Notes to the consolidated financial statements

General information

Orion Corporation is a Finnish public limited company domiciled in Espoo, Finland and registered at Orionintie 1, FI-02200 Espoo. Orion Corporation and its subsidiaries develop and manufacture human and veterinary pharmaceuticals and active pharmaceutical ingredients that are marketed globally.

The Group announced the sale of Orion Diagnostica in the financial year 2018. In these financial statements the comparison figures for 2018 show Orion Diagnostica as a discontinued operation in the following statements:

- Other comprehensive income in the consolidated statement of income
- Consolidated statement of cash flows

The Orion Group's first financial year was 1 July – 31 December 2006, because the Group came into being on 1 July 2006 following the demerger of its predecessor Orion Group into the pharmaceuticals and diagnostics business and a pharmaceutical wholesale and distribution business. Orion Corporation is listed on Nasdaq Helsinki. Trading in Orion's shares commenced on 3 July 2006.

At its meeting on 5 February 2020, the Company's Board of Directors approved the publication of these consolidated financial statements. Under the Finnish Limited Liability Companies Act, shareholders have the option to accept or reject the financial statements at the Annual General Meeting, which is held after the publication of the financial statements. In addition, the AGM may amend the financial statements. The financial statement documents can be viewed at the website www.orion.fi/en, and copies of the financial statements are available from Orion Corporation's headquarters, Orionintie 1, FI-02200 Espoo.

Accounting policies

The Consolidated Financial Statements of the Orion Group have been prepared in accordance with International Financial Reporting Standards (IFRS) applying the IAS and IFRS standards as well as SIC and IFRIC interpretations effective at 31 December 2019. International Financial Reporting Standards refer to the standards and their interpretations approved for application in the EU in accordance with the procedure stipulated in the EU's regulation (EC) No. 1606/2002 and embodied in the Finnish Accounting Act and provisions issued under it. The notes to the consolidated financial statements have also been prepared in accordance with the requirements in Finnish accounting legislation and Community law that complement the IFRS regulations.

The information in the consolidated financial statements is based on historical costs, except for financial assets separately recorded at fair value through profit or loss or items recorded through equity.

Monetary figures in the financial statements are expressed in millions of euros unless otherwise stated.

New IFRS standards and IFRIC interpretations adopted in financial year 2019

The following new standards, interpretations and amendments to existing standards and interpretations endorsed by the EU and applicable to the Group's operation model have been adopted as of 1 January 2019.

- IFRS 16 (new), Leases
- IAS 19 (amended), Employee benefits
- IFRIC 23 (new), Uncertainty over income tax treatments

The adoption of the IFRS 16 standard is described in the following paragraph. The amendment to the IAS 19 standard and the new IFRIC 23 interpretation have no material effect on the consolidated financial statements.

Adoption of IFRS 16 (Leases) on 1 January 2019

IFRS 16 (Leases) has replaced IAS 17 and related interpretations, which previously regulated the accounting treatment of leases, as of 1 January 2019. The Group has applied the simplified method permitted by IFRS 16 in the transition and recognised the cumulative effect in the opening balance sheet on 1 January 2019 as retained earnings and does not present comparative information.

The Group has recognised as lease liability under IFRS 16 the present value of remaining lease payments, discounted using the Group's incremental borrowing rate. The right-of-use asset has been measured at carrying amount as if the standard had been applied since the commencement date of the lease. The right-of-use asset is measured by discounting future lease payments using the Group's incremental borrowing rate from the adoption date. The difference in value of the lease liability and the right-of-use assets has been recognised in equity as adjustment to retained earnings.

The Group has applied the following practical expedients permitted under IFRS 16 in its adoption of the standard. The Group has applied a single discount rate to a portfolio of leases with reasonably similar characteristics. In the transition, leases previously classified as finance leases have been recognised at the carrying amounts of the right-of-use assets and lease liabilities measured applying IAS 17. In addition, the Group has applied the exemptions permitted by the standard and accounted for leases for which the term ends within 12 months of the date of initial application as short-term leases and for leases of low-value assets as low-value asset leases. The expense arising from these have been recognised through profit or loss in the accounting period beginning on 1 January 2019. The Group will assess details such as the accuracy of lease terms after the date of initial application and revise these later if mandated by facts.

The Group has assessed the impact of IFRS 16 on the consolidated balance sheet with regard to all leases identified by the Group as well as with regard to any arrangements that may involve leases. The Group identified a total of around 400 leases in different operating countries. The weighted average of the Group's incremental borrowing rate, or the discounting rate used in transition, is based on IRS market rates plus a country risk based premium.

