International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

12 March 2012

**Exposure Draft II, "Revenue from Contract with Customers"**

Dear Sir/ Madam

The Roche Group has a turnover of CHF 42.5 bn. (EUR 33.9 bn.) a year derived from our worldwide healthcare business - pharmaceuticals and diagnostics - and employs 80,000 people. As at 31 December 2011, we had a market capitalisation of CHF 136 bn. (EUR 111.6 bn.). We have been preparing our consolidated financial statements in accordance with IFRS/IAS since 1990 and therefore have a substantial interest in how these will develop.

We welcome the opportunity to provide commentary on the Exposure Draft: Revenue from Contracts with Customers as proposed by the Board.

Generally, we support the proposals but in certain instances as outlined in the appendix to this letter, we believe more detail and clarity is required in order to communicate the intention of the Boards clearly and comprehensively.

In particular, we welcome the changes made to the 2010 ED which reflects some of the proposals as stated in our 18 October 2010 comment letter as regards:

- The elimination of the distinction between exclusive and non-exclusive licences;

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- Permitting the allocation of revenue using the residual method although only in limited circumstances;
- Providing better guidance on accounting for contracts satisfied over a period of time;
- Providing some clarity on the application of the control concept, though we note that there is no definition of control; etc.

We are encouraged by the approach of the Boards to be open to comments and suggestions from preparers. Nevertheless we are disappointed that ED II on Revenue did not incorporate any changes to our concerns as regards:

- Eliminating the need to present credit risk on the face of the financials as a deduction from sales;
- Conducting the onerous test at a performance obligation level and the disclosure requirements associated with this;
- The excessive disclosure requirements in general (see also our comments below).

Whilst we found additional clarification guidance helpful in theory, following our review of the latest proposals, we also encountered some difficulties as regards:

- Determination of a "customer" ;
- Clearly articulating whether certain transactions as would be illustrated in this paper could be accounted for at a point in time or over a period of time;
- Determining how total revenue from two or more combined contracts should be allocated to performance obligations identified. This will also be illustrated by way of example;
- Application of the time value of money concept to transaction price allocation for performance obligations satisfied over a period of time;
- Clarifying when variable consideration is different from contingent consideration

With reference to recent disclosure requirements proposed in the ED, over recent years we note an increasing number of comments from users of financial statements about the volume and complexity of disclosures that companies provide in their annual and interim financial statements. A general theme is that there is a high volume of data given about technical areas of limited interest to many users, making it difficult for readers to identify the more important points about the company's results. This trend is driven by:

- Standards that require high levels of disclosure. Notable here are IFRS 2, IFRS 3 and IFRS 7. This trend is continuing with the revised version of IAS 19, which further expands already extensive disclosures in the area of Pensions.
- Insufficiently explicit statements from standard setters and regulators about applying materiality in preparing financial statements.
- A checklist approach from Auditors and Regulators about compliance.

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- Additional disclosure is largely added to existing requirements, rather than removing existing requirements elsewhere when adding new ones.

A consequence of this for preparers is that companies' limited internal resources are consumed by implementing "disclosure-heavy" standards of limited use to many users, which diverts these resources away from improving other areas of financial reporting which may be of more interest to users.

We note comments to this effect given not only by preparers, but also by Analyst representative groups, the Big-4 audit firms and the Regulatory authorities. We note also the work of Scottish and New Zealand professions with their "Losing the Excess Baggage" report from July 2011.

In spite of all these comments, almost every new proposal from the IASB features expanded disclosures. Collecting this data is not free; it requires internal resources to implement, and costs to maintain and audit. All of these costs are ultimately borne by the shareholders.

The appendix to this letter documents our detailed responses to the questions set out in the ED.

Sincerely,

F. Hoffmann-La Roche AG

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**Question 1**

**Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?**

We agree with the requirements as articulated in ED 35 and 36. However, we believe further clarification is required. Following participation in the IASB and EFRAG field-test, we present some of our findings in the paragraphs below.

With reference to activities in the Pharmaceuticals industry, we note that the proposals may give rise to changes in the way some of our transactions are currently accounted and reported as illustrated in the example below:

**Example I**

When a compound has an indefinite useful life, but is transferred to an alliance partner for a 12 year period, as a first step, the question arises as to whether this relationship between the licensor and the licensee is such that the licensee is a "customer" in line with the provisions of the ED. Additionally, the following questions arise:

i. Is the licence transferred to the licensee at a specific point in time and if so, can revenue be recognised in its entirety on transfer of the licence at contract execution? or;

ii. Is the licence transferred over time (since the licensee obtains control of the licence for a limited period of time when compared to the useful life of the compound) and thus the licensee does not obtain substantially all (or a majority of) the risks and benefits associated with the licence? In this case, revenue should be recognised evenly over the term of the contract i.e. 12 years in the above example.

