1. Accounting Policies

Dechra Pharmaceuticals PLC is a public limited company, which is listed on the London Stock Exchange and incorporated and domiciled in the United Kingdom. The address of its registered office is 24 Cheshire Avenue, Cheshire Business Park, Lostock Gralam, Northwich, England. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below, these have been applied consistently in all years presented with the exception of the adoption of new accounting standards as outlined below.

(a) Statement of Compliance

These consolidated financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRSs) and IFRS Interpretations Committee (IFRS IC) as adopted by the European Union, and the Companies Act 2006 applicable to companies reporting under IFRS. The Company has elected to prepare its Parent Company financial statements in accordance with FRS 101 and they are separately presented on pages 204 to 214.

(b) Basis of Preparation

The Group’s business activities together with the factors likely to affect its future development, performance and position are set out in the Strategic Report on pages 10 to 77. The Directors have a reasonable expectation that the Company and Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis of accounting in preparing the annual financial statements. Refer to the Financial Review on page 33 for details, including our consideration of the impact of COVID-19 on this assessment. The consolidated financial statements are presented in Sterling, rounded to the nearest 0.1 million. They are prepared on a going concern basis and under the historical cost convention, except where IFRSs require an alternative treatment. The principal variations relate to derivative financial instruments, cash settled share-based transactions, contingent consideration and assets and liabilities acquired through business combinations that are stated at fair value. The preparation of consolidated financial statements in conformity with IFRSs requires the use of accounting estimates and for management to exercise its judgement in the process of applying the Group’s accounting policies. These judgements and estimates are based on historical experience and management’s best knowledge of the amounts, events or actions under review and the actual results may ultimately differ from these estimates. Areas involving a high degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are, where necessary, disclosed separately.

Prior Year Restatement

In preparation of the financial statements, comparative amounts have been restated to reflect the hindsight adjustments made on the provisional Dechra Brasil Produtos Veterinarios LTDA (formerly Laboratorios Vencofarma do Brasil Ltda) (Dechra Brazil) acquisition accounting adjustments. Hindsight adjustments have been made to intangible assets, tangible assets, inventory, trade receivables and deferred tax liabilities (note 31).

Critical Judgements in Applying the Group’s Accounting Policies and Key Sources of Estimation Uncertainty

In the process of applying the Group’s accounting policies, the Directors have made the following judgements and estimates where the actual outcome may differ from that calculated. The key judgements and key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing material adjustment to the carrying values of the assets and liabilities within the next financial year, are summarised below.

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1. Accounting Policies continued

Non-underlying Items

The Group presents a number of non-GAAP measures. This is to allow investors to understand the underlying performance of the Group, excluding items associated with areas such as: amortisation of acquired intangibles; remeasurement and accounting for the passage of time in respect of contingent considerations; unwind of fair value adjustments to inventory arising from business combinations; non-recurring expenses relating to Brexit; expenses relating to acquisition and subsequent integration activities; rationalisation of the manufacturing organisation; loss on extinguishment of debt; and the revaluation of deferred tax balances following substantial tax legislation changes. Management utilise this measure to isolate the impact of exceptional, one-off or non-trading related items and consequently the classification of these items requires judgement. Further details can be found in note 5.

Adoption of New and Revised Standards

The following standards, amendments to standards or interpretations have been adopted for the first time from 1 July 2019. Please refer to note 35 for more detail on the impact of adoption on the financial statements.

- IFRS 16 ‘Leases’ provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value.
- IFRIC 23 ‘Uncertainty over Income Tax Treatment’ provides clarity on how to apply the recognition and measurement requirements in IAS 12 ‘Income Taxes’ when there is uncertainty over income tax treatments. Adoption of this interpretation did not have a material impact on the Group’s financial statements.
- IFRS 3 ‘Business Combinations’ - The Group has early adopted the amendments to apply an optional concentration test to assess whether substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or group of similar identifiable assets. The optional concentration test was applied in the acquisition of the Mirataz product rights (refer to note 31).

