

Company Registration Number 741598

IBM United Kingdom Limited

Financial Statements

31 December 2018

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IBM United Kingdom Limited

Financial Statements

For the Year Ended 31 December 2018

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IBM United Kingdom Limited

Company Information

For the Year Ended 31 December 2018

Company registration number	741598
The board of directors	W Kelleher F Sciutti T Eagle
Company secretary	I Ferguson
Registered office	PO Box 41 North Harbour Portsmouth Hampshire PO6 3AU
Independent auditors	PricewaterhouseCoopers LLP Chartered Accountants & Statutory Auditors Savannah House 3 Ocean Way Southampton Hampshire SO14 3TJ
Bankers	National Westminster Bank Plc 69 High Street Cosham Hampshire PO6 3DA

IBM United Kingdom Limited

Strategic Report

For the Year Ended 31 December 2018

The directors present their strategic report of IBM United Kingdom Limited ('the company') for the year ended 31 December 2018.

Review of the business

International Business Machines Corporation ('IBM') is a globally integrated enterprise operating in over 175 countries, bringing innovative solutions to a diverse client base to help solve some of their toughest business challenges and build smarter businesses.

As a global cloud platform and cognitive solutions company, IBM continually evolves to remain at the forefront of technological innovation to shape the future of society with governments, corporations, academia and business partners. Today, IBM creates value for clients through integrated solutions and products that leverage our strategic and continued investment in innovative technologies such as AI and hybrid cloud. These are enabling businesses to transform at scale supported by IBM's deep expertise in industries and business processes, industry leading portfolio of consulting and IT implementation services, cloud and cognitive offerings, and enterprise systems and software. This is all bolstered by IBM's prized research, development and technical talent around the world.

The company has a number of software development laboratories, based across the UK, which develop new products for IBM worldwide and enable IBM to offer its customers current information technology solutions to transform our client's businesses allowing them to better compete in their markets.

IBM's clients include many of the world's more successful enterprises. These clients are at an inflection point, poised to enter a new chapter of their digital reinventions. New technologies, such as Artificial intelligence, cloud, security, blockchain and quantum computing are unlocking unprecedented opportunities for businesses. Work processes are being reimagined for speed and vastly smarter decision making. To win in these disruptive times requires that businesses learn – learn by extracting insights from their data and by applying those insights to how work is done. This will only be possible if the world can trust that data is being collected, managed and analysed responsibly. At IBM, we have deepened our longstanding commitment to the responsible stewardship of technology.

The IBM group continues to evolve its global operating model to improve the utilisation of global resources and skills in support of the delivery of its services and solutions to clients. The company is both a beneficiary of global resource skills from overseas as well as providing UK employed expertise to the rest of the IBM group.

The IBM group also prides itself as a progressive corporate citizen and proactively engages government organisations, industry bodies, communities and experts on issues that matter for our time. These include building the right skills for the future through influencing a major reinvention of education with the expansion of our Pathways to Technology programme; committing to building an inclusive workforce, working to ensure the efficient use of energy and resources and managing impacts on the environment and climate.

IBM's unwavering global commitment to the responsible stewardship of data and powerful new technologies has earned the trust of clients and society as a whole. Combined uniquely with innovative technologies, deep industry expertise, and security the company helps empower people to do good, access new opportunities and make the world better, safer and smarter – for the many, not just the few.

IBM's products, services and people are enabling clients to write the next chapter of their digital reinvention whilst reaffirming IBM's longstanding reputation for trust, integrity and responsibility.

IBM United Kingdom Limited

Strategic Report

For the Year Ended 31 December 2018

Review of the business (continued)

	2018 £m	2017 £m	Yr-to-Yr
Revenue	3,824.8	3,713.3	3.0 %
Gross profit margin	6.3 %	5.1 %	23.5 %
Administrative expenses, impairment losses on financial assets and other operating income	(174.3)	(9.0)	1,836.7 %
Operating profit	67.0	182.1	(63.2)%
Profit before income tax	114.4	109.2	4.8 %

The full trading results and cash flows for the year and the company's financial position at the end of the year are shown on pages 13 to 18 of the financial statements.

Total revenue increased by 3.0 percent compared to 2017. Revenue from the core business units ('Home Revenue' per note 3 of the financial statements) increased by 5.3 percent. Export revenues, which are derived from sales of services, including research and development, to companies in the IBM group overseas, decreased by 6.1 percent compared to 2017. Gross profit margins increased by 1.2 points year on year, which represents £50.2 million.

The increase in profit before taxation is mainly driven by decreases in impairment of investments charges of £395.3 million being partially offset by a decrease in dividends received of £253.2 million compared to 2017 and by a decrease in net interest on defined benefit asset of £20.8 million.

The company delivered £138.6 million in cash flows from operating activities, an increase of £111.8 million compared to 2017. An income tax refund of £2.7 million has been received during the year (2017: £26.1 million was paid). Cash generated from operations has increased by £81.4 million.

The increase of the retirement benefit balance (from a net pension liability of £33.7 million to a net pension asset of £38.6 million) resulted from actuarial gains and a decreased minimum funding requirement liability.

The financial position of the company has changed year on year to a closing net asset position of £2,037.8 million from £2,013.3 million in 2017. The increase of £24.5 million is mainly driven by the increase in the retirement benefit asset, a £33.9 million benefit from the adoption of IFRS 15 and the profit for the year offset by the payment of dividends.

Principal risks and uncertainties

The key business risks affecting the company are considered to relate to the economic environment, technology obsolescence and the competitive environment. Domestic demand remains the main growth engine helped by a dynamic labour market and very easy credit conditions.

Economic Environment

If overall demand for services, software and systems changes, whether due to general economic conditions or a shift in corporate buying patterns, sales performance could be impacted.

IBM United Kingdom Limited

Strategic Report

For the Year Ended 31 December 2018

The company aligns with market conditions by having a mixture of offerings with long-term contractual income streams as well as transaction based sales. The company also has the ability to sell its skilled resource to other companies within the IBM group.

While the final outcome of the Brexit process is unclear, we believe that the best outcome for business is that the United Kingdom (UK) / European Union (EU) negotiations result in future arrangements which will not materially interrupt business. However, we have taken the prudent step of making contingency plans to deal with a scenario in which there is not a comprehensive agreement, either when the UK leaves the EU or at the end of any transition period.

Technology Obsolescence

Information Technology solutions are rapidly evolving and, in order to stay relevant to our clients, in 2018 IBM spent globally almost \$5.4 billion on research and development of new products and solutions. The company not only benefits from this research and development work but it also provides skilled UK resources to IBM in support of this innovation work.

Competitive Environment

The company operates in a highly competitive market against many large established providers as well as new providers entering the UK market. Competitors, like IBM, continue to make acquisitions. Their strategy of buying up small companies gives them a local identity and track record along with in demand skills in key areas.

The company continues to transform itself to remain price competitive in the market as well as promoting our ability to innovate and integrate for our clients. The directors consider this to be a unique proposition which sets IBM apart from its competition.

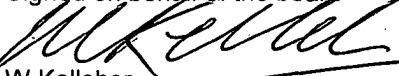
Key performance indicators

The company is managed by the UK board along with other UK IBM entities. The performance and results for all UK entities are analysed on a worldwide IBM measurement basis, at a business unit level. For this reason, other than the figures disclosed above, the directors of the company believe that analysis using key performance indicators is not appropriate for an understanding of the development, performance or position of the business shown in these financial statements. The development, performance and position of International Business Machines Corporation, which includes the UK entities, is discussed in the Corporation's annual report for the year ended 31 December 2018, which does not form part of this report.

Future developments

The company is well placed to continue to deliver value to its clients and consistent financial results via the ongoing business transformation, fast growing cloud and cognitive opportunities, attracting more developers to make the company cloud platform more successful and new products and offerings and expansion of the business through acquisition. The company continues to increase investment and training in key skills and build on its track record related to Artificial Intelligence, Cybersecurity, and Blockchain.

Signed on behalf of the board


W Kelleher
Director

11 July 2019

IBM United Kingdom Limited

Directors' Report

For the Year Ended 31 December 2018

The directors present their annual report and the audited financial statements of IBM United Kingdom Limited ('the company') for the year ended 31 December 2018.

A review of the business including the results for the year, details of principal risks and uncertainties, key performance indicators and future developments of the company's business are covered in the Strategic Report.

The company has one overseas branch, which is based in Gibraltar.

Dividends

On 27 November 2018 the directors recommended a dividend of £233.5 million (2017: £nil).

During 2018 the company received distributions in cash from its partnership interest in IBM Atlantic C.V. (Netherlands) for a total value of £4.4 million. In April 2018 the company received a dividend in specie of £10.2 million from its subsidiary Integral Solution Limited, which was offset against an intercompany payable due to this subsidiary. In November 2018 the company received cash dividends of £97.5 million and £63.3 million from its subsidiaries i2 Holdings Limited and i2 Intermediate Holdings Limited respectively.

Events after the reporting date

There have been no significant events affecting the company since the year end.

Financial risk management

The company is exposed to a variety of financial risks as a result of its operations which include the effects of changes in market prices, credit risk, liquidity risk, interest rate risk and currency risk. The company has a strong risk management programme in place aligned to the worldwide programme of the company's ultimate parent company, International Business Machines Corporation.

Price risk

The financial risk posed by external vendors is managed and controlled by IBM's central procurement function. Procurement is the only business unit in IBM which is authorised to make financial commitments to external vendors. The unit has responsibility for achieving overall value for IBM in terms of supplier selection at the optimum price. All procurement activities are carried out under worldwide IBM guidelines. The financial risk posed by sales price is managed through a central pricing team. The business only agrees to sign contracts once the appropriate pricing approval has been obtained.

Credit risk

The company has in place policies that require appropriate credit checks on potential customers before sales are made, and regular reviews of credit limits on existing customers are carried out. The company also manages its credit risk by factoring certain trade receivables. Any losses incurred in the collection of factored debt sold are not borne by the company.

Liquidity and interest rate risk

If required, the company has access to internal funding from IBM International Treasury Services Unlimited Company ('the Treasury Centre') in Ireland. The Treasury Centre is ultimately funded by International Business Machines Corporation. Any borrowing is treated as short term debt finance. The company did not have any short term or long term debt finance at 31 December 2018 or 2017. Currently the company has a net cash position and loans surplus cash to the Treasury Centre. Given the cash position, liquidity risk is minimal.

As the company invests or borrows cash balances internally, it operates daily in either a cash or overdraft position with no fixed period debt in place. Interest is paid or earned on the daily balance using the variable one month interest rate as the base.

IBM United Kingdom Limited

Directors' Report

For the Year Ended 31 December 2018

Currency risk

As part of International Business Machines Corporation's global hedging strategy the company operates a 12 month forward rolling hedging programme with a non UK group undertaking to hedge a proportion of its US dollar costs arising from transactions with both related companies and suppliers. Foreign currency forward contracts are entered into with a third party bank by the IBM International Treasury Services Unlimited Company ('the Treasury Centre') which in turn passes down the impacts of these derivatives by entering into matching intercompany derivatives with the company. The company does not apply hedge accounting for these derivatives.

Financial instruments

Details of the company's financial risk management objectives and policies, including the use of financial instruments, are included in note 23 to the financial statements.

Research and development

Specific product development projects are carried out at laboratories, in various locations throughout the UK, on behalf of International Business Machines Corporation and its subsidiaries. The expenditure incurred on these projects in the year of £165.1 million (2017: £164.0 million) was recharged to other IBM group companies.

Acquisitions

On 1 April 2018 the company acquired 100% of the share capital of The Analytic Sciences Corporation Limited for £5.1 million from WSI Corporation (USA).

On 30 June 2018 the company acquired 100% of the share capital of Blue Wolf Global Limited for £0.9 million from Blue Wolf Group LLC (USA).

On 1 August 2018 the company acquired 100% of the share capital of Heartbeat Experts Limited for £0.6 million from HBE Solutions LLC (USA).

On 1 December 2018 the company acquired 100% of the share capital of Oniqua Europe Limited for £0.8 thousand.

Pension matters

On 26 October 2018 the High Court in the case of Lloyds Pension Group Trustees Limited vs Lloyds Bank PLC, confirmed that UK defined benefit pension plans are required to equalize pension benefits to take into account unequal guaranteed minimum pension (GMP) benefits accrued during the years 1990-1997. As a result of this judgement, IBM recorded an increase of £98.6 million to the pension benefit obligations for the IBM UK defined benefit plan. This amount was recorded as a past service cost in the income statement for the year ended 31 December 2018.

In addition, the company is a defendant in approximately 285 individual actions brought in 2010 by participants of the defined benefits plans who left the company. These actions, which allege constructive dismissal and age discrimination, have been brought in the Employment Tribunal in Southampton.

Employee involvement

Employees receive information on the financial and economic factors affecting the performance of the business, along with product announcements, details of organisational changes and all other matters of direct concern and interest to them. This information is provided by the company's intranet site and by the internal publication 'Link.me'.

There is a quarterly cascade of business performance information cascaded from the Chairman and CEO, followed by a Geography analysis and then a Country analysis. This is available to every employee.

IBM United Kingdom Limited

Directors' Report

For the Year Ended 31 December 2018

Business Leaders run Town Hall meetings in the different IBM locations to provide regular face to face communications on current business performance, and other topics of interest.

Managers are an essential element of the communications cascade and key messages are shared on team calls and in face to face meetings.

An annual Pulse Survey evaluates employee engagement.

Consultation bodies, consisting of representatives of the employee population who are elected to represent the views of employees and consult with the company on major areas of interest, are formed as and when required.

The company continues to support employee share ownership of International Business Machines Corporation, through established employee share schemes, membership of which is service related. In addition, all IBM employees have the opportunity to purchase International Business Machines Corporation shares through the IBM Employee Share Purchase Plan, which is intended to encourage employees to take active ownership in IBM and to be committed to its long-term success.

In the United Kingdom, IBM launched the volunteering initiative in 2003. The Community Challenge concept is for teams of IBM volunteers to work with not-for-profit organisations and schools to deliver projects such as promoting literacy and introducing young people to technology. Once a year, IBM employees nominate charitable projects that utilise IBM Volunteering Challenges tools and IBM skills to deliver projects working with local communities across the United Kingdom.

Employees with a disability

Under the 2010 Equality Act IBM's focus on disability strives to eliminate disadvantage and provide support to employees with disabilities, such that we are able to attract, develop and retain the broadest range of experience and skill.

The corporation commits to providing workplace adaptations to ensure that every disabled employee is able to achieve their career potential.

Directors' indemnity and insurance

As permitted by the Articles of Association, the directors have the benefit of an indemnity which is a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006. The company has granted this indemnity in favour of the directors of the company as is permitted by Section 232-235 of the Companies Act 2006. The indemnity was in force throughout the last financial year and is currently in force. International Business Machines Corporation has purchased Directors' and Officers' liability insurance cover for the directors against liabilities arising in relation to the company, as permitted by the Companies Act 2006. This insurance does not cover criminal activity.

Directors

The directors who served the company during the year and up to the date of signing these financial statements were as follows:

T Eagle

V Khurana (resigned 15 March 2018)

W Kelleher

F Sciutti (appointed 15 March 2018)

IBM United Kingdom Limited

Directors' Report

For the Year Ended 31 December 2018

Statement of disclosure of information to auditors

Each of the persons who are directors at the date of approval of this report confirm that:

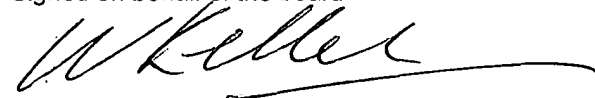
- there is no relevant audit information of which the company's auditors are unaware, and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

Independent auditors

PricewaterhouseCoopers LLP are deemed to be re-appointed under section 487(2) of the Companies Act 2006.

Signed on behalf of the board



W Kelleher

Director

11 July 2019

IBM United Kingdom Limited

Statement of Directors' Responsibilities

For the Year Ended 31 December 2018

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that year. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

IBM United Kingdom Limited

Independent Auditors' Report to the Members of IBM United Kingdom Limited

For the Year Ended 31 December 2018

Report on the audit of the financial statements

Opinion

In our opinion, IBM United Kingdom Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Financial Statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2018; the income statement, the statement of comprehensive income, the statement of cash flows, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

IBM United Kingdom Limited

Independent Auditors' Report to the Members of IBM United Kingdom Limited

For the Year Ended 31 December 2018

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 9, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

IBM United Kingdom Limited

Independent Auditors' Report to the Members of IBM United Kingdom Limited

For the Year Ended 31 December 2018

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.



Robert Girdlestone (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants & Statutory Auditors
Southampton

12 July 2019

IBM United Kingdom Limited

Income Statement

For the Year Ended 31 December 2018

	Note	2018 £m	2017 £m
Revenue	3	3,824.8	3,713.3
Cost of sales	4	(3,583.5)	(3,522.2)
Gross profit		241.3	191.1
Administrative expenses	4	(143.7)	(11.3)
Net impairment losses on financial assets and contract assets	4	(31.4)	(0.4)
Other operating income		0.8	2.7
Operating profit		67.0	182.1
Interest income calculated using the effective interest method	9	3.1	5.7
Other finance costs	10	(8.8)	(10.4)
Impairment of investments	14	(122.0)	(517.3)
Income from investments	14	175.4	428.6
Net interest on defined benefit asset	24	(0.3)	20.5
Profit before income tax		114.4	109.2
Income tax credit / (expense)	11	9.0	(59.4)
Profit for the year		123.4	49.8

The notes on pages 19 to 101 form part of these financial statements.

IBM United Kingdom Limited

Statement of Comprehensive Income

For the Year Ended 31 December 2018

	Note	2018 £m	2017 £m
Profit for the year		123.4	49.8
Other comprehensive income / (expense)			
Items that will not be reclassified to profit or loss			
Actuarial gain / (loss) on defined benefit pension schemes	24	125.3	(962.7)
Deferred tax in respect of defined benefit pension schemes	16	(21.3)	163.7
Other comprehensive income / (expense) for the year, net of income tax		104.0	(799.0)
Total comprehensive income / (expense) for the year		227.4	(749.2)

The notes on pages 19 to 101 form part of these financial statements.

IBM United Kingdom Limited

Statement of Changes in Equity

For the Year Ended 31 December 2018

	Note	Share capital £m	Share premium £m	Retained earnings £m	Total equity £m
At 1 January 2017		956.4	743.7	1,267.1	2,967.2
Profit for the financial year		-	-	49.8	49.8
Actuarial loss on defined benefit pension schemes	24	-	-	(962.7)	(962.7)
Deferred tax in respect of defined benefit pension schemes	16	-	-	163.7	163.7
Total comprehensive expense		-	-	(749.2)	(749.2)
Purchase of own shares		-	-	(200.0)	(200.0)
Recognition of share-based payments	25	-	-	(5.0)	(5.0)
Deferred tax in respect of share-based payments	16	-	-	0.3	0.3
Total transactions with owners		-	-	(204.7)	(204.7)
At 31 December 2017 as originally presented		956.4	743.7	313.2	2,013.3
Impact of adoption of IFRS 15		-	-	33.9	33.9
At 1 January 2018 restated		956.4	743.7	347.1	2,047.2
Profit for the financial year		-	-	123.4	123.4
Actuarial gain on defined benefit pension schemes	24	-	-	125.3	125.3
Deferred tax in respect of defined benefit pension schemes	16	-	-	(21.3)	(21.3)
Total comprehensive income		-	-	227.4	227.4
Dividends paid	30	-	-	(233.5)	(233.5)
Recognition of share-based payments	25	-	-	(2.3)	(2.3)
Deferred tax in respect of share-based payments	16	-	-	(1.0)	(1.0)
Total transactions with owners		-	-	(236.8)	(236.8)
At 31 December 2018		956.4	743.7	337.7	2,037.8

The notes on pages 19 to 101 form part of these financial statements.

