

To the Point

FASB – final guidance

FASB clarifies the guidance on collaborative arrangements

The guidance clarifies how the revenue standard affects the accounting for collaborative arrangements.

What you need to know

- ▶ The FASB amended ASC 808 and ASC 606 to clarify that certain transactions between participants in a collaborative arrangement should be accounted for under ASC 606 when the counterparty is a customer.
- ▶ The guidance precludes an entity from presenting consideration from a transaction in a collaborative arrangement as revenue from contracts with customers if the counterparty is not a customer for that transaction.
- ▶ The guidance amends ASC 808 to refer to the unit-of-account guidance in ASC 606 and requires it to be used only when assessing whether a transaction is in the scope of ASC 606.
- ▶ The guidance is effective for public business entities in fiscal years beginning after 15 December 2019, and interim periods therein, and for all other entities, in fiscal years beginning after 15 December 2020, and interim periods beginning the following fiscal year. Early adoption is permitted for entities that have adopted ASC 606.

Overview

The Financial Accounting Standards Board (FASB or Board) issued targeted amendments¹ to Accounting Standards Codification (ASC) 808, *Collaborative Arrangements*, and ASC 606, *Revenue from Contracts with Customers*, that require transactions in collaborative arrangements to be accounted for under ASC 606 if the counterparty is a customer for a good or service (or bundle of goods and services) that is a distinct unit of account. The amendments also preclude entities from presenting consideration from transactions with a collaborator that is not a customer together with revenue recognized from contracts with customers.

Entities often enter into collaborative arrangements to jointly develop and commercialize intellectual property (e.g., a drug candidate in the life sciences industry, a motion picture in the entertainment industry). While these arrangements generally are in the scope of ASC 808, the guidance states that transactions between the parties are in the scope of ASC 606 if the counterparty meets the definition of a customer in ASC 606 for a distinct good or service (i.e., a unit of account under ASC 606). The Board issued the guidance in response to requests that it clarify whether and if so when transactions between parties to collaborative arrangements are in the scope of the new revenue guidance in ASC 606.

ASC 808 provides guidance for the presentation and disclosure of transactions in collaborative arrangements, but it does not provide recognition or measurement guidance. The amendments do not change this. As a result, the diversity in practice in how entities account for and recognize consideration received and paid for these arrangements may continue when the counterparty is not a customer.

Historically, some entities concluded that transactions in these arrangements were part of their ordinary activities that were in the scope of either ASC 606 or legacy revenue guidance. Others applied some or all of the revenue guidance by analogy or applied a reasonable, rational and consistently applied policy election. The amendments retain this approach and state that entities should account for transactions in collaborative arrangements that are outside the scope of other guidance, including ASC 606, by analogy to authoritative accounting literature or, if there is no appropriate analogy, by using a reasonable, rational and consistently applied accounting policy election.

Key considerations

The amendments clarify that transactions in a collaborative arrangement should be accounted for under ASC 606 when the counterparty is a customer for a distinct good or service (i.e., a unit of account). The guidance adds a reference in ASC 808 to the unit-of-account guidance in ASC 606 and requires that it be applied only to assess whether transactions in a collaborative arrangement are in the scope of ASC 606.

A unit of account (identified using the unit-of-account guidance in ASC 606) comprising multiple goods and/or services (i.e., a distinct bundle of goods or services) would be outside the scope of ASC 606 if it includes both transactions with a customer and transactions that are not with a customer.

For units of account that are in the scope of ASC 606, the amendments clarify that all of the guidance in ASC 606 applies, including the guidance on recognition, measurement, presentation and disclosure.

Illustration 1 – Transactions in the scope of ASC 606 under the new guidance

Biotech and Pharma enter into an arrangement to jointly develop a drug candidate. Biotech agrees to provide a license of intellectual property to the drug molecule and to develop the drug candidate in exchange for a fee from Pharma. Both parties will participate in and share the costs of the research and development (R&D) activities.

Analysis

Biotech determines that the arrangement is in the scope of ASC 808. To determine whether any of the transactions in the arrangement are in the scope of ASC 606, it evaluates whether Pharma is a customer for any aspect of the arrangement. Biotech determines that providing a license of intellectual property is part of its ordinary activities but providing R&D activities in the context of this collaboration is not. Therefore, Pharma is its customer only for the license transaction.

