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Date	September 27, 2010

– **Siemens AG’s response to the EFRAG Draft comment letter on the Exposure Draft „Revenue from Contracts with Customers“**

Dear Sir/Madam,

Siemens AG appreciates the opportunity to respond to the comments and proposals set out in EFRAG’s comment letter on the Exposure Draft „Revenue from Contracts with Customers (ED). For Siemens, the ED is of utmost importance because the recognition of revenue provides the most relevant information about the performance of an entity, in particular its profitability. In addition, the increasing use of financial statement information for internal reporting purposes means that any final guidance on revenue recognition will have a significant impact on an entity’s internal controlling processes.

We have structured our response into two sections: In the first section, we focus on the key issues identified by EFRAG related to the proposed revenue recognition model developed by the IASB. In the second section, we comment on EFRAG’s proposed alternative model on revenue recognition for construction contracts.

If you have any questions please do not hesitate to contact Nikolaus Starbatty (nikolaus.starbatty@siemens.com, phone: +49 89 636 36371).

Sincerely yours,

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1. With regard to “General comments” as requested by IASB:

Do you support:

(a) The approach of developing a new standard on revenue recognition, or do you think that amending IAS 11 and IAS 18 to address existing practical issues would be preferable?

(b) The alternative revenue recognition model presented in Appendix 3 or the model proposed by the IASB in the ED?

(a) In our view, the existing guidance in IAS 11 and IAS 18 is well established and well understood by users. By no means do we think that the guidance in the existing standards on revenue recognition is insufficient and hence, needs significant improvements. However, we acknowledge the Board’s desire to develop a single revenue recognition model that applies to all types of contracts. From a constituent perspective, the Board must ensure that the information provided to users by a single revenue recognition model faithfully represents an entity’s transactions and does not come with undue costs for preparers. It is our impression that the proposed model is likely to not adequately reflect an entity’s performance in a number of cases. This specifically applies to the accounting for construction contracts. A final standard, in our opinion, needs to consider these issues and eventually comprise more than one approach if this is necessary in order to provide decision-useful information about an entity’s performance.

Siemens recommends developing a new standard that does not result in significant differences compared to the existing guidance on revenue recognition. We are aware of some problems in applying the existing standards but the IASB and EFRAG should bear in mind that the principles of the existing standards are well implemented by entities. The implementation of the proposed model will result in significant one time, and ongoing, costs if the model results in entities separating a contract into a large number of performance obligations. This would affect, for example, internal management, controlling, IT systems and external reporting.

Hence, we take the view that the Board should thrive on amending the proposed model so as to result in similar answers when accounting for contracts with customers.

(b) Despite not agreeing with some important aspects of the proposed EFRAG model affecting the accounting for construction contracts we prefer the EFRAG model compared to the model proposed by the IASB.

A major issue related to EFRAG’s model that Siemens does not agree with is the performance obligation approach that applies to construction contracts. The proposed approach to split construction contracts into several performance obligations will face preparers with significant

costs without increasing decision usefulness of financial statements. Another issue to point out is the “irrevocable right” as one condition to meet before an entity recognizes revenue (for a detailed discussion please refer to our response to question 9).

2. With regard to question 6 “Financing components” by IASB

Do you think that the proposals in the ED requiring adjusting revenue for the time value of money would result in significant costs compared to the current practice? If so, why, and do you have any suggestions on how the principle could be applied in a less costly manner?

Generally we agree with the proposed model to reflect the time value of money if the contract includes a material financing component. To avoid significant time and effort to identify and allocate the financing component we would like to underline the “materiality clause”.

3. With regard to question 9 “onerous performance obligation” by IASB

Do you agree with EFRAG that the onerous test should be carried out at contract level, and not at performance obligation level? If so, do you, as EFRAG accept that nevertheless loss making performance obligations are reported as such when performed, disregarding when in the course of the contract that performance obligation is satisfied?

We strongly support EFRAG’s proposed onerous test on contract level.