IBM United Kingdom Limited

Statement of Financial Position

As at 31 December 2018

	Note	2018 £m	2017 £m
Non-current assets			
Property, plant and equipment	12	235.9	227.3
Intangible assets	13	334.8	312.3
Investments	14	1,681.5	1,829.7
Deferred tax assets	16	58.1	88.5
Finance receivables	17	12.9	9.3
Other non-current assets	20	156.8	134.1
Retirement benefit asset	24	38.6	-
		2,518.6	2,601.2
Current assets			
Inventories	18	2.0	6.5
Finance receivables	17	11.5	12.4
Income tax receivable		4.4	-
Trade and other receivables	19	204.6	278.0
Receivables from related parties	30	851.3	907.8
Derivatives from related parties	30	11.6	-
Cash and cash equivalents		66.5	17.0
Other current assets	20	202.9	119.9
		1,354.8	1,341.6
Total assets		3,873.4	3,942.8
Non-current liabilities			
Deferred revenue	3	(204.1)	(139.4)
Provisions for liabilities and charges	21	(6.6)	(4.3)
Retirement benefit obligation	24	-	(33.7)
Other payables	22	(1.7)	(4.1)
		(212.4)	(181.5)
Current liabilities			
Deferred revenue	3	(320.0)	(429.9)
Provisions for liabilities and charges	21	(2.2)	(10.9)
Income tax liabilities		-	(23.4)
Trade and other payables	22	(457.2)	(459.7)
Payables to related parties	30	(843.8)	(817.1)
Derivatives to related parties	30	-	(7.0)
		(1,623.2)	(1,748.0)
Total liabilities		(1,835.6)	(1,929.5)
Net assets		2,037.8	2,013.3

The notes on pages 19 to 101 form part of these financial statements.

IBM United Kingdom Limited

Statement of Financial Position

As at 31 December 2018

	Note	2018 £m	2017 £m
Issued capital and reserves			
Share capital	31	956.4	956.4
Share premium	31	743.7	743.7
Retained earnings		337.7	313.2
Total equity		2,037.8	2,013.3

The financial statements on pages 13 to 101 were approved by the directors and authorised for issue on 11 July, 2019, and are signed on their behalf by:



W Kelleher
Director

Company registration number: 741598

The notes on pages 19 to 101 form part of these financial statements.

IBM United Kingdom Limited

Statement of Cash Flows

For the Year Ended 31 December 2018

	Note	2018 £m	2017* £m
Net cash inflows from operating activities	29	138.6	26.8
Cash flows from investing activities			
Payments to acquire property, plant and equipment		(72.7)	(56.8)
Proceeds from the sale of property, plant and equipment		-	5.4
Cash acquired with purchase of business		2.1	-
Payments to acquire investments in subsidiaries		(6.6)	(1,865.0)
Dividends received		165.2	353.3
Purchase of own preference shares		-	(200.0)
Decrease in long-term deposits with related parties		-	1,400.0
Decrease/(increase) in short-term deposits with related parties		53.3	(237.3)
Net cash inflows / (outflows) from investing activities		141.3	(600.4)
Cash flows from financing activities			
Repaid loan received from immediate parent company		-	578.1
Interest received		3.1	5.7
Dividends paid		(233.5)	-
Net cash (outflows) / inflows from financing activities		(230.4)	583.8
Net (decrease) / increase in cash and cash equivalents		49.5	10.2
Cash and cash equivalents at beginning of year		17.0	6.8
Cash and cash equivalents at end of year		66.5	17.0

*The company has changed its cash flow presentation to show cash movements in respect of short-term deposits with related parties as an investing activity, rather than as a movement in cash and cash equivalents. The prior year amounts have been re-presented to be consistent with this revised presentation for the purposes of comparison. The impact on the comparative figures was to increase the cash outflow from investing activities and reduce the net increase in cash and cash equivalents by £237.3 million.

The notes on pages 19 to 101 form part of these financial statements.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies

Basis of preparation

IBM United Kingdom Limited (the 'company') is a private company, limited by shares and is incorporated and domiciled in the United Kingdom and registered in England and Wales under the Companies Act 2006. These financial statements have been prepared under the historical cost convention with the exception of certain items which are measured at fair value as disclosed in the accounting policies below. These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, interpretations issued by the International Financial Reporting Standards Interpretations Committee (IFRS IC) and as applied in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

These financial statements contain information about IBM United Kingdom Limited as an individual company and do not contain consolidated financial information as the parent of a group. The company is exempt under section 401 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertakings are included by full consolidation in the publicly available consolidated financial statements of its ultimate parent company, International Business Machines Corporation, incorporated in the United States of America.

The principal accounting policies adopted in the preparation of the financial statements are set out below. The policies have been applied consistently to all years presented, unless otherwise stated. The preparation of financial statements in compliance with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the company's accounting policies. The areas where significant judgements and estimates have been made in preparing the financial statements are disclosed in note 2 to the financial statements.

The directors have prepared the accounts on a going concern basis based on the anticipated future performance of the business. The directors note the company has net current liabilities due to the structure of intercompany transactions. They have considered whether these amounts are expected to be repaid within 12 months of signing the accounts but have also obtained a letter of support from an intermediate holding company confirming they would provide funding support if required.

International Financial Reporting Standard 8 "Operating Segments" (IFRS 8)

The company is excluded from the scope of IFRS 8 "Operating Segments" and has not voluntarily prepared analysis of operating segments within the notes to these financial statements.

New and amended standards adopted by the company

The following standards, interpretations and amendments have been adopted in the financial statements for the first time for the year beginning 1 January 2018:

- **IFRS 9, Financial instruments.** The company adopted IFRS 9, Financial Instruments, from 1 January 2018. The company elected not to restate comparative figures and recognise any adjustments to the carrying amounts of financial assets and liabilities in the opening retained earnings as of the date of initial application of the standards, 1 January 2018. Consequently, the revised requirements of the IFRS 7, Financial Instruments: Disclosures, have only been applied to the current year. The comparative year disclosures repeat those disclosures made in the prior year.

The significant new accounting policies applied in the current year are described in note 1. Accounting policies applied prior to 1 January 2018 and applicable to the comparative information are disclosed in note 1.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

The following table reconciles the carrying amounts of each class of financial assets as previously measured in accordance with IAS 39 and the new amounts determined upon adoption of IFRS 9 on 1 January 2018.

In millions of GBP	Measurement category		Carrying value under IAS 39 - 31 December 2017	Effect of adopting IFRS 9	Carrying value under IFRS 9 - 1 January 2018
	IAS 39	IFRS 9			
Cash and cash equivalents	L&R	AC	17.0	-	17.0
Finance receivables					
Finance lease receivables	L&R	AC	0.1	-	0.1
Customer loans	L&R	AC	21.6	-	21.6
Total finance receivables			21.7	-	21.7
Receivables from related parties	L&R	AC	907.8	-	907.8
Trade and other receivables					
Trade receivables	L&R	FVOCI	73.3	-	73.3
Equity investments	AC	FVPL	75.3	-	75.3
			1,095.1	-	1,095.1

(a) Cash and cash equivalents

All classes of cash and cash equivalents were reclassified from loans and receivables ("L&R") measurement category under IAS 39 to amortised costs ("AC") measurement category under IFRS 9 at the adoption date of the standard. The expected credit losses ("ECL") for cash and cash equivalents balances were insignificant.

(b) Finance receivables

Based on a business model assessment carried out by the company, it was established that finance receivables have to be classified as a "Held to collect" business model. As a result, finance receivables were reclassified from the loans and receivables ("L&R") measurement category under IAS 39 to the amortised costs ("AC") measurement category under IFRS 9 at the adoption date of the standard.

(c) Trade and other receivables

Based on a business model assessment carried out by the company, it was established that trade receivables have to be classified as a "Held to collect and sell" business model. As a result, trade receivables were reclassified from the loans and receivables ("L&R") measurement category under IAS 39 to the fair value through other comprehensive income ("FVOCI") measurement category under IFRS 9. Due to the short-term nature of trade receivables and the relatively small factoring fee, the difference between amortised cost and fair value was insignificant.

The impact of revaluation from the loans and receivables measurement category to the fair value through other comprehensive income category was negligible due to the short-term collectability of trade receivables.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

The amount of the provision for impairment of receivables under IAS 39 at 31 December 2017 was equal to the new credit loss allowance at 1 January 2018 measured in accordance with the expected loss model under IFRS 9. The impact of IFRS 9 adoption on the impairment values for the financial assets was insignificant.

At 31 December 2018, all of the company's financial liabilities except for derivatives were carried at amortised costs ("AC"). The derivatives belonged to the fair value through profit & loss ("FVTPL") measurement category under IAS 39. There were no changes to the classification and measurement of financial liabilities.

The following table shows the insignificant impact, net of tax, of the transition to IFRS 9 on reserves and retained earnings as of 1 January 2018:

In millions of GBP	Share capital	Share premium	Retained earnings	Total equity
Amounts at 31 December 2017 prior to adoption of IFRS 9	956.4	743.7	313.2	2,013.3
Reclassification of Trade receivables from AC to FVOCI	-	-	-	-
Recognition of ECL under IFRS 9 for Trade receivables at FVOCI	-	-	-	-
At 1 January 2018 (under IFRS 9)	956.4	743.7	313.2	2,013.3

-- **IFRS 15, Revenue from Contracts with Customers.** The company applied IFRS 15 for the first time in the 2018 financial statements with the date of initial application of 1 January 2018 by using the modified retrospective transition method.

Under the modified retrospective transition method, the company applies the new policy retrospectively only to contracts that are not completed contracts at the date of initial application. Accordingly, the 2017 comparative information was not restated and the cumulative effects of initial application of IFRS 15 were recognised as an adjustment to the opening balance of retained earnings as of 1 January 2018. The comparative information continued to be reported under the previous accounting policies governed under IAS 18.

In addition, the company has elected the practical expedient not to retrospectively restate contracts that were modified before the date of initial application and reflected the aggregated effect of all modifications that occurred before the date of initial application.

At adoption, £51.9 million was reclassified from other assets to contract assets to establish the opening balance for net contract assets. In-scope sales commission costs previously recorded in the Income Statement were capitalised in deferred costs in accordance with the transition guidance, in the amount of £42.1 million. Deferred income of £0.5 million was recorded for certain software licenses that will be recognised over time versus at a point in time under previous guidance. Additionally, net deferred taxes were reduced by £7.7 million in the Statement of Financial Position, resulting in a cumulative-effect net increase to retained earnings of £33.9 million. The company expects revenue recognition for its broad portfolio of hardware, software, and services offerings to remain largely unchanged.

The detailed impact of the change in accounting policy on revenue is disclosed further below in the revenue recognition section.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

The other relevant amendments listed below did not have any impact on the amounts recognised in prior years and are not expected to significantly affect the current or future years:

- Amendments to IFRS 2, Share-based Payment;
- Annual Improvements to IFRSs 2014-2016 cycle - Amendments to IFRS 1 and IAS 28;
- IFRIC 22 - Foreign Currency Transactions and Advance Consideration.

New standards, interpretations and amendments not yet effective and not early adopted by the company

The following new standards, interpretations and amendments which have not been applied in these financial statements, will or may have an effect on the company's future financial statements:

In January 2016, the IASB issued the new standard IFRS 16, which changes the accounting for leases. The guidance requires lessees to recognise right-of-use assets and lease liabilities for most leases in the Statement of Financial Position. The new standard uses a single model for lessee accounting, eliminating the distinction between operating and finance leases. The guidance makes some changes to lessor accounting to align with the new revenue recognition guidance. The guidance also requires qualitative and quantitative disclosures to enable the users of financial statements to assess the impact from leases on the company's financial position, financial performance and cash flows. The guidance is effective 1 January 2019 and early adoption is permitted. The company is going to adopt the guidance on the effective date using the transition option whereby prior comparative years will not be retrospectively presented in the financial statements. The right-of-use assets are measured at the amount of lease liability on adoption (adjusted for any prepaid or accrued expenses). The company has elected to apply the practical expedients not to reassess prior conclusions related to contracts containing leases, use single discount rate to portfolio of leases with similar characteristics and impair the right-of-use assets with previously recognised onerous lease provisions. The company has made a policy election to not recognise right-of-use assets and lease liabilities for short-term leases for all asset classes and low value asset leases for certain mobile phone devices.

A cross-functional implementation team has evaluated the lease portfolio and implemented system, process, control and policy changes. The company also has gathered lease data in order to comply with the requirements in the guidance. The guidance will have a material impact on the Statement of Financial Position as of the effective date. At 1 January 2019, the company expects to recognise right-of-use assets and lease liabilities of £162.6 million and £158.9 million, respectively. The transition adjustment to be recognised in retained earnings at the effective date will not be material.

The following new standards and their amendments have been endorsed by the European Union, but they are not mandatory for the year ended 31 December 2018 and they have not been early adopted:

- IFRIC 23 Uncertainty over Income Tax Treatments (effective from 1 January 2019, endorsed on 23 October 2018);
- Amendments to IAS 19 Employee Benefits (effective from 1 January 2019, endorsed on 13 March 2019);
- Annual Improvements to IFRSs 2015 – 2017 Cycle – Amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23 (effective from 1 January 2019, endorsed on 14 March 2019);
- Amendments to IFRS 9 Prepayment Features with Negative Compensation (effective from 1 January 2019, endorsed on 22 March 2018);
- Amendments to IAS 28 Long-term Interests in Associates and Joint Ventures (effective from 1 January 2019, endorsed on 8 February 2019);

The following new standards and their amendments have not yet been endorsed by the European Union:

- Amendments to References to the Conceptual Framework in IFRS Standards (effective from 1 January 2020);
- Amendments to IFRS 3 Definition of a Business (effective from 1 January 2020);
- Amendments to IAS 1 and IAS 8 Definition of material (effective from 1 January 2020).

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1. Accounting policies (continued)

New standards, interpretations and amendments not yet effective and not early adopted by the company (continued)

There are no other new standards, interpretations or amendments not yet effective or endorsed by the European Union which are expected to have a material impact on the future financial statements of the company.

Revenue recognition under IFRS 15

The company accounts for a contract with a customer when it has written approval, the contract is committed, the rights of the parties, including payment terms, are identified, the contract has commercial substance and consideration is probable of collection.

Revenue is recognised when, or as, control of a promised product or service transfers to a customer, in an amount that reflects the consideration to which the company expects to be entitled in exchange for transferring those products or services. If the consideration promised in a contract includes a variable amount, the company estimates the amount to which it expects to be entitled using either the expected value or most likely amount method. The company's contracts may include terms that could cause variability in the transaction price, including, for example, rebates, volume discounts, service-level penalties, and performance bonuses or other forms of contingent revenue.

The company only includes estimated amounts in the transaction price to the extent it is highly probable that a significant reversal of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is resolved. The company may not be able to reliably estimate contingent revenue in certain long-term arrangements due to uncertainties that are not expected to be resolved for a long period of time or when the company's experience with similar types of contracts is limited. The company's arrangements infrequently include contingent revenue. Estimates of variable consideration and the determination of whether to include estimated amounts in the transaction price are based on all information (historical, current and forecasted) that is reasonably available to the company, taking into consideration the type of customer, the type of transaction and the specific facts and circumstances of each arrangement. Changes in estimates of variable consideration are included in the disclosure in note 3.

The company's standard billing terms are that payment is due upon receipt of invoice, payable within 30 days. Invoices are generally issued as control transfers and/or as services are rendered. Additionally, in determining the transaction price, the company adjusts the promised amount of consideration for the effects of the time value of money if the billing terms are not standard and the timing of payments agreed to by the parties to the contract provide the customer or the company with a significant benefit of financing, in which case the contract contains a significant financing component. As a practical expedient, the company does not account for significant financing components if the period between when the company transfers the promised product or service to the customer and when the customer pays for that product or service will be one year or less. Most arrangements that contain a financing component are financed through the company's Global Financing business and include explicit financing terms. Income from these financing transactions is out of the scope of IFRS 15.

The company may include subcontractor services or third-party vendor equipment or software in certain integrated services arrangements. In these types of arrangements, revenue from sales of third-party vendor products or services is recorded net of costs when the company is acting as an agent between the customer and the vendor, and gross when the company is the principal for the transaction. To determine whether the company is an agent or principal, the company considers whether it obtains control of the products or services before they are transferred to the customer. In making this evaluation, several factors are considered, most notably whether the company has primary responsibility for fulfilment to the customer, as well as inventory risk and pricing discretion.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

The company recognises revenue on sales to solution providers, resellers and distributors (herein referred to as "resellers") when the control over goods and services passes to the reseller and the reseller is considered the principal for the transaction with the end-user customer.

The company reports revenue net of any revenue-based taxes assessed by governmental authorities that are imposed on and concurrent with specific revenue-producing transactions.

The company assesses collectability at the inception of a contract. If a contract meets the collectability criterion at contract inception, the criterion should not be reassessed unless there is an indication of a significant change in facts and circumstances. If consideration for an overall arrangement is not considered collectible but cash is received, revenue cannot be recognised until there are no remaining obligations and substantially all of the consideration has been received, or the contract is terminated, or the company stops transferring goods/services and has no obligation to transfer additional goods/services and the cash is non-refundable in all cases. Prior to the adoption of the new revenue standard, revenue is recorded when cash is received for poor credit rated customers and suspense customers.

In addition to the aforementioned general policies, the following are the specific revenue recognition policies for arrangements with multiple performance obligations and for each major category of revenue.

Arrangements with Multiple Performance Obligations

The company's global capabilities as a cognitive solutions and cloud platform company include services, software, hardware and related financing. The company enters into revenue arrangements that may consist of any combination of these products and services based on the needs of its customers. For example, a customer may purchase a server that includes operating system software. In addition, the arrangement may include post-contract support for the software and a contract for post-warranty maintenance service for the hardware. These types of arrangements may also include financing provided by the company. These arrangements consist of multiple products and services, whereby the hardware and software may be delivered in one period and the software support and hardware maintenance services are delivered over time. In another example, the company may assist the customer in building and running an enterprise information technology (IT) environment utilizing a private cloud on a long-term basis and the customer periodically purchases hardware and/or software products from the company to upgrade or expand the facility. The services delivered on the cloud are provided on a continuous basis across multiple reporting periods, and the hardware and software products are provided in each period the products are purchased.

The company continues to build new products and offerings and continuously reinvent its platforms and delivery methods, including through the use of cloud and as-a-Service models. These are not separate businesses; they are offerings across the segments that address market opportunities in analytics, data, cloud and security. Revenue from these offerings follows the specific revenue recognition policies for arrangements with multiple performance obligations and for each major category of revenue, depending on the type of offering, which are comprised of services, hardware and/or software.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

To the extent that a product or service in multiple performance obligation arrangements is subject to other specific accounting guidance, such as leasing guidance, that product or service is accounted for in accordance with such specific guidance. For all other products or services in these arrangements, the criteria below are considered to determine when the products or services are distinct and how to allocate the arrangement consideration to each distinct performance obligation. A performance obligation is a promise in a contract with a client to transfer products or services that are distinct. If the company enters into two or more contracts at or near the same time, the contracts may be combined and accounted for as one contract, in which case the company determines whether the products or services in the combined contract are distinct. The contracts may be combined and accounted for as one contract if the contracts are negotiated as a package with a single commercial objective, or the amount of consideration to be paid in one contract depends on the price or performance of the other contract, or the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

A product or service that is promised to a client is distinct if both of the following criteria are met:

- The client can benefit from the product or service either on its own or together with other resources that are readily available to the client (that is, the product or service is capable of being distinct); and
- The company's promise to transfer the product or service to the client is separately identifiable from other promises in the contract (that is, the product or service is distinct within the context of the contract).