Our current accounting treatment would require that this transaction be accounted for as a transfer of rights to use the compound over time and thus, revenue would be recognised evenly over the 12 year term.

Where the compound has a useful remaining useful life of 12 years and was being transferred to the licensee for a 12 year period, we consider that this scenario under the proposals in ED II would be

representative of a "sale" type transaction. All the revenue would be recognised upfront on contract execution.

In our view, under the proposals in ED II the licensor would have no other performance obligation to transfer to the licensee other than to maintain the patents associated with the transferred asset and this duty does not constitute a performance obligation transferred to the licensee.

**Example II**

As a second example, Company A enters into a licence agreement with Company B to transfer the rights to use a compound for a consideration of $125m for a 15 year period. In a separate supply agreement signed on the same date, A is required to supply B quantities of the compound which B cannot obtain from other suppliers on the market. The licence would be useless to B if they cannot receive supply of the compound from A. Under the supply agreement, A delivers the compound to B over a 3 year period at a price which gives rise to a loss of $25m in total. The fair value of the licence is $75m. B will continue to use the licence even after the supply agreement is fully executed and completed.

***Question***

Is the licence transferred at a point in time or over time?

Observations:

In the example above, it is clear that the patents associated with the licence constitute an asset that already exists, and thus does not meet the criteria outlined in ED 35a – "entity creates or enhances an asset that the customer controls as the asset is created or enhanced", but meets the criteria outlined in 35b – "customer simultaneously receives and consumes asset, another entity would have to substantially re-perform, entity entitled to payment". The supply of compound on the other hand, meets the criteria outlined in ED 35a and 35b.

The patents associated with the licence have an alternative use, as the same rights could be granted to another "customer" in a different region for instance, thus complying with ED 36.

Conclusions:

In our view, under the proposals in ED II, the licence is transferred at a specific point in time but since it is useless to the licensee without the supply of compound, the two performance obligations are combined as a single performance obligation and revenue is recognised over time in a manner

that depicts the pattern of transfer of goods and services. We expand this example further in our response to question 4.

Contrasting Example II with Example III below appears to give conflicting conclusions and clear guidance is required when accounting for non-distinct goods and services combined to form one performance obligation:

**Example III**

Within our Diagnostics business, it is customary to either place diagnostic instruments at customer locations e.g. laboratories, hospitals, patient testing centres, etc. for free or on lease. In some regions these machines are sold separately to customers.

A typical contract with a customer would include the placement of instruments at customer locations, the sale of reagents for use with such instruments and an instrument maintenance service – three performance obligations, none of which are onerous. It should be noted that these reagents are typically used in closed systems, meaning that Roche reagents can only be used with Roche instruments. One cannot use Roche reagents with Siemens instruments for example – the "razor and blade" or "closed systems" model.

Given this scenario, under the proposals in ED II, we consider that the placement of instruments and the sale of reagents – two performance obligations – should be combined as one single performance obligation based on the following:

- ED 28 suggests goods are distinct if regularly sold separately OR if the customer can benefit from the good or service on its own or with other resources readily available to the customer. We consider that in the sale of reagents in "closed systems" this criterion is not met.
- ED 29 negates 28 and suggests that goods and services be "bundled" if goods and services are highly interrelated (integrated) **and** are significantly modified or customised to fulfil the contract. We consider that these criteria are met for "closed systems" as the reagent vials have to be configured to fit the instruments (integration) and each instrument delivered to a customer must be calibrated according to customer demand and requirements (significantly modified/customised). This point is also justified by BC 79 – goods and services used as inputs to a single process that is the output of the contract.
- ED 42 – Entity has a right to invoice the customer for an amount corresponding to the value to the customer of the entity's performance completed to date. We consider that for closed systems, revenue should be recognised based solely on the sale of reagents.

The service element can be priced separately as it can be sold to customers via a separate contract.

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Given this, under the proposals in ED II, we consider that the service piece is a separate, stand-alone performance obligation.

***Question***

How should the revenue generated from the sale of reagents be accounted for?

- Should we apply the residual method when allocating revenue for the sale of reagents and the placement of instruments since the service contract can be priced separately? or;
- Should all the revenue be recognised as reagents are sold since this drives the generation of revenue with no amounts allocated to the instrument or the maintenance service?

