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

18 October 2010

## **Exposure Draft, "Revenue from Contracts with Customers"**

Dear Sir/ Madam

The Roche Group has a turnover of CHF 49.1 bn. (EUR 32.5 bn.) a year derived from our worldwide healthcare business - pharmaceuticals and diagnostics - and employs 80,000. As at December 2009, we had a market capitalisation of CHF 151.3 bn. (EUR 101.1 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.

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

Our comments should be read in the context of existing IFRSs, particularly IAS 18. Future developments in the conceptual framework and other standards may well affect the principles underlying a revenue recognition standard for contracts with customers.

There are two main standards on revenue recognition under existing IFRS – IAS 11 Construction Contracts and IAS 18 Revenue. We welcome the work being carried out on consolidating the standards so as to have a single revenue recognition standard. In our opinion, a fully-converged and simplified standard will be beneficial to financial reporting. We recognise that the existing guidance on accounting for revenue under IFRS is "light", involves significant conceptual issues, including performance reporting. Thus, we believe a fundamental overhaul of the existing revenue standards is appropriate.

However, we are concerned that the ED has been issued prior to the completion of the conceptual framework project and without thorough conceptual debate as to what is revenue, why the revenue number is important to the users of financial statements and why the basis for revenue provides useful information.

Primarily, we believe the information provided via financial reporting should be useful to the users. In our opinion, the proposals in the ED may not meet this objective. The ED proposes that revenue should be recognised only when control of goods and services is transferred to the customer. We do not support this model especially since is not clear to us why the proposals would result in more useful information.

We believe that the revenue number should be a measure of normal operating business <u>activity</u> carried out to fulfil a contract with a customer. A change in the revenue recognition model as proposed by the ED may prove to be extremely expensive for both preparers and users of financial statements. We propose that a thorough cost / benefit assessment be carried out in order to determine whether the benefits of implementing the proposals outweigh its costs.

Our general comments on the ED, in no order of importance, are summarised below. Detailed comments are contained in the Appendix to this document.

We generally support the proposed guidance on combining and segmenting contracts. It is our opinion that more clarification is required as to when contract modifications should be accounted for as a separate contract rather than a contract extension.

We support the proposed guidance for separating performance obligations. However, we believe more clarification is required on the concept of "distinct good or service". In addition to this, we believe that only an entity's own customary business practices should be considered, rather than the business practices of other entities.

We do not believe that the adoption of the "control" model is the way forward, especially in circumstance where services are transferred on a continuous basis. In any case, we believe the definition of control should be developed at the conceptual framework level to ensure consistency across the standards.

In our opinion, there appears to be a dichotomy between the "control" concept (as illustrated in paragraphs 26 and 27 on page 22 of the ED) and the indicators of control – paragraph 30 on page 23.

We do not support the reflection of the customer's credit risk in the revenue number.

We believe subsequent changes in transaction price estimates should be allocated to relevant performance obligations directly giving rise to such changes, based on facts and circumstances surrounding each transaction. We are not in favour of assigning changes in price estimates solely on the basis of stand-alone selling prices.

We do not support the proposal to recognise a liability for an individual onerous performance obligation under an overall profitable contract.

In our view, the IASB has yet to demonstrate that the proposed ED would substantially better than the existing revenue standards in order to justify the cost of the transition. Mere convergence with US GAAP as suggested by the IASB Staff member present at the EFRAG / IASB Outreach event in Brussels is extremely detrimental to preparers who as yet fail to see how the current proposals prove superior to what is already applied in practice.

Sincerely,

F. Hoffmann-La Roche AG

Ian Bishop Head of Accounting & External Reporting Michelle Olufeso Accounting & External Reporting

## Ouestion 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 to segment contracts and (b)to account for a contract modification as a separate contract?

We broadly agree with the proposed principle as regards combination and segmentation of contracts, however, we believe the concept of price independence warrants more clarification and its application, better illustrated with more complex and practical examples.

