June 30, 2015

Technical Director
File Reference No 2015-250
FASB
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Subject: Proposed Accounting Standards Update: Identifying Performance Obligations and Licensing

Dear Technical Director:

Pfizer is a research-based, global pharmaceutical company headquartered in New York. We discover, develop, manufacture and market leading medicines and vaccines, as well as many of the world’s best-known consumer healthcare products. In 2014, we reported revenues of $50 billion and total assets of $169 billion.

We appreciate the opportunity to respond to the FASB Proposed Accounting Standards Update: Identifying Performance Obligations and Licensing (“the proposed ASU”). We thank the Board for continuing to engage with its constituents and for continuing to be open to opportunities for simplification and improvement.

General Comments – Identifying Performance Obligations

- 606-10-25-16A – While we support the additional language that “an entity is not required to identify promised goods or services that are immaterial in the context of the contract”, we request that the Board reconsider its conclusion in BC 16 in the proposed update to “not [pursue the concept of inconsequential or perfunctory] because of its potential disadvantages.”

The phrase “inconsequential or perfunctory” is a long-standing notion that preparers have applied in practice for many years. As such, we also think that the addition of the concept of “inconsequential or perfunctory” would enhance a preparer’s ability to properly apply the immateriality filter.

We’ve heard preparers questioning whether the inclusion of an 800 number on a product represents a separate performance obligation. We doubt very much that those types of questions would have been or will be raised under a filter of “inconsequential or perfunctory”. Further, we think that the conclusion reached in Example 44-Warranties (606-10-55-309 in the proposed Update) would have been easier to reach and more intuitive using the added filter of “inconsequential or perfunctory.”
We request the following changes (underlined items reflect our suggested changes):

**606-10-25-16A** An entity is not required to identify promised goods or services that are immaterial or otherwise inconsequential or perfunctory in the context of the contract. An entity shall evaluate whether optional goods or services (that is, those subject to a customer option to acquire additional goods or services) provide the customer with a material right in accordance with paragraphs 606-10-55-42 through 55-43.

In addition, we request that the SEC’s clarifications as to how to apply the concept be brought into ASC 606 as well (as found in Topic 13A3C, Revenue Recognition: Inconsequential or perfunctory performance obligations: Question 2).

- **606-10-25-18A** – We support the simplification election not to account for shipping and handling as promises to the customer (i.e. performance obligations) when performed after a customer obtains controls of the goods. However, we do not believe that shipping and handling, after the customer has obtained control of the goods, should be considered “activities to fulfill the promise to transfer the good”. In our view, if the customer has already obtained control of the goods and revenue has been recognized, we find it potentially confusing that there should be activities yet to be undertaken to fulfill the promise to the customer. As such, we propose the following changes (underlined items reflect our suggested changes):

**606-10-25-18A** An entity that promises a good to a customer also might perform shipping and handling activities related to that good. If the shipping and handling activities are performed before the customer obtains control of the good (see paragraphs 606-10-25-23 through 25-30 for guidance on satisfying performance obligations), then the shipping and handling activities are not promises to the customer. Rather, shipping and handling are activities to fulfill the promise to transfer the good. If the shipping and handling activities are performed after a customer obtains control of the good, then the entity may elect to not account for shipping and handling as promised services to the customer. Activities to fulfill the promise to transfer the good. An entity making this election would not evaluate whether shipping and handling are promised services to the customer. An entity that applies this election shall comply with the accounting policy disclosure requirements in paragraphs 235-10-50-1 through 50-6.

**General Comments – Licensing**

- **606-10-55-62** – We strongly support the Board’s clarification that a license to functional intellectual property could result in a “right to access”.

In the case of collaborations within the pharmaceutical industry, when an entity licenses its technology rights to the collaboration partner at the initiation of the collaboration, such license would typically have stand-alone functionality. However, due to the fact that the entity out-licensing the rights, as part of its obligations under the collaboration, would continue performing activities that do not transfer a good or service to the customer but that would substantively change the intellectual property, we believe that the license revenue should be recognized over time. As such, even though collaborative arrangements
are not within the scope of ASC 606, we believe that this clarification is necessary as we would use the guidance in ASC 606, by analogy, for the licensing component of the collaboration.

- **606-10-55-65** – We strongly support the Board’s suggested addition, found in new paragraph 65B, to the guidance related to sales-based or usage-based royalties, which provides that sales-based or usage-based royalties need not be split for purposes of applying the guidance.

- **606-10-55-368 to 606-10-55-370** – We recommend that Case A be removed as, practically, we have not seen cases in the pharmaceutical industry where (i) intellectual property is licensed without the manufacturing know-how, when the manufacturing process is of a highly specialized nature such that no other entity can manufacture the drug (i.e., which would mean that the exclusivity of the drug is based partially or fully on the manufacturing patent) and therefore the licensee is fully dependent on the licensor/the entity to manufacture the drug and (ii) this would be in the form of a revenue transaction and not a collaboration.

If it were a collaboration, the manufacturing activities would typically be part of the activities shared between the parties and would not represent a sale of services between the collaborating partners. Also, the partners would typically share in the profits from the sale to third party customers, rather than the reporting entity just receiving a fee for its manufacturing services.