The proposals in ED II provide no clear guidance on how the above transaction in Example III should be accounted for. In addition to the examples provided, with reference to Examples I and II clarification is required on:

Who is a customer?

By way of background, in the Pharmaceuticals and Medical Devices Industries, it is usual for companies to grant to "others" the right to use patents associated with compounds, technology or other intangible assets via licences as part of the entity's ordinary activities. In such circumstances, it is not clear to us whether such "others" in this context meets the "customer" definition unless the term "goods" can also refer to non-inventory items such as intangible assets.

With reference to the point mentioned above as to what constitutes a customer, and bearing in mind the scope exception in ED 9e – "non-monetary exchanges between entities in the same line of business…..", it is our opinion that the wording in ED 10 needs either clarification or expansion in order to enable constituents to appropriately apply the definition of a customer. ED 10 states that "a customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities".

We acknowledge that where one party to a Research and Development collaboration is required to reimburse costs associated with the project to their counterpart, then such reimbursements should be accounted for as a reduction in Research and Development expenses and not as revenue in line with ED 9e.

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**Question 2**

**Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9)', or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?**

In our view, the event which gives rise to the generation of revenue is very different from the subsequent event which may give rise to credit losses on receivables and thus, this element should be recognised and measured separately. Furthermore, it is normal business practice to sell goods and services to customers whose customer history suggest they will make payments for satisfied performance obligations. In our view, a company that has a non-AAA rating may still make 100% of the payments due from them as depicted by the customer history to date. Thus, we would not expect that any provision for credit risk should be recognised for such customers.

We are not in favour of the proposal to recognise credit risk in a line adjacent to revenue on the face of the income statement. Whilst we acknowledge that any diminution in the value of receivables should be recognised in the income statement, preferably as an operating expense (excluding any financing element which would be a financing expense) because in substance it is part of the cost of doing business, we are not clear on why the Boards would suggest that any credit risk be captured in the manner proposed, especially since allowances for bad debts are currently disclosed to users in the IFRS 7 notes. It would appear to us that this proposal is addressing a perceived issue in the financial services industry which is not applicable to general preparers. We would prefer that the final standard allow preparers to use their judgement about the presentation of gains/losses from credit risk, with the guidance that, while showing as a separate line item adjacent to revenue may be appropriate for some preparers (for example financial services companies where a significant proportion of revenues is generated from lending money), for other preparers it may be appropriate to include it as part of another line item (for example "marketing and distribution costs" or "sales, general and admin costs").

In principle, we welcome the revised proposal to capture subsequent credit risk effects in the same credit risk line, which is a more acceptable development than what was proposed in the 2010 ED. However, we fail to see how investors will be presented with decision useful information since subsequent adjustments to credit risk associated with current and prior periods would be captured in this line.

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We believe that the basis for impairing receivables should be dependent on the business models of entities taking into account management judgement and the facts and circumstances of each customer relationship and the markets they operate in, amongst other things. Most entities in practice currently apply the expected loss model when accounting for receivables when market circumstances amongst other factors, give an indication that a provision should be made for potential bad debts. We see no need to apply a model that is of more relevance for financial institutions.

Following outreach with IASB and FASB staff, we communicated the fact that we do not support the proposed "Three bucket" model under IFRS 9 which has not been finalised. Whilst this may work well for the financial services sector whose business model includes loans to customers, this feature is not normal for Corporates and where it exists, the amount involved are very immaterial.

On a practical note, the proposal to apply a top-level deduction on revenue following sales to customers really does not capture the economic reality of customer relationships. Currently, our systems in place are quite robust in automatically ageing debtors at customer level and controllers familiar with various markets are better placed to judge when such receivables prove doubtful and thus need to be provided for.

Finally the wording of ED II that the gains/losses from credit risk should be presented as a separate line item "adjacent to revenue" seems to be deliberately unclear. We would recommend that the final standard be explicit about how this should be presented in the Income Statement, with illustrative examples where appropriate.

**Question 3**

**Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?**

We agree with the proposed requirements, especially the proposal to recognise revenue to the extent that the revenue is reasonably assured. Within the Pharmaceuticals Industry, we often have

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circumstances in which the consideration for licences transferred to "customers" could be in the form of the successful achievement of milestones associated with the various phases in Research and Development. Such consideration cannot be deemed reasonably assured as regulatory approval is required at various stages of the research and development process before they can formally be deemed "complete". There is no guarantee that such approval would be obtained.