New Standards and Amendments to Standards or Interpretations

A number of amendments to IFRSs became effective for the financial year beginning on 1 July 2019. The other standards did not have any impact on the Group’s accounting policies and did not require retrospective adjustments.

(c) Basis of Consolidation

Subsidiary Undertakings

Subsidiary undertakings are fully consolidated from the date on which control is transferred to the Group. They cease to be consolidated from the date that the Group no longer has control. All subsidiary undertakings have been consolidated. Inter-company transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated on consolidation. The financial statements of all subsidiary undertakings are prepared to the same reporting date as the Company, with the exception of Genera Pharma d.o.o., Dechra Brazil and Dechra-Brovel S.A. de C.V. (all of which prepare local financial statements to 31 December each year, in line with local tax authority regulations).

Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased to recognise the investor’s share of the change in net assets of the investee after the date of acquisition. Intangible assets identified as part of the notional purchase price allocation are amortised over the useful life of each asset, with the Group’s share recognised as a charge in the income statement.

The Group’s share of post-acquisition profit or loss is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. Distributions received from an associate reduce the carrying amount of the investment.

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to share of profit/(loss) of associates in the income statement.

Gains and losses resulting from upstream and downstream transactions between the Group and its associate are only recognised to the extent realised. Any unrealised gains or losses are eliminated, to the extent of the Group’s interest in the associate. Accounting policies of associates have been aligned where necessary to ensure consistency with the policies adopted by the Group.
Notes to the Consolidated Financial Statements

1. Accounting Policies continued
   (d) Foreign Currency Translation
      (i) Functional and Presentational Currency
          The consolidated financial statements are presented in Sterling, which is the Group's presentational currency, and are rounded to
          the nearest hundred thousand, except where it is deemed relevant to disclose the amounts to the nearest million. Items included
          in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment
          in which the entity operates (the functional currency).

      (ii) Foreign Currency Translation
          Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the
          transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of
          monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, with the exception of
          differences on transactions that are subject to effective cash flow hedges, which are recognised in other comprehensive income.

      (iii) Foreign Operations
          The income and expenses are translated to Sterling at the average rate for the period being reported. The assets and liabilities of
          foreign operations are translated to Sterling at the closing rate at the reporting date. Foreign currency differences on all translations
          are recognised in other comprehensive income in the foreign currency translation reserve, a separate component of equity.

          Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity
          and translated at the closing rate. On disposal of a foreign entity, accumulated exchange differences previously recognised in other
          comprehensive income are recognised in the income statement in the same period in which the gain or loss on disposal is recognised.

   (e) Accounting for Financial Assets and Liabilities, Derivative Financial Instruments and Hedging Activities

      Financial Assets
      At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through
      profit or loss (FVPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial
      assets carried at FVPL are expensed in profit or loss.

      Management determines the classification of its financial assets at initial recognition in accordance with IFRS 9, which defines three
      categories that debt instruments may be classified as, depending on the purpose for which the assets are held. These categories are:

      • Amortised cost;
      • Fair value through other comprehensive income (FVOCI); and
      • Fair value through the profit and loss (FVPL).

      Amortised cost relates to assets that are held for collection of contractual cash flows. Where those cash flows represent solely payments
      of principal and interest, they are measured at amortised cost. Interest income from these financial assets is included in finance income
      using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in the income statement. All
      material financial assets of the Group are held at amortised cost.

      Financial assets are derecognised when the rights to receive cash flows from the assets have expired or have been transferred and
      the Group has transferred substantially all risks and rewards of ownership. Gains and losses (both realised and unrealised) arising from
      changes in the value of financial assets held at fair value through the income statement are included in the income statement in the
      period in which they arise.

      Derivative Financial Instruments
      The Group uses derivative financial instruments to manage its exposure to interest rate risks. In accordance with its treasury policy, the
      Group does not hold or issue derivative financial instruments for speculative purposes. However, derivatives that do not qualify for hedge
      accounting are accounted for as trading instruments. Derivatives are initially recognised at fair value on the date a derivative contract is
      entered into and are remeasured to fair value at each reporting date.