If these criteria are not met, the company determines an appropriate measure of progress based on the nature of its overall promise for the single performance obligation. When products and services are distinct, the arrangement consideration is allocated to each performance obligation on a relative standalone selling price basis. The revenue policies in the Services, Hardware and/or Software sections below are then applied to each performance obligation, as applicable.

To the extent the company grants the customer the option to acquire additional products or services in one of these arrangements, the company accounts for the option as a distinct performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into the contract (e.g., a discount incremental to the range of discounts typically given for the product or service), in which case the customer in effect pays in advance for the option to purchase future products or services. The company recognises revenue when those future products or services are transferred or when the option expires.

Services

The company's primary services offerings include infrastructure services, including outsourcing, and other managed services; application management services; global process services (GPS); maintenance and support; and consulting, including the design and development of complex IT systems to a customer's specifications (e.g., design and build). These services offerings fall under the company's Global Business Services segment, and Technology Services & Cloud Platforms segment. Many of these services can be delivered entirely or partially through cloud or as-a-service delivery models. The company's services are provided on a time-and-material basis, as a fixed-price contract or as a fixed-price per measure of output contract and the contract terms range from less than one year to over 10 years.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

In services arrangements, the company typically satisfies the performance obligation and recognises revenue over time. In design and build arrangements, the performance obligation is satisfied over time either because the customer controls the asset as it is created (e.g., when the asset is built at the customer site) or because the company's performance does not create an asset with an alternative use and the company has an enforceable right to payment plus a reasonable profit for performance completed to date. In most other services arrangements, the performance obligation is satisfied over time because the customer simultaneously receives and consumes the benefits provided as the company performs the services.

In outsourcing, other managed services, application management, GPS and other cloud-based services arrangements, the company determines whether the services performed during the initial phases of the arrangement, such as setup activities, are distinct. In most cases, the arrangement is a single performance obligation comprised of a series of distinct services that are substantially the same and that have the same pattern of transfer (i.e., distinct days of service). The company applies a measure of progress (typically time-based) to any fixed consideration and allocates variable consideration to the distinct periods of service based on usage. As a result, revenue is generally recognised over the period the services are provided on a usage basis. This results in revenue recognition that corresponds with the value to the customer of the services transferred to date relative to the remaining services promised.

Revenue from time-and-material contracts is recognised on an output basis as labour hours are delivered and/or direct expenses are incurred. Revenue from as-a-Service type contracts, such as Infrastructure-as-a-Service, is recognised either on a straight-line basis or on a usage basis, depending on the terms of the arrangement (such as whether the company is standing ready to perform or whether the contract has usage-based metrics). If the as-a-Service contract includes setup activities, those promises in the arrangement are evaluated to determine if they are distinct.

Revenue related to maintenance and support services and extended warranty is recognised on a straight-line basis over the period of performance because the company is standing ready to provide services throughout the contract period.

In fixed-price design and build contracts, revenue is recognised based on progress towards completion of the performance obligation using a cost-to-cost measure of progress (i.e., percentage-of-completion (POC) method of accounting). Revenue is recognised based on the labour costs incurred to date as a percentage of the total estimated labour costs to fulfil the contract. Due to the nature of the work performed in these arrangements, the estimation of cost at completion is complex, subject to many variables and requires significant judgment. Key factors reviewed by the company to estimate costs to complete each contract are future labour and product costs and expected productivity efficiencies. If circumstances arise that change the original estimates of revenues, costs, or extent of progress toward completion, revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are reflected in revenue on a cumulative catch-up basis in the period in which the circumstances that gave rise to the revision become known to the company. The amount of revenue recognised in the reporting period on a cumulative catch-up basis (i.e., from performance obligations satisfied, or partially satisfied, in previous periods).

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

The company performs ongoing profitability analyses of its design and build services contracts accounted for using a cost-to-cost measure of progress in order to determine whether the latest estimates of revenues, costs and profits require updating. For a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision. An onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

In some services contracts, the company bills the customer prior to recognising revenue from performing the services and the amount is classified as a deferred income. In other services contracts, the company performs the services prior to billing the customer. When the company performs services prior to billing the customer in design and build contracts, the right to consideration is typically subject to milestone completion or customer acceptance and the unbilled accounts receivable is classified as a contract asset.

Billings usually occur in the month after the company performs the services or in accordance with specific contractual provisions.

Hardware

The company's hardware offerings include the sale or lease of system servers and storage solutions. These hardware offerings fall under the company's Systems segment. These products can also be delivered through as-a-Service or cloud delivery models, such as Storage-as-a-Service. The company also offers installation services for its more complex hardware products. Hardware offerings are often sold with distinct maintenance services, described under the Services section above.

Revenue from hardware sales is recognised when control has transferred to the customer which typically occurs when the hardware has been shipped to the customer, risk of loss has transferred to the customer and the company has a present right to payment for the hardware. In limited circumstances when a hardware sale includes customer acceptance provisions, revenue is recognised either when customer acceptance has been obtained, customer acceptance provisions have lapsed, or the company has objective evidence that the criteria specified in the customer acceptance provisions have been satisfied. Revenue from hardware sales-type leases is recognised at the beginning of the lease term. Revenue from rentals and operating leases is recognised on a straight-line basis over the term of the rental or lease. Income from these transactions are out of the scope of IFRS 15.

Revenue from as-a-Service arrangements hardware offerings is recognised either on a straight-line basis or on a usage basis as described in the Services section above. Installation services are accounted for as distinct performance obligations with revenue recognised as the services are performed. Any cost of standard warranties is accrued when the corresponding revenue is recognised. Shipping and handling activities are accounted as distinct performance obligations with revenue recognised when control is transferred to the customer.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

Software

The company's software offerings include: solutions software, which comprises of analytics, data and security; transaction processing software, which primarily runs mission-critical systems for customers; integration software, which helps customers to create, connect and optimize their applications data and infrastructure; and, operating systems software, which provides operating systems for IBM Z and Power Systems hardware. These software offerings fall under the company's Cognitive Solutions segment. Many of these offerings can be delivered entirely or partially through as-a-Service or cloud delivery models, while others are delivered as on-premise software licenses.

Revenue from perpetual (one-time charge) license software is recognised at a point in time at the inception of the arrangement when control transfers to the customer, if the software license is distinct from the post-contract support offered by the company. In limited circumstances, when the software requires continuous updates to provide the intended functionality, the software license and post-contract support are not distinct and revenue for the single performance obligation is recognised over time as the post-contract support is provided. This is only applicable to certain security software perpetual licenses offered by the company. Prior to the adoption of the new revenue standard, the company recognised revenue for these software licenses at a point in time at the inception of the arrangement.

Revenue from post-contract support is recognised over the contract term on a straight-line basis because the company is providing a service of standing ready to provide support, when-and-if needed, and is providing unspecified software upgrades on a when-and-if available basis over the contract term.

Revenue from software hosting or Software-as-a-Service arrangements is recognised either on a straight-line basis or on a usage basis as described in the Services section above. In software hosting arrangements, the rights provided to the customer (e.g., ownership of a license, contract termination provisions and the feasibility of the customer to operate the software) are considered in determining whether the arrangement includes a license. In arrangements that include a software license, the associated revenue is recognised in accordance with the software license recognition policy above rather than over time as a service.

Revenue from term license software is recognised at a point in time for the committed term of the contract (which is typically one month due to customer termination rights). However, if the amount of consideration to be paid in exchange for the license depends on customer usage, revenue is recognised when the usage occurs.

Standalone Selling Price

The company allocates the transaction price to each performance obligation on a relative standalone selling price basis. The standalone selling price (SSP) is the price at which the company would sell a promised product or service separately to a customer. In most cases, the company is able to establish SSP based on the observable prices of products or services sold separately in comparable circumstances to similar customers. The company typically establishes a standalone selling price range for its products and services which are reassessed on a periodic basis or when facts and circumstances change.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

In certain instances, the company may not be able to establish a standalone selling price range based on observable prices and the company estimates the standalone selling price. The company estimates SSP by considering multiple factors including, but not limited to, overall market conditions, including geographic or regional specific factors, competitive positioning, competitor actions, internal costs, profit objectives and pricing practices. Additionally, in certain circumstances, the company may estimate SSP for a product or service by applying the residual approach. This approach has been most commonly used when certain perpetual software licenses are only sold bundled with one year of post-contract support and a price has not been established for the software. Estimating SSP is a formal process that includes review and approval by the company's management.

Services Costs

Recurring operating costs for services contracts are recognised as incurred.

For fixed-price design and build contracts, the costs of external hardware and software accounted for under the cost-to-cost measure of progress are deferred and recognised based on the labour costs incurred to date (i.e., the measure of progress), as a percentage of the total estimated labour costs to fulfil the contract as control transfers over time for these performance obligations.

Certain eligible, non-recurring costs incurred in the initial phases of outsourcing contracts and other cloud-based services contracts (i.e., setup costs) are capitalised when the costs relate directly to the contract, the costs generate or enhance resources of the company that will be used in satisfying the performance obligation in the future, and the costs are expected to be recovered. These costs consist of transition and setup costs related to the installation of systems and processes and other deferred fulfilment costs, including, prepaid assets used in services contracts (i.e., prepaid software or prepaid maintenance), and other deferred fulfilment costs eligible for capitalization. Capitalised costs are amortised on a straight-line basis over the expected period of benefit, which includes anticipated contract renewals or extensions, consistent with the transfer to the customer of the services to which the asset relates. Additionally, fixed assets associated with these contracts are capitalised and depreciated on a straight-line basis over the expected useful life of the asset.

If an asset is contract specific, then the depreciation period is the shorter of the useful life of the asset or the contract term. Amounts paid to customers in excess of the fair value of acquired assets used in outsourcing arrangements are deferred and amortised on a straight-line basis as a reduction of revenue over the expected period of benefit. The company performs periodic reviews to assess the recoverability of deferred contract transition and setup costs. This review is done by comparing the carrying amount of the asset to the remaining amount of consideration the company expects to receive for the services to which the asset relates, less the costs that relate directly to providing those services that have not yet been recognised. If the carrying amount is deemed not recoverable, an impairment loss is recognised.

In situations in which an outsourcing contract is terminated, the terms of the contract may require the customer to reimburse the company for the recovery of unbilled accounts receivable, unamortised deferred costs incurred to purchase specific assets utilized in the delivery of services and to pay any additional costs incurred by the company to transition the services.

Software Costs

Certain eligible, non-recurring costs incurred in the initial phases of Software-as-a-Service contracts are deferred and amortised over the expected period of benefit, which includes anticipated contract renewals or extensions, consistent with the policy described for Services Costs. Recurring operating costs in these contracts are recognised as incurred.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

Incremental Costs of Obtaining a Contract

Incremental costs of obtaining a contract (e.g. sales commissions) are capitalised and amortised on a straight-line basis over the expected customer relationship period if the company expects to recover those costs. The company previously expensed these costs as incurred. The expected customer relationship is determined based on the average customer relationship period, including expected renewals, for each offering type and ranges from three to six years. Expected renewal periods are only included in the expected customer relationship period if commission amounts paid upon renewal are not commensurate with amounts paid on the initial contract. Incremental costs of obtaining a contract include only those costs the company incurs to obtain a contract that it would not have incurred if the contract had not been obtained. The company has determined that certain commissions programs meet the requirements to be capitalised. Some commission programs are not subject to capitalization as the commission expense is paid and recognised as the related revenue is recognised. Additionally, as a practical expedient, the company expenses costs to obtain a contract as incurred if the amortisation period would have been a year or less. These costs are included in selling, general and administrative expenses.

Product Warranties

The company offers warranties for its hardware products that generally range up to three years, with the majority being either one or three years. Estimated costs for standard warranty terms are recognised when revenue is recorded for the related product. The company estimates its warranty costs standard to the product based on historical warranty claim experience and estimates of future spending and applies this estimate to the revenue stream for products under warranty. Estimated future costs for warranties applicable to revenue recognised in the current period are charged to cost of sales. The warranty liability is reviewed quarterly to verify that it properly reflects the remaining obligation based on the anticipated expenditures over the balance of the obligation period. Adjustments are made when actual warranty claim experience differs from estimates. Costs from fixed-price support or maintenance contracts, including extended warranty contracts, are recognised as incurred.

Revenue from extended warranty contracts is initially recorded as deferred income and subsequently recognised on a straight-line basis over the delivery period because the company is providing a service of standing ready to provide services over such term.

Contract Assets and Trade and Other Receivables

The company classifies the right to consideration in exchange for products or services transferred to a customer as either a receivable or a contract asset. A receivable is a right to consideration that is unconditional as compared to a contract asset which is a right to consideration that is conditional upon factors other than the passage of time. The majority of the company's contract assets represent unbilled amounts related to design and build services contracts when the cost-to-cost method of revenue recognition is utilized, revenue recognised exceeds the amount billed to the customer, and the right to consideration is subject to milestone completion or customer acceptance. Contract assets are generally classified as current and are recorded on a net basis with deferred income (i.e., contract liabilities) at the contract level.

Transition Disclosures

Additionally, in accordance with the modified retrospective method transition requirements, the company will present the financial statement line items impacted and adjusted to compare to presentation under the prior revenue standard during the first year of adoption of the new revenue standard. The following tables summarize the impacts as of 31 December 2018 and for the financial year ended 31 December 2018.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

As disclosed below, the adoption of IFRS 15 resulted in changes in the following accounting policies:

- (a) accounting for certain security software perpetual licenses;
- (b) accounting for incremental costs of obtaining a contract;
- (c) accounting for contract assets and notes and accounts receivable-trade.

Had the company continued to apply the previous accounting policies on these transactions, the impact on each financial statement line items in 2018 would be as follows:

Statement of Comprehensive Income (extract)		2018		2018
		As reported	Adjustments	Balances without adoption of IFRS 15
	Note	£m	£m	£m
Revenue	3	3,824.8	(0.2)	3,824.6
Cost of sales	4	(3,583.5)	3.5	(3,580.0)
Income tax credit	11	9.0	(3.4)	5.6
Total comprehensive income for the year		227.4	(0.1)	227.3

Statement of Financial Position (extract)		2018		2018
		As reported	Adjustments	Balances without adoption of IFRS 15
	Note	£m	£m	£m
Non-current assets				
Deferred tax assets	16	58.1	4.3	62.4
Other non-current assets	20	156.8	(15.9)	140.9
Current assets				
Other current assets	20	202.9	(22.6)	180.3
Current liabilities				
Deferred revenue		320.0	(0.2)	319.8
Equity				
Retained earnings		337.7	(34.0)	303.7

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

Statement of Cash Flows (extract)	2018	Adjustments	2018
	As reported		Balances without adoption of IFRS 15
	£m	£m	£m
Cash flows from operating activities			
Profit before income tax	114.4	3.3	117.7
Opening retained earnings adjustment net of deferred tax	-	(41.6)	(41.6)
(Increase)/decrease in trade and other receivables	(11.5)	38.5	27.0
Decrease in trade and other payables	(65.0)	(0.2)	(65.2)
Net cash inflow from operating activities	138.6	-	138.6

Accounting policies for comparative information:

Revenue, including intercompany revenue, is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

The company recognises revenue only if it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably. The company recognises revenue when it has persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable and the collectability is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the client, risk of loss has transferred to the client and the client acceptance has been obtained, client acceptance provisions have lapsed or the company has objective evidence that the criteria specified in the client acceptance provisions have been satisfied. No revenue is recognised if there are significant uncertainties regarding recovery of consideration due, associated costs or the company's continuing involvement with goods.

Hardware and Leases

Revenue from hardware sales or finance leases is recognised when the product is shipped to the client and when the significant risk and rewards of ownership have been transferred to the buyer. Any cost of warranties and remaining obligations that are inconsequential or perfunctory are accrued when the corresponding revenue is recognised. Revenue from rentals and operating leases is recognised on a straight line basis over the term of the rental or lease (see the Leasing accounting policy).

Software

Revenue from perpetual (one time charge) licensed software is recognised at the inception of the licence term. Revenue from term (monthly licence charge) arrangements is recognised on a subscription basis over the period that the client is using the licence. Revenue from maintenance, unspecified upgrades and technical support is recognised over the period such items are delivered.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

Services

The company's primary services offerings include information technology (IT) datacenter and business process transformation outsourcing, Cloud Services, application management services, technology infrastructure and system maintenance, web hosting, and the design and development of complex IT systems to a client's specifications (design and build). These services are provided on a time and materials basis, as a fixed price contract or as a fixed price per measure of output contract, and the contract terms generally range from less than one year to ten years. Revenue from IT datacentre and business process transformation outsourcing contracts is recognised in the year the services are provided using either an objective measure of output or a straight line basis over the term of the contract. Under the output method, the amount of revenue recognised is based on the services delivered in the year as stated in the contract.

Revenue from Cloud Services (SaaS, IaaS, PaaS, BPaaS) is recognised on a consumption basis.

Revenue from application management services, technology infrastructure and system maintenance, and web hosting contracts is recognised on a straight line basis over the term of the contract.

Revenue from time and material contracts is recognised at the contractual rates as labour hours are delivered and direct expenses are incurred. Revenue related to extended warranty and product maintenance contracts is deferred and recognised on a straight line basis over the delivery period.

Revenue from fixed price design and build contracts is recognised where the outcome of a contract can be reliably estimated, and revenue and costs are recognised under the percentage of completion (POC) method. Under the POC method, revenue is recognised based on the costs incurred to date as a percentage of the total estimated costs to fulfil the contract. If circumstances arise that may change the original estimates of revenues, costs, or extent of progress toward completion, then revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are reflected in the income statement in the year in which the circumstances that give rise to the revision become known by management.

The company performs ongoing profitability analysis of its services contracts in order to determine whether the latest estimates, such as revenue, costs of sales or profits, require updating. If, at any time, these estimates indicate that the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately.

In some of the company's services contracts the company bills the client prior to performing the services. These balances are held as deferred income in the statement of financial position until the service is performed. In other services contracts the company performs the services prior to billing the client. These balances are held as amounts recoverable on contracts in the statement of financial position until the client is billed. Billings usually occur in the month after the company performs the services or in accordance with specific contractual provisions.

Multiple-element arrangements

The company enters into multiple-element software and non-software related revenue arrangements, which may include any combination of services, software, hardware and/or financing. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met:

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Revenue recognition under IFRS 15 (continued)

Software related revenue arrangements

The functionality of the delivered element(s) is not dependent on the undelivered element(s).

There is a fair value of the undelivered element(s).

Delivery of the delivered element(s) represents the culmination of the earnings process for that element(s).

Non-software related revenue arrangements

The delivered item(s) has value to the client on a standalone basis.

There is objective and reliable evidence of the fair value of the undelivered item(s).

If the arrangement includes a general right of return relative to the delivered item(s), the delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the company.

If these criteria are not met, revenue is deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. If there is objective and reliable evidence of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative fair value. There may be cases, however, in which there is objective and reliable evidence of fair value of the undelivered item(s) but no such evidence for the delivered item(s). In those cases, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered item(s) equals the total arrangement consideration less the aggregate fair value of the undelivered item(s). The revenue policies described above are then applied to each unit of accounting, as applicable.

Interest revenue calculated using the effective interest method

Interest revenue represents interest income which is recognised on an accruals basis using the effective interest rate method.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The company as lessor

Amounts due under finance leases are recorded as finance receivables at the amount of the company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the company's net investment outstanding in respect of the leases.

Rental income from operating leases is recognised on a straight-line basis over the term of the lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

The company as lessee

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Administrative expenses

Administrative expenses are recognised in the income statement as incurred. Administrative expenses include selling expenses, salaries, office supplies, non-income taxes, insurance and office rental.

Research and development

Costs of product development inclusive of margins are recharged to other IBM group companies.

Deferred transition costs

Costs related to delivering services under long-term contractual arrangements, including costs relating to bid and proposal activities, are expensed as incurred.

