FASB Emerging Issues Task Force

Issue No. 07-1

Title: Accounting for Collaborative Arrangements

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Dates previously discussed: March 15, 2007; June 14, 2007

Previously distributed EITF materials: Issue Summary No. 1, dated February 26, 2007; Working Group Report No. 1 (distributed as Exhibit 07-1C to Issue Summary No. 1); Issue Summary No. 1, Supplement No. 1, dated May 30, 2007; Working Group Report No. 2 (distributed as Exhibit 07-1B to Issue Summary Supplement No. 1)

References:

FASB Statement No. 2, *Accounting for Research and Development Costs* (FAS 2)

FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries* (FAS 94)

FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R)

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (APB 18)

APB Opinion No. 22, *Disclosure of Accounting Policies* (APB 22)

EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" (Issue 99-19)

EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" (Issue 01-9)

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

Background

1. Entities may enter into an arrangement to jointly develop and commercialize intellectual property or otherwise participate in some type of joint operating activity. For example, in the biotechnology and pharmaceutical industries, because the development of a drug candidate into a commercially viable product may take many years, and because of the considerable amount of resources required to develop a product and the financial risks involved, companies often enter into arrangements to jointly develop, manufacture, distribute, and market a drug candidate. Other industries that may utilize these types of arrangements include, but are not limited to, the motion picture, software, and computer hardware industries.

2. The activities associated with these arrangements may be conducted by the participants without the creation of a separate legal entity. In some arrangements, a legal entity may be utilized for specific activities or for a specific geographical location. In arrangements in which a separate legal entity is not utilized, generally the participants will share, based on contractually defined calculations, the profits or losses from the associated activities. The types of activities conducted under a collaborative arrangement to jointly develop and commercialize intellectual property may include research and development, marketing (including promotional activities and physician detailing), general and administrative activities, manufacturing, and distribution. The arrangement may provide that one participant has sole or primary responsibility for certain activities or that one or more participants have shared responsibility for certain activities.

3. The issues previously discussed by the Task Force were:

Issue 1— How to determine whether an arrangement constitutes a collaborative arrangement within the scope of this Issue

Issue 2— How costs incurred and revenue generated on sales to third parties should be reported by the participants in a collaborative arrangement in each of their respective income statements

Issue 3— How an entity should characterize payments made between participants in a collaborative arrangement in the income statement

Issue 4— What participants should disclose in the notes to the financial statements about a collaborative arrangement.

Previous Task Force Discussion

4. The Task Force reached a tentative conclusion on Issue 1 that a collaborative arrangement is a contractual arrangement in which the parties are active participants to the arrangement and are exposed to significant risks and rewards that are dependent on the ultimate commercial success of the endeavor. An entity should evaluate all relevant facts and circumstances when evaluating whether an arrangement is a collaborative arrangement. Many collaborative arrangements relate to the development and commercialization of intellectual property. However, there may also be collaborative arrangements that do not relate to intellectual property.

5. The Task Force reached a tentative conclusion on Issue 2 that transactions with third parties (that is, revenue generated and costs incurred by participants in a collaborative arrangement) should be reported on the appropriate line item in each company's respective financial statement pursuant to the guidance in Issue 99-19. For example, a participant in a collaborative arrangement who is deemed to be the principal for a given transaction would record that transaction on a gross basis in its financial statements. In reaching that tentative conclusion, the Task Force elected not to pursue an accounting model that would be based on the equity method of accounting under APB 18.

6. On Issue 3, the Task Force reached a tentative conclusion that the income statement characterization of payments between participants pursuant to a collaborative arrangement should be evaluated based on the nature and contractual terms of the arrangement, the nature of each entity's business operations, and whether those payments are within the scope of other authoritative literature regarding income statement characterization. If the payments are within the scope of other authoritative literature, then an entity should apply the relevant provisions of that literature. To the extent that these payments are not within the scope of other authoritative accounting literature, the income statement characterization for the payments should be based on an analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. For example, if one party to an arrangement is required to make a payment to the other party to reimburse a portion of that party's research and

development cost, that portion of the net payment may represent a research and development expense pursuant to FAS 2 in the payor's financial statements.

7. On Issue 4, the Task Force reached a tentative conclusion that a participant in a collaborative arrangement should disclose annually:

a. Information about the nature and purpose of its collaborative arrangements
b. Its rights and obligations under the collaborative arrangements
c. The stage of the underlying endeavor's life cycle
d. The accounting policy for collaborative arrangements in accordance with APB 22
e. The income statement classification and amounts attributable to transactions between other participants to the collaborative arrangement
f. Amounts due from or owed to other participants under the collaborative arrangements.

Information related to individually significant collaborative arrangements should be disclosed separately.