Following the adoption of IFRS 16, the Group has recognised an increase of EUR 8.6 million in right-of-use assets. EUR 8.9 million has been recognised as increase in lease liabilities on the balance sheet. EUR 0.2 million has been recognised as decrease of retained earnings in equity. EUR 0.0 million has been recognised as an increase in deferred tax assets.

BALANCING LEASE COMMITMENTS ON 31 DECEMBER 2018 TO LEASE LIABILITIES ON 1 JANUARY 2019

EUR million	
Lease commitments on 31 December 2018	**14.5**
Discounted value on 1 January 2019	13.8
Finance lease liabilities on 31 December 2018	1.6
Short-term and low-value leases	-4.5
Leases commencing in 2019 not yet included in the lease liability	-2.0
Lease liabilities on 1 January 2019	**8.9**

Consolidation Principles

Subsidiaries

The consolidated financial statements cover the parent company Orion Corporation and all companies directly or indirectly owned by it and controlled by the Group. A company is controlled by the Group if the Group is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Internal shareholdings have been eliminated using the acquisition method of accounting. In the consolidated financial statements, acquired subsidiaries are fully consolidated from the date the Group acquires control, and divested subsidiaries are deconsolidated from the date control ceases. All intra-Group transactions, receivables and liabilities, distribution of profit and unrealised internal gains are eliminated in the compilation of the consolidated financial statements. The consolidated profit for the financial year is divided into portions attributable to owners of the parent company and non-controlling interests. The portion of the equity attributable to the non-controlling interests is included in Group equity and specified in the statement of changes in equity.

Associates, joint ventures and joint operations

Associates are all companies over which the Group has significant influence but not control. Significant influence generally means a shareholding of 20% to 50% of the voting rights.

Joint ventures are joint arrangements in which the parent companies or subsidiaries have joint control of an entity that is not part of the Group and in which a parent company or subsidiary has rights to the net assets of the arrangement. Associates and joint ventures are incorporated into the consolidated financial statements using the equity method of accounting.

Joint operations are joint arrangements that have been implemented without a separate investment instrument or in which the legal form of the arrangement is such that the parties have direct rights to certain assets or obligations for certain liabilities. Joint operations are incorporated into the consolidated financial statements in accordance with the proportional interest in the joint operation.

If the Group's share of the losses of an associate or joint venture exceeds the carrying amount, it is not consolidated unless the Group has made a commitment to fulfil the liabilities of the associate or joint venture.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing the performance of the operating segments, is the President and CEO of Orion Corporation, who makes the Group's strategic decisions. The Group consists of one business area, "Pharmaceuticals business", which comprises five business divisions. Due to the nature of the business model and corporate governance, the entire Group is reported as a single operating segment.

Foreign currency translation

Functional and presentation currency

Items included in the financial statements of each of the Group's companies are measured using the currency of the primary economic environment in which the company operates (the functional currency). The consolidated financial statements are presented in euros, which is the functional currency of the parent company of the Group and the Group's presentation currency for the consolidated financial statements.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items in foreign currencies at the end of the reporting period in the statement of financial position are measured using the exchange rates at the end of the reporting period. Foreign exchange gains and losses from translation of the items are recognised in the statement of comprehensive income. Exchange rate gains and losses related to business operations are included in the corresponding items above the operating profit line. Exchange rate differences resulting from hedges made for hedging purposes but for which hedge accounting under IFRS 9 does not apply are included as net amounts within other operating income or expenses. Exchange rate gains and losses related to financial liabilities and receivables in foreign currencies and foreign exchange derivatives related to them are included in financial income and expenses. Non-monetary items in foreign currencies in the statement of financial position which are not measured at fair value are measured using the exchange rate at the date of the transaction.

Group companies

For all Group companies with a functional currency different from the Group's presentation currency, the income statements are translated into euros using average exchange rates for the reporting period, and the statements of financial position are translated into euros using the exchange rates at the end of the reporting period. Any exchange difference arising from this and translation differences arising from elimination of the acquisition costs of these companies are recognised in equity and changes are disclosed in the items under other comprehensive income. There are no Group companies operating in a country with hyperinflation.

The accumulated translation differences related to divestment of Group companies, which are recognised in equity, are recognised as gains or losses in the statement of comprehensive income.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the exchange rate at the end of the reporting period.