Non-recurring costs which are directly incurred in the initial transition and transformation stages of a specific outsourcing contract are capitalised as an asset under the heading 'Deferred transition costs'. These consist of transition and set up costs related to the installation of systems and processes and are amortised on a straight line basis over the remaining life of the contract. The company performs periodic reviews to assess the recoverability of the deferred costs by comparing the minimum remaining contractual net cash inflows to the unamortised contract costs. If such minimum contractual net cash inflows are not sufficient to recover the unamortised costs, an impairment is recognised. Any impairment of deferred costs is included within the heading 'cost of sales'.

Finance costs

Finance costs represent interest on bank overdrafts and short term borrowings and are accounted for on an accruals basis.

Foreign currencies

The financial statements of the company are presented in British Pounds Sterling, which is the functional currency of the company.

Transactions denominated in foreign currencies are translated at the rate prevailing at the transaction date. Foreign exchange differences are recognised in the income statement in the year of settlement of these items.

At each reporting date, monetary items denominated in currencies other than British Pounds Sterling are retranslated at the rates prevailing at the reporting date. The resulting foreign exchange differences are recognised in the income statement for the year.

Employee benefits

Provision is made for benefits accruing to employees in respect of wages and salaries and annual leave when it is probable that settlement will be required and they are capable of being measured reliably. Provisions made in respect of employee benefits expected to be settled within 12 months are measured at their nominal values using the remuneration rate expected to apply at time of settlement.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Employee benefits (continued)

Defined contribution retirement plans

Contributions to defined contribution retirement plans are recognised as an expense when the employees have rendered services entitling them to the contributions.

Defined benefit retirement plans

The amount recognised in the statement of financial position in respect of defined benefit retirement benefit plans is the net defined benefit asset adjusted for the limiting effect of the asset ceiling. The net defined benefit asset comprise of the fair value of plan assets less the present value of the defined benefit obligation. The asset ceiling is limited to the present value of benefits accruing to the company available in the form of refunds and reductions in future contributions to the plan.

The defined benefit obligation is calculated by independent actuaries using the projected unit credit method with actuarial valuations carried out at the end of each annual reporting period. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that have terms to maturity approximating to the terms of the related pension obligation.

Remeasurements are charged or credited to equity in other comprehensive income in the period in which they arise.

Service cost and net interest expense on net liability are recognised immediately in the income statement as employee benefits expense and finance cost, respectively.

Share based payments

Share options

The company has an equity settled share option scheme. Share options of International Business Machines Corporation are granted to certain employees (including key management personnel) of the company. The rights to these options are granted by International Business Machines Corporation, the ultimate parent company. The fair value of the employee services received in exchange for the grant of share options is recognised as an expense with a corresponding adjustment to equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the effect of any non-market based vesting conditions. Non-market based vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each reporting date, the company revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of the original estimates, if any, in the income statement for the period, and a corresponding adjustment to retained earnings, as the company does not have a separate equity compensation reserve arising on the issue of share-based payments.

Fair value is measured using the Black-Scholes pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Share based payments (continued)

As per the terms of the arrangement with International Business Machines Corporation, the company is required to compensate International Business Machines Corporation for the difference between the market value of the underlying shares on exercise date and the proceeds from exercise of the share options. This intercompany charge is denominated in US Dollars based on the US Dollar market value of the underlying shares and exercise price. Foreign exchange differences arising on the retranslation of the balance outstanding at each reporting date and at the date of settlement are recognised in the income statement for the period. The inter-company charge is first offset to equity against the equity compensation reserve arising on the issue of share-based payments and the excess, if any, is accounted for as a capital distribution from the company to its ultimate parent.

Share awards

Share awards are equity awards paid out in International Business Machines Corporation shares after a period of time, generally vesting against service or performance conditions. The fair value of each share award is measured at the market price of International Business Machines Corporation shares on the date of grant.

Employee Share Purchase Plan

International Business Machines Corporation also provides an employee share purchase plan (ESPP), enabling eligible participants worldwide to purchase full or fractional common shares in International Business Machines Corporation through payroll deductions at a 5% discount to the market price. For purchases prior to 1 April 2005, employees obtained a 15% discount on the market price of the shares. Any discount provided to the company's employees under the ESPP is considered compensation expense.

Taxation

Income tax expense represents the current tax calculated on taxable profits for the year, any adjustments in respect of prior periods and the deferred tax charge or credit for the year.

The current tax is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Taxation (continued)

Deferred tax is calculated at the tax rates that have been enacted or substantively enacted and that are expected to apply in the year when the liability is settled or the asset realised. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

Property, plant and equipment

Property, plant and equipment held for use in the supply of goods or services, or for administrative purposes, are stated in the statement of financial position at cost less any accumulated depreciation and accumulated impairment losses.

The depreciable amount of an asset is determined after deducting its residual value. The residual value of an asset is the estimated amount that the company would obtain from the disposal of the asset, after deducting the estimated cost of disposal.

Depreciation is charged so as to write off the cost of assets less their residual value over their estimated useful lives, using the straight-line method. The estimated useful lives used in the calculation of depreciation are as follows:

Buildings and leasehold improvements	5 - 50 years
Plant and equipment	1.5 - 7 years
Fixtures and fittings	5 - 15 years

Depreciation is not charged on land.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement for the year.

Investments in subsidiaries

Investments in subsidiaries are initially recorded at cost, considered to be equal to the fair value of the company acquired. Post transfer of trade from the subsidiary to IBM United Kingdom Limited a transfer is made from investments to goodwill representing the difference between the fair value of the company acquired and the predecessor book value of the net assets. Investments in subsidiaries are tested annually for impairment and carried at cost less accumulated impairment losses.

Intangible assets

Intangible assets, other than goodwill, represent the fair value of identifiable assets purchased as part of the acquisition of the trade and associated assets and liabilities of fellow subsidiary undertakings. Intangible assets are amortised on a straight line basis over their finite useful life of between 6 and 8 years. Amortisation of intangible assets is included in administrative expenses in the income statement.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Intangible assets (continued)

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets of the acquired subsidiary at the date of acquisition which are subsequently transferred in to the company. Goodwill is deemed to have an indefinite life and is tested annually for impairment and carried at cost less accumulated impairment losses.

Impairment of assets

Investments in subsidiaries and intangible assets are reviewed annually for impairment. If the carrying amount exceeds the recoverable amount an impairment loss is recognised in the income statement for the difference. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use.

Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount might not be recoverable. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or group of assets (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at the end of each financial year.

Inventories

Finished goods and goods held for resale are stated at the lower of cost and net realisable value.

Costs comprise direct materials and, where applicable, those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average cost method. Provision is made where necessary for obsolete, slow moving and defective stocks.

Financial instruments

Classes of financial instruments

The company considers the following to be its classes of financial assets: cash at bank; derivative assets; finance receivables; trade and other receivables; receivables from related parties, derivatives from related parties. The following financial liabilities are presented as separate classes of financial liabilities: derivative liabilities; trade and other payables and payables to related parties.

Financial assets and financial liabilities are recognised initially at fair value in the company's statement of financial position when the company becomes party to the contractual provisions of the instrument. In determining the fair value of its financial instruments, the company uses a variety of methods and assumptions that are based on market conditions and risks existing at each reporting date. For the majority of financial instruments, standard market conventions and techniques such as discounted cash flow analysis, replacement cost and termination cost are used to determine fair value. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realised. After the initial recognition, an expected credit losses allowance ("ECL") is recognised for financial assets measured at amortised costs ("AC") and investments in debt instruments measured at fair value through other comprehensive income ("FVOCI"), resulting in an immediate accounting loss.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Financial instruments (continued)

a) Financial assets

Financial assets – classification and subsequent measurement – measurement categories

The company classifies financial assets in the following measurement categories: fair value through profit or loss ("FVTPL"), FVOCI and AC. The classification and subsequent measurement of debt financial assets depends on: (i) the company's business model for managing the related assets portfolio and (ii) the cash flow characteristics of the asset.

Financial assets – classification and subsequent measurement – business model

The business model reflects how the company manages the assets in order to generate cash flows – whether the company's objective is: (i) solely to collect the contractual cash flows from the assets ("held to collect contractual cash flows"), or (ii) to collect both the contractual cash flows and the cash flows arising from the sale of assets ("held to collect contractual cash flows and sell") or, if neither of (i) and (ii) is applicable, the financial assets are classified as part of "other" business model and measured at FVTPL.

The business model is determined for a group of assets (on a portfolio level) based on all relevant evidence about the activities that the company undertakes to achieve the objective set out for the portfolio available at the date of the assessment. Factors considered by the company in determining the business model include the purpose and composition of a portfolio, past experience on how the cash flows for the respective assets were collected, how risks are assessed and managed, how the assets' performance is assessed and how managers are compensated.

Financial assets – classification and subsequent measurement – cash flow characteristics

Where the business model is to hold assets to collect contractual cash flows or to hold contractual cash flows and sell, the company assesses whether the cash flows represent solely payments of principal and interest ("SPPI"). Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the financial asset is classified and measured at FVTPL.

In making this assessment, the company considers whether the contractual cash flows are consistent with a basic lending arrangement, i.e. interest includes only consideration for credit risk, time value of money, other basic lending risks and profit margin. The SPPI assessment is performed on initial recognition of an asset and it is not subsequently reassessed.

Financial assets – reclassification

Financial instruments are reclassified only when the business model for managing the portfolio as a whole changes. The reclassification has a prospective effect and takes place from the beginning of the first reporting period that follows after the change in the business model. The company did not change its business model during the current and comparative period and did not make any reclassifications.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Financial instruments (continued)

Financial assets impairment – credit loss allowance for ECL

The company assesses, on a forward-looking basis, the ECL for debt instruments measured at AC and FVOCI and for the exposures arising from loan commitments and financial guarantee contracts, for contract assets. The company measures ECL and recognises net impairment losses on financial and contract assets at each reporting date. The measurement of ECL reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

Debt instruments measured at AC and contract assets are presented in the statement of financial position net of the allowance for ECL. For debt instruments at FVOCI, changes in amortised cost, net of allowance for ECL, are recognised in profit or loss and other changes in carrying value are recognised in OCI as gains less losses on debt instruments at FVOCI.

For trade receivables, receivables from related parties (except deposits with related parties) and contract assets, the company applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from the initial recognition of the receivables, see note 23 (Credit risk) for further details.

For all other financial assets the company applies a three stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter ("12 Months ECL"). If the company identifies a significant increase in credit risk ("SICR") since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any ("Lifetime ECL"). Refer to note 23 for a description of how the company determines when a SICR has occurred. If the company determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. In case of Stage 3 the company will now recognise interest income on a net basis. This means that interest income will be calculated based on the gross carrying amount of the financial asset less ECL. The company's definition of credit impaired assets and definition of default is explained in note 23. The note 23 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the company incorporates forward-looking information in the ECL models.

Financial assets – write-off

Financial assets are written-off, in whole or in part, when the company has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a derecognition event. The company may write-off financial assets that are still subject to enforcement activity when the company seeks to recover amounts that are contractually due, however, there is no reasonable expectation of recovery.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Financial instruments (continued)

Derivative financial instruments

Derivative financial instruments are carried at their fair value. All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss for the year. The company does not apply hedge accounting. Fair value is determined in the manner described in note 23.

Financial assets - derecognition

The company derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the company has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement whilst (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all the risks and rewards of ownership but not retaining control.

Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

Cash and cash equivalents

Cash and cash equivalents include deposits held at call with banks. Cash and cash equivalents are carried at AC because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL. Features mandated solely by legislation, such as the bail-in legislation in certain countries, do not have an impact on the SPPI test.

Trade and other receivables

Trade receivables are recognised initially at fair value and as a result of the business model assessment trade receivables are subsequently measured at fair value through other comprehensive income. The company designated trade receivables as the held to collect and sell business model. All other receivables are recognised initially at fair value and are subsequently carried at AC using the effective interest method.

Finance receivables

Finance receivables are recognised initially at fair value and are subsequently carried at AC using the effective interest method. Finance receivables with remaining maturity longer than 12 months are designated as non-current. Finance receivables with remaining maturity shorter than 12 months are designated current.

b) Financial liabilities

Classification

Financial liabilities are classified into the following specified categories: financial liabilities 'at fair value through profit or loss' (FVTPL) and financial liabilities measured at 'amortised cost'. The classification depends on the nature and purpose of the financial liabilities and is determined at the time of initial recognition.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Financial instruments (continued)

Financial liabilities at fair value through profit and loss

Financial liabilities at fair value through profit or loss are financial liabilities held for trading. A financial liability is classified in this category if it is acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Liabilities in this category are classified as current liabilities.

Amortised cost

The amortised cost of a debt instrument is calculated using the effective interest method which allocates interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition. Financial instruments held at amortised cost include 'trade and other payables' (excluding 'other payables', 'accrued expenses' and 'social security and other taxes'), and 'payables to related parties' (notes 22 and 30).

Derivative financial liabilities

A financial liability is classified as held for trading if:

- It has been acquired or incurred principally for the purpose of selling or repurchasing it in the near term; or
- On initial recognition it is part of a portfolio of identical financial instruments that the company manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in the income statement. Gains and losses are included in the 'cost of sales' line item in the income statement. Fair value is determined in the manner described in note 23.

Trade and other payables

Trade and other payables are recognised when the company becomes obliged to make future payments resulting from the purchase of goods or services. Amounts are unsecured and usually settled on standard commercial trade terms. Trade and other payables are initially measured at fair value.

Trade and other payables are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Financial instruments (continued)

Derecognition of financial liabilities

The company derecognises financial liabilities when, and only when, the company's obligations are discharged, cancelled or they expire.

Debt and equity instruments

Debt and equity instruments are classified as either liabilities or as equity in accordance with the substance of the contractual arrangement.

Interest and dividends

Interest and dividends are classified as expenses or as distributions of profit consistent with the statement of financial position classification of the related debt or equity instruments or component parts of compound instruments.

Accounting policies under IAS 39 for comparative information:

Derivative financial assets

A financial asset is classified as held for trading if:

- It has been acquired principally for the purpose of selling it in the near term; or
- On initial recognition it is part of a portfolio of identical financial instruments that the company manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in the income statement. Gains and losses are included in the 'cost of sales' line item in the income statement. Fair value is determined in the manner described in note 23.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the reporting date which are classified as non-current assets. Loans and receivables comprise 'finance receivables', 'trade and other receivables', 'other assets' (excluding 'prepayments' and 'deferred costs') and 'receivables from related parties' (notes 17, 19, 20 and 30).

Cash at bank

Cash at bank comprises cash on hand and demand deposits.

Trade and other receivables and finance receivables

Trade and other receivables and finance receivables are measured on initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Accounting policies (continued)

Financial instruments (continued)

An allowance for uncollectible trade and other receivables and finance receivables is recorded based on a combination of write-off history, ageing analysis, and any specific, known troubled accounts. Receivable balances include trade debtors, finance leases and loans. Below are the methodologies the company uses to calculate its impairment reserves, which are applied consistently to its different portfolios.

The company reviews all trade and other receivables and finance receivables on a regular basis. The review consists primarily of an analysis based upon current information available about clients, such as financial statements, news reports and published credit ratings, as well as consideration of the current economic environment, collateral net of repossession costs and prior history. Additionally, portfolios are collectively assessed (excluding accounts that have been specifically reserved), based upon credit ratings, probability of default, term, asset characteristics, and loss history to determine if there is objective evidence of impairment.

Objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

If there is objective evidence that accounts receivable are impaired, the company calculates an impairment loss by comparing the asset's carrying amount and the present value of the expected future cash flows. Any resulting impairment loss is recognised in the income statement. The carrying amount of the impaired receivable is reduced through the use of a specific allowance account.

Losses incurred on trade and other receivables are charged against the allowance when management believes the uncollectability of the receivable is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Provisions

Provisions are recognised when the company has a present obligation as a result of a past event, and it is probable that the company will be required to settle that obligation. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the reporting date, and are discounted to present value where the effect is material.

Provisions for environmental remediation are recognised when the company introduces to market a product which, under European Union directives, the company is required to take back from the customer free of charge at a later date, for disposal in an environmentally friendly manner.

Provisions for vacant space and restructuring costs are recognised when the company has a detailed formal plan for the restructuring that has been communicated to affected parties.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

2 Significant accounting estimates and judgements

The application of accounting standards and policies requires the company to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are readily apparent from other sources. Judgements and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Accounting judgements

The following are the judgements, apart from those involving estimations, that the company has made in the process of applying the accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Revenue recognition

Application of the various accounting principles in IFRS related to the measurement and recognition of revenue requires that the company make judgements and estimates. Specifically, complex arrangements with non-standard terms and conditions may require significant contract interpretation to determine the appropriate accounting, including whether promised goods and services specified in an arrangement are distinct performance obligations. Other significant judgements include determining whether the Company or a reseller is acting as the principal in a transaction and whether separate contracts should be combined and considered part of one arrangement.

Revenue recognition is also impacted by the company's ability to determine when a contract is probable of collection and to estimate variable consideration, including, for example, rebates, volume discounts, service-level penalties, and performance bonuses. The company considers various factors when making these judgements, including a review of specific transactions, historical experience and market and economic conditions.

Asset ceiling to net pension surplus

IAS 19 "Retirement Benefits" places a ceiling on a pension asset that can be recognised on a company's balance sheet to that which can be recovered by the company either through a refund of surplus or a reduction in future contributions. Whether an asset ceiling applies for a particular scheme is dependent on the provisions in the pension scheme's Trust Deed and Rules relating to employer contributions, refunds of surplus and termination. Significant judgements for the company include determining whether the company has an unconditional right to a refund of surplus and/or the value of a reduction in future contributions.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

2 Significant accounting estimates and judgements (continued)

Accounting estimates

The company makes assumptions and estimates concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The assumptions and estimates that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Long-term contracts

The company enters into numerous service contracts through its Global Technology Services and Global Business Services businesses. During the contractual period, revenue, cost and profits may be impacted by estimates of the ultimate profitability of each contract, particularly contracts for which the company uses the percentage of completion ("POC") method of accounting. If at any time these estimates indicate the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately. The company performs ongoing profitability analysis of its services contracts in order to determine whether the latest estimates require updating. Key factors reviewed by the company to estimate the future costs to complete each contract are future labour costs, future product costs and productivity efficiencies.

Pension assumptions

The measurement of the company's defined benefit obligation to its employees and net periodic pension cost/income requires the use of certain assumptions, including, among others, estimates of discount rates and inflation. Changes in these assumptions may affect the future funding into the pension plan, the charge or credit to the income statement and the actuarial gain or loss recognised in the statement of comprehensive income (note 24).

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Revenue

Revenue represents the net amounts received and receivable for goods and software sold by the company to outside customers, less return and allowances and revenue arising from services provided for the year.

An analysis of the company's revenue for the year is as follows:

	Home £m	Export £m	Total £m
2018			
Revenue from contracts with customers			
Hardware	185.8	-	185.8
Software	667.9	-	667.9
Services	2,256.6	713.4	2,970.0
	3,110.3	713.4	3,823.7
Revenue from other sources			
Financing	1.1	-	1.1
	3,111.4	713.4	3,824.8
2017			
Revenue from contracts with customers			
Hardware	136.4	-	136.4
Software	651.3	-	651.3
Services	2,164.9	759.7	2,924.6
	2,952.6	759.7	3,712.3
Revenue from other sources			
Financing	1.0	-	1.0
	2,953.6	759.7	3,713.3

Revenue is derived from goods and services supplied from the United Kingdom. Exports are to fellow subsidiary, group undertakings and the ultimate parent company. Home revenue includes an immaterial amount generated from sales made within Gibraltar.

Hardware includes sales of servers, from supercomputers to mid range technology, and storage technology.

