognised Income statement – rental expense on a straight line basis <p>(Off-balance sheet)</p>	<ul style="list-style-type: none"> Balance sheet – keeps leased asset Income statement – depreciation expense and lease income on a straight line basis

Finance lease

Lessee	Lessor
<ul style="list-style-type: none"> Balance sheet – recognise leased asset and lease liability Income statement – depreciation expense and finance expense <p>(On-balance sheet)</p>	<ul style="list-style-type: none"> Balance sheet – lease receivable Income statement – profit on sale and finance income

New accounting models for lessees and lessors



Agenda

Lease accounting model

Lease definition and scoping

Lease accounting concepts

Other relevant concepts

How it will impact you

Next steps



Lease definition

Lease: A contract in which the right to use a specified asset (the underlying asset) is conveyed, for a period of time, in exchange for consideration. Definition focuses on control of a specified asset.

Control is conveyed when a customer can direct the use, and receive the benefit from use, of a specific asset.(concept aligned with revenue recognition standard)

Contracts that meet the definition of a lease

Within scope	Within scope with exceptions	Outside scope
<ul style="list-style-type: none">• Leases of non-core assets• Long leases of land• Rental of offices and retail spaces• Rental of office equipment, or other equipment• Sale and leasebacks• Subleases• Leases of inventory	<ul style="list-style-type: none">• Leases with service components• Short-term leases• Leases of intangibles (for lessees)	<ul style="list-style-type: none">▪ Service concession arrangements▪ Leases of:<ul style="list-style-type: none">➢ intangibles (for lessors)➢ natural resources and exploration➢ biological assets

Multiple underlying assets in a single lease component

If a separate lease component includes more than one underlying asset, then the entity should determine the 'primary asset' within the lease component. The entity would then perform the lease classification tests based on the nature of the primary asset.

This would include, for example, determining whether the primary asset was property or non-property and hence which lease classification test to apply.

Application for combined leases of land and building:

If a lease component contains land and a building, then an entity would use the economic life of the building when assessing whether the lease term was for a major part of the economic life of the underlying asset for the purposes of lease classification.

Unlike the current lease accounting standard, there is no requirement to consider the land and the buildings separately to determine the lease classification.

Agenda

Lease accounting model

Lease definition and scoping

Lease accounting concepts

Other relevant concepts

How it will impact you

Next steps



Measurement of Lease Liability

Lease liability – Defined as present value of lease payments

Includes expectations about –

- **Lease term**
- **Contingent rentals (only if based on a rate or index)**
- **Residual value guarantees**
- **Termination penalties**
- **Purchase options**

Subsequent measurement

- **IAS 39 – effective interest rate accruals**
- **Reassess if significant change in relevant factors**

Assessment of lease term

Lease term: The non-cancellable period *plus any optional periods for which there is a significant economic incentive to exercise the option to extend the lease (or not to terminate the lease early)*

Consider economic factors in estimating lease term:

Contractual	Asset	Market	Entity specific
<ul style="list-style-type: none">• Level of rentals in any secondary period• Contingent payments• Renewal options• Return costs	<ul style="list-style-type: none">• Nature of item• Location• Existence of significant leasehold improvements	<ul style="list-style-type: none">• Market rentals or prices for comparable properties	<ul style="list-style-type: none">• Lessee's intentions• Lessee's past practice

Reassessment

- Reassess if significant change in relevant factors
- Market-based factors excluded from reassessments
- Introducing additional P&L and Balance Sheet volatility compared to current standard

Agenda

Lease accounting model

Lease definition and scoping

Lease accounting concepts

Other relevant concepts

How it will impact you

Next steps



Sale and lease back transactions

- **The ED proposes that the accounting treatment for sale and leaseback transactions would depend on whether the transaction transfers control of the underlying asset to the transferee.**
- **The control principle would be applied to the entire transaction and not just the sale portion.**
- **If the transaction meets the ‘transfer of control’ criterion, then the transferor would recognise a sale and apply the lessee accounting requirements while the transferee would recognise a purchase and apply the lessor accounting requirements.**
- **Where the criterion is not met, the transferor would not derecognise the underlying asset and consequently recognise the amounts received as a financial liability. The transferee would correspondingly recognise the amount paid as a financial asset.**
- **Under the proposals, there would be a reduced accounting incentive to conduct sale and lease-back transactions, because the transaction would always be on-balance sheet for the lessee/transferor. The only question would be the quantum of measurement of the asset and liability.**

Sub lease transactions

- **A sub lease transaction is defined as a transaction in which an underlying asset is re-leased between the original lessee (or intermediate lessor) to a third party and the lease ('head lease') between the original lessor and the lessee remains in effect.**
- **The intermediate lessor would account for assets and liabilities arising from the head lease under either Type A or Type B lease accounting model for lessees depending on the lease classification.**
- **When classifying a sub-lease, the intermediate lessor and the sub-lessee would evaluate the sub-lease with reference to the underlying asset, not with reference to the intermediate lessor's ROU asset under the original lease.**
- **In practice, this guidance could lead to a frequent asymmetry between the way in which an intermediate lessor accounts for a head lease and sub-lease relating to the same underlying asset – even if the terms of the two leases are similar.**

Agenda

Lease accounting model

Lease definition and scoping

Lease accounting concepts

Other relevant concepts

How it will impact you

Next steps



Key impact of proposals

Lessees

- All leases “on balance sheet”
- Front-loaded interest expense; decrease interest coverage ratio; increase EBITDA (for most equipment leases)
- New liability measurement basis
- Reassessment → volatility

Lessors

- Receivable and residual recognised for most equipment leases
- Front-loaded finance income PLUS possible upfront profit when the R&R method is applied
- New asset measurement basis
- Reassessment → volatility

Key actions for lessees and lessors

- Communication with stakeholders regarding changes in results and ratios
- Review impact on debt covenants of GAAP changes
- Debate on whether tenants will start looking for shorter term leases – no firm evidence of this yet!!!
- Monitor re-deliberations and consider responding to forthcoming ED!

How will it impact you?

- **Larger balance sheet** – companies that are leasing under operating leases will have to record additional (and potentially substantial) assets and liabilities on the balance sheet
- The timing of **profit recognition will alter** as a straight line rental payment will be exchanged for a front end loaded lease expense (cost and interest);
- **Key ratios will change**, with the proposals likely to increase early year EBITDA, but reduce net profit;
- **Existing contracts will be affected**, so the contract you enter into today won't necessarily result in what you expect tomorrow;
- The **accounting complexity** will increase resulting in increasing cost to administer at a time when most companies are looking to shed cost;
- The deviation between cash and profit will increase;
- Tax rules may be based on existing accounting requiring two sets of records to be maintained; and
- Educating banks / lenders, investors and regulators will take time.

Next Steps

**Consider submitting your comments/views to the Exposure Draft
*By 13 September 2013***

New IFRS planned for 2014

Effective date expected for 2017?

Questions?





cutting through complexity™

THANK YOU

Presented by

**Shantanu Sonde
Manager**

Accounting Advisory Services

T: +44 (0) 776 817 8287

E: shantanu.sonde@kpmg.co.uk

© 2013 KPMG LLP, a UK LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (KPMG International), a Swiss entity. All rights reserved.

The KPMG name, logo and 'cutting through complexity' are registered trademarks or trademarks of KPMG International Cooperative (KPMG International).

Q&A

The UK Chapter is grateful to its Annual Sponsors:



Conclusions and Feedback

The UK Chapter is grateful to its Annual Sponsors:



Annual Sponsors

The UK Chapter is grateful to its Annual Sponsors:

