June 11, 2018

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116


Dear Technical Director:

We appreciate the opportunity to comment on the proposed ASU, Collaborative Arrangements (Topic 808): Targeted Improvements.

We appreciate the Board’s effort to make limited amendments to clarify when collaborative arrangements are also within the scope of Topic 606. However, we believe practice issues and diversity around the accounting for collaborative arrangements stem from the absence of a comprehensive recognition and measurement model for those arrangements. As a result, we believe the practice issues and diversity will continue unless the Board creates a comprehensive model to address collaborative arrangements.

In addition, we believe the proposals provide limited benefits to stakeholders because entities are already making judgments about whether a collaborative arrangement within the scope of Topic 808 is also within the scope of Topic 606. Because Topic 606 just became effective for public business entities, we believe it will take some time to understand the extent of diversity in practice, if any, the proposals would address. We recommend that the Board wait to issue the proposals as a final standard until it can observe how practice develops under Topic 606. Depending on how practice develops, it may or may not become apparent that standard setting is necessary, including the possibility that the Board should undertake a comprehensive project to address the accounting for collaborative arrangements.

Assuming the Board issues the proposals as a final ASU, our letter addresses key aspects of the proposals that we believe the Board should clarify in the final ASU:

1) Components of a collaborative arrangement: The proposals refer to an undefined concept of a ‘component of a collaborative arrangement’ that an entity would need to identify before it evaluates whether a contract is within the scope of Topic 606. We suggest using a framework and terminology more consistent with Topic 606 to avoid unintended consequences. (Question 4).

2) Sequence of paragraphs 808-10-15-5A through 5C: We believe the sequence of the scope and unit of account guidance is inconsistent with Topic 606. We recommend using a framework and terminology that is consistent with Topic 606 to avoid unintended consequences. (Question 4).
3) FASB Concepts Statement 6 definition of revenue: It appears that income would have to be within the scope of Topic 606 to be presented as revenue unless it is directly related to third-party sales. We believe that an entity should be allowed to present as revenue in the income statement amounts that meet the Concepts Statement 6 definition of revenue even if those amounts are outside the scope of Topic 606. (Question 3).

4) Payments directly related to third-party sales of either party: We believe further clarification is needed to explain how this exception is consistent with the definition of revenue in FASB Concepts Statement 6 and to explain what is meant by ‘production inputs’ as that term is used in the basis for conclusions of the proposals. (Question 3).

5) Collaborative arrangements that are not completed: We support the proposals to use transition practical expedients consistent with those used in Topic 606. However, it is not clear what would constitute a collaborative arrangement that is not complete. We suggest using terminology and a definition consistent with Topic 606 to avoid unintended consequences and to reduce the implementation burden of the proposals beyond what was already required to implement Topic 606. (Question 6).

Our recommendations and responses to the Questions for Respondents are included in the Appendix to this letter.

* * * * * * *

If you have questions about our comments or wish to discuss the matters addressed herein, please contact Prabhakar Kalavacherla at (415) 963-8657 or pkalavacherla@kpmg.com or Nick Burgmeier at (212) 909-5455 or nburgmeier@kpmg.com.

Sincerely,

KPMG LLP

KPMG LLP
Appendix – Responses to Questions for Respondents

Question 1:
Would the amendments in this proposed Update clarify when a transaction between collaborative participants is within the scope of the revenue guidance in Topic 606? Would the proposed amendments reduce diversity in practice in this area? If not, please explain why.

We believe the proposals provide limited benefits to stakeholders because entities are already making judgments about whether a collaborative arrangement within the scope of Topic 808 is also within the scope of Topic 606. In addition, we believe there are inconsistencies between the scoping and unit of account guidance in the proposals and Topic 606 that could have unintended consequences on the implementation of Topic 606 (see Question 4).

Because Topic 606 just became effective for public business entities, we believe it will take some time to understand the extent of diversity in practice, if any, that the proposals would address. We suggest that the Board consider waiting to issue the proposals as a final standard until it can observe how practice develops under Topic 606. Depending on how practice develops, it may or may not become apparent that standard setting is necessary, including the possibility that the Board should undertake a comprehensive project to address the accounting for collaborative arrangements.

