AstraZeneca

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
21 October 2010

Dear Sirs

Exposure draft ED/2010/6 – Revenue from Contracts with Customers

AstraZeneca welcomes the opportunity to comment on the proposals contained within the exposure draft ED/2010/6.

We support the objectives of the exposure draft as set out in paragraphs IN1 and IN3. Our detailed responses to the questions in the exposure draft are included as an Appendix to this letter. Our responses have been drafted based on accounting for the specific revenue streams we have in the Pharmaceutical sector, and do not address issues that may be specific to other industries but not relevant to us (e.g. long term construction contacts). We draw your attention to our answers to questions 3 and 4 where we highlight difficulties, or apparent unexpected accounting results, we have encountered in applying the requirements of the exposure draft to common pharmaceutical industry transactions. We also have concerns over the proposed disclosure requirements as set out in our response to question 10.

This response represents the view of AstraZeneca PLC. Should you have any queries or wish to discuss our response further, please do not hesitate to contact me on +44 1625 517279.

Yours faithfully

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Appendix

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Question 1: Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether: (a) to combine two or more contracts and account for them as a single contract; (b) to segment a single contract and account for it as two or more contracts; and (c) to account for a contract modification as a separate contract or as part of the original contract. Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

Response: We agree with the principle proposed.

Question 2: The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Response: We agree with the principle proposed.

Question 3: Do you think that the proposed guidance in paragraphs 25–31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

Response: We support the proposed guidance in paragraphs 25 to 31 but note that judgement will still need to be exercised in weighing up conflicting factors for certain more complicated contracts. For example, in our business out-licensing agreements are becoming more common, where one party 'sells' to another the right to develop a particular compound in a specific way. Such agreements may include clauses that indicate the purchaser has control of the asset (e.g. it has the ability to prevent other entities directing the use of, and receiving benefit from, a good or service) but may not satisfy any of the individual factors included in paragraph 30 (e.g. payment may be conditional on achievement of future milestones by the purchaser, legal title of the intellectual property may not have passed, physical possession may not be relevant, the design of the 'product' being sold may not be customer specific). Even with the additional guidance included in B33 to B37, we struggle to determine exactly how the exposure draft would require accounting for such contracts.

However, we don't believe that greater guidance and industry specific consideration should be included in the standard. Rather, we believe that, applying the comparability principles contained within paragraph 39 of the Framework, common interpretations of the requirements of paragraphs 25 to 31 should be allowed to develop to resolve such apparent difficulties in applying the proposed standard.

Question 4: The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price. Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

Response: We agree with this proposal. However, we have concerns with the application of the exposure draft to royalty income streams, where we earn a royalty on sales made by a third party and sales-related milestones, where we earn milestone income based on a third party achieving certain sales thresholds. Under existing GAAP, royalty income is only recognised when the third party makes a sale and we are reasonably able to estimate the levels of such sales. We believe that the point of

sale by the third party is the right point at which to recognise royalty income in our statements. Similarly, sales-related milestone income is currently recognised when it becomes receivable, i.e. when the sales threshold is achieved.

However, under the new proposals, we are concerned that there may be an expectation that the point of recognition of such income could be brought forward, even possibly to the point of contract agreement, if income can be 'reasonably estimated'. In practice, third party sales are very difficult to predict with any level of certainty for any significant period of time in advance of those sales being made. Under the wording of the exposure draft, it could be argued that we might be able to predict the level of third party sales, and hence royalty income, to the level of certainty required under paragraphs 38 and 39, for a period of perhaps one month, three months, a year (or some other time period) in advance of the third party sale and therefore recognise revenue at some point in time between contract agreements and third party sale. The use of such a point in time between contract agreement and third party sale appears arbitrary, confusing to the user of financial statements, implies a greater level of certainty over such income streams than exists in practice and is likely to increase the level of inconsistency between financial statements. We would therefore request some further guidance within the proposals on when such royalty and sales-related revenue streams should be recognised. We consider it highly important that management judgement (on estimation of revenue) should not create significant differences in the timing of recognition of such revenue streams between entities.