The structure of contracts in our business are dependent on the nature of assets / or other deliverables transferred, the circumstances under which such transfer is made and the potential value of the deliverables to the "customer". Contracts may be priced interdependently depending on bulk purchases, existing customer relationships and the potential for conducting business in the foreseeable future.

With reference to example 2 in the application guidance, it is not clear to us how the board reached the conclusion that the circumstances described give rise to the contract being accounted for as a "contract modification" and not a separate contract or a contract extension. This conclusion appears to be inconsistent with the guidance included in paragraph 14 of the ED - that the price of one contract is not interdependent with the price of another contract solely because the customer receives a discount as a result of an existing customer relationship. Given this lack of clarity, we believe transactions which have the same underlying characteristics may be accounted for differently. This would reduce the usefulness of financial statements to users and therefore not facilitate comparability. We therefore urge the Board to reconsider clarifying substantially, the 'price interdependence' concept.

## **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?

We support the proposed guidance for separating performance obligations, but believe that the concept of goods or services being distinct should be made with sole reference to <u>an entities' normal business practice</u> rather than the business practices of another entity.

We support the proposal which requires an entity to consider its own business practice in determining how to separate performance obligations as outlined in pp 20 of the ED. However, paragraph 23 (a) of the ED suggests that an entity should also consider what other entities do when considering whether its goods or services are distinct. We disagree with this. We believe an entity should consider its own customary

business practice rather than the business practice of any other entity as entities in the same industry may well adopt very different business practices in the execution of their business.

With reference to example 10, it is unclear to us how the Board arrived at its conclusion to combine the licence and the R & D service, especially given the simplicity of the scenario presented. In our business, it is quite usual to transfer technological licence rights to a potential customer without the provision of services to support the use of such technology and thus, one could argue that the licence has a distinct function and profit margin and thus the consideration attributable to this performance obligation could be recognised separately from that attributable to the R & D service, which can also be distinct.

In other cases, licences could be given for specialised compounds which required the transfer of technological know-how to the client in order to facilitate proper use of the licensed IP. In such a circumstance, we would support the conclusion reached by the Board.

## 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?

We do not support the proposed control model for revenue recognition. We believe the use of an activity-based model which takes into account the risks and rewards approach and the fulfilment of performance obligations would provide more decision-useful information to users. We believe an activity -based revenue recognition model takes into account the fact that an entity engaged in the provision of services to a customer (especially in construction related contracts), satisfies its performance obligation to provide services over a period of time. During this period of performance, "control" of the ensuing asset may not necessarily transfer to the customer until completion. However, the entity, in satisfying its obligation to provide a service, generates an asset at the customer's request and thus, should be able to recognise some revenue in compensation for the asset generated on behalf of the customer by virtue of the contractual relationship that exists between the parties. To facilitate the recognition of revenue, we believe that, where the seller acquires a clear and incontrovertible right to a payment, e.g. by meeting a milestone, the entity should recognise as revenue at that point, the value of work carried out up to that point.

In circumstances where the asset generated by the entity is tailored primarily to the request of t he customer and thus, may not be transferable to another, we believe an entity should be able to recognise revenue based on the activity already undertaken in the process of generating the asset required.

With reference to the 'control' concept, we believe that the definition of control should be addressed at the conceptual framework level to ensure that this concept is applied consistently across all relevant standards. Currently the control concept applied in the ED is very different from the control model applied in IAS 27 and SIC 12.

We also note that the term "right to use" as applied in this ED - article 27 does not necessarily trigger the same accounting considerations / implications of the same term in the Leasing ED.

We have concerns re: the application of the proposed guidance to service contracts. We believe the transfer of control should be assessed, taking into account the economic substance of transactional relationships between the seller and the customer.

With reference to pp 27 - reference is made to the customer's ability to direct the use of a good or service evidenced by the customer's present right to obtain substantially all of the potential cash flows from the asset so transferred. We believe that a customer may still direct the use of a good or service ("control") even when it does not obtain substantially *all* of the potential cash flows from the asset or utilise the asset for *all* of its remaining useful life.

