



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

15 June 2009

Discussion Paper, Revenue Recognition

Dear Sirs

The Roche Group has a turnover of CHF 46 bn. a year (EUR 29 bn.) derived from our worldwide healthcare business - pharmaceuticals and diagnostics - and employs over 80,000 worldwide. We have a market capitalisation (end 2008) of CHF 141 bn. (EUR 95 bn.) We have been preparing our consolidated financial statements according to IFRS/IAS since 1990 and therefore have a substantial interest in how these will develop. Please find our comments on the Discussion Paper below.

CHAPTER 2

Question 1

Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

While we acknowledge the fact that a single revenue recognition principle might be desirable in theory, we recall that the primary objective of the IASC Foundation is to develop standards **“to help participants in the world's capital markets and other users make economic decisions.”** We are not entirely convinced that the single principle that is being suggested would necessarily lead to that objective being better met than at present. We are not aware of any grave shortcomings in present IFRS in the large majority of cases, though we acknowledge that the unsatisfactory situation in US GAAP, which leads to many restatements of financial statements, offers scope for improvements and that certain specific points in IFRS – e.g. multiple-element contracts– also



warrant attention. However, we are not convinced that a root-and-branch revision of IAS 11 and IAS 18, with all the attendant dangers of unintended consequences for what is for most users a key piece of important information in the financial statements, is either needed or desirable. We would have preferred an evidence-based approach which would have looked first at the aspects of revenue recognition which are broken, and we do not believe that there are really so many of these. The single method proposed does not appear to us to faithfully represent economic phenomena in all cases (long-term construction contracts and software development seem to us clear examples where this is not so) or to provide adequate information to the users and help entities to communicate with them. This is partly, but not only, because the proposed approach focuses on changes in assets and liabilities, while for both preparers and users it is flows, activity and transactions which are more important for assessing the entity's performance, and these are basically ignored in any direct sense in the proposals. The proposed principle would tend to introduce a more legalistic view on revenue recognition and to induce entities to separate contracts into different phases, "creating" transfers of assets to their customers in order to be able to achieve a certain revenue pattern. This would contravene many of the qualitative characteristics which financial information should have. Finally, we understand that many users are disappointed that the Discussion Paper does not examine the recognition of costs, especially for entities working on long-term contracts, as users' key focus is on profit recognition, not purely revenue recognition.

Question 2

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

See our answer to Question 1 above.

Question 3

Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

For our industry it would be useful to clarify the term "two or more parties" as there may be both direct and indirect customers. Indirect customers (e.g. medical insurance organisations) can be regarded as parties to a contract who never control the goods but are entitled to discounts, in addition to the hospitals or pharmacies which actually sell them to the patients and claim the reimbursement from the insurance company. By virtue of a contract between the pharmaceutical company and the insurance company, the latter is entitled to a discount based on the consumption (or even efficacy) of drugs consumed by its policy holders.

CHAPTER 3

Question 4

Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition



would inappropriately identify or omit deliverables in (or components of) the contract.

The proposed definition seems to us to lead to too broad an application in terms of warranties and the transfer of an asset to a customer. According to paragraph 3.7 any enforceable promise, which we understand also encompasses warranties, gives rise to an asset to be transferred as a result of entering into a contract. While we agree that warranties that are encompassed in a contract between a manufacturer and its suppliers such as in the home appliance business give rise to a performance obligation, we consider that infrequent major recalls that occur in the consumer goods industry or statutory warranties of “fit-for-purpose”, which can potentially give rise to product liability claims over many years, do not give rise to a performance obligation: such contingent liabilities should be treated as an expense. See also our answer to question 6 regarding returns. Moreover, we think the definition of a performance obligation should be clarified to make it clear that goods used in the performance of services do not give rise to a performance obligation.

Question 5

Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

A contract can indeed bundle separate performance obligations, and unbundling all separate performance obligations would be unnecessarily complex. If different performance obligations are provided at the same time, then the different performance obligations ought not need to be unbundled.