8. At the June 14, 2007 EITF meeting, the Task Force asked the FASB staff to provide illustrative examples to demonstrate the application of the tentative conclusion on Issue 3, which have been included in Exhibit 07-1A of this Issue Summary Supplement. Also attached as Exhibit 07-1B is a draft abstract of the tentative conclusions reached during previous meetings on this Issue. After the Task Force's consideration of the illustrative examples in Exhibit 07-1A, the staff will recommend that the Task Force affirm its tentative conclusion on Issue 3 at the September 11, 2007 EITF meeting. The staff will also ask the Task Force whether the illustrative examples supporting Issue 3 should be included in the draft abstract.

Accounting Issues and Alternatives

Question 1: Does the Task Force wish to affirm its tentative conclusion on Issue 3?

9. The staff received a number of questions on how to apply the tentative conclusion on Issue 3 following the June 14, 2007 EITF meeting. In this Issue Summary Supplement the staff does not

plan to ask the Task Force to redeliberate Issue 3 since the Task Force reached a tentative conclusion at its June 14, 2007 meeting. However, the staff requests that the Task Force review the way in which the tentative conclusion is articulated in the draft abstract (Exhibit 07-1B) and discuss whether any clarifications or modifications are necessary. The staff believes that the approach outlined in the tentative conclusion reached on Issue 3 is similar to the way in which entities currently analyze an accounting issue. Accordingly, the staff would expect an entity to assess presentation questions associated with a collaborative arrangement in a similar manner absent a consensus being reached on Issue 3. Furthermore, the staff believes that this tentative conclusion will not be a significant change to practice.

Question 2: If the Task Force elects to affirm its tentative conclusion on Issue 3, does the Task Force wish to include the examples for Issue 3 in the draft abstract?

10. In developing the examples for Issue 3, the staff became concerned that those examples may be oversimplified and may not capture the wide variety of facts and circumstances associated with collaborative arrangements. One factor for Task Force consideration is the potential for over reliance on the examples and inappropriate analogies drawn to situations that were not contemplated by the Task Force or the staff. The examples contained in Exhibit 07-1A do not consider the complexities in the various types of arrangements that would be considered collaborative arrangements under Issue 1. In addition, the tentative conclusion on Issue 3 requires an assessment of the nature of the arrangement, the nature of the entity's business operations, the contractual terms of the arrangement, and whether payments are within the scope of other authoritative literature, which requires a detailed analysis of the facts and circumstances in each situation.

Exhibit 07-1A

EXAMPLES ILLUSTRATING THE APPLICATION OF THE TENTATIVE CONCLUSION ON ISSUE 3 OF ISSUE 07-1

The following examples illustrate potential application of the tentative conclusion on Issue 3 to the facts presented. The evaluations following each of the example fact patterns are not intended to represent the only manner in which the tentative conclusion on Issue 3 could be applied. Further, the alternative view discussed in footnote 1 of Illustration 2 is not intended to represent the only possible alternative view. For the purpose of these illustrations, assume that all of the arrangements are collaborative arrangements within the scope of this Issue.

Illustration 1

Facts: Big Pharma and Biotech agree to equally participate in the results of research and development activities for a drug candidate and in the commercialization activities if and when the drug candidate is approved for sale, pursuant to a joint development and marketing agreement (a 50 percent/50 percent arrangement). Biotech is responsible for conducting research and development activities relating to the drug candidate, and Big Pharma is responsible for the commercialization activities if and when the drug candidate is approved for sale. On a quarterly basis, Big Pharma and Biotech provide the other party financial information about the research and development activities performed by Biotech and the commercialization activities performed by Big Pharma under the joint development and marketing agreement. One participant is required to make a payment to the other participant for the net proportionate share of the excess of the companies' combined operating results pursuant to their joint development and marketing agreement. In the first annual period of the collaborative arrangement, Biotech incurred research and development expenses of $10 million and Big Pharma had sales of $50 million and related manufacturing expenses of $20 million and marketing expenses of $10 million, Big Pharma makes a payment to Biotech of $15 million, such that each participant realizes $5 million, net (sales of $50 million in total, less total expenses of $40 million, divided by 2), from sales of the drug.

Evaluation: Consistent with the tentative conclusion on Issue 2, Big Pharma concludes that it is the principal on the sales transactions with third parties and will present 100 percent of the sales, cost of sales, and marketing expenses in its income statement. As the arrangement addresses several different activities, Big Pharma has evaluated the income statement characterization for payments associated with each separate activity. Big Pharma disaggregates the $15 million net payment between the parties in accordance with the nature of the individual item and characterizes the profit sharing portion of the payment for 50 percent of the profit related to the sales as cost of sales ($10 million) and characterizes the portion of any payments to Biotech for research and development activities as research and development expense ($5 million). Big Pharma presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

Sales to third parties	$50,000
COGS (including $10,000 paid to Biotech for profit sharing)	30,000
SG&A	10,000
R&D (including $5,000 paid as a reimbursement of Biotech's expenses incurred)	5,000
Net profit	$ 5,000

Biotech records research and development expense ($10 million) for its research and development activities. Biotech concludes that Big Pharma is its customer with respect to the intellectual property transfer and the research and development services. Additionally, licensing intellectual property and contract research and development services are part of Biotech's business operations. Accordingly, Biotech characterizes the portion of the net payment related to research and development services and the portion of the net payment for profit sharing as revenue ($5 million and $10 million, respectively). Biotech will not present sales, cost of sales, or marketing expenses related to the sales transactions with third parties because it is not the principal on those transactions.

