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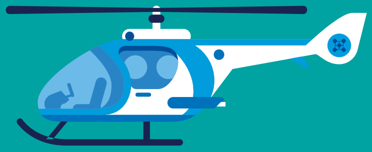

Defining Issues®

FASB finalizes targeted improvements for collaborative arrangements

November 6, 2018

KPMG reports on ASU 2018-18[1], which clarifies the interaction between collaborative arrangements and the new revenue standard.

Applicability

All companies that have collaborative arrangements.

Key facts and impacts

The issuance of ASC 606[2] raised questions about the interaction between the guidance on collaborative arrangements and revenue recognition. Specifically, there was uncertainty about when a company should apply the new revenue standard to collaborative arrangements.

To address this uncertainty, ASU 2018-18:

- clarifies that certain transactions between collaborative partners should be accounted for as revenue under ASC 606 when the collaborative partner is a customer;
- provides guidance specifying that a distinct good or service is the unit of account for evaluating whether a transaction is with a customer; and
- precludes a company from presenting transactions with a collaborative partner that are not in the scope of ASC 606 together with revenue from contracts with customers.

The ASU does not address the recognition and measurement for collaborative arrangements that are not in the scope of ASC 606.

Background on collaborative arrangements

Companies often enter into collaborative arrangements to jointly develop and commercialize intellectual property such as a drug candidate. Current accounting guidance defines a collaborative arrangement and provides presentation and disclosure guidance. However, it does not provide a recognition and measurement model. Therefore, there is diversity in practice related to how companies account for collaborative arrangements.

Before ASC 606 became effective, a company often applied legacy revenue recognition guidance to transactions with a collaborative partner for activities that were part of its ongoing major or central operations. For example, a biotech company often applied legacy revenue guidance when it provided a license and R&D service to a pharmaceutical company.

In contrast, when the activities were not an output of its ongoing major or central operations, a company would often analogize to revenue guidance or apply another reasonable recognition and measurement policy, but it would not present that income as revenue.

For example, a pharmaceutical company in a collaborative arrangement with another

[1] ASU 2018-18, Clarifying the Interaction Between Topic 808 and Topic 606

[2] ASC 606, Revenue from Contracts with Customers

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pharmaceutical company often did not present transactions with collaborative partners as revenue but often analogized to revenue recognition guidance for recognition and measurement purposes.

While there was diversity in practice before ASC 606, its issuance raised new questions about the interaction between it and the accounting for collaborative arrangements. Specifically, questions emerged about when ASC 606 should be applied to collaborative arrangements.

Scoping and unit-of-account guidance

ASU 2018-18 clarifies that a collaborative arrangement in the scope of ASC 808 may also be in the scope of other GAAP, including ASC 606. To determine if a collaborative arrangement is also in the scope of ASC 606, a company uses the unit-of-account guidance in ASC 606 to identify a distinct good or service (or bundle of goods or services) in the collaborative arrangement.

The company then evaluates whether that distinct good or service is transferred to a customer (i.e. it is an output of the company's ordinary activities). If so, then that unit of account is in the scope of ASC 606. The company would apply ASC 606's recognition, measurement, presentation and disclosure requirements to that unit of account.

In some cases, a distinct good or service consists of multiple goods or services that are not distinct because ASC 606 requires a company to combine goods or services until it identifies a bundle of goods or services that is distinct. However, if a portion of the unit of account is not with a customer, the unit of account is not in the scope of ASC 606. The company would determine the appropriate accounting consistent with other transactions in collaborative arrangements that are not directly in the scope of other GAAP for recognition and measurement purposes.[3]

Many companies already apply ASC 606 when the collaborative partner is a customer. As a result, we do not expect a significant change in practice for those companies. However, companies with a combined unit of account may need to take a fresh look and carefully evaluate whether they are still in the scope of ASC 606, which may affect the presentation of the transactions as discussed below.

Transactions not in the scope of ASC 606

The FASB decided not to provide a recognition and measurement model for all transactions in collaborative arrangements. When other GAAP does not apply for recognition and measurement purposes, including ASC 606, the unit of account, recognition and measurement should be based on an analogy to other GAAP. If there is no appropriate analogy, a company should select a reasonable, rational and consistently applied accounting policy.

However, the FASB indicated that a company could apply ASC 606 to non-revenue transactions by analogy, or as a policy election, as long as it presents the transaction separately from revenue recognized from contracts with customers as discussed below.[4]

Presentation

The ASU also precludes companies from presenting transactions with collaborative partners outside the scope of ASC 606 together with revenue in the scope of ASC 606.

During redeliberations, the Board clarified that its intent was to preclude the aggregation of transactions in collaborative arrangements outside the scope of ASC 606 with revenue that was in its scope. The Board indicated that it did not want to broadly preclude companies from presenting collaborative income as revenue. The Board also acknowledged that companies currently use judgment to determine whether the transaction should be presented in the broader revenue category and said it did not intend to change that practice.[5]

We do not expect a significant change in presentation for transactions that are presented in line items other than revenue (e.g. other income or contra research and development) when they are not in ASC 606's scope. However, if a transaction with a collaborative partner is not in ASC 606's scope, but meets the definition of revenue in FASB Concepts Statement 6[6], the company may need to reevaluate its historical presentation and present the transaction in a separate line item in revenue.

[3] BC26 of ASU 2018-18

[4] BC31 of ASU 2018-18

[5] BC29 of ASU 2018-18

[6] FASB Concepts Statement 6, Elements of Financial Statements

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Effective dates and transition

	Public business entities	All other entities
Annual periods – Fiscal years beginning after	December 15, 2019	December 15, 2020
Interim periods – In fiscal years beginning after	December 15, 2019	December 15, 2021
Early adoption allowed?	Yes, as long as a company has already adopted the guidance in ASC 606.	

A company is required to apply the ASU retrospectively to the date it initially applied ASC 606. A company should record a cumulative effect adjustment to the opening balance of retained earnings at the later of the earliest annual period presented or the date of the initial application of ASC 606.

A company may elect to apply the guidance to all contracts or only to uncompleted contracts at the date of initial application of ASC 606. A contract that is not completed refers to an arrangement for which all (or substantially all) of the revenue and expenses were recognized using guidance that was in effect before the date of initial application.[7]

A company may also elect to apply the practical expedient for contract modifications from ASC 606 that allow it to account for the modifications occurring before the date of initial application as if they existed from the beginning of the original contract.

A company shall provide the disclosures in ASC 250-10-50-1 through 50-2 related to a change in accounting principle in the period in which it adopts this ASU. However, a company does not need to provide the disclosures in paragraph 250-10-50-1(b)(2) related to the effect on financial statement line items.

[7] BC37 of ASU 2018-18

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KPMG's Financial Reporting View

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