Ms. Susan M. Cosper  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

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Proposed Accounting Standards Update, Collaborative Arrangements (Topic 808) – Targeted Improvements (File Reference No. 2018-240)

Dear Ms. Cosper:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update (ASU), Collaborative Arrangements – Targeted Improvements, from the Financial Accounting Standards Board (FASB or Board).

We support the FASB’s objective to clarify when certain transactions between participants in a collaborative arrangement should be accounted for as revenue under Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers. We believe the proposed changes to the scope of ASC 808 would clarify, in many instances, that a collaborative arrangement in the scope of ASC 808 could have one or more transactions also in the scope of ASC 606. However, we’ve identified several areas where we believe clarification is needed to achieve the Board’s objective.

Clarifying when ASC 606 applies

We support the Board’s proposal to clarify the scoping guidance in ASC 808 and believe the amendments would remove doubt about whether a counterparty in a collaborative arrangement also could be a customer for one or more transactions. However, we believe entities may need to apply significant judgment to implement the proposed amendments and could reach different conclusions about whether a counterparty is a customer in similar situations.

In Appendix A, we discuss our recommendations for further guidance or clarifications the Board could consider to enable entities to implement the proposed amendments and provide more comparability for certain transactions between collaborative participants. These recommendations include adding guidance or clarifications with regard to (1) whether a combined unit of account (identified using the unit-of-account guidance in ASC 606) would be outside the scope of ASC 606 if it includes both transactions with a customer and transactions that are not with a customer, (2) proposed paragraphs 808-10-15-5A and 15-5B, (3) the scoping of cost-sharing and profit-sharing payments, as illustrated in Examples 1 and 2 in the proposed ASU and (4) the accounting for transactions directly related to third-party sales.
Presentation

We believe the proposed guidance on how amounts from transactions that are not in the scope of ASC 606 or are not directly related to third-party sales should be presented in an entity’s statement of comprehensive income is unclear.

As discussed in Appendix A, we do not believe the Board should preclude the presentation of amounts recorded for collaborative arrangements as revenue when the amounts are not received from a customer or directly related to third-party sales. We are concerned that the benefits of this proposed change don’t outweigh the consequences of providing a less meaningful presentation of financial information about an entity’s collaborative arrangements. We also believe that entities are best positioned to determine the appropriate presentation of their collaborative activities, and the robust disclosures currently required by both ASC 808 and ASC 606 would provide transparency to users of the financial statements about the presentation of and accounting policies for transactions in collaborative arrangements.

Additional observations

We recommend that the Board consider making additional amendments to Examples 1 through 3 or adding new examples of collaborative arrangements in the life sciences industry that include a license of intellectual property (IP) and up-front payments and reflect the fact that research and development (R&D) and commercialization activities commonly occur in separate phases of a product candidate’s life cycle. It is our understanding that collaborative arrangements in the life sciences industry typically include licenses of IP and up-front payments to the licensor. We also note that once regulatory approval for a product candidate is obtained, significant R&D activities (and therefore R&D reimbursements) usually stop and commercialization activities begin.

Our responses to the questions in the proposal are included in Appendix A. We also have included additional suggestions in Appendix B.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst & Young LLP
Appendix A — Responses to questions posed in the Proposed ASU, Collaborative Arrangements (Topic 808) — Targeted Improvements

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 proposed amendments, including the proposed changes to paragraph 606-10-15-3, would clarify that a collaborative arrangement in the scope of ASC 808 could have one or more transactions also in the scope of ASC 606 (i.e., when the counterparty is a customer for a unit of account). These amendments would remove doubt about whether a collaborator also could be a customer in a collaboration arrangement and codify the Board’s intent about the applicability of ASC 606 to collaborative arrangements, as discussed in paragraphs BC55 and BC56 of the Background Information and Basis for Conclusions of ASU 2014-09.