Property, plant and equipment

Property, plant and equipment comprise mainly factories, offices and research centres, and machines and equipment for manufacturing, research and development. Property, plant and equipment are measured at their historical cost, less accumulated depreciation and impairment, and are depreciated over their useful life using the straight-line method. The residual value and useful life of property, plant and equipment are reviewed when necessary, but at least at every year end for the financial statements, and adjusted to correspond to probable changes in the expectations of economic benefits. The estimated useful lives are as follows:

- Buildings 20–50 years
- Machinery and equipment 5–10 years
- Other tangible assets 10 years

Land is not depreciated. Repair and maintenance costs are recognised as expenses for the reporting period. Improvement investments are capitalised if they are expected to generate future economic benefits. Gains and losses on disposals of property, plant and equipment are recognised in the statement of comprehensive income.

Intangible assets

Research and development costs

Research costs are expensed as incurred in the statement of comprehensive income. Intangible assets generated from development activities are recognised in the statement of financial position only if the expenditure of the development phase can be reliably determined, the product is technically feasible and commercially viable, the product is expected to generate future economic benefits and the Group has the intention and resources to complete the development work. The Group's view is that until an authority has granted marketing authorisation, it could not be demonstrated that an intangible asset would generate future economic benefits. The Group has therefore not capitalised its internal development costs. The same principle for recognition has been applied for externally purchased services. Software, buildings, machinery and equipment used in research and development activities are depreciated and recognised under research and development costs over their useful life.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired company at the date of acquisition. Goodwill is measured at cost less accumulated impairment losses. For the purpose of impairment testing, goodwill is allocated to cash-generating units or groups of cash-generating units that are expected to benefit from the business combination. Cash-generating units have been grouped according to operating segment. The goodwill in the consolidated statement of financial position arose prior to the adoption of IFRS, and it corresponds to the carrying amount according to the previous financial reporting standards, which was used as the deemed cost on 1 January 2004 when making the transition to IFRS.

Intangible rights and other intangible assets

Intangible rights and other intangible assets are measured at their historical cost, less accumulated amortisation and impairment. They are amortised over their useful life, usually five to ten years, using the straight-line method. As a rule, acquired marketing rights are amortised over the remaining term of the contract.

Externally acquired intangible rights, such as product and marketing rights, are recognised in the statement of financial position. For a product under development, the cost bases are assessed. The costs of payments for research and development work undertaken that has not yet generated an intangible right recognisable in the statement of financial position are recognised as research and development costs. However, if an intangible right is considered to have been transferred to the Group, the costs are recognised in the statement of financial position. Amortisations of marketing authorisations, and product and marketing rights included in the intangible rights are disclosed under selling and marketing expenses, and recording of an amortisation expense will commence when an authority has issued authorisation for marketing of the product and selling of it commences.

Impairment of property, plant, equipment and intangible assets

At the end of each reporting period, the Group assesses whether there are indications that an asset may be impaired. If there are any such indications, the respective recoverable amount is assessed. As regards goodwill and an intangible asset not yet available for use, the assessment is undertaken annually even if no such indications had become apparent. The recoverable amount is the higher of the asset's fair value less selling costs or value in use. The value in use is obtained by discounting the present value of the future cash flows from that asset. The discount rate is the weighted average cost of capital (WACC) calculated before tax and using Standard & Poor's index for the healthcare industry as the debt-to-equity ratio. The index corresponds to the potential and risks of the asset under review.

An impairment loss is recognised in the statement of comprehensive income for the amount by which the asset's carrying amount exceeds its recoverable amount. An impairment loss other than on goodwill is reversed if there is a change in the circumstances and the asset's recoverable amount exceeds its carrying amount. An impairment loss is not reversed to more than what the carrying amount of the asset would have been had there been no impairment loss.

Impairment of goodwill is recognised in the statement of comprehensive income under Other operating expenses, which include expenses not allocable to specific operations. Intangible assets not yet available for use, comprising mainly marketing authorisations and product rights, are tested for impairment individually for each asset carrying material value in the statement of financial position. Impairment charges are recognised as an expense under the appropriate activity, and for marketing authorisations and product and marketing rights under selling and marketing expenses.

Leases

Determining whether an arrangement contains a lease

The Group will assess at the time of inception whether a contract is, or contains, a lease. A contract contains a lease when it contains an identified asset and it conveys the right to direct the use of that asset for a specific period of time. The precondition is that the Group pays a consideration to the contracting party in exchange for this right.