Software sales include operating systems, middleware and industry specific solutions for Commerce, Cloud, Security, Analytics, Mobile and use of Social Media. IBM is helping our clients to remove the barriers that impede the flow of information within their enterprises by increasingly providing open standards-based software solutions.

Services revenue includes various types of assistance to customers. Global Services offers customers comprehensive IT services integrated with business insight to reduce costs, improve productivity, and gain competitive advantage. Many client contracts in the United Kingdom begin with engagement with the Global Business Services division, where consultants and industry experts provide deep industry knowledge. This division also provides Application Development and Maintenance services. The Global Technology Services unit provides a full range of IT services, including managing and operating entire information technology systems, consulting on the best use of technology infrastructure, maintaining systems, Cloud Service offerings (SaaS, IaaS, PaaS, BPaaS) and Business Continuity and Recovery Services.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Revenue (continued)

Disaggregation of revenue from contracts with customers

The following table provide details of revenue by major products/service offerings

	2018 £m	2017 £m
Intercompany Sales and Services	741.0	787.7
Cognitive Solutions	573.4	735.5
Global Business Services	1,004.7	935.0
Technology Services & Cloud Platforms	1,259.3	1,091.7
Systems	213.3	161.9
Other	32.0	0.5
	3,823.7	3,712.3

Reconciliation of contract balances

	2018 £m	At 1 Jan 2018 £m
Trade receivables, net of provision for impairment	204.6	278.0
Contract assets, net of provision for impairment	59.9	51.9
Deferred revenue (non-current)	(204.1)	(139.4)
Deferred revenue (current)	(320.0)	(429.9)
	(259.6)	(239.4)

Refer to note 23 for the loss allowance provided for trade receivables and contract assets.

The amount of revenue recognised during the year that was included within the deferred income balance at 1 January 2018 primarily relates to services and software.

During the year, revenue was increased by £4.9 million for performance obligations satisfied (or partially satisfied) in the previous year, mainly due to changes in estimates on percentage-of-completion based contracts.

Deferred revenue represents contract liabilities where consideration received in advance of performance obligations. It is considered current or non-current based on when the performance obligation will be satisfied.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Revenue (continued)

	2018 £m
Contract assets	
Balance at the beginning of year	51.9
Transfer to receivables	(46.0)
Increase due to revenue recognised during the period less amounts billed to customers	54.0
Balance at the end of the year	59.9
Deferred revenue	
Balance at the beginning of year	(569.3)
Revenue recognised that was included in the deferred revenue balance at the beginning of the year	429.6
Increases due to billings, excluding amounts recognised as revenue during the year	(384.4)
Balance at the end of the year	(524.1)

Remaining performance obligations

The remaining performance obligation disclosure provides the aggregate amount of the transaction price yet to be recognised as of the end of the reporting period and an explanation as to when the company expects to recognise these amounts in revenue. It is intended to be a statement of overall work under contract that has not yet been performed and does not include contracts in which the customer is not committed, such as certain as-a-Service, governmental, term software license and services offerings. The customer is not considered committed when they are able to terminate for convenience without payment of a substantive penalty. The disclosure includes estimates of variable consideration, except when the variable consideration is a sales-based or usage-based royalty promised in exchange for a license of intellectual property. Additionally, as a practical expedient, the company does not include contracts that have an original duration of one year or less. Remaining performance obligation estimates are subject to change and are affected by several factors, including terminations, changes in the scope of contracts, periodic revalidations, adjustment for revenue that has not materialized and adjustments for currency.

At 31 December 2018, the aggregate amount of the transaction price allocated to the remaining performance obligations related to customer contracts that are unsatisfied or partially unsatisfied was £7,159.6 million. Given the profile of contract terms, approximately 45 percent of this amount is expected to be recognised as revenue over the next two years, approximately 36 percent between three and five years and the balance thereafter.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Revenue (continued)

	2018 £m	At 1 Jan 2018 £m
Deferred costs		
Capitalised costs to obtain a contract	38.6	42.1
Deferred costs to fulfil a contract		
Deferred setup costs	164.9	156.7
	203.5	198.8

Of the total, £137.1 million is non-current and £66.4 million is current. The non-current and current balance of deferred costs are included within Other assets (note 20).

On 1 January 2018, in accordance with the transition guidance, £42.1 million of in-scope sales commissions that were previously recorded in the Income statement were capitalised as costs to obtain a contract. The related tax impact of £7.7 million was recognised as a deferred tax liability.

The total amount of deferred costs amortised during the year was £18.9 million. There were no material impairment losses incurred during the period.

4 Expenses by nature

	2018 £m	2017 £m
Costs of services and products	2,032.7	1,987.7
Cost of licences	132.1	135.0
Employee expenses (note 7)	1,105.9	1,137.2
Pension expenses (note 7)	190.9	19.5
Depreciation of property, plant and equipment (note 12)	63.9	61.5
Amortisation of deferred transition costs	65.3	61.2
Loss on disposal of property, plant and equipment	0.2	0.3
Property rental costs (note 5)	34.1	39.8
Advertising costs	41.6	43.2
Net foreign currency exchange (gain) / loss	(11.9)	14.8
Impairment losses on financial assets and contract assets	31.4	0.4
Write down of inventories	0.4	0.4
Other expenses	71.9	32.9
Total cost of sales, administrative expenses and net impairment losses / (gain) on financial assets and contract assets	3,758.5	3,533.9

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

4 Expenses by nature (continued)

The administrative expenses in the prior year were significantly lower due to the adjustment of the pension expenses. The increase in impairment losses on financial and contract assets is due to the recognition of expected credit loss allowances for receivables due from related parties.

5 Lease income / (costs)

Details of operating lease and finance lease income included in revenue in the income statement are set out below:

	2018 £m	2017 £m
Lease income:		
- Finance lease interest income	1.1	1.0

Details of operating lease costs are set out below:

	2018 £m	2017 £m
Operating lease costs:		
- Land and buildings	(34.1)	(39.8)
- Plant and equipment	(21.7)	(12.9)

6 Auditors' remuneration

	2018 £000	2017 £000
Audit services in respect of the company's financial statements	865	805
Audit related assurance services	310	148
Taxation advisory services	-	195
All other services	42	47
	1,217	1,195
Audit services in respect of the company's associated pension scheme	82	82

In addition, auditors' remuneration of £137,000 (2017: £122,000) was borne by this company on behalf of fellow IBM United Kingdom group undertakings.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

7 Employee expenses

	2018	2017
	£m	£m
Wages and salaries	973.4	1,003.1
Social security costs	116.5	117.6
Pension cost for defined contribution pension plans	79.2	80.9
Pension cost for defined benefit pension plans (note 24)	13.1	8.6
Pension cost for defined benefit pension plans - GMP charges (note 24)	98.6	-
Release of defined benefit provision to pension cost (note 24)	-	(70.0)
Share based payment expense (note 25)	16.0	16.5
	1,296.8	1,156.7

Pension costs including a provision charge of £111.7 million (2017: release of £61.4 million) in respect of defined benefit pension schemes represent amounts charged to operating profit. These amounts do not include amounts credited to finance income (see note 24) and amounts recognised in the statement of comprehensive income in respect of defined benefit pension schemes.

The average monthly number of employees, including directors, during the year was made up as follows:

	2018	2017
	Number	Number
Services and marketing	9,207	9,993
Product development	2,090	2,131
	11,297	12,124

These totals include employees who have fixed-term contracts with the company. They also include 65 employees (2017: 77 employees) whose duties were carried out mainly outside of the United Kingdom.

8 Directors' emoluments

The emoluments of the directors and the number of share options and share appreciation rights, in International Business Machines Corporation, exercised by the directors in respect of their services as directors or otherwise in connection with the management of the company, its parent IBM United Kingdom Holdings Limited and its parent IBM North Region Holdings, are shown in the following sections of this note. It is not practicable to perform any allocation of these total emoluments between the respective companies as such amounts are earned in respect of the directors' services to the group of companies as a whole.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

8 Directors' emoluments (continued)

The directors' aggregate emoluments in respect of qualifying services were:

	2018 £	2017 £
Short-term employee benefits	2,490,332	1,687,597
Post-employment benefits	71,422	78,850
Share-based payments	710,747	580,681
	2018 Number	2017 Number
Number of directors who exercised share options	-	-
Number of directors who received shares in respect of qualifying service under a long term incentive scheme	4	7
Number of directors who are deferred members of defined benefit schemes	-	2
Number of directors who accrued benefits under defined contribution schemes	4	7

One director was appointed and one director resigned during the year. One director was appointed and four directors resigned during the prior year.

Aggregate emoluments receivable under long term incentive schemes, excluding share based payments, were £nil (2017: £nil).

Emoluments of highest paid director:

	2018 £	2017 £
Short-term employee benefits	1,409,965	447,334
Post-employment benefits	31,830	12,582
Share-based payments	76,906	73,634

The highest paid director received shares in respect of qualifying services under a long term incentive scheme during 2018 and 2017. No other emoluments under long term incentive schemes were received by the highest paid director.

The highest paid director did not exercise share options during 2018 or 2017.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

9 Interest income calculated using the effective interest rate method

	2018 £m	2017 £m
Interest income calculated using the effective interest rate method		
Interest on loans to immediate parent company at amortised cost	-	1.6
Interest on loans to group undertakings at amortised cost	3.0	4.0
	3.0	5.6
Other similar income		
Other interest receivable	0.1	0.1
	3.1	5.7

Interest on amounts owed by immediate parent company and interest bearing amounts owed by group undertakings are charged at variable rates based on LIBOR.

10 Other finance costs

	2018 £m	2017 £m
Finance costs from group undertakings	5.4	5.3
Other interest payable	3.3	5.1
Other finance costs	0.1	-
	8.8	10.4

Interest on loans from group undertakings is charged at variable rates based on LIBOR.

Finance costs incurred from group undertakings include £4.3 million (2017: £3.8 million) of factoring charges. Other finance costs £0.1 million (2017: £nil) represent external factoring charges.

11 Income tax (credit) / expense

(a) Analysis of expense in the year

	2018 £m	2017 £m
Current tax:		
UK corporation tax based on profit for the year at 19.00% (2017: 19.25%)	14.6	10.9
Adjustments relating to prior years	(24.0)	29.1
Total current tax	(9.4)	40.0
Deferred tax:		
Movements on temporary differences	(1.2)	28.4
Adjustments relating to prior years	1.6	(9.0)
Total deferred tax (note 16)	0.4	19.4
Income tax (credit) / expense	(9.0)	59.4

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

11 Income tax (credit) / expense (continued)

(b) Reconciliation of tax (credit) / expense

The tax assessed on the profit for the year is lower (2017: higher) than the standard rate of corporation tax in the UK of 19.00% (2017: 19.25%).

	2018 £m	2017 £m
Profit before income tax	114.4	109.2
Tax at the domestic income tax rate of 19.00% (2017: 19.25%)	21.7	21.0
Effects of:		
Adjustments relating to prior years	(22.4)	20.1
Expenses not deductible for tax purposes	25.0	102.3
Income not subject to UK tax	(33.7)	(82.7)
Change in recognition of losses	(0.4)	-
Share option (credit) / charge	(0.5)	1.3
Withholding tax	1.2	1.7
Movement in unrecognised deferred tax	-	(0.5)
Adjustment to tax rates	0.1	(3.8)
Total income tax (credit) / expense (note 11(a))	(9.0)	59.4

(c) Factors that may affect future tax expense

Finance Act 2016 included legislation to further reduce the rate from 19% to 17% with effect from 1 April 2020. The impact of these changes is reflected in any closing deferred tax balances.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

12 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Fixtures and fittings £m	Total £m
Cost				
At 1 January 2017	109.1	421.5	290.7	821.3
Additions	5.7	40.1	11.0	56.8
Disposals	-	(69.5)	(1.3)	(70.8)
At 31 December 2017	114.8	392.1	300.4	807.3
Additions	6.1	62.2	4.4	72.7
Disposals	-	(26.9)	-	(26.9)
At 31 December 2018	120.9	427.4	304.8	853.1
Accumulated depreciation				
At 1 January 2017	78.3	303.9	201.4	583.6
Charge for year	2.6	44.2	14.7	61.5
Disposals	-	(63.9)	(1.2)	(65.1)
At 31 December 2017	80.9	284.2	214.9	580.0
Charge for year	2.8	47.6	13.5	63.9
Disposals	-	(26.7)	-	(26.7)
At 31 December 2018	83.7	305.1	228.4	617.2
Net book value				
At 31 December 2018	37.2	122.3	76.4	235.9
At 31 December 2017	33.9	107.9	85.5	227.3

The net book value of land and buildings relates entirely to freehold assets.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

13 Intangible assets

	Goodwill £m	Other intangible assets £m	Total £m
Cost			
At 1 January 2017	623.1	0.7	623.8
Transfers from investments (note 14)	0.1	-	0.1
At 31 December 2017	623.2	0.7	623.9
Transfers from investments (note 14)	22.5	-	22.5
At 31 December 2018	645.7	0.7	646.4
Accumulated amortisation and impairment			
At 1 January 2017	(310.9)	(0.7)	(311.6)
At 31 December 2017	(310.9)	(0.7)	(311.6)
At 31 December 2018	(310.9)	(0.7)	(311.6)
Net book value			
At 31 December 2018	334.8	-	334.8
At 31 December 2017	312.3	-	312.3

Impairment

The directors conducted an impairment review of the intangible assets held by the company in accordance with IAS 36. No impairment charge has been recognised as a result of this review.

It is not possible to track the cash flows of each constituent of goodwill hence management have deemed there to be one cash generating unit, and have therefore assessed the carrying value of goodwill, together with the carrying value of investments, for impairment based on the company's cash flow model.

The recoverable amount of goodwill was determined based on value in use calculations. These calculations used pre-tax cash flow projections based on financial budgets approved by management covering a five year period and are denominated in British Pound sterling. Cash flows beyond the five year period are extrapolated using estimated growth rates. The growth rate of 2.5% (2017: 2.5%) used is in line with the long term average growth rate for the industry in which the group operates. The pre-tax discount rate used in this calculation was 11.5% (2017: 11.5%). The post-tax discount rate was 10% for both years. If the pre-tax discount rate used for impairment review increased by 1% to 12.5% there would still be no impairment. A 1% decrease in the growth rate to 1.5% would also not cause any impairment.

The key assumptions used in the impairment testing were a) discount rates and b) rates of growth.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

13 Intangible assets (continued)

a) Discount rate

The discount rate reflects management's estimate of the pre-tax cost of capital employed in the current market and the risks specific to the information technology industry.

b) Rates of growth

Management have reviewed industry forecasts and consider the rate of 2.5% to be reasonable for the purposes of the impairment test.

14 Investments

	£m
Cost	
At 1 January 2017	413.4
Additions	1,940.3
Transfers to goodwill (note 13)	(0.1)
At 31 December 2017	2,353.6
Additions	6.5
Liquidations	(10.2)
Transfers to goodwill (note 13)	(22.5)
At 31 December 2018	2,327.4
Impairment	
At 1 January 2017	(6.6)
Impairment charge for the year	(517.3)
At 31 December 2017	(523.9)
Impairment charge for the year	(122.0)
At 31 December 2018	(645.9)
Net book value	
At 31 December 2018	1,681.5
At 31 December 2017	1,829.7

On 1 April 2018 the company acquired 100% of the share capital of The Analytic Sciences Corporation Limited for £5.1 million. As a result of this acquisition, the company indirectly owns Weather Services International Limited and The Weather Channel Global Media Limited. Goodwill of £4.8 million arose on the transfer of the trade and assets to the company on 1 November 2018.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

14 Investments (continued)

On 30 June 2018 the company acquired 100% of the share capital of Blue Wolf Global Limited for \$1.2 million, translated into GBP at the spot rate on the day of the transaction to £0.9 million. As a result of this acquisition, the company indirectly owns Bluewolf International Limited. Goodwill of £0.9 million arose on the transfer of the trade and assets to the company on 1 November 2018.

On 1 August 2018 the company acquired 100% of the share capital of Heartbeat Experts Limited for \$0.7 million, translated into GBP at the spot rate on the day of the transaction to £0.6 million. Goodwill of £0.3 million arose on the transfer of the trade and assets to the company on 1 August 2018.

On 1 December 2018 the company acquired 100% of the share capital of Oniqua Europe Limited for AUD 1.3 thousand, translated into GBP at the spot rate on the day of the transaction to £0.8 thousand. No goodwill arose on the transfer of the trade and assets to the company on 1 December 2018.

During the prior year the company acquired 100% of the share capital of Truven Health Analytics UK Limited. The transfer of the trade and assets of Truven Health Analytics UK Limited to the company has taken place on 1 August 2018 and goodwill of £16.5 million arose on this transaction.

Dividends received in the income statement of £175.4 million were from the following companies: i2 Holdings Limited (£97.5 million), i2 Intermediate Holdings Limited (£63.3 million), IBM Atlantic CV (£4.4 million) and Integral Solution Limited (£10.2 million). The dividends from i2 Holdings Limited, i2 Intermediate Holdings Limited and IBM Atlantic CV with a total value of £165.2 million, were received in cash. The dividends from Integral Solution were received as dividends in specie.

At the year end the directors conducted an impairment review of the investments held. As a result the company impaired the investments in i2 Holdings Limited and i2 Intermediate Holdings Limited by £122.0 million due to the decrease of their net assets following the distribution of dividends. The directors consider all other investments to be supported by the fair value of their underlying net assets.

During 2018 Integral Solution Limited went into liquidation. The amounts written off investments represents the net book value of investment cost less the recovered share capital. The write off charged to administrative expenses in the income statement is £10.2 million.

During the prior year Cascade Hosting and Applications Services UK Limited went into liquidation, the net book value of investment of £1 was written off to the income statement.

During the prior year the company made the following transactions:

On 3 October 2017 the company acquired 100% of the share capital of IBM International Treasury Services Unlimited Company (Ireland) for £1,822.8 million. Subsequently, as a result of various transactions undertaken by IBM International Treasury Services Unlimited Company (Ireland) between 6 October 2017 and 11 October 2017, the company obtained an indirect 5.06% ownership in IBM Treasury Corporation (Barbados) through its investment in IBM International Treasury Services Unlimited Company (Ireland).

On 13 October 2017 the company received a dividend in kind from IBM International Treasury Services Unlimited Company (Ireland) in the form of partnership interest in IBM Atlantic C.V. The partnership interest had a fair value of £75.3 million. On 15 December 2017, the company received a further dividend in cash from IBM International Treasury Services Unlimited Company (Ireland) of €400.0 million, translated into GBP at the spot rate on the day of the transaction to £353.3 million.

On 14 December 2017 the company acquired 100% of the share capital of International Business Machines Limited for £0.9 million.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

14 Investments (continued)

On 31 December 2017 the Directors carried out an impairment review of the company's investment in IBM International Treasury Services Unlimited Company (Ireland) and as a result impaired the investment by £517.3 million. The main cause of the impairment, due to the decrease in the fair value of IBM International Treasury Services Unlimited Company (Ireland), was as a result of the decrease in the net assets of IBM International Treasury Services Unlimited Company (Ireland) due to the dividends paid to the company since it was acquired.

Subsequent to the above impairment review, on 31 December 2017 the company transferred its investment in IBM International Treasury Services Unlimited Company (Ireland) to a subsidiary, International Business Machines Limited, by way of a share exchange agreement. The company acquired a further 1,305,477,461 £1 shares in International Business Machines Limited in exchange for its holding in IBM International Treasury Services Unlimited Company (Ireland).

In relation to these transactions, the disclosure note above includes within additions in the prior year:

- £1,822.8 million representing the transaction that took place on 3 October 2017 for the acquisition of IBM International Treasury Services Unlimited Company (Ireland).
- £0.9 million representing the transaction that took place on 14 December 2017 for the acquisition of International Business Machines Limited.