We believe practice issues and diversity around the accounting for collaborative arrangements stem from the absence of a comprehensive recognition and measurement model for those arrangements. As a result, we believe the practice issues and diversity will continue unless the Board creates a comprehensive model to address these collaborative arrangements.

Assuming the Board proceeds to issue final guidance based on the proposals, we believe some changes would clarify the Board’s intent. See Questions 3 and 4.

Question 2:
Is additional guidance necessary to determine whether a collaborative participant is a customer? If so, please provide suggestions.

No. We agree with the Board’s decision not to provide additional guidance about whether a collaborative participant is a customer, as that evaluation is not unique to transactions in a collaborative arrangement. Many entities are already applying judgment to evaluate whether a collaborative partner is a customer as they implement Topic 606. Providing additional guidance could lead to unintended consequences outside of the accounting for collaborative arrangements.

If the Board issues a final ASU, we believe the illustrative examples should more clearly state that a collaborative arrangement is within the scope of Topic 606 because the entity is transferring goods or services that are an output of its ordinary activities. For example, proposed paragraph 808-10-55-5 states only that “Biotech has concluded that the research and development services to Pharma represent a distinct service provided to Pharma as a customer.”

Focusing on whether the activities are an output of an entity’s ordinary activities would be consistent with the definition of a customer in Topic 606. Therefore, we suggest modifying paragraph 808-10-55-5 and other similar statements to say, for example, “Biotech has concluded that the research and development services to Pharma represent a distinct service provided to Pharma as a customer.”
Question 3:

Are the proposed amendments on presentation in paragraph 808-10-45-3 operable? Would the proposed amendments reduce diversity in practice in this area?

Because the definition of a customer is derived from the definition of revenue in FASB Concepts Statement 6, we agree with the Board that in many cases it would be inconsistent to conclude that the counterparty is not a customer and still present income received as revenue. However, based on paragraphs 808-10-45-3 and 808-10-15-5B, it appears that income would have to be within the scope of Topic 606 to be presented as revenue unless it is directly related to third-party sales. We believe that there are some circumstances in which an entity should be allowed to present as revenue in the income statement amounts that meet the Concepts Statement 6 definition of revenue even if those amounts are outside the scope of Topic 606.

For example, an entity that entered into a collaborative arrangement to jointly operate a hospital with and lease a facility to the counterparty could present the lease income as revenue under current GAAP if leasing was a part of its ongoing major or central operations, even though the lease is not within the scope of Topic 606. We suggest clarifying paragraph 808-10-45-3 to state that an entity can present as revenue in its income statement, income that is within the scope of guidance other than Topic 606 if it results from activities that constitute the entity’s ongoing or major central operations.

We also believe that the Board should clarify how the exception for transactions that are “directly related to a third-party sale of either party” is consistent with the Concepts Statement definition of revenue. For example, paragraph BC20 of the proposals provides examples of transactions directly related to third-party sales, including “sales of ‘production inputs’ or other items to a collaborative partner that are eventually sold to a third party.” However, the definition of a ‘production input’ is unclear, and it is unclear how those items meet the Concepts Statement definition of revenue if they are not outputs of the entity’s ordinary activities. We understand that in practice some entities present certain payments received after commercialization as revenue and do not object to the exception, but it would be helpful to clarify a principle behind these exceptions to avoid unintended consequences.

We suggest modifying the examples in the proposals or adding new examples to the final ASU to illustrate the definition of a production input and to illustrate how that definition would be applied to common fact patterns. For instance, none of the examples address licenses of IP, which are common in collaborative arrangements. It also would be helpful to preparers to include in the final ASU examples of how an entity should apply the proposals to manufacturing or co-promotion arrangements after commercialization.

We observe that in paragraph 808-10-55-13 (Example 3), Little Pharma analogizes a profit sharing payment received to a royalty and presents that payment as revenue. A sales- or usage-based royalty paid in exchange for a license of intellectual property is a concept used in Topic 606 that represents a narrow exception to the overall model. However, Example 3 does not include a license. As a result, we believe this example could create unintended consequences as some could read the example to suggest that entities can apply the royalty exception by analogy to contracts without a license of IP. To avoid these consequences, we suggest deleting the reference to a royalty:
Little Pharma also concludes that the portion of the net payable directly related to profit sharing from Big Pharma’s third-party sales in Europe and Asia is analogous to a royalty should be characterized similar to Little Pharma’s own third-party sales and therefore should characterize the $10.5 million should be presented as revenue similar to a royalty.