The asset can be identified either explicitly, for example, based on a specific identification code, or implicitly, when the asset is not specified in the contract but in practice the contract can only be performed using a specific asset. The identified asset may also be a physically separable part of a larger asset, if it represents a substantial part of the total capacity of the asset. If the contracting party may substitute the asset with another one and gain financially in the process, the contract does not involve an identified asset and thus does not constitute a lease.

A contract conveys control to the Group when the Group gains substantially all the economic benefits from using the asset and has the right to direct the use of the identified asset during its useful life. Determination of the Group's right to direct the use of an asset involves considering its right to change things such as:

- what type of output is generated;
- when the output is generated;
- where the output is generated; and
- how much output is generated

Separating components of a contract

In some cases, contracts may contain lease components, which is due to the fact that the contract obligates the contracting party to provide various obligations to the Group. In such multi-component arrangements, the Group will specify each lease component and process them separately in accounting. The right to use the underlying asset is a separate lease component when the Group is able to benefit from the use of the asset either as such or jointly with other easily accessible resources and the asset is not highly dependent on other assets stipulated by the contract or it is not strongly attached to them. The Group allocates the contractual consideration to each lease component in proportion to their relative individual prices.

Lease term

The lease term is the period during which the lease cannot be cancelled. The lease term is extended by the period covered by an extension or termination option, if the Group is reasonably certain to exercise the extension option or not to exercise the termination option.

Leases with a term of 12 months or less and leases of low-value assets are classified as operating leases. For these leases, the lease payable to the lessor is recorded as an expense on an accrual basis. The underlying assets are not capitalised in the balance sheet.

Recognition at the inception of the lease

At the commencement of a lease, the Group recognises a lease liability and a corresponding right-of-use asset.

The lease liability is measured at the present value of the lease payments payable over the lease term that have not yet been paid. The leases are discounted at the rate implicit in the lease or the Group's incremental borrowing rate. In practice, the Group discounts the leases using the Group's incremental borrowing rate, since the rates implicit in the Group's leases typically cannot be readily determined. The incremental borrowing rate is based on market rates plus a country risk associated premium.

The right-of-use asset is initially measured at acquisition cost, which includes the original amount of the lease liability plus any initial direct costs incurred by the Group, estimated restoration costs and any lease payments made at or prior to commencement, less lease incentives obtained.

Leases paid by the Group consist of fixed payments, variable leases, amounts payable based under residual value guarantees, purchase option exercise prices, if it is reasonably certain that the option will be exercised as well as of payments associated with termination sanctions if it has been taken into account in the lease term that the Group will exercise its lease termination option.

When a variable lease depends on an index or a rate, these are taken into consideration when determining lease liability. Variable lease payments are initially measured using the index or rate as at the commencement date. Other variable leases, such as leases to be payable based on asset performance, are not included in the lease liability. Factually fixed payments, which are dependent on the functioning of an asset, for example, are taken into consideration when measuring the lease liability.

Subsequent measuring of a lease

After lease commencement, the Group measures the right-of-use asset using the acquisition cost model. The right-of-use asset is measured at acquisition cost less accumulated depreciation and accumulated impairment, adjusted by any cost of remeasurement of the lease liability. Depreciation is recognised in accordance with IAS 16 (Property, plant and equipment). The residual value and useful life of the right-of-use asset is reviewed when necessary, but at least at every year end for the financial statements, and an impairment is recognised if expected economic benefits change.

The Group values the lease liability in subsequent periods using the effective interest method.

The lease liability is remeasured if actual lease payments materially differ from lease payments contained in the original measurement and if the change in lease payments is based on clauses of the lease agreement that were in force at the inception of the lease. The lease is subsequently remeasured, for example, when there is a change in future lease payments due to a change in the index or rate used to determine those payments, or if there is a change in the amounts expected to be payable under a residual value guarantee. Changes in the assessment of a purchase option of an underlying asset or an extension or termination option may also lead to a remeasurement of the lease liability. The carrying amount of the right-of-use asset is adjusted by the lease liability amount following a remeasurement, or if the right-of-use asset has a carrying amount of zero, it is recognised through profit or loss.

The Group may re-negotiate leases during the lease term. Changes may lead to a revision of the duration of the lease term or to changing the underlying asset. The Group processes lease modifications in accordance with IFRS 16 as modifications of the scope of the lease or of the consideration payable, which were not part of the original terms agreed at the inception of the lease.

Borrowing costs

Borrowing costs are recognised in the statement of comprehensive income as an expense in the period in which they are incurred. Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that requires a substantial period of time to be made ready are capitalised as a part of the cost of that asset.