Much of the diversity in practice in the accounting for collaborative arrangement occurs because ASC 808 does not provide recognition and measurement guidance for transactions in a collaborative arrangement. Although the proposed amendments would provide a framework to evaluate the scope of guidance for transactions in collaborative arrangements, it’s unclear whether or how much the amendments would reduce diversity in practice because the Board would be codifying the approach many entities are already following under ASC 606. That is, upon adoption of ASC 606, many entities reassessed the elements of their collaborative arrangements and are accounting for transactions under ASC 606 if the collaborator is considered the entity’s customer for that aspect of the arrangement. Although we support the Board’s efforts to clarify when a transaction between collaborative participants is in the scope of ASC 606, we believe further guidance or clarification is needed to enable entities to implement these amendments and limit additional diversity in practice.

Specifically, we suggest that the Board consider making clarifications to address the observations we describe below about the following topics:

► Scoping of transactions that are part of a combined unit of account that have customer and noncustomer elements
► Proposed paragraphs 808-10-15-5A and 808-10-15-5B
► Scoping of cost-share and profit-share payments, as illustrated by the proposed amendments
► Accounting for transactions directly related to third-party sales

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1 Paragraph BC55 of ASU 2014-09 states, “The Boards noted that a contract with a collaborator or a partner ... also could be within the scope of Topic 606 if that collaborator or partner meets the definition of a customer for some or all of the terms of the arrangement.”

2 Paragraph BC56 of ASU 2014-09 states, “The Boards also noted that in some cases it might be appropriate for an entity to apply the principles of Topic 606 to some transactions with collaborators or partners.”
Scoping of transactions that are part of a combined unit of account that have customer and noncustomer elements

We believe that a combined unit of account (identified using the unit-of-account guidance in ASC 606) would be outside the scope of ASC 606 if it includes both transactions with a customer and transactions that are not with a customer as illustrated in the example below. That is, only units of account that are composed entirely of goods or services provided to a customer would be accounted for under ASC 606. We recommend that the Board clarify this aspect of the scoping guidance to reduce diversity in practice.

The following example is common in the life sciences industry for collaborative arrangements that include early-stage technologies or early-stage drug candidates:

Biotech and Pharma enter into an arrangement to jointly develop a drug candidate that is in the early stages of development. Biotech agrees to provide a license of IP to the drug molecule that is to be developed to Pharma in exchange for a fee. Both parties will be active participants that are exposed to the risks and rewards of the R&D activities. 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, Biotech evaluates whether Pharma is a customer for any aspect of the arrangement. Biotech determines that providing a license of IP is part of its ordinary activities, but providing R&D activities is not. Therefore, Pharma is Biotech’s 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 because of its specialization in and expertise with the early-stage drug candidate, the license provides little or no utility to the counterparty absent its ongoing R&D activities. As a result, Biotech concludes that the license of IP is not distinct from the R&D activities (i.e., it has a combined unit of account).

If the FASB moves ahead with the proposal without further clarifying its intent, entities could reach different conclusions about which accounting guidance to apply to some collaborative arrangement transactions (i.e., whether a combined unit of account that has transactions with a customer and transactions that are not with a customer is in or out of the scope of ASC 606). Further, if the Board were to require an entity to account for a combined unit of account that has transactions with a customer and transactions that are not with a customer under ASC 606, this treatment may create accounting complexity by requiring entities to apply ASC 606 to transactions with noncustomers. This could result in an accounting outcome that does not accurately reflect the economics of the arrangement and the relationship between the collaborative partners.

Proposed paragraphs 808-10-15-5A and 808-10-15-5B

Our understanding is that a transaction in a collaborative arrangement would be in the scope of ASC 606 if the collaborative partner is a customer and there are distinct goods or services being provided to this partner. We believe the intent of proposed paragraph 808-10-15-5A is to instruct entities to identify and separate any transactions with a collaborative partner that are in the scope of
ASC 606 using the guidance in paragraph 606-10-15-4. That is, proposed paragraph 808-10-15-5A would instruct an entity to apply paragraph 606-10-15-4 to separate the distinct ASC 606 elements from the ASC 808 elements and any other non-ASC 606 elements in an arrangement. We believe proposed paragraph 808-10-15-5B provides additional clarity about what would be in the scope of ASC 606 by emphasizing that the distinct goods or services (separated in accordance with the unit-of-account guidance in paragraphs 606-10-25-19 through 25-22) that are with a customer should be accounted for using all principles of ASC 606.