      Cash Flow Hedges
      Changes in the fair value of derivative financial instruments designated as cash flow hedges are recognised in other comprehensive
      income to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised
      immediately in the income statement. If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold,
      terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in
      other comprehensive income remains there until the forecast transaction occurs.

      Net Investment Hedge
      For hedges of net investments in foreign operations, where the hedge is effective movements are recognised in other comprehensive
      income. Ineffectiveness is recognised in the income statement. Gains and losses accumulated in equity are included in the income
      statement when the foreign operation is partially disposed of or sold.
1. Accounting Policies continued
   
   (e) Accounting for Financial Assets and Liabilities, Derivative Financial Instruments and Hedging Activities continued

   Net Investment Hedge

   For hedges of net investments in foreign operations, where the hedge is effective, movements are recognised in other comprehensive income. Ineffectiveness is recognised in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is partially disposed of or sold.

   Trade Receivables

   Trade receivables are recorded at aggregate invoice value (including value added tax or other sales taxes) less loss allowances, which are calculated using the expected loss model. Where trade receivables contain a significant financing component, they are then carried at amortised cost using the effective interest rate method, less loss allowances. Other receivables are recorded at their transaction value.

   The Group assesses, on a forward-looking basis, the expected credit losses associated with its trade and other receivables. The Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables. Where there is a specific risk surrounding a receivable then a credit loss allowance of 100% is applied.

   Trade and Other Payables

   Trade and other payables are initially recognised at fair value and subsequently at amortised cost.

   Borrowings and Borrowing Costs

   Borrowings are recognised initially at fair value net of directly attributable transaction costs incurred. Borrowings are subsequently stated at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest rate method. Borrowings are classified as current liabilities unless the Group has a right to defer settlement of the liability for at least 12 months after the reporting date.

   Borrowing costs directly attributable to the acquisition, construction, or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognised in the income statement in the period in which they are incurred.

   (f) Property, Plant and Equipment

   Owned Assets

   Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses.

   Depreciation

   Depreciation is charged to the income statement on a straight-line basis over the estimated useful life of each part of an item of property, plant and equipment. Land is not depreciated. Assets in the course of construction are not depreciated until the date the assets become available for use. The estimated useful lives are as follows:

   • freehold buildings 25 years
   • short leasehold buildings period of lease
   • plant and fixtures 3 to 15 years
   • motor vehicles 4 years

   The residual value, where significant, is reassessed annually.

   (g) Intangible Assets

   Goodwill

   All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries and associates. In respect of business acquisitions that have occurred before 1 July 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the separable assets, liabilities and contingent liabilities acquired.

   Acquisitions after this date fall under the provisions of ‘IFRS 3 Business Combinations’. For these acquisitions, transaction costs, other than share and debt issue costs, are expensed as incurred and subsequent adjustments to the fair value of consideration payable are recognised in the income statement.

   Contingent consideration is measured at fair value based on an estimate of the expected future payments.
1. Accounting Policies continued.

(g) Intangible Assets

Goodwill continued

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is allocated to cash generating units and is tested annually for impairment.

Research and Development Costs

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense is incurred.

The Group is also engaged in development activity with a view to bringing new pharmaceutical products to market. Due to the strict regulatory process involved, there is inherent uncertainty as to the technical feasibility of development projects often until regulatory approval is achieved, with the possibility of failure even at a late stage. The Group considers that this uncertainty means that the criteria for capitalisation are not met unless it is highly probable that regulatory approval will be achieved and the project is commercially viable. Internally generated costs of development are capitalised, once the criteria are met, in the consolidated statement of financial position unless those costs cannot be measured reliably or it is not probable that future economic benefits will flow to the Group, in which case the relevant costs are expensed to the income statement as incurred.

Where development costs are capitalised, the expenditure includes the cost of materials, direct labour and an appropriate proportion of overheads. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses.

Acquired Intangible Assets

Intangible assets recognised as a result of a business combination are stated at fair value at the date of acquisition less accumulated amortisation and impairment losses. The Group has early adopted the amendments to IFRS3 ‘Business Combinations’ and applied the optional concentration test in relation to the acquisition of Miratz (refer to note 31).