Government grants

Government grants related to research activities are recognised as decreases in the research expenses incurred in the corresponding reporting period. If an authority decides to convert an R&D loan into a grant, that is recognised in the statement of comprehensive income under other operating income. Government grants related to the acquisition of property, plant and equipment or intangible assets are recognised as decreases in their acquisition costs. Such grants are recognised as income in the form of reduced depreciation during the useful life of the asset.

Inventories

Inventories are presented in the statement of financial position using the standard price for self-manufactured products, and for purchased products the weighted average cost method using the value of the purchase and variable conversion costs, or if lower, the net realisable or replacement value. Inventories are valued at the cost of the materials consumed plus the cost of conversion, which comprises costs directly proportional to the amount produced and a systematically allocated share of fixed and variable production overheads.

The net realisable value is the estimated selling price obtainable through normal business, less the estimated expenses incurred in finalising the product and selling it.

Financial assets and liabilities

Classification

The Group’s financial items are recognised and measured at amortised cost or at fair value through profit or loss. The classification of assets depends on the business models defined by the Company and on the cash flows of the financial assets based on contract. The classification may change following a change in business model. Classification per item in statement of financial position is found in the note concerning financial assets and liabilities.

1. Measured at amortised cost

When the target of the business model is to hold financial assets for the purpose of collecting cash flows based on contract and the cash flows are based exclusively on the payment of equity and interests, assets are classified at amortised cost. Of the Group’s financial assets trade receivables, other receivables and financial assets are classified at amortised cost. Financial liabilities except for derivatives are classified at amortised cost.

2. Recognised at fair value through profit or loss

Financial assets are measured at fair value through profit or loss when they are not held for collecting cash flows based on contract nor for both collecting cash flows and for sale or when they were classified at this class in the initial classification. The Group's financial assets recognised at fair value through profit or loss comprise derivatives, shares and interests and money market investments. Of financial liabilities, derivatives are measured at fair value.

A financial asset or liability with maturity over 12 months from the reporting date is included in the non-current assets or liabilities in the statement of financial position. If a financial asset is intended to be held for less than 12 months or its maturity is less than 12 months from the reporting date, it is included in the current assets in the statement of financial position. The credit limits of bank accounts to the extent that they are used and commercial paper issued by the Company are included in interest-bearing current liabilities, as are any repayments of capital of non-current interest-bearing liabilities due in the next 12 months.

Recognition and measurement

Purchases and sales of financial assets are recognised in the accounting through settlement date accounting except for derivatives, which are recognised on the acquisition date. Financial assets measured at amortised cost are also initially recognised at fair value, but transaction costs are taken into account in the value. After initial measurement, the value of these financial assets is measured at amortised cost using the effective interest method less any impairment. Impairment losses are recognised in the statement of comprehensive income.

Financial assets at fair value through profit or loss are initially recognised at fair value, and transaction costs are recognised as expenses in the statement of comprehensive income. Unrealised and realised gains and losses due to changes in the fair value are recognised through profit or loss. Fair value is based on the quoted market price on the end date of the reporting period.

Financial liabilities are initially recognised in accounting at fair value less transaction costs. Subsequently, financial liabilities except derivative liabilities at fair value through profit or loss are measured at amortised cost using the effective interest method.

A financial asset is derecognised in the statement of financial position when the Group no longer has the contractual rights to receive the cash flows or when it has substantially transferred the risks and income from the asset to outside the Group. Liabilities are derecognised in the statement of financial position once the debt has extinguished.

Impairment

At the end of each reporting period, it is assessed whether there is any objective evidence of expected credit losses regarding an item in the Group's financial assets.
Impairments are estimated in two different ways, either based on the amount of expected credit losses in the next 12 months or based on the amount of expected credit losses over the entire lifetime of the financial asset. As a rule, the used time period is the next 12 months unless there are specific grounds for a significantly increased credit risk of a financial asset.

Criteria applied by the Group in stating that there is significantly increased credit risk:

- issuer's or debtor's considerable financial problems
- breach of contract terms, such as neglecting payments or payments long overdue
- high probability of bankruptcy or other financial restructuring of debtor

For trade receivables, the Company applies a simplified model based on the amount and due date distribution of overdue receivables. Trade receivables do not include a significant financing component, and thus expected credit losses are recognised over the entire lifetime of the financial asset. Historical credit loss experience is used as the basic information in the provision matrix, and it is adjusted as needed with a future outlook estimate.

Expected credit losses are recognised through profit or loss, with the counter-item reducing the item in financial assets. Recognition takes place at the next reporting date.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, bank deposits and assets in bank accounts, and liquid debt instruments. Liquid debt instruments are short-term certificates of deposit and commercial paper with maturities initially of no more than three months issued by banks and companies.