To clarify the intent of the proposed amendments, we recommend the following changes to proposed paragraphs 808-10-15-5A and 15-5B (proposed text is underlined):

808-10-15-5A A collaborative arrangement within the scope of this Topic may have components that are within the scope of other Topics. If there are one or more transactions in a component of a collaborative arrangement that are with a customer wholly or partially within the scope of Topic 606 on revenue from contracts with customers, an entity shall apply the guidance in paragraph 606-10-15-4 to determine how to separate and initially measure any distinct goods or services, as described in paragraph 808-10-15-5B components. If a component of a collaborative arrangement is not wholly or partially within the scope of Topic 606 but instead is wholly or partially within the scope of other Topics, an entity should follow the recognition and measurement provisions of those other Topics.

808-10-15-5B An entity shall apply Topic 606 only if the other party is a customer in the context of a promised good or service (or bundle of goods or services) that is distinct within the collaborative arrangement, separated determined in accordance with paragraphs 606-10-25-19 through 25-22. For any distinct element goods or services within the scope of Topic 606, an entity is required to apply all the guidance in Topic 606, including the recognition, measurement, presentation, and disclosure requirements.

Scoping of cost-share and profit-share payments, as illustrated by the proposed amendments

We note that the profit-share payments in Examples 1 and 2 in the Implementation Guidance and Illustrations section of the proposal are accounted for under the guidance in ASC 606. However, it is unclear to us why Biotech’s profit-share payments in these examples are considered to be in the scope of the revenue guidance (i.e., ASC 606), when previously under ASC 808 the payments were not in the scope of other authoritative literature (e.g., they were not in the scope of the legacy revenue guidance in ASC 605).

We recommend that the Board reconsider the amendments to Biotech’s accounting conclusions in one or both of these examples (the current guidance in ASC 808 has Biotech accounting for all activities and amounts received outside of the revenue guidance because it concluded that the transactions were not in the scope of other authoritative guidance). Alternatively, the Board could consider amending Examples 1 and 2 to provide the relevant factors that were evaluated when making the conclusions regarding the accounting guidance to apply to the profit-share payments in these examples.
Accounting for transactions directly related to third-party sales

We interpret the proposed amendments in paragraph 808-10-45-3 as allowing entities to classify amounts directly related to third-party sales (including profit-share payments) as revenue, regardless of whether the underlying transactions are accounted for under ASC 808, ASC 606 or other authoritative guidance. We note that paragraph BC20 of the Basis for Conclusions states “because the scope of the amendments in this proposed Update excludes transactions directly related to sales to third parties, the Board did not change the revenue presentation requirements for transactions directly related to sales to third parties, such as... (b) profit share receivables from collaborative partners for third-party sales” (emphasis added). We believe our interpretation is consistent with current practice and may best reflect the nature and purpose of collaborative arrangements (i.e., for the parties to share in the risks and rewards of the commercial activities related to their joint efforts even though the results may not be the direct selling efforts of the reporting entity).

If our understanding is incorrect and the Board’s intent is to require that all amounts directly related to third-party sales be accounted for under ASC 606 (regardless of whether the related performance in the contract is in the scope of ASC 808 or other authoritative guidance), we are concerned about the consequences of this decision. We believe that requiring entities to apply ASC 606 to amounts directly related to third-party sales (e.g., profit-share payments) could result in accounting complexity and diversity in practice due to confusion about how to apply ASC 606 (which focuses on the accounting for goods and services) to payments, especially in situations when entities account for all consideration related to their performance in a collaborative arrangement under other guidance.