Question 5: Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

Response: Although we do not consider that this proposal would result in a significant change to our initial measurement of revenue in most cases, we believe that this proposal would increase the complexity of recording revenue transactions and is not useful in industries where sales prices do not include a margin for expected bad debt losses, such as the pharmaceutical industry. Recording a judgement on customer credit risk on every sale, and making the corresponding adjustments to revenue, will be onerous for a majority of preparers and we request that current accounting practice is retained.

Question 6: Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Response: We agree with this proposal.

Question 7: Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

Response: We agree with this proposal and support the boards' attempt to provide greater clarity on how the 'value' of individual performance obligations should be calculated.

Question 8: Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria. Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

Response: We agree with this proposal.

Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Response: We agree with this proposal.

Question 10: The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Response: We believe that, in the normal course of business, we would generally not have any 'contract balances' and we do not feel that the proposed disclosures would give any meaningful information to users of our financial statements. We feel that these disclosures are only relevant when considering long-term contracts rather than all revenue contracts, which for us generally result in revenue recognition immediately (or shortly after) the performance obligation is satisfied. Mandating this disclosure for all contracts currently accounted for under IAS 18 will, in our opinion, force companies into onerous disclosure preparation which will provide information that is neither relevant nor useful to the users of the financial statements. Our objection with the proposed disclosure is similar in many ways to that we, and many other contributors, expressed on the proposed mandatory use of a direct cash flow statement in the discussion paper 'Preliminary views of Financial Statements Presentation'.

Question 11: The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

Response: We agree with the requirements included in paragraphs 77 and 78.

Question 12: Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

Response: We agree with the requirements included in paragraph 74.

Question 13: Do you agree that an entity should apply the proposed requirements retrospectively (i.e. as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why? Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

Response: In principle, we agree that the proposed requirements should be applied retrospectively but, for practical purposes, suggest that the period of implementation of this standard should be of such a length to allow entities to fully assess the impact of the requirements on past transactions. The requirement for full retrospective application (on all material contracts) is likely to be onerous on the preparers of financial statements and while we believe it is preferable to having two different revenue recognition standards applied to similar transactions in the same set of financial statements, we ask the boards to consider the amount of manual restatement preparers will need to undertake in setting the adoption date.

Question 14: The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Response: Whilst we are keen not to expand the proposed application guidance significantly, as we believe that the Standard would be in danger of becoming become a rules-based rather than principles-based standard, we draw your attention to our responses to questions 3 and 4 above. We believe that further guidance in the area of royalties may be useful for the preparers of financial statements.

Question 15: The boards propose that an entity should distinguish between the following types of product warranties:

a) *a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.*
b) *a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract. Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?*

Response: We agree with this proposal, although we consider our pharmaceutical business does not have any warranties that would fall under (b) above.

Question 16: The boards propose the following if a licence is not considered to be a sale of intellectual property: (a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and (b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence. Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

Response: We believe that for most out-licensing deals, taking into account the situation outlined in paragraph B38, we satisfy our performance conditions up-front on the granting of the right to use the intellectual property associated with a compound and therefore believe that recognition of revenue is appropriate at this point (although payments dependent on the third party achieving certain development or sales milestones are often so uncertain that, applying the requirements of paragraphs 38 and 39, will result in recognition of the milestone payments once the development or sales milestone is achieved by the third party). In some cases, we can see that deferral of revenue over the period of an agreement would be appropriate but we do not believe that the distinction between exclusive and non-exclusive is the decisive factor in coming to this judgement for a pharmaceutical business. In our view, the length of the licence is more important, i.e. if the licence is granted for the majority of the patent life, it is effectively a sale and should be recognised upfront and if not, it is effectively the rental of our asset (intellectual property) for a set period and should be recognised over that period. For example, revenue from two non-exclusive licences granted for the same 5 year period (for an asset with 10 year patent protection) should, in our view, both be recognised as licence rentals on a straight line basis over 5 years.

Question 17: The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

Response: We agree with this proposal.