The transfer of the investment in IBM International Treasury Services Unlimited Company (Ireland) to International Business Machines Limited that took place on 31 December 2017 had a net £nil impact on the company's investments as both companies at the time of the transfer were wholly owned subsidiaries. Therefore, this transaction is not visible in the disclosure note above.

The company also made the following acquisitions during the prior year.

On 31 January 2017 the company acquired 100% of the share capital of Truven Health Analytics UK Limited for £20.0 million. As a result of this acquisition, the company acquired indirectly the ownership in Simpler Consulting Limited.

On 1 December 2017 the company acquired 8.99% ownership in Kenexa Technology Inc. (USA) for £21 million. Furthermore on 1 December 2017 the company together with International Business Machines Corporation formed a new company Kenexa Technology LLC (USA) holding 25% ownership. On 31 December 2017 Kenexa Technology Inc. merged with and into Kenexa Technology LLC. The company retained 25% ownership in Kenexa Technology LLC.

On 14 December 2017 the company acquired 100% of the share capital of two entities: 010414 UK Limited and 251211 UK Limited for £0.1 million and £0.3 million respectively.

The company had beneficial ownership of all the ordinary share capital and voting rights of the following companies at 31 December 2018 and 2017 (unless otherwise stated).

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

14 Investments (continued)

Name of subsidiary / associate / other investment	Country of registered office	Holding	Nature of business
Direct holdings			
Heartbeat Experts Limited	Great Britain	100%	Trading
IBM Atlantic CV (Partnership)	Netherlands	0.003%	Trading
Kenexa Technology LLC	United States	25%	Trading
Oniqua Europe Limited	Great Britain	100%	Trading
Truven Health Analytics UK Limited	Great Britain	100%	Trading
010414 UK Limited	Great Britain	100%	Non-trading
251211 UK Limited	Great Britain	100%	Non-trading
Blue Wolf Global Limited	Great Britain	100%	Non-trading
i2 Holdings Limited	Great Britain	100%	Non-trading
i2 Intermediate Holdings Limited	Great Britain	100%	Non-trading
International Business Machines Limited	Great Britain	100%	Non-trading
The Analytic Sciences Corporation Limited	Great Britain	100%	Non-trading
Algorithmics Risk Management Limited	Great Britain	100%	Dormant
Cleversafe UK Limited	Great Britain	100%	Dormant
EZLegacy UK Limited	Great Britain	100%	Dormant
i2 Limited	Great Britain	100%	Dormant
Kenexa Quorum Holdings Limited	Great Britain	100%	Dormant
MH (UK) Limited	Great Britain	100%	Dormant
Optevia Limited	Great Britain	100%	Dormant
Resilient Systems Europe Limited	Great Britain	100%	Dormant
Silverpop Systems Limited	Great Britain	100%	Dormant
SPSS Limited	Great Britain	100%	Dormant
Sterling Commerce (UK) Limited	Great Britain	100%	Dormant
Transitive Corporation Limited	Great Britain	100%	Dormant

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

14 Investments (continued)

Name of subsidiary / associate / other investment	Country of registered office	Holding	Nature of business
Indirect holdings through Algorithmics Risk Management Limited			
Algorithmics (UK) Limited	Great Britain	100% (indirect)	Dormant
Indirect holdings through Algorithmics (UK) Limited			
Algorithmics (Beijing) Risk Management Consulting Company Limited (China)	China	100% (indirect)	Dormant
Indirect holdings through Blue Wolf Global Limited			
Bluewolf International Limited	Great Britain	100% (indirect)	Trading
Indirect holdings through International Business Machines Limited			
IBM International Treasury Services Unlimited Company	Ireland	100% (indirect)	Trading
Indirect holdings through IBM International Treasury Services Unlimited Company (Ireland)			
IBM Treasury Corporation	Barbados	5.06% (indirect)	Trading
Indirect holdings through Kenexa Quorum Holdings Limited			
Kenexa Global Recruitment Services Limited	Great Britain	100% (indirect)	Dormant
Indirect holdings through The Analytic Sciences Corporation Limited			
Weather Services International Limited	Great Britain	100% (indirect)	Trading
Indirect holdings through Weather Services International Limited			
The Weather Channel Global Media Limited	Great Britain	100% (indirect)	Trading
Indirect holdings through Transitive Corporation Limited			
Transitive Limited	Great Britain	100% (indirect)	Dormant

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

14 Investments (continued)

Name of subsidiary / associate / other investment	Country of registered office	Holding	Nature of business
Indirect holdings through Truven Health Analytics UK Limited			
Simpler Consulting Limited	Great Britain	100% (indirect)	Trading

The registered address for Optevia Limited, Truven Health Analytics UK Limited, 010414 UK Limited, Algorithmics Risk Management Limited, i2 Holdings Limited, i2 Intermediate Holdings Limited, International Business Machines Limited, Kenexa Quorum Holdings Limited, Cleversafe UK Limited, EZLegacy UK Limited, i2 Limited, MH (UK) Limited, Resilient Systems Europe Limited, Silverpop Systems Limited, SPSS Limited, Sterling Commerce (UK) Limited, Transitive Corporation Limited, Algorithmics (UK) Limited, Kenexa Global Recruitment Service Limited, Transitive Limited, Simpler Consulting Limited, Heartbeat Experts Limited, Blue Wolf Global Limited, Bluewolf International Limited is PO BOX 41 North Harbour, Portsmouth, Hampshire, United Kingdom, PO6 3AU.

The registered addresses for the remaining subsidiary undertakings are as follows:

Name of subsidiary	Registered address
IBM Atlantic CV (Partnership)	Johan Huizingalaan 765, 1066 VH Amsterdam, the Netherlands
251211 UK Limited	76 Upper Ground, London, United Kingdom, SE1 9PZ
Kenexa Technology LLC	Corporation Trust Center, 1209 Orange Street, Wilmington, County of New Castle, Delaware, USA
Algorithmics (Beijing) Risk Management Consulting Company Limited (China)	2212A, 21/F Building 5, No 27 Central North 4 th Ring Road, Chaoyang District, Beijing, China (PRC)
IBM International Treasury Services Unlimited Company	IBM House, Shelbourne road, Ballsbridge, Dublin 4, D04NP20, Ireland
IBM Treasury Corporation	Radley Court, Lower Collymore Rock, St. Michael, Barbados
The Analytic Sciences Corporation Limited	76 Upper Ground, London, United Kingdom, SE1 9PZ
Wheather Services International Limited	76 Upper Ground, London, United Kingdom, SE1 9PZ
The Weather Channel Global Media Limited	76 Upper Ground, London, United Kingdom, SE1 9PZ
Oniqua Europe Limited	Ben Lomond View Riverside Business Park, 23 Pottery Street, Greenock, Renfrewshire, Scotland, PA15 2UZ

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

15 Purchase of business

During the year the company acquired the trade and associated assets and liabilities of these direct and indirect subsidiary undertakings: Truven Health Analytics UK Limited, Heartbeat Experts Limited, The Analytic Sciences Corporation Limited, Blue Wolf Global Limited, Oniqua Europe Limited, Simpler Consulting Limited, Weather Services International Limited, The Weather Channel Global Media Limited and Bluewolf International Limited for a consideration of £3.9 million. The transfers of assets and liabilities were at net book value. All the transfers were completed through a non-interest bearing related party payable.

During the prior year the company did not acquire trade and associated assets and liabilities of any subsidiary undertakings.

The impact of this is set out in the table below:

	2018 £m
Property, plant and equipment	0.1
Trade and other receivables due after one year	0.1
Trade and other receivables due within one year	4.0
Receivables due from related parties	18.1
Other assets	0.4
Cash and cash equivalents	2.1
Trade and other payables due within one year	(1.5)
Payables due to related parties	(18.9)
Other liabilities	(1.7)
Corporation tax	1.2
Total net assets acquired at book value	3.9

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

16 Deferred tax assets / (liabilities)

Movement in the deferred tax asset / (liability)

	Fixed asset temporary differences £m	Short term temporary differences £m	Retirement benefit £m	Total £m
At 1 January 2017	55.5	23.9	(135.5)	(56.1)
Credited / (charged) to the income statement	8.2	(5.1)	(22.5)	(19.4)
Credited to statement of comprehensive income	-	-	163.7	163.7
Credited to reserves in respect of share options	-	0.3	-	0.3
At 31 December 2017	63.7	19.1	5.7	88.5
Impact of adoption IFRS 15	-	(7.7)	-	(7.7)
(Charged) / credited to the income statement	(2.6)	(6.8)	9.0	(0.4)
Charged to statement of comprehensive income	-	-	(21.3)	(21.3)
Charged to reserves in respect of share options	-	(1.0)	-	(1.0)
At 31 December 2018	61.1	3.6	(6.6)	58.1

The deferred tax asset mostly relates to non-current items. The amount of £54.5 million (2017: £69.4 million) should be recovered more than 12 months after the reporting date and the amount of £3.6 million (2017: £19.1 million) is expected to be recovered no more than 12 months after reporting date.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

16 Deferred tax assets / (liabilities) (continued)

Movement in the unrecognised deferred tax asset:

At 1 January 2017	0.6
Movement in unrecognised amounts in the year	(0.5)
At 31 December 2017	0.1
Movement in unrecognised amounts in the year	-
At 31 December 2018	0.1

The company has £0.1 million (2017: £0.1 million) of potential deferred tax assets in respect of trading balances from acquired companies, which has not been recognised on the grounds that this is not considered recoverable in the foreseeable future. There is no unrecognised deferred tax in respect of the retirement benefit scheme.

The recognition of deferred tax assets is determined by reference to the company's estimate of recoverability based on models to forecast future taxable profits.

17 Finance receivables

	2018 £m	2017 £m
Non-current finance receivables at amortised cost		
Customer loans	12.9	9.3
	12.9	9.3
Current finance receivables at amortised cost		
Finance lease receivables	-	0.1
Customer loans	11.5	12.3
	11.5	12.4

Finance lease receivables are for leases that relate principally to the company's equipment and are generally for terms ranging from two to seven years. Customer loan receivables are provided by the company to clients to finance the purchase of IBM's software and services.

Finance lease and customer loan receivables include invoiced amounts not paid at the end of the year. The average contractual credit period on invoiced amounts is 30 days. Unless specifically negotiated, interest is charged at 8% above base rate per annum, in line with the Late Payment of Commercial Debts (Interest) Act 1998, on the outstanding balance. The company has fully provided for all invoiced amounts aged over 365 days.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

17 Finance receivables (continued)

Before entering into a finance lease arrangement, the company undertakes a credit assessment on the proposed transaction, either through the IBM Credit Team or, for certain transactions of a lower size, a credit scoring system based on external credit agency information, to assess the customer's credit quality and define credit limits by customer. Credit limits for most customers are valid for no more than six months, and are reviewed if required to be extended. The balances on leases for hardware are usually secured over the leased equipment and the fair value of the collateral held by the company is £nil (2017: £0.2 million).

As of 31 December 2018, finance lease and customer loan receivables of £nil (2017: £nil) were past due but not impaired.

In determining the recoverability of the finance lease and customer loan receivables, the company considers any change in the credit quality of the receivables balance from the date credit was initially granted up to the reporting date. The concentration of credit risk is limited due to the customer base being large and diverse. Accordingly, the directors believe that there is no credit provision required.

Amounts due from lessees under finance leases are recognised as receivables at the amount of the company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the company's net investment outstanding in respect of the leases.

Amounts receivable under finance leases:

	Minimum lease payments		Present value of minimum lease payments	
	2018 £m	2017 £m	2018 £m	2017 £m
Not later than one year	-	0.1	-	0.1
	-	0.1	-	0.1
Less:				
Unearned finance income	-	-	-	-
	-	0.1	-	0.1

The interest rate inherent in the leases is fixed at the contract date for the entire lease term. The average effective interest contracted is approximately 4.73% (2017: 4.26%) per annum.

IBM United Kingdom Limited

Notes to the Financial Statements For the Year Ended 31 December 2018

18 Inventories

	2018	2017
	£m	£m
Finished goods and goods for resale	2.0	6.5

Finished goods and goods for resale includes an allowance for obsolescence of £2.2 million (2017: £1.9 million).

The cost of inventories recognised as an expense and included in 'cost of sales' amounted to £222.6 million (2017: £190.2 million).

19 Trade and other receivables

	2018	2017
	£m	£m
Current		
Trade receivables - billed	75.4	73.8
Trade receivables - unbilled	124.2	-
Less: credit loss allowance	(1.0)	(0.5)
Amounts recoverable on contracts	-	51.9
Accrued income	-	139.3
Financial assets	198.6	264.5
Other receivables	6.0	13.5
	204.6	278.0

IBM United Kingdom Limited has entered into agreements under which it sells for cash certain of its trade receivables. One agreement is signed with IBM United Kingdom Financial Services Limited ("the factor"), a group undertaking, based in the United Kingdom, of IBM and other agreement with BNP Paribas Factor. The terms of the agreement preclude the repurchase of any trade receivables which have been sold to the factor. Any losses incurred in the collection of the debt sold under these agreements are not borne by the company. The open trade receivables as of 31 December sold to IBM United Kingdom Financial Services Limited totalling £178.7 million (2017: £158.7 million) and the open trade receivables as of 31 December sold to BNP Paribas Factor totalling £ 4.9 million (2017: £nil) have been excluded from the statement of financial position in accordance with IFRS 9 "Financial Instruments".

The majority of customers are on immediate payment terms. No interest is charged on the trade receivables for the first 30 days from the date of the invoice. Thereafter, interest is charged at 8% above base rate per annum, in line with the Late Payment of Commercial Debts (Interest) Act 1998, on the outstanding balance. The company has provided fully for all receivables over 365 days old. Trade receivables between 30 and 365 days old are provided for based on estimated irrecoverable amounts from the sale of goods, determined by reference to past default experience.

Before accepting any new customer, the company uses an external credit scoring system to assess the potential customer's credit quality and define credit limits by customer. Limits and scoring attributed to customers are reviewed annually.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

19 Trade and other receivables (continued)

Included in the company's trade receivable balance are receivables with a carrying amount of £64.6 million (2017: £58.5 million) which are past due at the reporting date for which the company has not provided as there has not been a significant change in credit quality and the company believes that the amounts are still considered fully recoverable. The company does not hold any collateral over these balances. The average past due age of these receivables is 12 days (2017: 14 days).

The credit quality of billed trade receivables is shown in the following table:

Internal rating (GRMG)	Description	2018 £m	2017 £m
1	Excellent	32.3	34.6
2 - 3	Good	24.7	17.3
4 - 5	Satisfactory	14.4	16.3
6	Special monitoring	3.4	5.0
7	Default	0.6	0.6
		75.4	73.8

20 Other assets

	2018 £m	2017 £m
Non-current		
Prepayments	19.7	17.8
Deferred costs	137.1	116.3
	156.8	134.1
Current		
Prepayments	76.6	79.5
Deferred costs	66.4	40.4
Contract assets	59.9	-
	202.9	119.9

In 2018 the company adopted IFRS 15 which resulted in an increase of deferred costs by incremental costs of obtaining a contract (deferred sales commission costs) in the amount of £38.5 million. Further impact of IFRS 15 adoption is a new reporting category "contract assets". In prior year the equivalent of contract assets is presented as "amounts recoverable on contracts" in the note 19.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

21 Provisions for liabilities and charges

	2018 £m	2017 £m
Non-current		
Asset retirement obligation	6.6	4.3
	6.6	4.3
Current		
Restructuring provision	1.3	3.0
Asset retirement obligation	0.9	3.3
Other provisions	-	4.6
	2.2	10.9

The restructuring provision relates both to the consolidation of the company's property portfolio and to workforce restructuring. These provisions are expected to be utilised over the next year. The property element of the provision recognised is based on the excess of the estimated cash flows to meet the unavoidable cost under the rental contract over the estimated cash flows to be received from sub-leasing. The estimated cash flows are discounted using a market determined risk adjusted rate.

The asset retirement provision is a legal or constructive obligation associated with dismantling, removing and restoring items of property held under an operating lease. A provision is recognised and measured, both initially and subsequently, at the estimated expenditure required to settle the present obligation at the reporting date discounted at a current market-based discount rate. The provision is reviewed at each reporting date and adjusted to reflect the current best estimate. When the effect of a change in estimated outflows of resources embodying economic benefits and/or the discount rate is material, that change is recognised and the related asset retirement costs are capitalised by increasing the carrying amount of the related asset by the same amount as the liability. Capitalised asset retirement costs are subsequently depreciated over the shorter of the lease term of the related property or the useful life of the related asset.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

21 Provisions for liabilities and charges (continued)

	Restructuring provision £m	Asset retirement obligation £m	Other provisions £m	Total £m
At 1 January 2017	12.0	8.6	-	20.6
Charged to the income statement	7.1	0.8	4.6	12.5
Utilised during the year	(15.0)	(1.4)	-	(16.4)
Unwinding of discount	0.1	-	-	0.1
Released to the income statement	(1.2)	(0.4)	-	(1.6)
At 31 December 2017	3.0	7.6	4.6	15.2
Charged to the income statement	21.9	0.2	-	22.1
Utilised during the year	(23.6)	(0.1)	(2.7)	(26.4)
Released to the income statement	-	(0.2)	(1.9)	(2.1)
At 31 December 2018	1.3	7.5	-	8.8

22 Trade and other payables

	2018 £m	2017 £m
Non-current		
Other payables	1.7	4.1
Current		
Payable to trade suppliers	160.5	125.5
Accruals - financial liabilities	56.9	66.1
Financial liabilities	217.4	191.6
Accrued expenses	114.2	121.9
Social security and other taxes	125.6	146.2
	457.2	459.7

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments

Financial risk management

The company is exposed to a variety of financial risks as a result of its operations that include the effects of changes in liquidity and interest rate risk, credit risk, market prices, and foreign exchange risk. The company has a strong risk management programme in place aligned to the worldwide programme of the company's ultimate parent company, International Business Machines Corporation.

Capital risk management

The company manages its capital to ensure that the company will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The company's overall capital management strategy remains unchanged from the prior year and is controlled globally. The capital structure of the company consists of debt to related parties disclosed in note 30, and equity attributable to equity holders of the parent, comprising issued capital, share premium and retained earnings as disclosed in the statement of changes in equity.

The company has no externally imposed capital requirements to which it is subject.

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement, and the basis on which income and expenses are recognised in respect of each class of financial asset, financial liability, and equity instrument are disclosed in note 1 to the financial statements.

Categories of financial instruments

	2018 Amortised cost £m	2018 FVOCI £m	2018 FVTPL £m
Financial assets			
Finance receivables (note 17)	24.4	-	-
Trade and other receivables (note 19)	-	198.6	-
Receivables from related parties (note 30)	200.3	-	-
Deposits held with related parties (note 30)	651.0	-	-
Derivatives from related parties (note 30)	-	-	11.6
Cash at bank	66.5	-	-
Equity investments (note 14)	-	-	75.3
	942.2	198.6	86.9
Financial liabilities			
Trade and other payables (note 22)	(217.4)	-	-
Payables to related parties (note 30)	(819.7)	-	(24.1)
	(1,037.1)	-	(24.1)

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

	2017 Loans and receivables £m	2017 Amortised cost £m	2017 FVTPL £m
Financial assets			
Finance receivables (note 17)	21.7	-	-
Trade and other receivables (note 19)	264.5	-	-
Receivables from related parties (note 30)	203.5	-	-
Deposits held with related parties (note 30)	704.3	-	-
Cash at bank	17.0	-	-
Equity investments	-	75.3	-
	1,211.0	75.3	-
Financial liabilities			
Trade and other payables (note 22)	-	(191.6)	-
Payables to related parties (note 30)	-	(817.1)	-
Derivatives to related parties (note 30)	-	-	(7.0)
	-	(1,008.7)	(7.0)

Financial risk management objectives

IBM's corporate treasury function provides funding and risk management services to the UK group of companies. Risk management services are provided through the monitoring and management of financial risks relating to the operations of the company through internal risk reports addressing market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk, and cash flow interest rate risk.