Money market investments that are available-for-sale debt instruments with maturities initially of over three months and no more than twelve months and liquid bond funds are regarded as cash and cash equivalents in the statement of cash flows. Money market investments are part of the Group's active cash management.

Derivative instruments

Derivatives are classified as measured at fair value through profit or loss and are initially recognised at fair value on the date the derivative contract is entered into and are subsequently remeasured at their fair value using the closing market prices on the end date of the reporting period. Derivatives are recognised under other receivables and liabilities in the statement of financial position. The Group does not apply hedge accounting to foreign exchange derivatives that hedge items in foreign currencies in the statement of financial position or hedge highly probable forecast cash flows, even though they have been acquired for hedging purposes in accordance with the Group's treasury policy.

Both unrealised and realised gains and losses due to changes in the fair value of derivatives recorded through profit or loss are recognised in the reporting period in which they are incurred through profit or loss under either Other income and expenses or Finance income and expenses, depending on whether operational revenue or finance items have been hedged.

Equity

Ordinary shares are presented as share capital. Transaction costs directly due to issuance of new shares or options are presented in equity including tax effects as a decrease in payments received. If a Group company purchases shares in the Company, the payment and direct costs relating to the acquisition are deducted from the equity.

The expendable fund and reserve for invested unrestricted equity are included in distributable funds under the Finnish Limited Liability Companies Act.

Provisions and contingent liabilities

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

A restructuring provision is recognised when the Group has compiled a detailed restructuring plan, launched its implementation or informed the parties concerned.

A contingent liability is a potential liability based on previous events. It depends on the realisation of an uncertain future event beyond the Group's control. Contingent liabilities also include obligations that will most likely not lead to a payment or its size cannot be reliably determined. Contingent liabilities are disclosed in the Notes.

Employee benefits

Pension obligations

The Group has pension plans in accordance with each country's local regulations and practices. The Group has both defined contribution and defined benefit plans. In the defined contribution plans, the Group pays fixed contributions to separate entities. The Group has no legal or constructive obligations to pay further contributions if the recipient of the contributions is unable to pay the employee benefits. All the plans that do not fulfil these criteria are defined benefit plans. The payments to the defined contribution plans are recognised as expenses in the statement of comprehensive income in accordance with the contributions payable for the period.

The Group's most important defined benefit pension plans are in Finland, where statutory insurance under the Employees' Pensions Act has been arranged through the Orion Pension Fund for the Group's clerical employees and supplementary pension security for some of the clerical employees. In addition, the Group management has defined benefit pension plans taken out with life assurance companies. The obligations under the defined benefit pension plans have been calculated separately for each plan.

The pension expenses related to the defined benefit pension plans have been calculated using the projected unit credit method. The pension expenses are recognised as expenses by distributing them over the whole estimated period of service of the personnel. The net defined benefit liability to be recorded in the statement of financial position is the present value of the defined benefit obligation at the end date of the reporting period less the fair value of plan assets. The present value of the defined benefit obligation is the present value of the estimated future pensions payable, and the discount rate applied is the interest rate of low-risk bonds issued by companies with a maturity that corresponds to that of the defined benefit obligation as closely as possible. The interest rate is derived from bonds issued in the same currency as the benefits payable.

Items arising from remeasurement of defined benefit plan assets are recognised directly into components of other comprehensive income during the period when they arise. The most substantial items due to remeasurement in the Group are due to actuarial gains and losses and return on the plan assets (excluding net interest items).

The Group applies an accounting procedure in which net interest arising from plan assets is recognised functionally above operating profit as part of defined benefit plan pension expense.

Share-based payments

The benefits under the share-based incentive plan for key employees approved by the Board of Directors are recognised as an expense in the income statement during the vesting period of the benefit. The equity-settled portion is measured at fair value at the time of granting the benefit, and an increase corresponding to the expense entry in the statement of comprehensive income is recognised in equity. The cash-settled portion is recognised as a liability, which is measured at fair value at the end of the reporting period. The fair value of shares is the closing quotation for B shares on the day of granting the benefit.
Non-market vesting conditions, such as individual goals and result targets, affect the estimate of the final number of shares and amount of associated cash payments. The estimate of the final number of shares and associated cash payments is updated at the end of each reporting period. Changes in estimates are recognised in the statement of comprehensive income.

