

IFRS Foundation / IASB 30 Cannon Street London, EC4M 6XH

Dear Sirs,

File Reference No. 1820-100 Revenue Recognition Comment Letter Contact Ian Hargrave

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Date 6 August 2010

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in respect to Question 15 on Product Warranties:

At present warranty provisions are usually recognised as a cost of sale rather than as a reduction in revenue. Actual warranty costs can be determined (whether they be the cost of replacement product or repair), whereas warranty revenue may have no measurable market value if it is never sold separately but always included in each contract. It therefore seems more prudent to account for the known costs rather than to account for the estimated revenues, if the aim is attain consistency of reporting between different entities.

By offering a warranty, the selling entity is entering into a commitment to provide a potential future service at no further cost to the purchasing entity, but at a probably future cost to the selling entity. Clearly this probable reduction in contract profit needs to be recognised by the selling entity. The choice is whether to recognise the probable reduction in contract profit immediately (by accruing for the probable future costs) or deferring the notional warranty revenue over the period of the warranty.

If the selling entity considers the provision of warranty to be a core business activity, it may well actively sell extended warranties and hence have a more easily determined sales value for warranty. In such a case, the business will probably be structured so that the warranty sales value exceeds the probable costs. In such circumstances it is more prudent to defer the revenue than to accrue the potential costs.

Conversely, many entities consider the provision of warranty to be a necessary cost required (whether by statute or to be competitive) in order to achieve sales. It is quite possible that the probable costs for the selling entity would exceed notional warranty revenue for such a "loss leader". In such circumstances it is more prudent to accrue the probable costs than to defer the revenue.

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Another issue with deferring the revenue is that this leads to a presumption of going concern. Were an entity to cease selling a product on which it had offered a warranty, there would still be revenue appearing for some time after the sales ceased (maybe even for several years) under this proposed accounting treatment. This is counter intuitive and could be misleading. Conceptually it seems preferable that at the time trading ceases, the future warranty commitment to existing customers is shown as a liability for future costs rather than as a deferral of previous sales revenues, even if both appear as liabilities on the balance sheet.

There is a possibility that the situation could arise that both the current accounting treatment and the proposed new accounting treatment could coexist simultaneously: future probable warranty costs could be accrued and some sales revenue (for warranty) deferred. This would understate the contract profitability at the time the sale was first recognised and hence would not show a "true and fair view". There should be matching of revenues and costs in the same accounting periods. At present, both are recognised immediately (by recognising the revenue in full and making provision for probable warranty costs). Deferring the notional warranty revenue over the warranty term and recognising the costs as incurred is also acceptable. Deferring the warranty revenue and accruing the probable warranty costs immediately is not.

On balance, I believe that warranty should be explicitly excluded from the Accounting Standard and not considered as a separate performance obligation; unless it has been explicitly sold as an optional service and priced accordingly.

I trust that the above will be of assistance in your deliberations for the wording of the final Accounting Standard.

Yours faithfully,

lan Hargrave FCA MIAP FloD CDir