Other Intangible Assets

Other intangible assets that are acquired by the Group are stated at cost (including future milestone and royalty payments as applicable) less accumulated amortisation and impairment losses. Expenditure on internally generated goodwill and other intangibles is recognised in the income statement as an expense is incurred.

Intangible Assets Subsequent Expenditure

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates or extends the asset life. All other expenditure is expensed as incurred.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets unless such lives are indefinite or is otherwise stated below. Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment at each consolidated statement of financial position date. Intangible assets are amortised from the date that they are available for use. Assets in the course of construction are not amortised until the date the assets become available for use.

The estimated useful lives are as follows:

- software 5 to 7 years
- capitalised development costs 5 to 10 years or period of patent
- patent rights period of patent
- marketing authorisations indefinite life or period of marketing authorisation
- product rights 10 to 15 years
- commercial relationships 7 years
- brand 3 to 10 years
- acquired capitalised development costs 5 to 15 years
- pharmacological process 10 years

The pharmacological process from the acquisition of Putney Inc. and capitalised developed technology from the acquisition of AST Farma B.V. and Le Vet Beheer B.V. are amortised on a reducing balance method at a rate of 20% over a 10 year life based on the expected profile of future cash flows. All amortisation on a reducing balance methodology is recognised within selling and general administrative expenses with the exception of that in respect of the pharmacological process which is recognised within research and development expenses.
1. Accounting Policies continued
   (g) Intangible Assets continued
      Goodwill continued
      The amortisation of the intangible assets are classified as an administrative expense because they relate to the right to sell and distribute the product. Within the acquired intangibles the product rights encompass market authorisations, and the capitalised development costs encompass product authorisations subject to regulatory approval. The pharmacological process is classified as a research and development expense as it relates to the process of taking a product through to registration.
      When considering the basis of amortisation for our acquired intangibles, we consider a number of factors: the different market conditions which surround the intangible; the age of the products within developed technology; and their corresponding place within the lifecycle of the product.
   (h) Inventories
      Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.
      The cost of inventories is determined on the first-in, first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.
   (i) Cash and Cash Equivalents
      Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group’s cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.
   (j) Impairment
      The carrying amounts of the Group’s assets are reviewed at each consolidated statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, the asset’s recoverable amount is estimated.
      The recoverable amount of assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an appropriate rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.
      For goodwill, assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each consolidated statement of financial position date and when there is an indication that the asset is impaired.
      An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.
      Impairment losses recognised in respect of cash generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash generating units (group of units), and then to reduce the carrying amount of the other assets in the units (group of units) on a pro rata basis.
      An impairment loss in respect of goodwill is not reversed.
      In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.
      An impairment loss is reversed only to the extent that the asset’s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.
   (k) Dividends paid
      Dividends are recognised in the period in which they are approved by the Company’s shareholders or, in the case of an interim dividend, when the dividend is paid.
   (l) Employee Benefits
      Pensions
      The Group operates a stakeholder personal pension scheme for certain employees. Obligations for contributions are recognised as an expense in the income statement as incurred.
      Dechra Veterinary Products SAS and Dechra Veterinary Products BV participate in state-run pension arrangements. These are not considered to be material to the Group financial statements and are accounted for as defined contribution schemes, with contributions being recognised as an expense in the income statement as incurred.
      The Group sponsored defined benefit arrangements in certain countries, the most material being a defined benefit pension plan in the Netherlands. This was a funded career average pay arrangement, where pensionable salary was subject to a cap. The arrangement was funded through an insurance contract.
1. **Accounting Policies continued**
   
   (l) **Employee Benefits**

   From 1 January 2019, the employee pension benefit in the Netherlands is being provided through contributions to a defined contribution scheme and the Group's obligations under the previous pension arrangements ceased.

   The Group's net obligation in previous years in respect of defined benefit pension plans was calculated by estimating the amount of future benefit that employees had earned in return for their service in the current and prior periods.

