

Cash Flow

Payments for licensing and asset acquisitions of investigational compounds are included in operating activities as well as out-licensing proceeds. Payments for the acquisition of an ownership interest in a legal entity, including acquisitions that do not meet the accounting definition of a business are included in investing activities, as well as divestiture proceeds, royalties and other consideration received subsequent to the related sale of the asset or business. Other adjustments reflected in operating activities include divestiture gains and losses and related royalties, asset acquisition charges, gains and losses on equity investments and gains and losses on debt redemption.

Recently Adopted Accounting Standards

Revenue from Contracts with Customers

Amended guidance for revenue recognition was adopted in the first quarter of 2018 using the modified retrospective method with the cumulative effect of the change recognized in Retained earnings. The new guidance, referred to as ASC 606, requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers and replaces most of the existing revenue recognition standards in U.S. GAAP. A five-step model is utilized to achieve the core principle: (1) identify the customer contract; (2) identify the contract's performance obligation; (3) determine the transaction price; (4) allocate the transaction price to the performance obligation; and (5) recognize revenue when or as a performance obligation is satisfied.

The timing of recognizing revenue for typical net product sales to our customers did not significantly change. However, transaction prices are no longer required to be fixed or determinable and certain variable consideration might be recognized prior to the occurrence or resolution of the contingent event. As a result, certain revenue previously deferred under the prior standard because the transaction price was not fixed or determinable is now accounted for as variable consideration and might be recognized earlier provided such terms are sufficient to reliably estimate the ultimate price expected to be realized.

Estimated future royalties and contingent fees related to certain arrangements are now recognized prior to the third party sale or event occurring to the extent it is probable that a significant reversal in the amount of estimated cumulative revenue will not occur. The new guidance pertaining to the separation of licensing rights and related fee recognition did not significantly change the timing of recognizing revenue in our existing alliance arrangements that are currently generating revenue. The timing of royalties, sales-based milestones and other forms of contingent consideration resulting from the divestiture of businesses as well as royalties and sales-based milestones from licensing arrangements did not change.

The cumulative effect of the accounting change resulted in recognizing contract assets of \$214 million and a \$168 million increase in Retained earnings net of tax. The cumulative effect was primarily attributed to royalties and licensing rights reacquired by alliance partners that are expected to be received in the future and are not eligible for the licensing exclusion. As a result of the new guidance and cumulative effect adjustment, revenue was approximately \$197 million lower in 2018, compared to what would have been reported under the previous guidance. Refer to "—Note 2. Revenue" for further information.

Gains and Losses from the Derecognition of Nonfinancial Assets

Amended guidance for gains and losses from the derecognition of nonfinancial assets (ASC 610) was adopted in the first quarter of 2018 using the modified retrospective method. The amendments clarify the scope of asset derecognition guidance, add guidance for partial sales of nonfinancial assets and clarify recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers. Certain transactions such as the sale or transfer of product rights that do not constitute a business will require accounting similar to ASC 606 including the potential recognition of variable consideration. The amended guidance may result in earlier recognition of variable consideration depending on the facts and circumstances of each transaction.

The cumulative effect of the accounting change resulted in recognizing contract assets of \$167 million and a \$130 million increase in Retained earnings net of tax. The cumulative effect was primarily attributed to royalties and termination fees for licensing rights reacquired by third parties that are expected to be received in the future and are not eligible for the licensing exclusion. As a result of the new guidance and cumulative effect adjustment, Other income (net) was approximately \$140 million lower in 2018, compared to what would have been reported under the previous guidance.