Given the nature of our business, it is customary to transfer a license to a customer on either an exclusive or a non-exclusive basis. In most deal structures, we would have no future performance obligation. The license has a distinct function and a profit margin can be identified. The customer on the other hand, takes control of the license and uses it in line with the access rights granted, thus obtaining control of the license and being able to derive benefit from its use, regardless of whether the license granted is exclusive or not.

The proposals in the ED suggest the upfront revenue attributable to the license (ignoring downstream milestone receipts and royalties) on contract inception should be spread over the term of the license, if the license is exclusive, but recognised immediately if the license is non-exclusive. We are not clear on how this distinction between exclusive and non-exclusive licenses gives rise to very different results when fundamentally, the transferor has no further performance obligation to perform in both instances and the compensation for transferring the license is structured over the term of the license by way of upfront license fees, event milestones and royalties. We do not understand why in the case of an exclusive license, when substantially all the useful life is NOT transferred to the customer, this gives rise to the need to spread the upfront fee over the term of the license.

We believe the upfront fee receivable on contract signing should be recognised immediately when collectability is assured, and then subsequent milestone revenue recognised only when the milestone event is attained. It will also minimise complicated disclosures which will no doubt be needed if the proposals in this ED are applied to our business.

In addition, we also believe it would be helpful if the Board considers incorporating into any future revenue standard, clear guidance relating to "Principal / Agent" relationships and when revenue should be recognised. We note that in these relationships, the conditions outlined in B30 may be fulfilled, but revenue should not be recognised until sale to the ultimate end customer occurs, especially if the Principal / Agent contract clearly stipulates this condition. Current practice is to defer the associated revenue until the products are with the end customer and we urge the Board to consider including this proposal in any subsequent 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?

We generally agree with this proposal, however we would not favour estimating the price of single item transactions or items that have a stand-alone value which can be estimated reliably based on normal business activity and experience, on a probability-weighted basis, as in our view, this would neither necessarily provide transparent reporting to users nor provide materially superior information to the best estimate approach currently applied in practice.

With regards to accounting for sales returns, we urge the Board to consider, including in any proposed IFRS, the use of historical sales returns experience (when readily available) as a basis for attributing value to potential sales returns. This concept is currently used by most organisations and is proven to be an accurate reflection of real business experiences. In addition to this, we believe, a quarterly re-estimation of the sale prices on long lasting contracts with adequate adjustments does not appear to be reasonable nor reliable.

Furthermore, the proposals in the ED suggest that when accounting for upfront, milestone and royalty payments, "reasonably estimated" amounts should be recognised as revenue following the creation of a contract asset, for which control has been transferred to the customer.

In the Pharmaceutical business, this introduces a very high level of subjectivity, based on "Managements" determination as to what proportion of variable consideration based on expected values, can be "reasonably estimated" and thus, recognised as revenue.

Linking this argument with IAS 37 which requires that contingent assets should not be recognised in the financials until certainty is assured, this highlights an inconsistency between IAS 37 and the proposed revenue standard. We re-iterate, that there is currently an inconsistency in the accounting for intangible assets which are required to be expensed (more likely than not), if generated internally, capitalised at cost if purchased separately (IAS 38) or measured at fair value if acquired via business combination (IFRS 3). It would be helpful if the Board considers ensuring uniform accounting treatment for intangible assets across all standards.

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?

We do not support this proposal, firstly on the basis of presentation on the face of the income statement and secondly on the basis of revenue measurement,. With regards to presentation, we do not support the inclusion of the initial credit risk assessment in the revenue line and subsequent measurements reflected as a gain or loss in the income statement.

In our view, the basic calculation of the revenue number is "quantity supplied multiplied by price when goods are sold or an estimation of services rendered multiplied by contracted service rates for services rendered". We do not believe the proposal to factor in the customers credit risk when determining the revenue number will provide decision useful information to users. Further, the credit risk always relates to the value of the receivable which is reflected on the balance sheet and not the revenue number which is an income statement item. This point was raised to the staff member present at the EFRAG outreach session in Brussels, September 2010 and it was communicated that this point would need to be re-deliberated by the Board.