   That benefit was discounted to determine its present value, and the fair value of any plan assets is deducted. The liability discount rate is the yield at the Statement of Financial Position date using AA rated corporate bonds that have maturity dates approximating to the terms of the Group's obligations. The calculation was performed by a qualified actuary using the projected unit credit method.

   All actuarial gains and losses that arose in calculating the Group's obligation in respect of a scheme were recognised immediately in reserves and reported in the consolidated statement of comprehensive income. Where the calculation resulted in a benefit to the Group, the asset recognised was limited to the present value of any future refunds from the plan or reductions in future contributions to the plan.

   **Share-based Payment Transactions**

   The Group operates a number of equity settled share-based payment programmes that allow employees to acquire shares in the Company. The Group also operates a Long Term Incentive Plan for Directors and Senior Executives.

   The fair value of shares or options granted is recognised as an employee expense over the vesting period on a straight-line basis in the income statement with a corresponding movement to equity reserves. Fair values are determined by use of an appropriate pricing model and by reference to the fair value of the options granted. The amount to be expensed over the vesting period is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

   At each consolidated statement of financial position date, the Group revises its estimates of the number of share incentives that are expected to vest. The impact of the revisions of original estimates, if any, is recognised in the income statement, with a corresponding adjustment to equity reserves, over the remaining vesting period.

   The fair values of grants under the Long Term Incentive Plan have been determined using the Monte Carlo simulation model, as performed by a qualified third party valuation expert.

   The fair values of options granted under all other share option schemes have been determined using the Black–Scholes option pricing model, as performed by a qualified third party valuation expert.

   When the options are exercised, the Company issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium.

   National Insurance contributions payable by the Company on the intrinsic value of share-based payments at the date of exercise are treated as cash settled awards and revalued to market price at each consolidated statement of financial position date.

   **Bonus and Commission Payments**

   The Group operates sales incentive schemes for certain employees and third party sales representatives in particular territories. The related bonuses and commissions are accrued in line with the related sales revenues.

   (m) **Revenue Recognition**

   Revenue from the sale of goods is measured at the fair value of the consideration and excludes intra-group sales and value added and similar taxes. The primary performance obligation is the transfer of goods to the customer. Revenue from the sale of goods is recognised when control of the goods is transferred to the customer, at an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods. Revenue from third party manufacturing consists principally of the production of goods to customer specification together with the provision of technical services. Revenues from third party manufacturing are recognised upon completion of the work order, either the completion and agreed delivery of the product, or upon full provision of the service.

   As sales arrangements differ from time to time (for example by customer and by territory), each arrangement is reviewed to ensure that revenue is recognised when control of the goods have passed to the customer.

   • This review and the corresponding recognition of revenue encompasses a number of factors which include, but are not limited to the following:
     • reviewing delivery arrangements and whether the buyer has accepted title – we recognise the revenue at the point at which full title has passed; and/or
     • where distribution arrangements are in place, recognising when the goods pass to the third party customer (for example by reviewing insurance arrangements) and recognising revenue at the point at which title has passed.
1. Accounting Policies continued

(m) Revenue Recognition continued

Provision for rebates, returns, discounts and other variable consideration is reflected in the transaction price at the point of recognition to the extent that it is highly probable there will not be a significant reversal. The methodology and assumptions used to estimate rebates and returns are based on the most likely method of calculation. This is adjusted in light of contractual and legal obligations, historical trends, past experience and projected market conditions. Market conditions are evaluated using wholesaler and other third party analysis, and internally generated information.

(n) Leases

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- variable lease payments that are based on an index or a rate, initially measured using the index or rate as at the commencement date;
- amounts expected to be payable by the Group under residual value guarantees;
- the exercise price of a purchase option if the Group is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the Group exercising that option.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee’s incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to a right-of-use asset in a similar economic environment with similar terms, security and conditions. The lease liability is not materially sensitive to a reasonable change in discount rate and therefore will not represent a critical accounting estimate presented within the Annual Report.

Lease payments are allocated between principal and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset’s useful life and the lease term on a straight-line basis.

Payments associated with short term leases of equipment and vehicles and all leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short term leases are leases with a lease term of 12 months or less. Low-value assets comprise IT equipment and small items of office furniture.