Price risk

The financial risk posed by external vendors is managed and controlled by IBM's central procurement function. Procurement is the only business unit in IBM which is authorised to make financial commitments to external vendors. The unit has responsibility for achieving overall value for IBM in terms of supplier selection at the optimum price. All procurement activities are carried out under worldwide IBM guidelines. The financial risk posed by sales price is managed through a central pricing team. The business only agrees to sign contracts once the appropriate pricing approval has been obtained.

Foreign currency risk

The company undertakes certain transactions denominated in foreign currencies, hence exposures to exchange rate fluctuations arise. Foreign currency forward contracts are entered into with a third party bank by the IBM International Treasury Services Unlimited Company ('the Treasury Centre') which in turn passes down the impacts of these derivatives by entering into matching intercompany derivatives with the company. The company does not apply hedge accounting for these derivatives. Additionally, when loans and leases are supplied in a foreign currency, the company borrows from the Treasury Centre in the same foreign currency to fund the transaction, therefore hedging against foreign exchange risk.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

Foreign currency sensitivity

The company's foreign exchange rate risk results from the revaluation of its US dollar and Euro denominated transactions and balances with group undertakings and third party customers and suppliers. A 1 percent fluctuation is the rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates.

At 31 December 2018, if British Pounds Sterling weakened/strengthened against the US dollar by 1 percent, with all other variables held constant, pre-tax profit for the year would have been £0.6 million (2017: £0.7 million) lower/higher, arising principally on the foreign exchange translation of the related party payables at the reporting date.

At 31 December 2018, if British Pounds Sterling weakened/strengthened against the Euro exchange rate, with all other variables held constant, pre-tax profit for the year would have been £0.6 million (2017: £0.9 million) lower/higher, arising principally on the foreign exchange translation of the related party payables at the reporting date.

Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the company. The company has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral, where appropriate, as a means of mitigating the risk of financial loss from defaults. The company carries out credit checks on potential customers before contracts are entered into. This information is supplied by independent rating agencies where available and, if not available, the company uses other publicly available financial information and its own trading records to rate the major customers. Credit exposure is controlled by counterparty limits that are reviewed and approved by the risk management team annually.

Trade receivables consist of a large number of customers, spread across diverse industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable.

Cash balances are held with the Treasury Centre and with NatWest Bank, which the directors assess as having high credit ratings.

The company does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The company defines counterparties as having similar characteristics if they are related entities. Concentration of credit risk did not exceed 5 percent of gross monetary assets at any time during the year.

The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the company's maximum exposure to credit risk without taking account of the value of any collateral obtained.

The company has assessed the impact of credit valuation adjustments on the related party derivatives. As the contracts are short term in nature and the exposure is with a related party, it was determined that credit adjustments would have no impact on the valuation of these derivative contracts.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

The company has entered into various guarantee contracts including guaranteeing both subsidiary and group undertakings' liabilities. No liability is recorded in the statement of financial position at the reporting date as there have been no events which would trigger a material obligation under the guarantee. The maximum credit risk associated with these guarantees is not quantifiable due to the wide range of possible trigger events and hence the number of variables that exist.

The following types of financial assets are subject to impairment criteria for expected credit losses:

- (i) Trade receivables, related party receivables and contract assets
- (ii) Financing receivables
- (iii) Off balance sheet commitments which include future financing commitments and open lines of credit

Cash and cash equivalents are also subject to the impairment requirements of IFRS 9; they have no historical losses and an allowance for credit losses is not recorded for these assets.

The company applies the simplified approach in measuring expected credit losses which uses lifetime expected credit loss allowance for trade receivables, related party receivables and contract assets. To measure the expected credit losses they are grouped based on shared risk characteristics.

Trade receivables and related party receivables expected loss rates are determined using the historical propensity for the receivables to become uncollectible and are adjusted to reflect current and forward looking information on macroeconomic factors affecting the ability of customers to settle receivables.

Contract assets expected loss rates are determined using a credit risk rating for a respective customer.

The following table represents the analysis for trade receivables and contract assets for credit risk exposure. The gross carrying amount also represents the maximum exposure to credit risk for these assets.

	Current	0-30 days	31-90 days	91-180 days	180-365 days	365+ days	Total gross carrying amount
31 December 2018	£m	£m	£m	£m	£m	£m	£m
Trade receivables billed and unbilled	170.4	5.4	16.9	4.9	1.0	1.0	199.6
Expected loss rate	0.02%	0.03%	0.09%	1.08%	4.76%	100%	
Loss allowance	-	-	-	-	-	(1.0)	(1.0)
Related party receivables	123.7	90.7	0.8	0.4	0.3	15.2	231.1
Expected loss rate	0.01%	0.01%	0.28%	1.30%	5.71%	100%	
Loss allowance	(15.6)	-	-	-	-	(15.2)	(30.8)
Contract assets	59.9	-	-	-	-	-	59.9
Expected loss rate	0.3%						
Loss allowance	-	-	-	-	-	-	-

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

The deposits held with related parties of £651.0 million and cash at bank of £66.5 are subject to the impairment requirements of IFRS 9. As at 31 December 2018 the identified impairment loss was immaterial and not recorded. Cash is held at banks with short-term credit ratings of P-2 (Moody's Investors).

The company only accounted for specific loss allowances due to insignificant amounts of the calculated general loss allowances for receivables and contract assets.

The following represents the loss allowance for trade receivables and contract assets as of 31 December 2018 which reconciles to the opening loss allowance as follows:

	Contract assets £m	Trade receivables £m	Related party receivables £m
31 December 2017	-	(0.5)	-
Opening loss allowance 1 January 2018 (IFRS9)	-	(0.5)	-
Increase in loss allowance	-	(0.5)	(30.8)
31 December 2018	-	(1.0)	(30.8)

The following table represents the assumptions by credit risk rating grades:

Credit Risk Rating	GRMG rating	Company definition	Corresponding ratings of external international rating agencies (S&P)	Basis from recognition of ECL provision
Excellent	1	strong credit quality with low expected credit risk	AAA to BB+	Lifetime ECL
Good	2 - 3	adequate credit quality with a moderate credit risk	BB to B+	Lifetime ECL
Satisfactory	4 - 5	moderate credit quality with a satisfactory credit risk	B, B-	Lifetime ECL
Special monitoring	6	facilities that require closer monitoring and remedial management	CCC+ to CC-	Lifetime ECL
Default	7	facilities in which a default has occurred	C, D-I, D-II	Impaired or asset is written off

The analysis of credit risk exposure for trade receivables is presented in note 19.

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Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

The following represents the analysis of credit risk exposure for financing receivables and the expected credit loss recognised. The gross carrying amount also represents the maximum exposure to credit risk for financing receivables.

	Loans 2018 £m
Excellent	6.1
Good	5.7
Satisfactory	12.6
Specific impairment	-
Gross carrying amount	24.4
Loss allowance for credit losses	-
Carrying amount	24.4

All finance receivables are in stage 2 of IFRS model for expected credit losses.

The company did not include loss allowance for finance receivables due to an insignificant amount of ECL. The company decided to calculate only lifetime ECL and not 12 month ECL as it was impracticable to derive point-in-time probabilities of default. Therefore the company used current probabilities of default for lifetime ECL.

Maximum credit exposure for financial instruments not subject to impairment:

	Maximum exposure to credit risk £m
Financial assets at fair value through profit and loss	
Derivatives	11.6
Equity investment	75.3

Interest rate risk management

The company is funded internally by the Treasury Centre. As the company invests or borrows cash balances internally, it operates in either a receivable or payable position. Interest is paid or earned on the daily balance using the variable one month interest rate as the base.

Interest rate risk is managed at an IBM group level on a consolidated basis. The company's exposures to interest rates on financial assets and financial liabilities are detailed in the liquidity risk management section of this note.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

Interest rate sensitivity

The sensitivity analyses below have been determined based on the exposure to interest rates for non-derivative financial instruments at the reporting date. For variable rate liabilities, the analysis is prepared assuming the amount of liability outstanding at the reporting year end date was outstanding for the whole year. A 1 percent increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

At the reporting date, if interest rates had been 1 percent higher/lower and all other variables were held constant, the company's net profit would decrease/increase by £7.3 million (2017: decrease/increase by £9.0 million). This is mainly attributable to the company's exposure to interest rates on its variable rate borrowings and cash deposits.

Liquidity risk management

The company is funded internally by the Treasury Centre. The company manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities through its agreements with the Treasury Centre. The Treasury Centre is ultimately funded by International Business Machines Corporation. Currently the company has a net cash position and loans this cash to the Treasury Centre. Given the cash position, liquidity risk is minimal.

Liquidity and interest risk tables

The following table details the company's remaining contractual maturity for its financial liabilities. The tables below have been drawn up based on the undiscounted contractual cash flows of the financial liabilities including both interest and principal cash flows. The contractual maturity is based on the earliest date on which the company may be required to pay.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

	Weighted average effective interest rate %	Less than 1 year £m	1 - 5 years £m	+ 5 years £m	Total £m
2018					
Non-interest bearing:					
Trade and other payables	-	217.4	-	-	217.4
Payable to related parties	-	819.7	-	-	819.7
	-	1,037.1	-	-	1,037.1
Interest bearing:					
Payable to related parties	-	24.1	-	-	24.1
	-	24.1	-	-	24.1
2017					
Non-interest bearing:					
Trade and other payables	-	191.6	-	-	191.6
Payable to related parties	-	797.3	-	-	797.3
Derivatives to related parties	-	7.0	-	-	7.0
	-	995.9	-	-	995.9
Interest bearing:					
Payable to related parties	5.75	19.8	-	-	19.8

Amounts payable to related parties are unsecured and, where applicable, have a variable interest rate based on LIBOR.

The following table details the company's expected maturity of its financial assets. The table below has been drawn up based on the undiscounted cash flows of the financial assets including interest that will be earned on those assets. The inclusion of information on financial assets is necessary in order to understand the company's liquidity risk management as the liquidity is managed on a net asset and liability basis.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

	Weighted average effective interest rate %	Less than 1 year £m	1 - 5 years £m	+ 5 years £m	Total £m
2018					
Non-interest bearing:					
Trade and other receivables	-	198.6	-	-	198.6
Receivables from related parties	-	200.3	-	-	200.3
Derivatives from related parties	-	11.6	-	-	11.6
	-	410.5	-	-	410.5
Interest bearing:					
Receivables from related parties	0.48	651.0	-	-	651.0
Cash at bank	1.60	66.5	-	-	66.5
Customer loans	3.65	11.5	12.9	-	24.4
	-	729.0	12.9	-	741.9
2017					
Non-interest bearing:					
Trade and other receivables	-	264.5	-	-	264.5
Receivables from related parties	-	203.5	-	-	203.5
	-	468.0	-	-	468.0
Interest bearing:					
Receivables from related parties	0.22	704.3	-	-	704.3
Cash at bank	1.25	17.0	-	-	17.0
Finance lease receivables	4.26	0.1	-	-	0.1
Customer loans	3.59	12.3	9.3	-	21.6
	-	733.7	9.3	-	743.0

Amounts receivable from related parties are unsecured and, where applicable, have a variable interest rate based on LIBOR.

Fair value of financial instruments

The directors have carried out a review of the fair values of the financial assets and liabilities. The directors consider that the carrying values of financial assets and financial liabilities in the financial statements, except as detailed in the following table, approximate their fair values. The impact of discounting is not significant as the majority are short term and variable rated.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

	Carrying amount £m	Fair value £m
2018		
Non-current financial assets		
Customer loans	12.9	13.0
2017		
Non-current financial assets		
Customer loans	9.3	10.3

The fair value of the financial assets above is determined in accordance with level 3 fair value measurements with pricing models based on valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

For financial instruments that are subsequently measured at fair value, the fair value measurement is grouped into Levels 1 to 3 based on the following fair value hierarchy:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1, that are observable for the asset or liability, either directly (i.e. as price) or indirectly (i.e. derived from prices);
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The following table presents the company's assets and liabilities that are measured at fair value at 31 December 2018 and 31 December 2017:

	2018 Level 2 £m	2018 Level 3 £m	2017 Level 2 £m
Financial assets			
Trade receivables	-	198.6	-
Derivatives from related parties	11.6	-	-
Financial liabilities			
Payables to related parties	-	(24.1)	-
Derivatives to related parties	-	-	(7.0)

There are no financial instruments measured at fair value level 1.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Financial instruments (continued)

The fair value of trade receivables is the selling price at which the receivables can be sold to the factors.

The fair value of the derivative from related parties is derived as the unrecognised foreign currency gains or losses relating to hedged foreign currency financial assets and liabilities.

Derivative gain and loss recognised in the income statement

The amount recognised in the income statement in the year in respect of foreign currency forward exchange contracts was a loss of £15.2 million (2017: gain of £15.8 million).

24 Retirement benefits

	2018 £m	2017 £m
Statement of financial position asset / (liability) for		
Defined benefits plan	38.6	(33.7)
Income statement charge / (income) for:		
Defined benefits plan	116.9	(74.2)
Remeasurement gains / (losses) recognised in the statement of other comprehensive income		
Defined benefits plan	125.3	(962.7)
Cumulative actuarial losses recognised in the statement of other comprehensive income	(952.9)	(1,078.2)

Description of the pension plans

The IBM contributory pension plans, the IBM Pension Plan ('Main Plan') and the IBM IT Solutions Pension Scheme ('I Plan'), are administered separately from the company. The primary purpose of the plans is to provide retirement benefits to eligible employees after retirement and until death in respect of their service as employees. The assets of these plans, which comprise both defined benefit and defined contribution sections, are held in trust funds. The cost of the defined benefit sections of the plans is assessed in accordance with the advice provided by independent qualified actuaries. The defined benefit section of the Main Plan was closed to new members in April 1997. Employees who joined the company between April 1997 and April 2011 were eligible to become members of the defined contribution section of the Main plan. From April 2011 employees who join the company are eligible to become members of a group personal pension plan administered by Standard Life. The defined benefit sections were closed to future accrual from April 2011 with the exception of a sub-section of the population within the I Plan. An additional pension plan ('Prudential Platinum Plan') administers the pensions of employees transferring to IBM under a specific outsourcing contract. This is a defined benefit pension plan administered by Prudential on behalf of the company.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

24 Retirement benefits (continued) Regulatory framework

Actuarial valuations of the defined benefit sections of the pension plans are carried out every three years. The most recent valuations of the Main Plan and I Plan as at 31 December 2015 were carried out by an independent qualified actuary in October 2016 using the projected unit credit method. The actuarial valuation of the defined benefit sections of these plans as at this date showed a funding deficit of £392.0 million.

The Trustees of the Main and I Plans have agreed with the company a schedule of contributions for each of the plans that sets out the amount of the company's annual contributions from October 2016 to 20 October 2021 for the Main Plan and from October 2016 to 30 June 2022 for the I Plan, following the formal valuation of the plans at 31 December 2015. Under the agreed schedules the company is making deficit contributions of £23.0 million per year from 1 April 2017 to the defined benefit section of the Main Plan, and at a rate of the higher of 49% of pensionable earnings and £3.9 million, for the sub-section of the I Plan population for which accrued benefits are continuing to accrue, plus deficit contributions of £30.0 million per year from 1 January 2017 to the I Plan. Since March 2016, the company has the option to transfer Treasury Bills issued by the United States Government on a quarterly basis in lieu of cash contributions

A qualified independent actuary carries out an IAS 19 "Retirement Benefits" review of the Main and I Plans for the financial statements. At 31 December 2018 the IAS 19 valuation for these plans showed an asset of £38.6 million (2017: liability £33.7 million), while the tri-annual funding actuarial valuation at 31 December 2015 showed a deficit of £392.0 million. The reasons for the difference between the IAS 19 valuation and the tri-annual funding actuarial valuation is driven by the assumptions used. The tri-annual funding valuation was completed in October 2016. The technical provisions adopted in the tri-annual funding valuation include a 50 basis point margin from the return on investment to discount rate for prudence. The IAS 19 valuation was carried out using the conditions which existed at 31 December 2018, and as such does not include the assumptions incorporated into the funding valuation at 31 December 2015.

Due to the size of the Prudential Platinum Plan, detailed disclosure has not been made. The present value of the Prudential Platinum Plan defined benefit obligation amounts to £54.0 million (2017: £57.7 million). The fair value of the Prudential Platinum Plan assets amounts to £58.3 million (2017: £64.2 million).

Following the 2017 judgment of the Court of Appeal holding that the company acted lawfully in 2010 in closing its UK defined benefit plans to future accrual for most participants and in implementing a new retirement policy, the Employment Tribunal in Southampton UK is administering approximately 285 individual actions alleging constructive dismissal and age discrimination brought against the company in 2010 by employees who left the company at that time. The individual actions were previously stayed pending the Court of Appeal judgment. The directors do not expect a material liability to arise from these actions.

Governance

The Board of Directors of the Trustee Company, IBM United Kingdom Pensions Trust Limited, is responsible for the management of the Plan benefits, the design of the investment strategy and objectives and monitoring the assets of defined benefit plans to ensure that they achieve their fundamental objective of meeting pension liabilities as they become due. The Board of Directors of the Trustee Company also ensures that both defined benefit and defined contribution assets are administered according to specific legislation and plan documentation.

The Governance Committee is responsible for monitoring Plan risks and compliance and monitoring Trustee effectiveness.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

24 Retirement benefits (continued)

The Investment Committee, which is supported by independent investment advisors, ensures that the defined benefit and defined contribution funds meet their objectives. The Investment Committee approves and monitors policies and activities, such as investment policy, asset mix policy, performance benchmarks and objectives, investment strategies, active/passive policy target mix and delegation of authorities. The allocation of assets among various types of asset classes and the performance of investments held by defined benefit trusts (funds) are monitored by the Pensions Trust management on a monthly basis and reviewed by the Investment Committee on a quarterly basis. The portfolios are managed and reviewed on a daily basis by external investment managers based on the policies, targets and benchmarks established by the Investment Committee.

The Benefit Allocation Committee reviews and approves benefits payable to dependants of recently deceased Plan members.

The Dispute Resolution Committee meets, when required, to review complaints made by plan members together with any other related matters referred to it by the Trustee Board, and to make recommendations in respect of these matters to a meeting of the full Trustee Board of the Plan.

General risks

The company's obligations under defined benefit plans statutory minimum funding requirements may significantly vary depending on a number of market, economic, and demographic conditions, such as yields on government and corporate debt, return on plan assets invested in debt and equity securities as well as pooled funds, employee turnover and retiree mortality rates.

These risk factors may affect the company's future cash outflows to fund its obligations, amounts of periodic benefit costs used in calculating net profit and re-measurement charges reported in other comprehensive income.

Asset volatility

The plan liabilities are calculated using a discount rate set with reference to corporate bond yields; if plan assets underperform this yield, this will create a deficit. The plans' assets are broadly diversified and invested in developed world and emerging market equities, UK and overseas bonds and index linked gilts, UK property, reinsurance and private equity. In addition, to help minimise volatility in the value of the investments, the Trustee uses derivatives to hedge a proportion of its currency risk and interest rate and inflation rate risks.

Changes in bond yields

A decrease in corporate bond yields will increase plan liabilities, although this will be partially offset by an increase in the value of the plans' bond holdings.

Inflation risk

The pension obligations are linked to inflation, and higher inflation will lead to higher liabilities. The majority of the plan assets are either unaffected by (fixed interest bonds) or loosely correlated with (equities) inflation, meaning that an increase in inflation will also increase the deficit.