We believe the disclosure requirements as per IFRS 7 provide ample information about the customers credit risk and thus, adjusting the revenue number repeatedly over time does not appear to be very efficient and would not provide decision useful information.

It should be noted that the accounting systems in place currently record the revenue number based on the invoiced amount. The proposals in this ED would suggest that an impairment could be recorded against a newly created receivable and this, in our view is not practical.

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?

We agree with the proposal to take into account the time value of money to material transactions which have a financing component. However we are unclear as to how the terms "significantly before" and "significantly after" should be applied in practice. We would suggest that the Board provides clarification of these terms and their application in order to avoid inconsistencies in reporting practices.

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?

We agree with the proposals in pp 50 re: allocating transaction price to all separate performance obligations in proportion to their stand-alone selling prices at contract inception. However, we are not supportive of the proposal to allocate subsequent contract price changes to **all** performance obligations on the same basis as at contract inception, especially if such performance obligation have been fulfilled prior to the price changes being effected. We believe it makes economic sense to take into account the relevant facts and circumstances as applicable to performance obligations which give rise to such price changes and account for the transaction as such.

In our business, out-licensing contracts with multiple elements are often priced in a "bundle", such that certain high margin elements of the transaction may be heavily discounted based on deal structure. Given this, it will be inappropriate to allocate the overall discount to <u>all</u> the performance obligations on a pro-rata basis as this may give rise to losses on low-margin elements of the transaction, and thus onerous contract implications set in.

In addition to this, we are not in favour of accounting for onerous part(s) of a transaction which may give rise to onerous contract implications when the overall contract is profitable. We believe it is practical to test for onerous contracts at contract level and NOT at performance obligation level.

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?

We support the Boards' proposals to capitalise costs which qualify for capitalisation as contract costs, but fail to understand why *any* costs incurred to secure a contract <u>before</u> contract inception should be excluded For example, where a portion of a business (segregated by virtue of its nature) is to be sold off, and that portion of business is serviced by an IT system integrated into the IT systems of remaining businesses not being sold off, the potential sale of this portion of business may be contingent on there being an IT system in place, which would service the portion of business being sold. In our view, any costs incurred to develop a stand alone IT system should be included in the contract cost.

In addition to this, we do not think it appropriate to define the criteria about costs to fulfil a contract in a revenue standard. Such requirements should be clearly outlined in another more appropriate standard e.g. IAS 2 – Inventories or at Framework level.

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
- $(b) \ any \ additional \ liability \ recognised \ for \ an \ one rous \ performance \ obligation.$

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

In line with our comments in question 8, we believe costs incurred to generate assets as well as other costs incurred to secure contracts (in certain circumstances) should be capitalised and taken into account when determining contracts costs.

As regards onerous contracts – we believe the test should be conducted at contract level and not at performance obligation level as outlined in response to question 7.

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?

We agree with the Board's objective that disclosure requirements should help users of the financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. However, we believe the proposed disclosure requirements would substantially increase the already detailed disclosures currently provided and gathering the information as prescribed would prove to be extremely time consuming and expensive. IT systems would have to be modified to facilitate effective and efficient collection of data, which may not prove to be decision useful to users.

Given the nature of our business, the proposals in the ED will require that we assign transaction price to performance obligations which may never materialise. For example, where milestone payments are expected to be received in the future, the ED proposes that the transaction price be assigned to the milestone event when potential outcomes of achievement can be estimated. This would mean that revenue could be recognised prior to the achievement of the milestone event. If the milestone event does not materialise as is often the case in our business, the proposals will promote increased volatility of the revenue number for events that may never occur and this volatility will need to be disclosed extensively in the notes to the financial statements. This in our view would not provide useful information to users.

As regards disclosures pertaining to onerous performance obligations, these would prove useful if the amounts attributable to onerous contracts are expected to be substantial. Given the model developed in the ED, assigning the transaction price (and discounts) to performance obligations as outlined in our response to question 7 would not reflect the economic reality of the transaction. The complexity of communicating the existence of onerous performance obligations which form part of a profitable contract arrangement should not be under-estimated and we urge the Board to reconsider whether the communication of such information would prove to be decision useful.

