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16 August 2013

RE: Revenue Recognition Project: *Recognising minimum amount for Royalties Receivable*

Dear Sirs,

We are writing this letter in response to the conclusions drawn on paper 7C "Constraint- minimum requirements" by the Boards at the IASB and FASB meeting dated 24 July 2013. We appreciate the openness of both Staff and Board members taking time out to meet with us to discuss this issue on several occasions as well as the continued deliberations in recent Board meetings.

We strongly disagree with the conclusion reached by Board members on the basis of principle, suggesting in our case, that royalty revenue on out-licensed products should be recognised effectively prior to the underlying sales being made by the licensee. We believe this would be very difficult to apply in practice and result in lower quality financial reporting. In our view, revenues would be imprudently over-stated, as we would initially be recording current period income based on forecasts of future transactions which are, by their nature, inherently uncertain and which depend on the actions of third-parties beyond our control. The subsequent continuous adjustment process would mean that revenues in future periods would include true-ups based upon the licensee's actual sales and revised estimates of their future sales.

The concept of recognising a "minimum royalty" as decided by the Boards and the determination of such a minimum is somewhat vague, and since many of the underlying factors are inherently uncertain, will result in highly subjective estimates for amounts which can be very significant for the pharmaceutical industry. In our view, this means that reported revenue will not reflect actual performance as it will be based on subjective variables applied in determining the recognised minimum, would have no bearing on the royalty revenue

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actually generated from the deal in the current period and which could be subject to reversal based on external factors outside the control of the licensor. The nature of our industry includes many factors that are inherently uncertain and which can have a very significant impact. These include product safety issues, the introduction of competitor products, issues with licensees' distribution channels and sales capabilities, issues with manufacturing, etc. Indeed, we are not sure the corresponding debit entry for the "receivable" is really an asset. One could certainly not recover this amount prior to sales being made by the licensee.

It is difficult to see how the proposals would provide useful information to the users of financial statements, and we believe many users would back this out from their analysis causing a further growth in the use of non-GAAP measures. We see no appetite for users of our financial statements for such a treatment. In fact the main questions we receive in relation to royalty income relate to the quality and sustainability of such earnings, and we believe that this proposal, if implemented, would rather increase such concerns.

We appreciate the fact that the Boards strive to develop principles-based standards and paragraph 85 of the 2011 ED tended towards being rules-based. However, given our industry's business model and the inherent risks therein, we urge the Boards to evolve from a "one-size fits all" approach and develop principles-based standards that achieve a common sense result for all industries.

In addition to this, we note that the 2011 ED paragraph 85 which worked well for our industry whilst achieving the requisite needs of other industries. Following its removal, we believe proper consultation on this departure should be sought publicly from constituents in line with the due process.

We concur with the statements made in the letter on this issue by Allergan, Inc. on 1 August 2013 and urge the Board reconsider the Staff recommendations on this issue.

Sincerely,

F. Hoffmann-La Roche AG

Dr. Alan Hippe
Chief Financial Officer and
Member of the Corporate Executive Committee

Michelle Olufeso
Head of External Relations
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