Biotech then applies the unit-of-account guidance in ASC 606-10-25-19 through 25-22 and determines that the license of intellectual property is distinct from the R&D activities. Because the license is a distinct unit of account in a transaction with a customer, Biotech accounts for the license of intellectual property under ASC 606. Consistent with its past practices, Biotech accounts for amounts received from Pharma for the R&D activities as contra-R&D expense (i.e., outside of ASC 606 revenue).

If Biotech had determined that the license of intellectual property and the R&D activities were a combined unit of account, that entire unit of account would be outside the scope of ASC 606 because it would include transactions that are with a customer and others that are not with a customer.

How we see it

The guidance does not address how entities should account for transactions in collaborative arrangements that are not in the scope of ASC 606. That is, it does not provide unit of account, recognition or measurement guidance. As a result, entities will continue to account for these transactions using the residual guidance in ASC 808 that allows for accounting policies that reflect the economics of entities' collaborative arrangements, which will also result in continued diversity in practice in accounting for these arrangements.

The amendments preclude entities from presenting certain amounts received in collaborative arrangements as revenue from contracts from customers.

Presentation

The amendments preclude entities from presenting amounts related to transactions with a counterparty in a collaborative arrangement that is not a customer as revenue from contracts with customers.

The guidance in ASC 808 permits entities to classify transactions in a collaborative arrangement that are outside the scope of other guidance, including ASC 606, based on an analogy to other US GAAP guidance, or a reasonable, rational and consistently applied policy election, if there is no appropriate analogy.

The Board said in the Background Information and Basis for Conclusions of the Accounting Standards Update (ASU)² that it continues to believe that it might be appropriate to apply some or all of the principles in ASC 606 to a collaborative arrangement by analogy, even if the counterparty is not a customer, if more relevant authoritative guidance doesn't exist. However, an entity in this situation is not permitted to present payments from a transaction under ASC 808 as revenue from contracts with customers.

How we see it

We believe an entity may present amounts from transactions with a collaborator that are not in the scope of ASC 606 or other guidance in its gross profit on the income statement if it presents the amounts separately from revenue from contracts with customers (e.g., as "collaboration revenue"), as long as the presentation reflects the economics and nature of the transaction.

Transactions directly related to third-party sales

The amendments do not provide recognition and measurement guidance for transactions in a collaborative arrangement that are directly related to third-party sales. Therefore, the amendments do not make any changes to the accounting for those transactions. The Board provided³ two examples of transactions directly related to third-party sales: (1) sales of "production inputs" or other items to a collaborative partner that are eventually sold to third

parties and (2) profit share receivables from collaborative partners for third-party sales. Entities will need to determine the nature of these transactions to determine whether they are in the scope of ASC 606 or remain under ASC 808.

Transition and effective date

For public business entities, the amendments are effective for fiscal years beginning after 15 December 2019, and interim periods in those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after 15 December 2020, and interim periods in fiscal years beginning after 15 December 2021.

Entities are required to apply the amendments retrospectively to the date they initially applied ASC 606, and they may elect to do so either for all contracts or only for contracts that are not completed at the date they initially applied ASC 606 (i.e., the date of initial application). A completed contract is a contract for which all (or substantially all) of the revenue or expenses were recognized under guidance that was in effect before the date of initial application. ASC 606 was effective for public entities, as defined in the standard, for fiscal years beginning after 15 December 2017 and for interim periods therein and for all other entities for fiscal years beginning after 15 December 2018.

Early adoption is permitted, including in any interim period, provided an entity has already adopted ASC 606 or does so concurrently with the adoption of this guidance. The amendments provide the same transition practical expedient for contract modifications that entities can elect if they use the modified retrospective transition method in ASC 606. Entities are required to provide transition disclosures under ASC 250, *Accounting Changes and Error Corrections*.⁴

Endnotes:

-
- ¹ ASU 2018-18, *Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606*.
 - ² Paragraph BC31 of the ASU.
 - ³ Paragraph BC30 of the ASU.
 - ⁴ Entities are required to provide the disclosures in paragraphs ASC 250-10-50-1 through 50-2 (excluding the disclosure in paragraph ASC 250-10-50-1(b)(2)).

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.