However, where onerous contracts exist at contract level, we believe the disclosures as outlined in the ED would be appropriate, though admittedly, the onerous contract impact may not be material.

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?

We believe the concept of recognising revenue based on expected values which are not necessarily representative of amounts actually received or receivable poses a fundamental question – What exactly is revenue? The principle concept of the ED is based on the recognition of revenue when "control" of a contract asset is transferred to the customer.

In our view, there appears to be a disconnect between the control concept and the performance obligation notion. For example, where an exclusive license is transferred to a customer for a period of time which does not represent the remaining useful life of the license, the proposals in the ED suggest that upfront revenue receivable on the transfer of the license should be deferred revenue over the license period, even though the transferor has no future performance obligations to perform. However, where the license is transferred for a period of time which represents the remaining useful life of the license, then the upfront receipt should be recognised immediately.

Given the first scenario presented above, what disclosure requirements would the transferor be expected to disclose given that the license has been transferred on day one and no future performance obligations exist for the transferor?

Similarly, when the variable consideration for the transfer of a license includes future milestone receipts and royalties, we are not clear as to what disclosure requirements would provide decision useful information to users given that:

- i. The license has been transferred and the transferor has no future performance obligations;
- ii. The milestone event for say, obtaining FDA approval has a 60% probability of occurring (and thus an expected value is already recognised in revenue against a contract asset though this might never materialise)?

We urge the Board to reconsider the practical application of its proposals given the nature of our business, if only to ensure that users are not unduly burdened with additional disclosures that may not necessarily add value or meet the objective as intended by the Board.

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?

We agree with these proposals so far as they do not duplicate, but augment the disclosure requirements outlined in IFRS 8 – Operation Segments.

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.

We agree in principle that the information should be stated retrospectively in order to provide decision useful information to users. However, this can only be achieved at **great expense** and given the proposals in the ED and the nature of our business, we really do not believe the information provided will be reflective of the economic reality of our out-licensing deals. The restatement of the revenue number will involve:

- O Determining a probability weighted estimated variable price for "live" contracts signed in previous years, incorporate a credit risk element and subsequent changes to this thereafter;
- O Adjust historical revenue numbers accounted for on the basis of invoice amounts to one based on expected probability weighted values. This would involve significant system modifications and also changes to the internal control processes in order to accommodate the proposals in the ED;The existing revenue numbers would have to be modified to take into account any effects arising from changes in the timing of revenue recognition and any associated hedging techniques applied to such revenue numbers.

The implementation of these efforts will potentially give rise to revenue numbers which do not reflect the economic substance of the underlying transactions and ultimately, fail to provide decision useful information to users.

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?

We believe the principles outlined in the ED should be crystal clear so as to enhance its application to varying business scenarios. Whilst we appreciate that it is impossible to provide application guidance that is relevant to all industries, we note that the examples references are overly simplistic and usually do not provide relevant guidance applicable to complex business scenarios.

With reference to example 7 – non refundable upfront fees, this example does not really provide clarity to preparers active in the Pharmaceutical industry. When we transfer a license to a customer, barring the need to provide other services like supplying active pharmaceutical ingredient in certain circumstances, no future performance obligation exists. The license has a distinct function and a profit margin can be identified. The customer on the other hand, takes control of the license and uses it in line with the access rights granted, thus obtaining control and being able to derive benefit from its use, regardless of whether the license granted is exclusive or not. Example 7 suggests the upfront revenue attributable to the license on contract inception should be spread over the term of the license, if the license is exclusive, but recognised immediately if the license is non-exclusive. We are not clear on how this distinction between exclusive and non-exclusive licenses give rise to very different results when fundamentally, the transferor has no performance obligations to perform in both instances.

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?

We agree with the proposal.

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?