Given this, we would expect that no revenue should be recognised in the books of the licensor in respect of these milestone amounts as they are not "reasonable assured". We also note that the criteria stipulated in ED 85 could be extended in scope to include – other similar circumstances e.g. milestones associated with production volumes which give rise to the generation of revenue following contract inception / execution.

In our view, the text contained in ED 85 with reference to "…the customer promises to pay additional consideration" should be reworded to reflect the fact that contracts could be entered into in which the *total consideration* receivable on satisfaction of performance obligations is wholly dependent on subsequent sales and this would not necessarily be additional consideration.

We note that the definition of variable consideration in ED 53 which makes reference to discounts, rebates, etc. is very different from, for example, the definition of contingent consideration in IFRS 3. This may be dependent on future events based on activities undertaken by the licensee e.g. success of research and development activities or sales milestones and thus, we suggest that the Board clarify its intention.

**Question 4**

**For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?**

As stated in our 18 October 2010 comment letter, we do not support the requirement to conduct the onerous test at performance obligation level. To illustrate our issue with this, consider the facts of the previous Example II (replicated here for convenience):

As a second example, Company A enters into a licence agreement with Company B to transfer the rights to use a compound for a consideration of $125m for a 15 year period. In a separate supply agreement signed on the same date, A is required to supply B quantities of the compound which B cannot obtain from other suppliers on the market. The licence would be useless to B if they cannot

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receive supply of the compound from A. Under the supply agreement, A delivers the compound to B over a 3 year period at a price which gives rise to a loss of $25m in total. The fair value of the licence is $75m. B will continue to use the licence even after the supply agreement is fully executed and completed.

Company A also transfers to Company B over a 12 month period from contract execution, technological know-how to enable B to manufacture its own supply of compound after the expiry of the supply agreement. This technological know-how is transferred free of charge but would be priced at $3m on the open market.

Applying the steps to revenue recognition as proposed by ED II, three performance obligations are identified:

i. The transfer of the licence

ii. The supply of compound

iii. The transfer of technological know-how

However, as a result of the commercial objective of the transaction, all three performance obligations are combined into one single performance obligation to reflect the economic substance of the transaction. We are not clear on whether this means the total aggregated revenue receivable from the transaction should be allocated to the performance obligations identified based on the stand-alone market price of each performance obligation identified. If this is the case, then no onerous performance obligation exists at contract level and thus, no onerous performance obligation disclosures would be required. The following questions arise:

- How should the revenue associated with the licence be recognised?
    - Should a portion of the aggregated revenue be allocated to the licence and that portion recognised on the transfer of the licence? or;
    - Should a portion of the aggregated revenue be allocated to the licence and that portion spread over the supply period and beyond?

It is our view that the sale of compound would be recognised when sold, priced at the fair market price at which the compound is regularly sold.

Given this example, where the Boards agrees that the performance obligations identified above should be combined and accounted for as a single performance obligation, it would be helpful if guidance by way of an illustrative example is provided which clarifies the revenue recognition process. It will also be helpful if guidance is provided on how the impact of the time value of money should be allocated to performance obligations identified. In our view, the time value of money

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concept should only be applied to material amounts based on materiality thresholds established by management for the business as a whole. Given this, we do not expect to apply the time value of money concept to sales transactions with values below the threshold established within our organisation.

Should the Boards take the view that the example illustrated gives rise to separate performance obligations which should be accounted for separately, then we would appreciate that the final standard includes clear guiding principles which support this position. In our view, the fact that the compound is regularly sold separately and thus, could be accounted for separately does not reflect the true economics of the transaction, which highlights the fact that the compound cannot be used without the licence and vice versa.

We take the view that, in line with IAS 37, the onerous test should be conducted at contract level as is currently the case in practice. IAS 37.66 makes reference to "onerous contracts" where a liability is only recognised and measured as a provision if the supplier has a present obligation under the contract. On this basis, we would support the recognition of a liability and a corresponding expense, but only on contract level.

Conducting the onerous test at performance obligation level when the overall contract is profitable in our view is an exercise which will require undue resources to execute and the resulting information will not be decision useful to the users of financial statements. Also, in situations where performance obligations are combined because the commercial objective of the transaction warrants this, we consider that no onerous test will be necessary when the overall contract from a commercial objective perspective, is profitable.

IAS 37.10 defines a liability as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefit.