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

Based on our interpretation of the proposed guidance, we believe that entities should consider the definition of a customer in the Master Glossary of the Accounting Standards Codification when they determine whether a collaborative partner is a customer. The definition states that a customer is “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.” Entities may need to apply significant judgment when making this evaluation for a collaborative partner because the parties are participating in a joint operating activity and are both exposed to the risks and rewards dependent on the commercial success of that activity. Therefore, it may be difficult for one party to determine whether or how it is providing a good or service to the other party in a vendor-customer relationship.

Also, entities could reach different conclusions about when or whether their collaboration partner is a customer due to the significant judgment that may be needed when making this evaluation. This could contribute to continued diversity in practice in the accounting for transactions in collaborative arrangements.
We acknowledge that it may be difficult for the Board to provide additional implementation guidance to help entities make judgments about when a collaborative partner is also a customer without raising questions about the application of the term “customer” for revenue contracts under ASC 606. If the Board were to provide additional guidance, we recommend that it use concepts from ASC 606 (e.g., provide factors or considerations about how control of a promised good or service may transfer to a collaborative partner) to clarify when a collaborative partner is also 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?

We believe that the amendments to paragraph 808-10-45-3 in the proposed ASU are generally operable. However, we think the last sentence is unclear and the restrictions on presentation are unnecessary.

That is, it’s not clear to us what presentation the Board intended with its proposal to preclude an entity from presenting as revenue an amount received from a collaborator that is not a customer and that is not directly related to a third-party sale (e.g., an upfront payment for a license of IP). Absent further clarification, an entity could interpret the provision to preclude the use of a caption of “revenue” without specifying where this amount should be presented on the statement of comprehensive income. Therefore, an entity could report amounts recorded from its collaborative arrangements separately from revenue from contracts with customers (e.g., as collaboration income) as a component of gross profit. However, another entity may interpret the guidance as requiring presentation of these amounts below gross profit on the statement of comprehensive income (e.g., as a component of an expense line item, in other income or expense).

We do not believe the Board should preclude the presentation of amounts recorded for collaborative arrangements as revenue when the amounts are not received from a customer or directly related to third-party sales. We note that amounts received under collaborative arrangements may be the only source of revenue or income for some entities. In these situations, it is not uncommon for the amounts received to be classified as collaboration revenue or collaboration income on the statement of comprehensive income, even when the related transactions are not in the scope of ASC 606 or directly related to third-party sales.

In addition, some entities may believe it is important to include amounts received from collaborative arrangements in gross profit (as top-line inflows) rather than report such amounts as collaboration expenses or as a component of other income, which may receive less attention than if it were presented as a component of top-line results. Requiring these amounts to be presented below gross profit on the statement of comprehensive income could lead to a significant change in practice for some entities and may not provide the most useful information to users of the financial statements.

We anticipate that many entities will report other types of revenues (clearly delineated from revenues from contracts with customers) that are outside the scope of ASC 606 (e.g., leasing revenue, interest income from financing, revenue from financial instruments). We recommend that the Board clarify the proposed amendments to allow an entity to present amounts recorded from transactions in collaborative arrangements in its gross profit (as a component of top-line results) on the statement of comprehensive income provided the amounts are clearly delineated from ASC 606 revenues, either on the face of the financial statements or as disclosed in the notes to the financial statements. This
presentation would be consistent with the presentation of other non-ASC 606 revenues. We also believe that this presentation, along with the robust disclosures currently required by both ASC 808 and ASC 606, would make clear to users of the financial statements whether an amount is directly related to a transaction in the scope of ASC 606 or ASC 808. This transparency is required by ASC 808-10-50-1, which states:

“... a participant to a collaborative arrangement shall disclose all of the following:

d. The income statement classification and amounts attributable to transactions arising from the collaborative arrangement between participants for each period an income statement is presented.”

