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Accounting & Auditing News

IFRS 15 — *Revenue from Contracts with Customers*: Part 3M – Impact on Life Sciences Sector

How to identify and allocate revenue to different goods and services?

Background

Given the lack of specific guidance in IFRSs, there was greater room for judgment when identifying the goods and services within a contract and then allocating the revenue to those goods and services identified. Entities may have to amend their current accounting policies as a result of the more detailed guidance in IFRS 15 and in particular, the new rules on how revenue is allocated between different items. For example, in the life sciences industry, a single contract may include the sale of intellectual property, and the provision of subsequent research and development services relating to that intellectual property.

Effect

Careful analysis and judgment may be required to determine whether the sale of intellectual property and subsequent services should be regarded as distinct and, if so, to determine the appropriate allocation of revenue between them based on the requirements of the new standard. It will also be necessary to consider the appropriate profile for revenue recognition of revenue relating to the services, as they may not be provided on a straight line basis.

When should milestone payments and other variable or uncertain revenues be recognized?

Background

Contracts in the life sciences sector can be of a long-term nature and will often include significant variable elements such as rebates, incentives, performance bonuses, contingencies or concessions. Additional complexity may arise because attrition rates in the industry are often high. There are new specific requirements in respect of variable consideration such that it is only included in the transaction price if it is highly probable that the amount of revenue recognized would not be subject to significant future reversals as a result of subsequent re-estimation.

Effect

This approach to variable and contingent consideration is different from that previously reflected in IFRSs and, in certain scenarios, will require a significant degree of judgment to estimate the amount of consideration that should be taken into account. Where revenue is generated as the product progresses through the stages, typically via milestone payments that are awarded on the successful passing of a research phase, the high attrition rate may make it difficult to the determine the probability of success at the inception of the contract in order to make an upfront estimate of revenue. Accordingly, the profile of revenue recognition may change for some entities as a result.

How will the type of license sold impact when revenue is recognized?

Background

IFRS 15 distinguishes between licenses that represent the transfer of a right to use an entity's intellectual property and licenses that represent the provision of access, over a period of time, to an entity's intellectual property, and specifies criteria to determine which type of license is being sold. Revenue for the former will typically be recognized at a point in time; revenue for the latter will typically be recognized over a period of access.

Effect

It will be important to examine the specific terms of license arrangements in the light of this new guidance, and assess if changes are required to existing accounting policies. Where a change is required, this may have a significant impact on the timing of revenue recognition.

Should revenue be allocated to customer options to acquire additional goods or services at a discount?

Background

Some life sciences contracts include a right for a customer to purchase additional goods or services at a discount. For example, a company may sell the intellectual property in respect of a specific drug to another entity and at the same time grant that an entity an option to sub-contract the manufacture of the drug back to the seller at a fixed price, which might be below the price that another sub-contractor would charge. If such an option represents a material right for the customer, the seller will need to allocate a portion of the transaction price to the option and recognized revenue when control of the goods or services underlying the option is transferred to the customer, or when the option expires.

Effect

In this particular scenario, the company selling the license, will need to consider whether some of the revenue receivable at the time of granting the license should be deferred and instead recognized at a later date when the drugs are manufactured.

Are collaborative arrangements in the scope of the new standard?

Background

It is common to life sciences sector for two separate entities to combine their resources and collaborate in the development and production of a drug, where this is the case, an entity will have to assess whether the other entity is its customer in order to establish whether the transactions with the other entity are within the scope of the new standard.

Effect

The new standard introduces new specific guidance on this topic, and this may result in some arrangements that have not previously been regarded as revenue transactions nevertheless falling within the scope of the new standard. It may also result in some arrangements which have previously been treated as revenue transactions being outside of the scope of the new standard and entities will need to consider in this cases whether it is still appropriate to apply the new standard by analogy.

Please contact the Technical Research Group at +63 2 581 9000 local 9088/9165/9078 or e-mail phtr@deloitte.com for questions regarding this publication.

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Member of Deloitte Touche Tohmatsu Limited

19th Floor Net Lima Plaza

5th Avenue corner 26th Street

Bonifacio Global City, Taguig

Philippines 1634