We believe that it is counter-intuitive to recognize loss provisions for separate performance obligations in an entity’s financial statements if the overall contract with a customer is still profit-generating. Hence, we do not think a loss provision in this situation will lead to decision useful information to users of financial statements. In our view, these loss provisions are not consistent with liability definition in the Framework because we think the overall contract to be the appropriate unit of account. Under the proposed model, a liability may exist even if the overall inflows related to a contract exceed the overall outflows of resources. This may not lead to a faithful presentation of the financial position, performance and changes in the financial position of an entity. In addition, the IASB’s approach is not consistent with the guidance in IAS 37 that requires an entity to carry out an onerous test at contract level (and not performance obligation level).

4. With regard to question 10 “disclosure requirements” proposed by the IASB

EFRAG would welcome comments regarding the usefulness and the cost of preparing the disclosures required by the ED and an assessment of whether an acceptable trade-off between costs and benefits is met.

We think it worthwhile pointing out that some of the required disclosures in the exposure draft are already provided to users via the operating segments information under IFRS 8. However,

- thinking our opinion the disclosure package will impose significant additional costs on the preparers of financial statements without improving the decision usefulness of financial statements.

In particular, the proposed disclosure of the timing and amount of performance obligations, relating to contracts with an original duration exceeding one year appears to be extensive. In addition, there is a very high degree of uncertainty when estimating the timing of satisfaction of performance obligations in the future which does not support the aspect of decision-useful information. In our opinion the accounting model itself should provide decision-useful information to users of financial statements so that such excessive disclosure requirements are dispensable. To improve the usefulness of the disclosures we would recommend including the figures of order intake and orders on hand. These reviewable figures are a good basis for estimating future cash flows and are generally accepted by the market.

5. With regard to question 13 “effective date and transition” by IASB

Assuming that the proposals are to be applied retrospectively, how many years do you think would be necessary to implement the new requirements?

Given our large number of outstanding contracts including a high portion of long term construction contracts, a retrospective application of the proposals would result in very high costs for Siemens. The highly individualized conditions of many of our contracts would require a contract by contract assessment in order to apply the new model. To this adds that Siemens and other entities filing a 20-F-2 must present comparative figures for two years. Hence, Siemens would need to keep up and support both models of accounting for a minimum two years. Assuming Siemens applies the new standard as of fiscal 2013/2014, Siemens would be forced to implement the new accounting

model as early as 1 October 2011. On the other hand, a prospective application comes with other disadvantages. A prospective application would lead to applying two accounting models for of up to, and sometimes exceeding, 10 years.

In our view, the proposals should be applied retrospectively with materiality constraints. Importantly, the impact of implementing the proposals significantly reduces if a final guidance does not result in significant changes compared to the existing standards on revenue recognition.

6. With regard to question 14 “application guidance” by IASB

Do you think that the application guidance is sufficient to make the proposals of the ED operational in particular industries or are there any issues requiring specific consideration? If so, what are the issues?

In principle, we appreciate the proposed application guidance because it helps making the standard operational. However, in our opinion some parts of the proposed standard are not self-evident and we recommend working out robust definitions instead of clarifying the standard in the application guidance (e.g. example 11). If the standard itself is well defined the application guidance could focus more on examples where the accounting is not so obvious.

Additionally we do not understand the proposed accounting in example No. 29. This is because paragraph 66 of the Exposure Draft states that “*an entity shall present an unconditional right to consideration as a receivable (not as a contract asset) and shall account for that receivable in accordance with IFRS 9. A right to consideration is unconditional when nothing other than the passage of time is required before payment of that consideration is due.*” In our opinion, this criterion is fulfilled at contract inception (on 1 January). Why should an entity recognize the receivable only when it is due (on 31 January)?

In general we agree with EFRAG, recommending to clarifying the principles rather than adding application guidance.

