Johnson-Johnson

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Mr. Timothy S. Lucas Director of Research and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Dear Mr. Lucas.

Re: New Agenda Project: "The Recognition of Revenues and Liabilities"

Johnson & Johnson is pleased to comment on the FASB's New Agenda Project, "The Recognition of Revenues and Liabilities". We commend the Board on its efforts to develop a new general standard on revenue recognition and liabilities and to work with constituents to solicit input and exchange views.

The following are comments on specific areas.

### General Standard on Revenue Recognition

Current authoritative literature on revenue recognition is maintained within several pronouncements issued from different organizations. For example, pronouncements have been issued from the FASB, EITF, AICPA and the SEC. Each pronouncement encompasses a different level of detail and carries with it varying degrees of authority. As a result of this, inconsistent revenue recognition practices exist reflecting different views of what revenues should represent.

We welcome the FASB's suggestion to consolidate all of the relevant pronouncements into a single authoritative implementation guidance. Not only will this minimize the varied interpretations of the pronouncements, but it will also aid in providing standard guidance that is applicable across industries. Furthermore, one general standard will facilitate consensus on current outstanding issues.

#### Revenue Recognition Criteria

One question raised in the proposal document is whether current revenue recognition criteria should be revised. We do not feel that a revision of the criteria for recognizing revenue when it is realized or realizable and earned is required. However, having guidance which incorporates an element of performance would aid in strengthening the present revenue recognition criteria.

A distinction should be made and examples provided of what items constitute revenue, gains and other comprehensive income. Revenue should continue to be defined as monies earned from an entity's primary, ongoing activities. Gains generally arise out of an entity's ancillary activities. Other comprehensive income is altogether separate as this usually encompasses activities for which funds are not yet realized. Although we recognize the importance of addressing classifications of items included in the other comprehensive income category,

perhaps this would be better incorporated within the Board's agenda project on financial performance reporting by business enterprises.

# Revenue Recognition with Right of Return Provisions

The proposal document questions whether revenue recognition should be prohibited if the customer retains the right to return the product. We do not feel that the current guidance should be changed. In fact, the current guidance is consistent with the thinking that revenues should be measured in terms of changes in assets and liabilities, a position currently supported by FASB Concepts Statement No. 6, Elements of Financial Statements. Furthermore, the issuance of SAB 101 reinforces and strengthens the notion that revenue should be recognized when title and all risks and rewards of ownership have transferred to the buyer, which generally happens after delivery by the seller and acceptance by the buyer have occurred. The SAB supports the thinking that revenues should not be deferred if return privileges do not expire at the time of delivery and acceptance as long as return activity can be reasonably estimated.

Different industries maintain different periods over which return privileges expire. The healthcare industry has traditionally maintained longer return privilege periods due to the nature of the products sold. For example, hospitals and pharmacies may return products several months after being sold as product expiration dates approach due to a decline in patient consumption. In these instances, liability recognition for product returns is more appropriate as a reliable and reasonable estimate of future returns can be made at the time title and ownership transfers to the customers. Additionally, the present practice reinforces the matching principle.

### Multiple-Element Revenue Arrangements

Recognition for revenue arrangements that consist of multiple distinct elements should be based on a performance measurement criteria. Revenue should be recognized to the extent that performance by the seller has resulted in benefit accruing to the buyer. Delay of revenue recognition until a seller has fully performed all of the elements under a multiple-element arrangement and is no longer obligated goes against the earned criteria which requires that entities must have "substantially accomplished" what they set out to do to be entitled to the benefits.

As multiple-element arrangements consist of separate and distinct units, it would be beneficial for the FASB to provide guidance in how to determine the units and principles to be applied when allocating consideration to these units.

#### Use of Estimates

Generally, revenues should not be recognized based on estimates. However, very specific cases may exist which should be outlined as exceptions to the general rule. For example, exchange of items in nonmonetary transactions are valued and recorded in the financial statements based on estimates.

It would be beneficial for the Board to provide guidelines as to which types of transactions they are referring to in their discussions. Presently, there are several areas where estimates are used readily which may not be in the scope of the Board's agenda project. One such area involves the use of estimates in determining accruals that reduce revenues, such as reserve for sales returns, cash discounts and other similar items. Although estimation techniques are employed, it may be appropriate to do so in these transactions.

#### <u>Liabilities</u>

The proposal document questions various aspects of the liabilities definition. We believe that the definition should continue to focus on future sacrifices of economic benefits. Maintaining the concept of probable future sacrifices as it is currently defined lends itself to varied interpretations that are subjective in nature. This subjectivity goes against the reliability criteria

set forth for liabilities in Concepts Statement 5 which states that "information about the item is representationally faithful, verifiable, and neutral". Although not all future sacrifices should be recognized as liabilities as some may be remote in occurrence, we believe a more detailed and comprehensive definition of the term "probable" should be applied when recognizing liabilities.

Furthermore, the recognition of liabilities should not be restricted to arising only from legal obligations. Just as revenues may arise outside of legal obligations, so may liabilities be generated from constructive obligations. For example, although warranty obligations for highend merchandise have a finite period, customer requests for repairs subsequent to the expiration of the formal warranty agreement are still entertained by the seller. In these instances, the seller incurs and should recognize a liability in the financial records even though a legal, enforceable obligation does not exist. As such, customary business practices should be taken into consideration to determine when a liability exists. Similar theory is applied in SAB 101 in determining when persuasive evidence of an arrangement in a revenue transaction exists.

## Coordination with International Accounting Agencies

We strongly encourage coordination efforts with the International Accounting Standards Board (IASB) and other national standard setters. As the Accounting Standards Board (ASB) in the United Kingdom has already undertaken a similar project initiated in July 2001, synergies can be leveraged to ensure consistencies. This will help provide readers of financial statements more reliable and comparable data when measuring the financial performance of companies within similar industries across geographical boundaries.

We thank you in advance for your consideration. We will be pleased to work with the Board in developing guidance for the project and provide additional information or clarification.

Sincerely,

Stephen J. Cosgrove

Stephen J. Cosgrove Vice President, Corporate Controller