We have already addressed this point in our responses to questions 3 and 14. In our opinion, the Board needs to revisit the recognition of revenue for the out-licensing of intellectual property to a "customer", given the content of recent ED's on Revenue Recognition and Leasing. We note that the Leasing ED explicitly excludes intangible assets. However, during the EFRAG / IASB outreach in Brussels in September, the staff member responsible for the Revenue ED stated that the area of intangible assets would need further deliberation, especially since IAS 38 would be revisited. We therefore urge the Board to hold off any changes to the revenue accounting process linked to intangible assets until any revisions to IAS 38 has been completed.

It would be unfortunate if the existing ED's on revenue recognition and leasing were to be implemented, only to be revised at a later date following completion of work in IAS 38.

We believe the recognition of revenue for out licensing arrangements should take into consideration the existence of continuous involvement (or not) following the out-licensing of intellectual property to a "customer". Secondly, we believe that the right of use of an intangible asset could be addressed under the IASB's leasing ED. Secondly, given the nature of the Pharmaceutical business and the degree of uncertainty inherent in its operations - achievement of milestones in the R & D phases, the recognition of revenue prior to the revenue generating event occurring seems inappropriate to us.

Typically, when intellectual property is out-licensed to alliance partners, licenses granted could be either exclusive or non-exclusive dependent on the nature of rights licensed, the geographical location of the partner and the indication for which the rights have been granted, amongst other factors.

Paragraph 26 of the ED which states that a customer obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service. In addition to this, control includes the ability to prevent other entities from directing the use of, and receiving the benefit from,

a good or service. Given this, an entity could recognise an intangible asset when it can demonstrate (amongst other criteria) that it exercises "control" over intellectual property, in line with IAS 38.13 regardless of whether the rights obtained are exclusive or non-exclusive. The licensee obtains control of the license – exclusive or not, when it is able to use the license as prescribed and obtains benefit from such use.

Hence we do not support the proposal to make a distinction between exclusive and non-exclusive licenses because:

- a. License exclusivity (or not) merely gives rise to what essentially is the "right to use" intellectual property (IP). The control model does not highlight whether the "licensor" has outstanding performance obligations following the transfer of the license and;
- b. The licensor may have continued involvement in its relationship with the "customer" under the terms of the licensing agreement, dependent on deal structure.

With reference to the former, we believe that where the licensor transfers the right to use the asset to the licensee via a licensing agreement (exclusive or non-exclusive), the licensee is able to use and benefit from the license immediately. In circumstances where the licensor has no further performance obligations associated with the relationship with the licensee and the license so transferred is separable and has standalone value, the revenue receivable for the transfer of the license should be recognised immediately (especially when it is not refundable under any circumstances). The proposal in the ED is to defer the revenue receivable over the term of the license.

On the other hand, the ED suggests that where a license is transferred for what is substantially all of the remaining useful life of the asset or if a license granted is non-exclusive, then revenue should be recognised immediately.

We are not clear as to why this distinction is made without reference to whether or not the deal structure gives rise to a need to combine performance obligations which may have to be performed on a continuous basis and thus warrant the deferral of revenue.

We acknowledge that there are circumstances where licenses are transferred with other deliverables such as supply of API – Active Pharmaceutical Ingredient - for use with the license in the research and development of compounds. In such circumstances, the existence of a continuous obligation may give rise to the need to defer revenue over the supply term, especially in circumstances where the supply of material occurs at a loss.

In addition to this, we believe that the 'right to use' a license could in substance be a leasing arrangement and thus the application of the leasing standard to such scenarios may be more appropriate. Given this, we believe such out licensing arrangements could be scoped into the new standard on leases instead of being accounted for under the proposed ED on revenue. We note that leasing of intangibles is outside the scope of the recently published leasing ED. This, in our view will generate confusion since licensing agreements generally transfer "rights of use" in varying forms. It would be helpful if the board considers the use of terminology so that it can be applied consistently across all standards.

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?

We agree that the requirements for recognition and measurement of gains or losses on the sale of some non-financial assets should be consistent with the requirements of this new standard.