7. With regard to question 15 “distinction between the types of product warranties” by IASB

Do you agree with the proposals in the ED regarding accounting for and distinguishing between a warranty and a failed sale? If so, on what basis should the distinction be made?

The distinction between a warranty that provides a customer with coverage for latent defects in the product and a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer will be difficult and often, arbitrary. In our view, distinguishing between standard warranties (warranties which are usually granted in a business) and extended (abnormal) warranties would be more operational and presumably result in more decision-useful information for users.

We do not agree with the proposed accounting for warranties that provide a customer with coverage for latent defects in products. This is because with the delivery of a product control, typically, transfers to the customer. Therefore, no revenue should be withheld at this point of time. To the contrary a separation of a performance obligation related to latent defects for deferring parts of revenue would contradict the principle of distinct performance obligations. Therefore, it is more appropriate to account for the standard warranty as a liability in accordance with IAS 37. For extended warranties we agree that a separate performance obligation should be regularly identified.

8. With regard to question 16 “licensing arrangements” by IASB

Which of the alternatives (Alternative 1 to 3) do you prefer?

Siemens' assessment in relation to licensing arrangement needs to be finalized. For our final statement please refer to our comment letter to IASB.

9. With regard to the alternative model for revenue recognition by EFRAG

Are there issues that you would see in applying the proposed alternative model? If so, how could the model be further developed?

Please note that we accept and support IASB's decision to develop a new standard improving the decision-usefulness of revenue recognition. However, as stated in our response to Question 1 the

new model should not result in significant differences to the existing guidance for revenue recognition – specifically when applied to construction contracts.

Assuming that a single revenue recognition model applies to all types of contracts, we support EFRAG's alternative model, as the model allows for revenue recognition as an entity performs under a contract. Hence, some elements of EFRAG's model might help in making the proposed IASB model more robust so as to provide decision useful information to users of financial statements.

The EFRAG approach differs in one important aspect from the existing guidance in IAS 11. Under EFRAG's model, a contract is separated into several performance obligations that are accounted for separately if the contract comprises a number of items that are transferred to the customer at different points in time and that could be sold separately. Generally, Siemens does not agree with the approach to split a construction contract into several performance obligations. In our view, the approach results in significant practical issues without increasing decision usefulness for users.

From a Siemens perspective, the requirement of EFRAG's model to have an "irrevocable right" before an entity recognizes revenue needs further clarification:

Item 4 b)

"The contract must be such that the entity, as it progresses towards fulfilling its performance obligation, holds an irrevocable right to consideration, subject to continued performance. This right may be stipulated in the contract itself, stem from law or from law enforcement practices. In other words, the customer must be obliged, in one way or another, to pay for any work completed to date, as long as the entity performs under the contract."

Item 5:

"We think that an irrevocable right to consideration would generally exist in relation to:

(a) contracts for the delivery of customer-specific assets; and

(b) contracts for the delivery of assets of significant unit value and that are sold pursuant to small numbers of orders per year and/or of which manufacturing lead time (from order to delivery) is significant."

As described above EFRAG's proposal requires an "irrevocable right" that "the customer must be obliged to pay for any work completed to date". From our perspective these requirements are very

strict and extensive. In line with IFRS' basic principles a "legally enforceable contract" should be sufficient to allow an accounting under the proposed approach of revenue recognition for construction contracts.

For example, under German law there is no statute giving an entity an irrevocable right to consideration as the entity progresses towards fulfilling its performance obligations. For those contracts the right of compensation depends on customers' (partial) acceptance of the works. To apply the proposed alternative model for revenue recognition for contracts under German law reflecting the activity carried out, an explicit statement in the contract would be necessary. Without this statement the contract –even if it is a typical construction contract - would not fulfill the conditions for the new model of EFRAG and need to be accounted for as proposed by IASB. Considering the fact that it could be necessary to define a construction contract as one performance obligation for lack of distinction, the relating revenue would be recognized with transfer of control of goods and services which does not reflect entities performance and activities carried out.