We are not clear on why ED II proposes to limit the scope of the onerous test to performance obligations satisfied over time where this exceeds one year. As a principle, we believe that where a contract is onerous, the provisions of IAS 37 apply with no exceptions and this will ensure consistency in application. We are also of the opinion that where the transaction price is allocated to different performance obligations, this process should ensure that individual performance obligations are not loss making, taking into account the specific facts and circumstances for each customer relationship. Where some performance obligations give rise to a loss, then any margin made on another performance obligation associated with the same contract should be used as a basis for absorbing" any loss incurred by a loss making performance obligation. We would not

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support any proposal to allocate transaction price based on margins associated with each performance obligation identified.

**Question 5**

**The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:**

- **The disaggregation of revenue (paragraphs 114 and 115);**
- **A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117);**
- **An analysis of the entity's remaining performance obligations (paragraphs 119–121);**
- **Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123);**
- **A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).**

**Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the cost to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.**

Whilst we acknowledge that the disclosures on Revenues in the financial statements is of importance to users, we disagree with the proposals. In our view, they are unduly excessive and will increase the size of already voluminous disclosure requirements currently in place. The cost of providing this information for the annual report far exceeds any benefits to the users of financial statements. We question the validity of having such disclosures in the interim report.

We strongly disagree that any expansion to the requirements of IAS 34 as regards Interim Reporting are necessary. As is stated in IAS 34, the Interim Report is an update of the previous Annual Report and should be read in conjunction with that. We believe that it is unnecessary to routinely update all of these disclosures every three/six months. We rather refer to the already existing requirement of IAS 34:15 that preparers should provide an update of any material changes from the previous Annual Report.

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The provision of these disclosures would be expensive and burdensome, and would, we believe, provide little decision-relevant information to users between Annual Reporting periods, and indeed would question that it provides useful information even in the Annual Report. We do not know of any demand from our customers (our shareholders and others users) to receive this information quarterly or biannually, or indeed annually. As noted in our cover letter, we would encourage the IASB to revisit and reduce the excessive disclosure requirements in ED II for both annual and interim reporting.

Implementing the new standard will in any case be a considerable exercise. Including interim reporting requirements (and presumably comparative data) will accelerate an already tight implementation schedule by 6-9 months. For example, consider a company with a 31 December year-end that would apply the new standard for 31 December 2015, with 31 December 2014 as a comparative. If we now include a requirement for interim reporting, then the first data needs to be available for 31 March 2014 comparative for a quarterly preparer.

We believe that the existing requirements of IAS 34 are already sufficient, and allow and require preparers to draw material matters to the attention of readers. Once the new standard has been implemented and after there is some experience, there is the option to revisit IAS 34 at that point via implementation reviews.

**Question 6**

**For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?**

We generally agree that the concept of control should be applied consistently across all standards but would welcome prescribed guidance on how the impairment of receivables associated with the sale of property, plant and equipment should be presented in the financials.

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**Other comments**

**I. Presentation:**

With reference to credit risk, we are concerned that the proposals in the ED would require an expansion of the income statement as credit risk would now be required to be presented as illustrated below:

| | |
|---|---|
| Sales | XX |
| Credit Risk | (X) |
| Other Operating Income | XX |
| Credit risk on OOI | (X) |

Secondly, with reference to ED 106 as extracted below:

A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer, when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

Where an entity has transferred goods and services, and consideration for such transfers is dependent on the future performance of the customer– contingent consideration (not royalties) – it would be helpful if guidance could be provided as to whether this circumstance gives rise to a contract asset or not especially if such amounts are reasonably assured.

In addition to this, we are cautious of the proposal that remaining rights and obligations in a contract from a single unit of account should be accounted for and presented on a **net** basis as either a contract asset or contract liability.

We note that the concept of contract liabilities is not mentioned until ED104 on Presentation in the financials. It would be helpful if the final standard provides more guidance on this concept together with illustrative examples of these as we note that the existence of contract liabilities triggers major disclosure requirements. The same applies for contract assets.

**II. Performance Obligations**

In our view, clarity is required regarding when performance obligations are satisfied over time or at a point in time. Some constituents consider that where one particular good or service is delivered to the same customer under one contract over a period of time, this constitutes one performance

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obligation satisfied over time, with revenue recognised at the time each delivery is "satisfied", over that period of time. Others take the view that the each delivery of goods and services to the customer is representative of a single performance obligation satisfied at a point in time. Clarification would be helpful to confirm that the former is indeed the case.

We note that in situations where a supplier promises to provide its customers with incentives the accounting and disclosure requirements could be very different. For example, where free goods are given to the customer, a contract liability will have to be recognised in the books together with the disclosure requirements associated with these. Conversely, where a customer is refunded cash, such amounts are accrued for and reflected as an adjustment to the transaction price.