Conversely there are contracts where an entity is indeed incurring different performance obligations that should be reported separately, but preparers would need reliable separation criteria. The key criterion must be the faithful representation of economic phenomena. Therefore the unbundling should reflect the entity’s business model. Consequently if the entity is offering goods or services separately or in conjunction with other goods and services, then the performance obligations should be separated

Question 6

Do you think that an entity’s obligation to accept a returned good and refund the customer’s consideration is a performance obligation? Why or why not?

The answer to this question is linked to our answer to question 4 on warranties. While we agree that that an obligation to accept a good returned in line with the contract is a performance obligation, we consider that major recalls or occasional product liability claims do not give rise to a performance obligation and should be accounted for exclusively in accordance with IAS 37. In effect the trigger for a recall, for example, is generally a regulator's decision that is sometimes based on a different of interpretation of the safety thresholds, which may result in withdrawing a product in one market while it remains saleable in another.

Question 7

Do you think that sales incentives (e.g. discounts on future sales, customer loyalty points and



'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

The distinction between positive costs and reductions of revenues is often one of the most difficult lines to draw in practice. At the extreme we could say that discounts agreed to in the contract, or in the general terms and conditions under which the contract is agreed, are in effect reductions of price and therefore revenue, while special promotions like a free water glass with petrol (not contained in the normal sales terms and conditions) tend rather towards a selling cost – unless the entity happens to sell water-glasses as part of its normal business. In between there are infinite gradations which speak partly for and partly against each of the two possible classifications. Even in the first case it is sometimes difficult to distinguish between a trade discount and some form of reduction to compensate a wholesaler for particular services. This is one reason why we would conjure the Board to “tread carefully”, as “moving the goalposts” could create substantial confusion and demolish proper comparability for several years, unless the distinction is made especially robust and understandable.

CHAPTER 4

Question 8

Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

We do not believe that control results in a economically more realistic approach than risks and rewards. A strict control approach would result in more consistent and appropriate decisions about when assets are transferred. Assets are transferred when the buyer can dispose freely of them, i.e., re-sell them, pledge them, etc. Nor would a strict control approach be consistent with the Incoterms that are in use in international trade: if goods are sold FOB port of shipment, they belong to the buyer when they are loaded on the ship. The buyer does not physically control them but he could sell them during the transportation.

However we believe that, if the Board nevertheless decides to focus on the control criterion, it could solve this problem by defining control in terms of the ability to dispose of or assign the goods, instead of saying the customer controls the goods when it takes physical possession. This would also give a more realistic representation on bill-and-hold sales.

Question 9

The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

While, on the basis of the proposed model, revenue should be recognised only when a performance obligation is satisfied, this is only the final point of the process. The crux is that certain industries have a business model whereby they generate revenue at different steps of the execution of a



contract and the determination of those steps should be determined on the basis of facts and circumstances stemming from the business model of the entity rather than from steps arbitrarily determined in the contract to achieve a given pattern of revenue recognition. The Board could address this issue by modifying the notion of control in terms of economic substance rather than taking a legalist view based exclusively on physical control. (See question 8 above.)

CHAPTER 5

Question 10

In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

- (a) *Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?*

Assuming that the foregoing Discussion Paper proposals form the basis for the final standard, we agree that a performance obligation should be measured initially at the transaction price, which is a simple and relevant method.

- (b) *Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?*

We agree with the remeasurement of a performance obligation when a contract is deemed to be onerous in line with IAS 37 criteria.

- (c) *Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.*

We are not aware of performance obligations for which the proposed measurement approach would not provide decision-useful information.

- (d) *Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.*

We do not think this would be the case.

Question 11

The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (e.g. selling costs) are included in the initial



measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

- (a) *Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?*

We agree that the costs that an entity incurs to obtain a contract should be recognised as expenses. This method is simple and addresses the economic reality.

- (b) *In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.*

We do not think that would be the case

Question 12

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

We agree that the transaction price should be allocated to the performance obligations on the basis of an entity's stand alone prices of the goods or services underlying the performance obligations.

Question 13

Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

We agree that if an entity enters into a contract whereby providing goods and delivering services that are bundled with each other, the entity should estimate the stand alone price of the goods and services. However, for practical purposes, this should only be deemed necessary where there are material amounts involved in goods and services provided under the same contract in different period.



Sincerely,

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