

October 22, 2010

Ms. Leslie Seidman, Acting Chairman Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Nowalk, Connecticut 06856-5116

Sir David Tweedie, Chairman International Accounting Standards Board 30 Cannon Street London EC4M6xh United Kingdom

Re: File Reference: No. 1820-100, Exposure Draft: Revenue from Contracts with Customers

Dear Madam and Sir:

Johnson & Johnson welcomes the opportunity to comment on the FASB's exposure draft *Revenue from Contracts with Customers* (the "proposal"). Johnson & Johnson with approximately 114,000 employees worldwide is engaged in the research and development, manufacture and sale of a broad range of products in the health care field. The Company conducts business in virtually all countries of the world with the primary focus on products related to human health and well-being.

We agree with the core principle of the proposal that revenue should be recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration received, in exchange for those goods or services. We also agree with the Board's objective to establish a standard that an entity should apply to report useful information to users of its financial statements about the amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. The concept regarding "control" being transferred when products are shipped to a customer and recognizing revenue immediately is an important and positive change in the current practice. We believe that this proposal would result in a more consistent decision about when goods or services are transferred since the risk and rewards approach can result in different accounting for economically similar contracts. In the existing guidance, it can be difficult for an entity to judge whether some risks and rewards of ownership of a good or service has been transferred to the customer if the entity retains some risks and rewards. While we are supportive of the objectives of the proposal, we have concerns with some aspects relating to:

- Measuring the transaction price using weighted probability
- Variable Considerations
- Warranties provided to customers
- Customer risk in the initial measurement of revenue



- Licensing arrangements
- R&D Collaborations

Measuring transaction price

We do not agree with the proposal for recognizing revenue using the weighted probability approach as it is may not be the best measure of transaction price for many businesses. This weighted probability would not be reflective of the actual amounts to be received because it is a weighted calculation of possible outcomes. We propose the use of management's best estimate rather than a probability weighted approach since this will provide information on what management expects to receive based on historical analysis and/or trends. Additionally, the proposal adds unnecessary complex calculations, especially to the recording of standard routine sales transactions. While we acknowledge best estimate requires management judgment, a weighted probability still requires judgment but will add additional complexity to the preparers of the financial statements.

Variable consideration

The ED proposes that only similar type contract experiences be the criteria for determining variable consideration; however, we believe that all relevant data should be considered when determining transaction price and not be limited to just commercial experience. For example, current practice today excludes clinical trials, market studies, or other industry specific data from being a factor when considering an entity's historical experience. We also believe that comparables based on third party evidence should be used to develop historical experience when a new performance obligation can't be established based on their own historical evidence. Preparers should be able to rely on this type of data for new product launches to support revenue recognition using an estimated transaction price when similar contracts are not available. However, we do agree that if an entity is not able to estimate revenue for performance obligations that are subject to variable consideration, we would expect that those performance obligations would be bifurcated from the other performance obligations in the arrangement so that no revenue is allocated to them until management can reasonably estimate the variable consideration.

Another area of concern relates to the weighted probability approach since this has the potential to accelerate revenue recognition based on assigned probability, especially in cases where we have to recognize a milestone payment received prior to the associated event occurring or in cases where there is variable consideration. We are concerned about how the proposal will impact the life science industry and the accounting currently for milestone payments received. Today, this industry recognizes milestone payments received from partners when an event has been achieved. Within the life science industry, there is significant volatility in developing R&D assets as there are many failures in moving an early stage intellectual property to regulatory approval to be used in a commercial state. As a result, under the proposal, if a preparer were required to accrue a milestone payment prior to the contingency being resolved, it would result in an acceleration of revenue recognition. Consequently, the



accrual and revenue recognized in one period would be reversed in the subsequent period if the asset failed. We believe the current guidance used for accounting for milestones payments received reflect the true risk and economics for these transactions.