## III. Consideration Payable to Customer

With reference to BC160 – we believe the text making reference to US GAAP ASC 605-50-45-2 should be excluded as this guidance will no longer apply following the publication of the finalised standard on Revenue from contracts with customers. In addition to this, we believe the context in which the term "identifiable benefit" may not be exactly the same as the term "distinct" as presented in the ED and thus we strongly encourage removal of this text or any other reference to US GAAP in the final standard.

## IV. Pricing Schemes and Related Parties

In IN 36, the boards invite organisations to comment on whether the proposed requirements can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers.

Our sales transactions are typically contracted with one single customer, the distributor at list price. The distributor then sells these goods to hospitals and patients (the end-customer). In certain circumstances we provide additional goods for the same patients free or at reduced prices to certain governmental or charitable bodies. In other cases, instead of providing goods, we grant refunds.

We establish these contracts to provide the free/reduced price products and/or refunds with various organisations, not only with the distributors to which we sell the goods at list price. For example we might provide free/reduced price products directly to hospitals and provide refunds directly to healthcare insurers.

It will be challenging to apply the guidance on combination of contracts (ED 16-17) to these arrangements. These arrangements involve more than two parties and we have separate contracts

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with both of them (in the above example with the distributor and the hospital/healthcare insurer respectively). However these two parties are not considered related parties under IAS 24 *Related Party Disclosures* and therefore the contracts could not be combined. The exposure draft does not include specific guidance on how to account for these types of arrangements and accounting for these individual contracts separately would not always faithfully represent the substance of the arrangement.

We ask the Board to consider including such specific guidance in the final standard or consider allowing for the combination of contracts on a less restrictive basis than to same customer or related parties.

## V. Contract Modifications

Following review of the text contained in ED 22, it would be helpful if the wording contained therein can be made simpler to understand.

Our current interpretation is:

- Contract scope modification is accounted for as a separate contract if it results in the transfer of additional distinct goods and services. In this case the receipt of consideration for additional goods / services transferred is based on the entity's stand-alone selling price of such goods and services including adjustments to reflect circumstances of contract e.g. discounts.

- Where contract price modifications do not give rise to separate contracts, and the remaining goods and services to be transferred are distinct from goods and services transferred on or before contract modification. In this case the consideration already received from the customer but not yet recognised, together with any additional amounts the customer promises to pay following the contract modification, is allocated to the remaining performance obligations – prospective application.

- Where the original contract terms give rise to a single performance obligation (either alone or together with other performance obligations which have to be combined into a single performance obligation) which remains unchanged. In this case any change in contract price after contract inception (e.g. discounts awarded retrospectively) does not give rise to a separate contract. Such a price change is allocated to performance obligations identified and revenue already recognised for satisfied performance obligations is restated upwards or downwards as required – retrospective application.

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## VI. Disclosures

As stated earlier in this document, we consider that the proposed disclosure requirements are very extensive and in our view, will not provide users with relevant information which provides insight into the amount, timing and uncertainty of revenue and related cash flows.

It is our recommendation to the Board that disclosures such as:

- a reconciliation of contract asset and liability balances;
- the average transaction price allocated to outstanding performance obligations yet to be satisfied;
- the timing of when such performance obligations are expected to be satisfied;
- the recognition of onerous performance obligations

should be removed as in our view, they would not be decision useful information to users.

We have undertaken a detailed review of other disclosure requirements and note that we have not received any requests for the detail as specified in the ED. We would welcome any opportunity to discuss this further with the IASB as a way of identifying the actual needs of users.

With reference to disclosing the aggregate amount of transaction price allocated to outstanding performance obligations yet to be satisfied, together with the timing of such performance obligations being satisfied, we do not believe that this would be decision useful as the question arises as to how one quantifies revenue receivable from contracts that could be cancelled. In addition to this, the collection of data required to capture reconciling information for onerous performance obligations in numerical, tabular form, will be expensive and burdensome.

## VII. Transition

It is our view that full retrospective application will be extremely cumbersome and very expensive as organisations will most likely need to run parallel IT and reporting systems: one to maintain the "as-is" situation and another to accommodate the proposals as contained in ED II. Also, the restatement of comparative information will require significant resources and time (no less than 24 months) to update and amend IT and reporting systems in order to accommodate the proposed requirements especially where full retrospective application is required. We would welcome any practical expedients which significantly reduce the restatement process.