Life expectancy

The plans' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

24 Retirement benefits (continued)

Amounts recognised in the Statement of Financial Position and movement over the years:

Net retirement benefit asset / (obligation)

	2018 £m	2017 £m
Defined benefit obligation	(7,901.1)	(8,403.4)
Fair value of plan assets	8,909.5	9,268.2
Net asset before unrecognised surplus and minimum funding requirement liability	1,008.4	864.8
Derecognised asset surplus	(926.9)	(834.0)
Recognised minimum funding requirement liability	(42.9)	(64.5)
Unrecognised surplus and minimum funding requirement liability	(969.8)	(898.5)
Total	38.6	(33.7)

Defined benefit obligation

	2018 £m	2017 £m
Present value of defined benefit obligation at beginning of year	(8,403.4)	(8,224.1)
Current service cost	(6.8)	(7.4)
Interest cost	(191.1)	(203.1)
Contributions by plan participants	(0.3)	(0.4)
Actuarial gain / (loss) - experience	37.0	(44.1)
Actuarial gain / (loss) - financial assumptions	361.4	(365.9)
Actuarial gain - demographic assumptions	2.0	-
Benefits paid	401.5	372.8
Past service (cost) / income	(104.9)	68.8
Termination benefits	3.5	-
Present value of defined benefit obligation at end of year	(7,901.1)	(8,403.4)

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

24 Retirement benefits (continued)

Fair value of plan assets

	2018 £m	2017 £m
Fair value of plan assets at beginning of year	9,268.2	9,021.9
Interest income	211.5	223.6
Return on plan assets	(224.5)	345.8
Contributions by the employer	63.9	57.0
Contributions by plan participants	0.3	0.4
Benefits paid	(401.5)	(372.8)
Administration costs	(4.9)	(7.7)
Settlements	(3.5)	-
Fair value of plan assets at end of year	8,909.5	9,268.2

Impact of unrecognised surplus and minimum funding requirement liability

	2018 £m	2017 £m
Unrecognised surplus and minimum funding requirement at beginning of year	(898.5)	-
Interest on unrecognised surplus	(20.7)	-
Change in unrecognised surplus and minimum funding requirement during the year	(50.6)	(898.5)
Unrecognised surplus and minimum funding requirement at end of year	(969.8)	(898.5)

The company has an unconditional right to a refund of any surplus from the I Plan and the net retirement benefit asset is fully recognised. In respect of the M Plan the directors have concluded that the company does not have an unconditional right to a refund of any surplus or other economic benefits from an asset surplus. The company does not recognise the net retirement benefit asset surplus for the M Plan. In addition, the schedule of contributions agreed between the Trustees of the M Plan and the company meets the minimum funding requirement and gives rise to a liability. The minimum funding requirement liability recognised in respect of the M Plan is £42.9 million (2017: £64.5 million).

The High Court judgment delivered on 26 October 2018 in the Lloyds GMP pensions case has confirmed that pension schemes are required to equalise for the effects of unequal GMPs for the period since 17 May 1990. A figure of £98.6 million representing the estimated additional liabilities is shown as a past service cost in the 2018 Income statement.

As a result of the Court of Appeal IBM pensions judgment in 2017, the company adjusted its obligation under the plan. This adjustment resulted in a gain of £70 million for the year ended 31 December 2017, which was recorded in employee expenses in the Income statement.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

24 Retirement benefits (continued)

Amounts recognised in the income statement

	2018 £m	2017 £m
Current service cost	6.8	7.4
Past service cost	6.3	1.2
Past service income - plan amendments	98.6	(70.0)
Employee expense (note 7)	111.7	(61.4)
Administration costs	4.9	7.7
Interest cost on obligation	191.1	203.1
Interest income on plan assets	(211.5)	(223.6)
Interest cost on unrecognised surplus	20.7	-
Net interest on defined benefit asset	0.3	(20.5)
Defined benefit expense / (gain) in the income statement	116.9	(74.2)
Defined contribution expense in the income statement	79.2	80.9

Amounts recognised in other comprehensive income

	2018 £m	2017 £m
Remeasurement (losses) / gains on plan assets	(224.5)	345.8
Remeasurement gains / (losses) on plan liabilities	400.4	(410.0)
Change in unrecognised surplus and minimum funding requirement during the year	(50.6)	(898.5)
Change to gains / (losses) recognised in other comprehensive income	125.3	(962.7)
Cumulative remeasurement losses recognised in other comprehensive income at the start of the year	(1,078.2)	(115.5)
Cumulative remeasurement losses recognised in other comprehensive income at the end of the year	(952.9)	(1,078.2)

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

24 Retirement benefits (continued)

Fair value and composition of plan assets

The table below analyses plan assets carried at fair value, by valuation method. The different levels have been defined in note 23. The fair value and composition of plan assets is as follows:

	2018 Level 1 £m	2018 Level 2 £m	2018 Level 3 £m	2018 Total £m
Equity				
Equity securities	488.2	503.5	222.3	1,214.0
Fixed Income				
Government securities	-	3,309.4	-	3,309.4
Corporate bonds	-	717.1	-	717.1
Unit trust bonds	-	2,131.5	-	2,131.5
Other fixed income	-	170.0	-	170.0
Cash and cash equivalents				
Cash and cash equivalents	5.5	248.5	-	254.0
Others				
Real estate	-	-	347.3	347.3
Private equity	-	-	378.8	378.8
Other	-	387.4	-	387.4
Total market value of assets	493.7	7,467.4	948.4	8,909.5

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

24 Retirement benefits (continued)

	2017 Level 1 £m	2017 Level 2 £m	2017 Level 3 £m	2017 Total £m
Equity				
Equity securities	625.2	562.6	217.1	1,404.9
Fixed interest				
Government securities	-	4,033.5	-	4,033.5
Corporate bonds	-	750.6	-	750.6
Unit trust bonds	-	1,368.5	-	1,368.5
Other fixed income	-	180.8	-	180.8
Cash and cash equivalents				
Cash and cash equivalents	12.0	422.0	-	434.0
Others				
Real estate	-	-	342.7	342.7
Private equity	-	-	328.1	328.1
Other	0.4	424.7	-	425.1
	637.6	7,742.7	887.9	9,268.2

Scheme assets do not include any of the company's financial instruments or property occupied, or assets used, by the company.

IBM United Kingdom Limited

Notes to the Financial Statements For the Year Ended 31 December 2018

24 Retirement benefits (continued)

Significant actuarial assumptions

The main assumptions for the current year IAS 19 valuation are as follows:

	2018 %	2018 %	2018 %
	Main Plan	I Plan	Prudential
Discount rate	2.60	2.70	2.70
Retail price inflation assumption	3.10	3.10	3.10
Consumer price inflation assumption	2.10	2.10	2.10
Rate of salary increase	2.60	2.60	2.60
Pension increases for in-payment benefits			
- accrued before 6 April 1997 (until 2020)	1.55	3.10	-
- accrued before 6 April 1997 (thereafter)	-	3.10	-
- accrued between 6 April 1997 and 5 April 2005	2.10	3.10	-
- accrued after 5 April 2005	2.10	3.10	3.10
Pension increases for deferred benefits			
- accrued before 6 April 2009	2.10	2.10	-
- accrued after 5 April 2009	2.10	2.10	3.10

	2017 %	2017 %	2017 %
	Main Plan	I Plan	Prudential
Discount rate	2.30	2.40	2.50
Retail price inflation assumption	3.10	3.10	3.10
Consumer price inflation assumption	2.10	2.10	2.10
Rate of salary increase	2.60	2.60	2.60
Pension increases for in-payment benefits			
- accrued before 6 April 1997 (until 2020)	1.55	3.10	-
- accrued before 6 April 1997 (thereafter)	-	3.10	-
- accrued between 6 April 1997 and 5 April 2005	2.10	3.10	-
- accrued after 5 April 2005	2.10	3.10	3.10
Expected future pension increases			
- accrued before 6 April 2009	2.10	2.10	-
- accrued after 5 April 2009	2.10	2.10	3.10

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24 Retirement benefits (continued)

The actuarial valuation incorporates mortality assumptions in line with published statistics. The base tables adopted are the standard tables SAPS "S2" Light with multipliers of 105% for males, 85% for female pensioners and 90% for female dependants. Longevity improvements are assumed to be in line with CMI 2014 Core Projection Model up to 2015 and in line with the CMI 2015 Core Projection Model from 2015, both with a long term annual rate of improvement of 1.5% pa. The resulting life expectancies for the current and prior year IAS19 valuations are as follows:

	2018 Years	2017 Years
Longevity at age 65 for current pensioners		
- Men	88.5	88.6
- Women	91.5	91.5
Longevity at age 65 for future pensioners		
- Men	90.6	90.7
- Women	93.8	93.8

Sensitivities

The sensitivity analyses below have been determined on the basis of reasonably possible changes in actuarial assumptions at the end of the reporting year while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated.

	Main Plan	I Plan	Prudential
Discount rate			
0.25% increase	(231.0)	(55.0)	(2.5)
0.25% decrease	244.0	59.0	2.5
Mortality			
Increase of 1 year in expected lifetime of participant at age 65	209.0	40.0	1.9

Expected contributions

The expected contributions to defined benefit pension funds for the next reporting year after the company's reporting date are:

	£m
Contributions by the employer	57.4
Contributions by plan participants	0.3
	57.7

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Notes to the Financial Statements

For the Year Ended 31 December 2018

24 Retirement benefits (continued)

Maturity Profile

The duration of defined benefit pension obligations at the end of the reporting year on 31 December were as follows:

	Main Plan	I Plan
Duration of the plans in years	14.5	21.4

25 Share-based payments

Share-based incentive awards are provided to employees for shares in the ultimate parent company, International Business Machines Corporation, under the terms of the plans. Shares in the ultimate parent company are denominated in US dollars.

During the year the company recognised total expenses, excluding deferred tax, of £16.0 million (2017: £16.5 million) related to equity-settled share-based payment transactions.

Under the terms of the arrangement with International Business Machines Corporation, the intercompany payment made and offset to equity against retained earnings in respect of the difference between the market value of the underlying shares on exercise date and the proceeds from exercise of the share based payments is £2.3 million (2017: £5.0 million).

Share options

Share options are awards which allow the employee to purchase shares of International Business Machines Corporation at a fixed price. They are granted at an exercise price equal to or greater than the ultimate parent company's share price at the date of the grant. These awards, which generally vest 25 percent per year, are fully vested four years from the date of grant and have a contractual term of 10 years.

Details of the number of share options and the weighted average exercise price outstanding during the year are as follows:

	No. (‘000)	2018 Weighted average exercise price £	No. (‘000)	2017 Weighted average exercise price £
Outstanding at the beginning of the year	-	-	5	83.31
Exercised during the year	-	-	(4)	79.84
Expired during the year	-	-	(1)	79.84
Outstanding at the end of the year	-	-	-	-

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Notes to the Financial Statements

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25 Share-based payments (continued)

The weighted average share price at the date of exercise for share options exercised during 2017 was £122.16.

During the year no share options were granted (2017: no share options).

Share awards

In addition to share options, the company grants its employees share awards. These awards are made in the form of Restricted Stock Units (RSUs). RSUs are share awards that are granted to employees and entitle the holder to shares of International Business Machines Corporation's common stock as the award vests, typically over a two-to-five year period. The fair value of the award is determined and fixed on the grant date based on International Business Machines Corporation's share price. For RSUs awarded after 31 December 2007, dividend equivalents will not be paid. The fair value of such RSUs is determined and fixed on the grant date based on International Business Machines Corporation's share price adjusted for the exclusion of dividend equivalents.

Details of the number of RSUs outstanding during the year are as follows:

	2018 No. ('000)	2017 No. ('000)
Outstanding at the beginning of the year	480	550
Granted during the year	226	174
Released during the year	(152)	(166)
Forfeited during the year	(50)	(36)
Transferred during the year	9	(42)
Outstanding at the end of the year	513	480

RSUs transferred during the year relate to employees assigned to and from other countries.

The weighted average fair value of RSUs granted during the year was £70.60/\$94.17 (2017: £81.83/\$105.36).

Employee Share Purchase Plan

The company maintains an Employee Share Purchase Plan (ESPP). The ESPP enables eligible participants to purchase full or fractional shares of International Business Machines Corporation through payroll deductions at a 5% deduction from fair value.

In relation to the ESPP, £0.1 million (2017: £0.2 million) was recognised in the income statement during the year.

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Notes to the Financial Statements

For the Year Ended 31 December 2018

26 Operating lease commitments

At the reporting date, the company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2018		2017	
	Land and buildings	Other items	Land and buildings	Other items
	£m	£m	£m	£m
Within 1 year	30.6	23.3	26.6	9.7
Between 1 to 5 years	68.7	32.5	39.2	10.0
After more than 5 years	10.1	-	-	-
	109.4	55.8	65.8	19.7

At the reporting date the total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases amounted to £0.2 million (2017: £0.3).

27 Contingencies

The company has contingent liabilities in respect of bank and contractual performance guarantees, including on behalf of other group companies, and other matters arising in the normal course of business, including claims with customers. No material liability is expected to arise in respect of these arrangements.

The fair value of the performance guarantees at the year end is £nil (2017: £nil).

The company is defendant in approximately 285 individual cases brought in 2010 by participants of the defined benefit plans who left IBM. These claims are being administered by the Employment Tribunal in Southampton. See note 24 for further details.

28 Events after the reporting date

There have been no significant events affecting the company since the year end.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

29 Notes to the cash flow statement

Reconciliation of profit for the year to net cash inflow from operating activities

	2018 £m	2017 £m
Profit for the year	123.4	49.8
Adjustments for:		
Depreciation	63.9	61.5
Loss on disposal of property, plant and equipment	0.2	0.3
Impairment of investments	122.0	517.3
Income from investments	(175.4)	(428.6)
Loss on disposal of investment	10.2	-
Difference between pension charge and cash contribution	52.8	(110.8)
Difference between share based payment charge and cash contribution	(2.3)	(5.0)
Decrease in provisions	(6.4)	(5.4)
Increase in ECL provision to receivables	31.3	-
Finance income	(3.1)	(26.2)
Finance cost	9.1	10.4
Income taxes (credit) / charge	(9.0)	59.4
Changes in operating assets and liabilities:		
Increase in trade and other receivables	(11.5)	(67.6)
(Decrease)/ Increase in trade and other payables	(65.0)	2.2
Decrease in inventories	4.5	6.0
Cash generated from operations	144.7	63.3
Interest paid	(8.8)	(10.4)
Income tax refund / (paid)	2.7	(26.1)
Net cash inflow from operating activities	138.6	26.8

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

30 Related party transactions

Related parties include parent companies, entities under common control ('group undertakings'), subsidiaries and key management personnel. The company enters into transactions with related parties in the ordinary course of business for the purchase or sale of goods and services provided to and from related parties, purchase of investments from related parties, in relation to group funding arrangements with related parties and in relation to the factoring of trade receivables with related parties. Receivables from related parties also arise from group relief. The group relief receivable arises on the surrender of company losses to other group companies which are used in that company's tax return.

The following transactions were carried out with related parties, and were made on commercial terms and conditions:

Class of related party	Transaction type	2018	2017
		£m	£m
Immediate parent	Interest receivable	-	1.7
	Dividends paid	207.9	-
Subsidiary undertakings	Interest receivable	3.0	3.8
	Disposal of investments (note 14)	10.2	-
	Transfer of trade (note 15)	3.9	-
	Goodwill from transfer of trade (note 13)	22.5	-
	Dividends received (note 14)	165.2	353.3
	Dividends in specie received (note 14)	10.2	75.3
Other group undertakings	Sales	741.0	783.3
	Purchases	1,781.2	1,857.6
	Interest receivable	-	0.2
	Interest payable	5.4	5.3
	Sale of trade receivables	1,711.1	1,825.4
	Purchase of investments (note 14)	6.5	1,865.0
	Dividends paid	25.6	-

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

30 Related party transactions (continued)

Details of the amounts receivable from and payable to related parties are set out below:

Receivables from related parties

	2018 £m	2017 £m
Receivables from subsidiary undertakings	21.0	5.1
Receivable from other group undertakings	210.1	198.4
Less: provision for impairment of receivables from related parties	(30.8)	-
Short-term deposits held with subsidiary undertakings	651.0	704.3
	851.3	907.8

Included in amounts receivable from related parties is £651.0 million (2017: £704.3 million) which is interest bearing. The amounts are short-term deposits held with IBM International Treasury Services Unlimited Company (Ireland).

	2018 £m	2017 £m
Impairment losses recognised on receivables from related parties	(30.8)	-
	(30.8)	-

Payables to related parties

	2018 £m	2017 £m
Immediate parent	45.4	45.1
Subsidiary undertakings	305.6	304.2
Other group undertakings	492.8	467.8
	843.8	817.1

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

30 Related party transactions (continued)

Included in amounts payable to related parties is £24.1 million (2017: £19.8 million) which is interest bearing.

The amounts outstanding on these balances are unsecured and will be settled in cash. No guarantees have been given or received.

Derivative from related parties

	2018 £m	2017 £m
Other group undertakings	11.6	(7.0)

A group undertaking has a 12 month forward rolling hedging programme on behalf of the company to hedge a proportion of its US dollar costs arising from transactions with both related companies and suppliers. The basis of valuation of this is disclosed in note 23.

Key management compensation

Key management (including directors) have been determined to be the lead management of each of the lines of business in the United Kingdom. Members of key management are remunerated by the company. The total remuneration of members of key management paid by the company in the year in respect of services to the company was as follows:

	2018 £m	2017 £m
Short-term employee benefits	5.3	4.1
Post-employment benefits	0.5	0.3
Share-based payments	1.4	1.3
	7.2	5.7

Aggregate key management personnel benefits under long term incentive schemes excluding share based payments were £nil (2017: £nil).

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Notes to the Financial Statements

For the Year Ended 31 December 2018

31 Share capital

Allotted, called up and fully paid

	Number of shares	Ordinary shares £m	Preference shares £m	Share premium £m	Total £m
At 1 January 2017	956,427,061	956.4	-	743.7	1,700.1
Purchase of own preference shares	(5)	-	-	-	-
At 31 December 2017	956,427,056	956.4	-	743.7	1,700.1
At 31 December 2018	956,427,056	956.4	-	743.7	1,700.1

During 2017 the company purchased five own preference shares from IBM International Holding Finance Company Limited, par value £1. As a consequence the company created a capital redemption reserve in the amount of £5. The related share premium remained in the share premium capital account and the purchase price of £200.0 million was charged against the retained earnings of the company.

In the event of a winding up the holder of the preference shares shall be entitled to £1 per share, the issued share premium paid and any declared but unpaid dividends. The payment of a dividend on the preference shares is at the discretion of the directors of the company. The company has the right at any time to redeem all or any preference shares for an amount equal to its fair market value.

The holder of the preference shares has no right to vote at meetings, unless the business of the meeting includes a resolution for the liquidation of the company, a reduction of the capital of the company or a resolution adversely altering any of the special rights and privileges attached to the preference shares.

32 Significant non-cash investing and financing activities

Investing transactions that did not require the use of cash and cash equivalents and were excluded from the cash flow statement are as follows:

	2018 £m	2017 £m
Non-cash investing activities		
Proceeds from disposed subsidiary in form of other subsidiary's shares	-	1,305.5
Dividends in specie received	10.2	75.3
	10.2	1,380.8

There are no significant non-cash financing activities.

IBM United Kingdom Limited

Notes to the Financial Statements

For the Year Ended 31 December 2018

33 Ultimate parent company

The company's immediate parent undertaking is IBM United Kingdom Holdings Limited, which holds 89% of the shares and is registered in England and Wales.

The company's ultimate parent undertaking and controlling party is International Business Machines Corporation which is incorporated in the United States of America and is the parent undertaking of the smallest and largest group to consolidate these financial statements. Copies of the financial statements of this undertaking may be obtained from IBM Corporate Headquarters, New Orchard Road, Armonk, New York 10504.