Biotech presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

Revenues from Collaborative Arrangement	$ 15,000
COGS	-0-
SG&A	-0-
R&D	10,000
Net profit	$ 5,000

Illustration 2

Facts: Big Pharma and Biotech agree to equally participate in the results of research and development activities for a drug candidate and in the commercialization activities if the drug candidate is approved for sale, pursuant to a joint development and marketing agreement (a 50 percent/50 percent arrangement). Assume that Big Pharma and Biotech both agree to provide resources during the research and development phase, and Big Pharma is responsible for the commercialization activities if the drug candidate is approved for sale. As both participants are performing research and development activities, there may be periods in which Biotech must make a payment to Big Pharma for its proportionate share of the research and development activities and periods in which Big Pharma will make payments to Biotech. On a quarterly basis, Big Pharma and Biotech provide financial information about the research and development activities performed by both parties and the commercialization activities performed by Big Pharma under the joint development and marketing agreement. One participant is required to make a payment to the other participant for a proportionate share of the excess of the parties' combined operating results pursuant to their joint development and marketing agreement. In the first annual period of the collaborative arrangement, Biotech and Big Pharma incurred research and development expenses of $15 million and $10 million, respectively. Big Pharma had sales of $75 million and related manufacturing expenses of $22.5 million and marketing expenses of $20 million, Big Pharma makes a payment to Biotech of $18.75 million, such that each participant realizes $3.75 million, net (sales of $75 million in total, less total expenses of $67.5 million, divided by 2), from sales of the drug.

Evaluation: Consistent with the tentative conclusion on Issue 2, Big Pharma concludes that it is the principal on the sales transactions with third parties and will present 100 percent of the sales, cost of sales, and marketing expenses in its income statement. As the arrangement addresses several different activities, Big Pharma has evaluated the income statement characterization for payments associated with each separate activity. Big Pharma disaggregates the $18.75 million net payment between the parties in accordance with the nature of the individual item and characterizes the payment for 50 percent of the commercialization activities (sales to third parties less associated manufacturing and marketing costs), as cost of sales ($16.25 million) and characterizes any portion of the net payments made to Biotech for research and development activities as research and development expenses ($2.5 million). Big Pharma concludes that it would characterize any portion of the net payment from Biotech for research and development activities as a reduction of its research and development costs. Big Pharma's conclusion is based on the fact that performing contract research and development services is not part of its business operations. In addition, Big Pharma concludes that Biotech is not its customer with respect to the research and development activities in this arrangement. Big Pharma presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

Sales to third parties	$75,000
COGS (including $16,250 paid to Biotech for profit sharing)	38,750
SG&A	20,000
R&D (including $2,500 paid as a reimbursement of Biotech's expenses incurred)	12,500
Net profit	$ 3,750

Biotech records research and development expense ($15 million) for its research and development activities. Biotech will characterize the profit sharing payment received and the research and development reimbursement as revenue ($16.25 million and $2.5 million, respectively), based on the fact that licensing intellectual property and contract research and development services are part of Biotech's business operations. If Biotech were to owe Big

Pharma for a portion of the research and development costs, Biotech would characterize that payment as additional research and development expense. Biotech bases that conclusion on the fact that the general purpose of the collaborative arrangement is for the participants to work together to develop and commercialize a product. The shared research and development effort should be reflected as research and development expense in each of the participants' income statements.[1] Biotech will not present sales, cost of sales, or marketing expenses related to the sales transactions with third parties because it is not the principal on those transactions. Biotech presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

Revenues from Collaborative Arrangement	$18,750
COGS	-0-
SG&A	-0-
R&D	15,000
Net profit	$3,750

Illustration 3

Facts: Big Pharma and Little Pharma agree to jointly participate in the results of the research and development activities for a drug candidate and in the commercialization activities if and when the drug candidate is approved for sale, pursuant to a joint development and marketing agreement. Big Pharma and Little Pharma both agree to provide resources during the research and development and the commercialization activities. Little Pharma will be responsible for commercialization activities in the U.S., and Big Pharma will be responsible for commercialization activities in Europe and Asia. Under the arrangement, they will share research and development costs incurred on a 50 percent/50 percent basis. Little Pharma will retain 65 percent of the net profits from commercialization activities in the United States, and Big Pharma will retain 70 percent of the net profits from commercialization activities in Europe