Paragraph 606-10-50-4 has a complementary requirement to promote transparency:

“An entity shall disclose all of the following amounts for the reporting period unless those amounts are presented separately in the statement of comprehensive income (statement of activities) in accordance with other Topics:

a. Revenue recognized from contracts with customers, which the entity shall disclose separately from its other sources of revenue”

The proposed amendments do not address the measurement or recognition of units of account under ASC 808, so we believe the potential for diversity in the accounting for collaborative arrangements would continue. While precluding the presentation of certain amounts as revenue may reduce concerns about comparability of revenues between entities with collaborative arrangements, we don’t believe the benefits of this change outweigh the consequences of providing a less meaningful presentation of financial information about an entity’s collaborative arrangements.

**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 amendments in the proposal would clarify that entities should apply the unit-of-account guidance in ASC 606 to determine which transactions, if any, from a collaborative arrangement are in the scope of that standard. See our response to Question 1 above for our views on the proposed amendments to the scoping guidance.

We also believe it is clear in proposed paragraph 808-10-15-5B that entities would **not be required** to apply the unit-of-account guidance in ASC 606 to transactions that are not with a customer (i.e., transactions that are in the scope of ASC 808 and outside the scope of ASC 606). We support the Board’s decision, as described in paragraph BC21 of the Basis for Conclusions of the proposed ASU, to permit entities to apply any relevant aspect(s) of the guidance in ASC 606, including the unit-of-account guidance, by analogy or as a policy election to transactions in the scope of ASC 808 (and outside of the scope of ASC 606), without requiring the entity to apply all of the guidance in ASC 606 to the transaction. If our understanding is incorrect or inconsistent with the Board’s intent, we recommend that the Board clarify its intent.
**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?

We agree with the Board’s conclusion (as described in paragraph BC27 of the Basis for Conclusions) that additional recurring disclosures for collaborative arrangements aren’t necessary due to the robust disclosures already required under ASC 606 and ASC 808.

**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?

We agree with the proposed transition requirements, including the proposal that entities apply the guidance retrospectively to the date of initial application of ASC 606. However, we recommend that the Board consider clarifying or providing additional guidance on when a collaborative arrangement should be considered completed. We expect that, without additional guidance, entities that elect to apply the proposed guidance only to collaborative arrangements that are not completed may have questions about when to consider an arrangement completed (despite the language in BC29 of the Basis for Conclusions describing an uncompleted collaborative arrangement as one “that has one or more unperformed units of account”).

We believe that some entities would have questions about whether their performance under a collaborative arrangement is complete, similar to questions raised about the original language in ASC 606 that used performance as a basis for completed contracts (subsequently addressed in ASU 2016-12). For example, we believe that entities in the life sciences industry may apply the transition guidance differently to similar contracts because they may view the significance of any remaining performance differently (e.g., remaining performance in a joint steering committee).

**Question 7:** How much time is needed to implement the proposed amendments? Should early adoption be permitted?

We believe preparers are in the best position to comment on the time needed to adopt the proposed amendments, and we are supportive of providing the option to early adopt the guidance.

**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 entities that are not public business entities should have more time to implement the proposed amendments and that preparers are in the best position to comment on the amount of additional time needed.
Appendix B – Additional comments about the Proposed ASU, Collaborative Arrangements (Topic 808) – Targeted Improvements

We recommend the following clarifications to the language in the proposal:

In paragraph 808-10-55-18 of Example 4, the following edit is needed to clarify that Studio B is evaluating whether Studio A is its customer for purposes of the classification of net ultimate participation costs: “Studio B concludes that other authoritative accounting literature does not apply directly, including Topic 606, because Studio B Studio A is not a customer, regarding the income statement classification of net ultimate participation costs due from Studio A.”

For an arrangement that meets the definition of a collaborative arrangement under ASC 808, we believe it is clear from proposed paragraph 808-10-15-5B that all principles of ASC 606 (including disclosure requirements) would be applied to (1) a collaborative arrangement that is wholly in the scope of ASC 606 or (2) the transactions in a collaborative arrangement that are in the scope of ASC 606. However, it is unclear in these situations whether an entity would also be required to provide the ASC 808 disclosures for the arrangement or pieces of the arrangement under ASC 606. We recommend that the Board clarify whether the ASC 808 disclosure requirements would apply in these instances.