What we typically see in revenue transactions of such type is that the license would include all the IP related to the product, including the manufacturing IP, and, as such, the customer is able to choose to transfer the manufacturing to itself or to other providers, who specialize in manufacturing products of that nature. Consequently, the license and the manufacturing service would both be distinct, as the entity can benefit from the license with other available resources and can benefit from the manufacturing services together with the license transferred at inception. In addition, the license and the manufacturing services are not inputs to a combined item in the contract (based on the evaluation of the relevant factors in paragraph 606-10-25-21).

We are concerned that leaving the example “as is” may turn out to be confusing to preparers and auditors associated with the pharmaceutical industry, as, typically, manufacturing know-how is included within the IP being licensed to the customer and the manufacturing process almost always requires some lead time to transition to another manufacturer, if the customer chooses to do so. As such, we believe that this example may create an expectation that most manufacturing services would require bundling with the IP license while, as explained above, we believe that typically (and that also aligns to our understanding of practice under current GAAP) the manufacturing services and the license would both be distinct promises to the customer.

**Questions for Respondents**
See Appendix.

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We would be happy to discuss these matters further or to meet with you if it would be helpful.

Sincerely,

/s/ Loretta V. Cangialosi
Loretta V. Cangialosi
Senior Vice President and Controller

Attachment

cc: Frank D’Amelio
    Executive Vice President and Chief Financial Officer
Appendix

Questions for Respondents

Question 1: Paragraphs 606-10-25-14(b) through 25-15 include guidance on accounting for a series of distinct goods or services as a single performance obligation. Should the Board change this requirement to an optional practical expedient? What would be the potential consequences of the series guidance being optional?

Response:

We would prefer to limit diversity in practice; therefore, we do not support changing the current requirements to an optional practical expedient.

Question 2: Paragraph 606-10-25-16A specifies that an entity is not required to identify goods and services promised to a customer that are immaterial in the context of the contract. Would the proposed amendment reduce the cost and complexity of applying topic 606? If not, please explain why.

Response:

Yes, but we request the addition of the notion of “inconsequential or perfunctory”. See also our general comments in the body of our letter.

Question 3: Paragraph 606-10-25-18A permits an election to account for shipping and handling as an activity to fulfill a promise to transfer a good if the shipping and handling activities are performed after a customer has obtained control of the good. Would the proposed amendment reduce the cost and complexity of applying Topic 606? If not, please explain why.

Response:

Yes, we believe so, however, we do not believe that shipping and handling, after the customer has obtained control of the good, should be considered “activities to fulfill the promise to transfer the good”. In our view, if the customer has already obtained control of the goods and revenue has been recognized, we find it potentially confusing that there should be activities yet to be undertaken to fulfill the promise to the customer. See also our general comments in the body of our letter.

Question 4: Would the revisions to paragraph 606-10-25-21 and the related examples improve the operability of ASC 606 by better articulating the separately identifiable principle and better linking the factors to that principle? If not, what alternatives do you suggest and why?

Response:

Yes. And, we appreciate that the factors in 606-10-25-21 are not presented as an exhaustive
list.

**Question 5:** Would the revisions to paragraph 606-10-55-54 through 55-64, as well as the revisions and additions to the related examples, improve the operability of the implementation guidance about determining the nature of an entity’s promise in granting a license? That is, would the revisions clarify when the nature of an entity’s promise is to provide a right to access the entity’s intellectual property or to provide a right to use the entity’s intellectual property as it exists at the point in time the license is granted? If not, what alternatives do you suggest and why?

**Response:**

Yes. In addition, in 606-10-55-62, we strongly support the Board’s clarification that a license to functional intellectual property *could* result in a “right to access”. See also our general comments in the body of our letter.

**Question 6:** The revisions to paragraph 606-10-55-57 that state an entity should consider the nature of its promise in granting a license of intellectual property when accounting for a single performance obligation. Does the revision clarify the scope and applicability of the licensing implementation guidance? If not, why?

**Response:**

Yes, but we’d appreciate additional clarity as to why any single performance obligation, that would include a license with other goods or services, would always be subjected to the licensing implementation guidance rather than other guidance that may be more applicable to the performance obligation as whole.

**Question 7:** Would the revisions to paragraph 606-10-55-64 adequately communicate the Board’s intent: (a) that restrictions of time, geographical region, or use in a license of intellectual property are attributes of the license (and, therefore, do not affect the nature of an entity’s promise in granting a license or its assessment of the goods or services promised in a contract with a customer) and (b) about determining when a contractual provision is a restriction of the customer’s right to use or right to access the entity’s intellectual property? If not, what alternatives do you suggest and why?

**Response:**

We believe that paragraph 606-10-55-64 adequately communicates the Board’s intent that restrictions of time, geographical region, or use in a license of intellectual property are attributes of the license (and, therefore, do not affect the nature of an entity’s promise in granting a license or its assessment of the goods or services promised in a contract with a customer). However, we are concerned that the guidance is unclear for determining when a contractual provision is a restriction that might impact the pattern of revenue recognition.

**Question 8:** Would paragraphs 606-10-55-65 through 55-65B and the related example clarify the scope and applicability of the guidance on sales-based and usage-based royalties
promised in exchange for a license of intellectual property? If not, what alternatives do you suggest and why?

Yes. We strongly support the Board’s suggested addition of 65A and 65B to the “exception” that provides that sales-based or usage-based royalties need not be split for purposes of applying the guidance. See also our general comments in the body of our letter.