Lastly, we believe there is a need for further clarification as it relates to residual amounts. The current proposal is unclear if the residual method would be allowable and it does not specify what facts or circumstances are needed to be allowable. For example, Company A receives \$100M upfront for services to be performed over the next two years. The services include R&D trials, testing, and remediation of lab facility. Third party evidence supports \$25M for R&D trials, \$25M for testing and \$25M for remediation. There is an excess of \$25M remaining that is not allocated to the three deliverables. Would we simply allocate the \$25M ratably over the three elements? We believe yes, since it supports the allocation of the transaction price to all separate performance obligations in proportion to the standalone selling price of the good or service underlying each of those performance obligations at contract inception. Since there are three identifiable elements, we recommend that the identifiable benefits be allocated ratably over these elements.

Proposal for the accounting of warranties

We do not agree with the proposal to differentiate between latent defects that exist when the product is transferred to the customer and for defects that arise after the product is transferred to the customer. We do not distinguish between these types of warranties, since this type of distinction is very difficult to apply in practice and determination of when the defect occurred would be challenging. Rather, warranties are identified as those that are incurred in connection with the sale of goods and services and those that are sold separately. We view the former form of warranties as an intrinsic cost of a product sold and not as revenue generating activities. At the time of sale, our intention is to transfer goods or services that are not defective; as such, we believe that there is no separate performance obligation for the product warranty. We recommend that the Board retain the existing guidance on accounting for warranty obligations that are incurred in connections with the sale of a good or service.

Need to reflect customer risk in the initial measurement of revenue

The ED proposes that all collectability risk be reflected within the transaction price. While we agree with the Board that a customer's credit risk should be considered as an element of revenue recognition, we do not believe this should be considered in the measurement of the transaction price, but rather on the timing of when an entity recognizes revenue. For example, if management made an assessment of the credit worthiness of the customer and determined that the customer cannot pay, the sale would not be recognized until payment is assured. We do not believe that there are any weaknesses or inconsistencies with either the conceptual basis or application of the current accounting for collectability. We recommend that the Board allow the recognition of credit risk through the recognition of bad debt expense on the outstanding receivable (which is measured based on management's best estimate) and a

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corresponding allowance against receivables. We believe the recognition of sales and credit risk with customers should be viewed separately.

Additionally, we do not agree with the bifurcation of the original amount of revenue to be recognized and subsequent true-up of the sale. The ED is inconsistent by allowing the original estimate of variable consideration be recorded in revenue, but doesn't allow subsequent true-ups to be recorded into revenue. This method of revenue recognition will not provide users of the financial statements reliable information about revenue, since all true ups due to collectability will be recorded within other income rather than revenue.

Licensing of Intellectual Property

With respect to the revenue recognition for licenses of intellectual property, we disagree with the proposed conclusion that the pattern of revenue recognition should depend on whether the license is exclusive or not. We believe exclusivity affects the perceived value of a product or service and does not have bearing on when revenue should be recognized.

We believe that once the full economic value and benefit have been transferred to a licensee, and there is no continued involvement or performance obligations to the licensor, this transaction should represent a sale and with immediate revenue recognition. Said differently, revenue recognition would be recorded by the licensor once the licensee was able to fully benefit from the use of the intellectual property. We do agree that revenue would be recorded over the license period if the licensor has to satisfy a performance obligation in the arrangement.

R&D Collaborations

In considering the Board's definition of a customer, we understand it is the Boards intention to exclude R&D collaborations from the scope of the proposal. We agree because we do not view these collaborations as revenue generating activities, rather reimbursement of expenses between partners. We recommend that the definition of a customer be moved from the basis of conclusion section into the body of the standard.

In conclusion, we support the positive changes the Boards are trying to implement; however, we feel that the Boards should reassess the impacts of the above noted items.

Thank you very much for taking our comments into consideration.

Sincerely,

Stephen J. Cosgrove Vice President, Corporate Controller, Chief Accounting Officer