(o) Net Financing Costs

Net financing costs comprise interest payable on borrowings, unwinding of discount on provisions and deferred considerations measured at amortised cost, interest receivable on funds invested, gains and losses on hedging instruments that are recognised in the income statement (see accounting policy (e)) and gains or losses on the retranslation of financial assets and liabilities denominated in foreign currencies. Interest income is recognised in the income statement as it accrues. The Group capitalises borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

(p) Contingent Considerations

The Group has adopted the financial liability model when accounting for contingent consideration in respect of licensing agreements. The estimated future amounts payable for contingent consideration are recorded on initial recognition at the present value of the future cash flow payable, discounted with an appropriate discount rate, with a corresponding intangible asset recorded. The unwind of the liability, reflecting discounting for the passage of time, is recognised within the income statement as a finance expense and calculated using a risk-free discount rate. Contingent considerations are remeasured at each reporting date and any downward remeasurement of the related liability is adjusted against the intangible, with any excess over the carrying value of the intangible recognised in the income statement. Any upwards remeasurement is recognised as an increase to the intangible asset.
1. **Accounting Policies continued**

   (q) **Provisions**

   Provisions for legal claims, dilapidations, environmental remediation, deferred rent and advanced grants for property, plant and equipment are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are not recognised for future operating losses. Where there are a number of similar obligations, the likelihood that an outflow will be required on settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

   Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as an interest expense.

   (r) **Basis of Charge for Taxation**

   Income tax expense comprises current and deferred tax. Current and deferred taxes are recognised in the income statement except to the extent that it relates to a business combination or items recognised directly in equity or in other comprehensive income.

   Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the consolidated statement of financial position date, and any adjustment to tax payable in respect of previous years.

   Deferred tax is provided using the consolidated statement of financial position liability method and represents the tax payable or recoverable on most temporary differences which arise between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes (the tax base). Temporary differences are not provided for: goodwill that is not deductible for tax purposes; the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and do not arise from a business combination; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, and is based upon tax rates enacted or substantively enacted at the consolidated statement of financial position date.

   A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is not probable that the related tax benefit will be realised against future taxable profits. The carrying amounts of deferred tax assets are reviewed at each consolidated statement of financial position date.

   In respect of uncertain tax positions, where an outflow of funds is believed to be probable and a reliable estimate of the outcome of the dispute can be made, management provides for its best estimate of the liability. Such provisions are measured using either the best estimate, or the expected value model depending on management's judgement of which method better predicts the resolution of the uncertainty.

   The estimated annual benefit of global intellectual property and innovation incentives is accounted for within current and deferred tax. Current and deferred tax credits received in respect of share-based payments are recognised in the income statement to the extent that they do not exceed the standard rate of taxation on the income statement charge for share-based payments. Credits in excess of the standard rate of taxation are recognised directly in equity.

   (s) **Earnings per Share**

   The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares in issue during the period. Diluted EPS is determined by adjusting the profit attributable to ordinary shareholders and the weighted average number of ordinary shares in issue for the effects of all potential dilutive ordinary shares, which comprise share options granted to employees.

   The Group has also chosen to present an alternative EPS measure, with profit adjusted for non-underlying items. A reconciliation of this alternative measure to the statutory measure required by IFRS is given in the Financial Review on page 27. A breakdown of the non-underlying items is given in notes 4 and 5.

2. **Operating Segments**

   The Group has three reportable segments, as discussed below, which are based on information provided to the Board of Directors, which is deemed to be the Group’s chief operating decision maker. Several operating segments which have similar economic characteristics have been aggregated into the reporting segments. In undertaking this aggregation the assessment determined that the aggregated segments have similar products, production processes, customers and overall regulatory environments.

   The European Pharmaceuticals Segment comprises Dechra Veterinary Products EU, Dechra Veterinary Products International and Dechra Pharmaceuticals Manufacturing. This Segment operates internationally and manufactures and markets Companion Animal, Equine, Food producing Animal Products and Nutrition. This Segment also includes third party manufacturing and other revenues from non-core activities.