**Question 4:**

Would the proposed amendments on the unit of account clarify that the unit-of-account guidance in Topic 606 should be applied for determining if a transaction is within the scope of Topic 606? If not, please explain why.

We believe the Board should clarify several areas of the proposals:

*Components of a collaborative arrangement*

Paragraph 808-10-15-5A of the proposals refers to but does not define ‘component of a collaborative arrangement.’ The paragraph suggests that multiple components could be entirely or partially within the scope of Topic 606. It is unclear whether identifying components is a unique step in the model nor is it clear how to evaluate what constitutes a component. The lack of clarity could lead to diversity in practice or unintended consequences.

*Sequence of the guidance*

We believe the sequence of the scoping and the unit of account guidance is inconsistent with Topic 606. Under Topic 606, entities first evaluate whether a contract is entirely or partially within its scope. If the contract is partially within the scope of Topic 606 and partially within the scope of other Topics, the entity applies the guidance in 606-10-15-4 to separate and measure aspects of the contract that are within the scope of Topic 606. After the entity separates the parts of the contract that are within the scope of Topic 606 from the parts of the contract that are within the scope of other guidance, the entity applies the guidance in paragraphs 606-10-25-14 through 25-22 to identify performance obligations related to the goods or services that are within the scope of Topic 606.

It appears that under the proposals an entity would sequentially identify components (an undefined term) under Topic 606, evaluate the unit of account, and determine whether the counterparty is a customer instead of determining the scope and then evaluating the units of account. We understand that allocating between revenue and non-revenue elements on a relative stand-alone selling price basis may be a change in practice for some entities.

To address these issues, we suggest using terminology that would be more consistent with Topic 606 to minimize unintended consequences. We believe that, along with the proposed amendment to paragraph 606-10-15-3, the final ASU could simply state that a contract that is within the scope of Topic 808 can also be entirely or partially within the scope of Topic 606 for any goods and services transferred that are an output of the entity’s ordinary activities (i.e. the collaborative partner is a customer) if no other authoritative recognition and measurement guidance applies to those goods or services. The scoping paragraphs in Topic 606 should be sufficient to enable an entity to separate and measure the parts of the contract that are within the scope of Topic 606 from the parts of the contract that are outside the scope of Topic 606.
The final ASU could also, consistent with the proposals, amend Topic 808 to state that when no recognition and measurement guidance directly applies to some or all of a contract that is a collaborative arrangement, the entity would first consider whether other recognition and measurement guidance applies by analogy. If there is no appropriate analogy, an entity would apply a reasonable, rational and consistently applied accounting policy election for recognition and measurement.

**Question 5:**

Should a reporting entity be required to provide additional recurring disclosures (that is, incremental disclosures to those required in Topic 808 and Topic 606) because of the proposed amendments? If so, what additional recurring disclosures should be required?

No. We believe the disclosure requirements in Topic 808 and Topic 606 are sufficient.

**Question 6:**

Do you agree with the proposed transition requirements, including the retrospective application to the adoption date of Topic 606? If not, what transition method would be more appropriate and why?

Because the proposals affect Topics 808 and 606, we believe it is appropriate to require retrospective application to the adoption date of Topic 606.

We support using the practical expedients that were used in Topic 606. However, we believe that the phrase “collaborative arrangements that are not completed” is unclear and could lead to more contracts being evaluated on transition than would have been under Topic 606. Because collaborative arrangements could last many years and potentially incorporate multiple accounting contracts (e.g. materials purchased through purchases orders), the proposals could require an entity to reassess old contracts within a collaborative arrangement that would not have been evaluated on the adoption of Topic 606.

We recommend incorporating into the final ASU the completed contract definition from Topic 606 to ensure consistency between adoption of the ASU and adoption of Topic 606. We believe this would provide entities the ability to leverage their analysis of open contracts under Topic 606 when implementing the proposals.

**Question 7:**

How much time is needed to implement the proposed amendments? Should early adoption be permitted?

We believe this question is best addressed by financial statement preparers.

**Question 8:**

Should entities other than public business entities be provided with more time to implement the proposed amendments? If so, how much more time?

We believe this question is best addressed by financial statement preparers.