Income taxes

The income tax expense in the consolidated statement of comprehensive income includes taxes based on the profit of the Group companies for the financial year, tax adjustments for previous financial years and deferred tax. For items recognised directly in equity, the corresponding tax effect is also recognised in equity. Current tax is calculated on the basis of the tax rate in force in each country.

Deferred tax is computed on all temporary differences between the carrying amount and the taxable value. Deferred tax assets due to confirmed tax losses of Group companies are imputed only to the extent that they can be utilised in the future. Deferred taxes are computed using the tax rates valid or in practice approved at the end of the reporting period.

Revenue recognition principles

The Group’s net sales comprise three different revenue flows, for which the revenue recognition principles are described below.

Product sales

Consolidated net sales include revenue from sales of goods adjusted for indirect taxes and currency translation differences on sales in foreign currencies. A delivery to a customer of one batch of product constitutes one distinct performance obligation for which the revenue will be recognised in accordance with the delivery terms when the control is transferred from the Group to the customer. The selling price may include variable consideration, such as various discounts or incentives, among other things. The consideration is recognised as net sales that the Group expects to be entitled to taking into account the effects of discounts and incentives.

The Group has consignment stock arrangements in place with distributors and logistics partners operating in various countries. In these cases the Group owns the products held in the distributor's and logistics partners' consignment stock until they are delivered to the customer, at which point the Group recognises their sale in net sales. In Finland, the arrangement between Orion and Oriola explains a significant part of the Group's total consignment stock arrangements.

Net sales consisting of product sales also comprises royalties, which the Group recognises as revenue based on agreements signed with cooperation partners. The Group has sold the sales rights of certain products to cooperation partners and is entitled to royalties determined by the sales of these products achieved by the partners. The Group recognises the royalties as revenue once the partner has later sold the products to its own customers and the right to royalties has been established.

Revenue from sales rights to products

The Group enters into agreements in which it transfers the sales rights to a product already in the markets to an external party outside the Group and agrees to manufacture the product for that external party. For transferring sales rights and manufacturing products, depending on the agreement the Group may receive milestone payments, revenue from manufacture and sales of the products and royalty income. Typically milestone payments are fixed payments made at the time of signing of an agreement with no restitution obligation and payments related to the commercialisation of a product.

The Group itself has generally been manufacturing the product before the sale of sales rights to the product, so the Group would have know-how related to manufacture that would otherwise not be easily attained by the customer. The transferred sales rights and product manufacture, and royalty payments received later constitute two separate performance obligations. Some of the considerations are variable due to conditionality of milestone payments and value adjustments related to the sales price of the products.

The Group may receive under the agreement milestone payments related to commercialisation. They are considered as distinct performance obligations if they are satisfied by a certain volume of sales achieved by the customer. The accrued sales revenue entails value for the customer, so a performance obligation subject to sales volume is considered satisfied when the target for sales has been achieved. Performance obligations related to commercialisation are treated as performance obligations satisfied at a single point of time, because estimating future sales volume entails uncertainty factors.

Revenue from clinical phase research and development work undertaken with collaboration partners

The Group has entered into agreements with collaboration partners that relate to clinical phase research and development projects. Under these agreements milestone payments shall be paid when a certain development phase has been achieved. Milestone payments normally comprise a single upfront payment for Orion's past development work received on signing the agreement, and milestone payments based on the completion of subsequent phases or research results of the project later on. In addition, payments related to commercial rights to the finished product such as royalties may be agreed in the agreements. Depending on the content of the agreement, agreements may consist of performance obligations that are considered separately, or they may form a single service and product package that consists of performance obligations.

Fixed milestone payments on signing an agreement are considered as distinct performance obligations that are satisfied on signing of the agreement. Clinical phase trials may be conducted through many service providers, and the collaboration partner can then utilise in its own business operations the research results conveyed on signing. Research and development work performed during the agreement period is considered a separate performance obligation and milestone payments for this phase are processed as variable considerations because they are conditional on reaching specific phases or research results. Even though Orion satisfies the performance obligations over time, revenue is only recognised on confirmation of the final research results because a reliable evaluation of research results in advance would entail uncertainty factors.

The agreements may also include a decision on arranging manufacture of finished product if it can be commercialised. For each agreement, considerations related to commercialisation are evaluated on the basis of whether the milestone payments and sales of finished products together constitute a performance obligation or whether the milestone payments can be identified as performance obligations distinct from sales of the finished product. Likewise, on the basis of each agreement, it is evaluated whether the performance obligation related to milestone payments will be satisfied at a single point of time or over a period of time. Royalty payments are recognised as revenue when the partner has sold products subject to royalties.

Agreements usually do not include a financing component, because a significant portion of the considerations is variable and their reception will be confirmed in the future.

Interest and dividends

Interest income is recognised using the effective interest method and dividend income when the right to receive payment is established.

Contents of the function-based statement of comprehensive income

Cost of goods sold

The cost of goods sold comprises wages and salaries, materials, procurement and other costs related to manufacturing and procurement.

Selling and marketing expenses

The expenses of selling and marketing operations comprise costs related to the distribution of products, field sales, marketing, advertising and other promotional activities, including the related wages and salaries.

Research and development expenses

R&D expenses comprise wages and salaries, materials, procurement of external services and other costs related to R&D. R&D expenses also include expenses for R&D projects that are classified as joint operations. The portion of the expenses that corresponds to the Group's contractual share of a project is recognised as an expense.

Administrative expenses

Administrative expenses include general administrative and Group management costs.

The functions also bear the depreciation, amortisation and impairment of the assets they use, as well as some administrative overheads in accordance with the cost matching principle.

Critical accounting estimates and assumptions, and main related uncertainties

When compiling the financial statements, the Company's management had to make certain estimates and assumptions concerning the future that have an impact on the items included in the financial statements. The actual values may differ from these estimates. The estimates are mainly related to recognition of revenue, impairment testing of assets, the measuring of receivables and liabilities related to defined benefit pension plans, the recognition of provisions and income tax. In addition, the application of accounting policies calls for the exercise of judgement.

Within the Group, the principal assumptions concerning the future and the main uncertainties relating to estimates at the end of the reporting period that constitute a significant risk of causing a material change in the carrying values of assets and liabilities within the next financial year are the following:

Non-current assets

Actual cash flows can differ from estimated discounted future cash flows because changes in the long-term economic life of the Company's assets, the forecast selling prices of products, production costs and the discount rate applied in the calculations can lead to the recognition of impairment losses.

Employee benefits

The Group has various pension plans to provide for the retirement of its employees or to provide for when the employment ends. Various statistical and other actuarial assumptions are applied in calculating the expenses and liabilities of employee benefits, such as the discount rate, estimated changes in the future level of wages and salaries, and employee turnover. The statistical assumptions made can differ considerably from the actual trend because of, among other things, a changed general economic situation and the length of the period of service. The gains and losses due to changes in actuarial assumptions are recorded into components of other comprehensive income during the period in which they arise. The changes affect the comprehensive income for the period.

Income taxes

In preparing the financial statements, the Group estimates, in particular, the basis for recording deferred tax assets. For this purpose, an estimate is made of how probable it is that the subsidiaries will generate sufficient taxable income against which unused tax losses or unused tax assets can be utilised. The factors applied in making the forecasts can differ from the actual figures, and this can lead to expense entries for tax assets in the income statement.

Revenue

The Group has contracts with customers that may include transfer of sales rights to products, product manufacturing, clinical phase research and development work and terms related to commercialisation. The Group exercises judgement especially regarding the specification of distinct performance obligations, whether the performance obligations are recognised over time or at a single point of time and regarding the recognition time of variable considerations. The Group takes into account the limitation to revenue recognition and recognises revenue only to the extent that it is very likely that a significant reversal to accrued recognised revenue will not be needed. Management judgement related to revenue recognition exercised in the reporting period has been described in section Revenue recognition principles of these accounting policies and in note 1. Revenue from contracts with customers

There is more detailed information in the Notes about the effects of the key uncertainty factors and the estimates made by the Company's management on the above-mentioned financial statements items.
New IFRS standards and IFRIC interpretations to be applied in future financial periods

The following new standards, interpretations and amendments to existing standards are adopted by the Group as of 1 January 2020:

- *Conceptual framework* (amendment). The revised conceptual framework sets out the fundamental concepts that guide the IASB in developing standards adopted in previous years. The framework does not reverse the requirements of individual IFRS standards.
- IFRS 3 (amendment)[1], *Business combinations.* The amendment narrows down and clarifies the definition of business. Following this amendment, a simplified assessment is allowed on whether an acquired entity constitutes an asset group or a business.
- IAS 1, *Presentation of financial statements* and IAS 8, *Accounting policies, changes in accounting estimates and errors* (amendment). The amendments clarify the definition of materiality and improve the possibility for consistent application of the concept throughout IFRS standards.

Upcoming standard amendments are not expected to have a material effect on Orion's consolidated financial statements.

[1] The standard amendment has not yet been endorsed for adoption in the EU.