[1] An alternative view is that this payment would be subject to the guidance in Issue 01-9. Under that guidance, Biotech and Big Pharma are in a vendor-customer relationship, respectively. As a result, Biotech would presume that the payment should be characterized as a reduction of revenue, unless Biotech receives a separable, identifiable benefit in exchange, and can reasonably estimate the fair value of the benefit, in which case, expense classification would be permitted.

and Asia. On a quarterly basis, Big Pharma and Little Pharma provide financial information about the research and development and the commercialization activities performed by both parties under the joint development and marketing agreement, and one participant is required to make a payment to the other participant for a proportionate share of the excess of the parties' combined operating results pursuant to their joint development and marketing agreement. The results of the first annual period of the collaborative arrangement prior to any payments between the parties were as follows (in thousands):

	Little Pharma	Big Pharma	Combined
Sales	$120,000	$90,000	$210,000
Cost of sales	30,000	35,000	65,000
Sales, general and administrative	25,000	20,000	45,000
Research and development	35,000	20,000	55,000
Net profit	$ 30,000	$15,000	$ 45,000

Evaluation: Consistent with the tentative conclusion on Issue 2, Big Pharma concludes that it is the principal on the sales transactions with third parties in Europe and Asia and will present 100 percent of the sales, cost of sales, and marketing expenses related to those efforts in its income statement. As the arrangement addresses several different activities, Big Pharma has evaluated the income statement characterization for the payments associated with each separate activity. Big Pharma disaggregates the ~~$2.75~~$4.75 million net payment it ~~makes to~~receives from Little Pharma in accordance with the nature of the individual item and characterizes the profit sharing payment for 30 percent of the profit related to the sales in Europe and Asia as cost of sales ($10.5 million) and characterizes payments made to Little Pharma for research and development activities as research and development expenses ($7.5 million). Big Pharma concludes that it will characterize profit sharing payments from Little Pharma's sales in the United States as revenue ($22.75 million) similar to a royalty and will characterize any payment from Little Pharma for research and development activities as a reduction of its research and development costs. Big Pharma's conclusion is based on the fact that performing contract research and development services is not part of its business operations. In addition, Big Pharma concludes that Little Pharma is not its customer with respect to the research and development activities in

this arrangement. Big Pharma presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

Sales to third parties	$90,000
Revenue from Collaborative Arrangement	22,750
COGS (including $10,500 paid to Little Pharma for profit sharing)	45,500
SG&A	20,000
R&D (including $7,500 paid as a reimbursement of Little Pharma's expenses incurred)	27,500
Net profit	$19,750

Consistent with the tentative conclusion on Issue 2, Little Pharma concludes that it is the principal on the sales transactions with third parties in the U.S. and will present 100 percent of the sales, cost of sales, and marketing expenses related to those efforts in its income statement. As the arrangement includes several different activities, Little Pharma has evaluated the income statement characterization for payments associated with each separate activity. Little Pharma disaggregates the ~~$2.75~~$4.75 million net payment ~~received from~~paid to Big Pharma in accordance with the nature of the individual item and characterizes the profit sharing payment for 35 percent of the profit related to the sales in the U.S. as cost of sales ($22.75 million) and characterizes payments made to Big Pharma for research and development activities as research and development expenses. Little Pharma concludes that it will characterize profit sharing payments from Big Pharma's sales in Europe and Asia as revenue similar to a royalty ($10.5 million) and will characterize any payment from Big Pharma for research and development activities as a reduction of its research and development costs ($7.5 million). Little Pharma's conclusion is based on the fact that performing contract research and development services is not part of its business operations. In addition, Little Pharma concludes that Big Pharma is not its customer with respect to the research and development activities in this arrangement. Little Pharma presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

Sales to third parties	$120,000
Revenue from Collaborative Arrangement	10,500
COGS (including $22,750 paid to Big Pharma for profit sharing)	52,750
SG&A	25,000
R&D (including $7,500 received as a reimbursement from Big Pharma)	27,500
Net profit	$25,250

Illustration 4

Facts: Studio A and Studio B agree to jointly participate in the production and distribution of a major motion picture. These activities are not conducted through a legal entity. Studio A will manage the day-to-day production activities and will be responsible for distribution in the U. S., while Studio B will be responsible for distribution in Europe and Asia. Even though Studio A will be managing the production, under the arrangement, both studios agree that they will share equally in all production costs incurred. For purposes of this example, no license to intellectual property has been conveyed to Studio B. Further, Studio A will pay Studio B 50 percent of the net profits from the U.S. distribution to Studio B, and Studio B will pay Studio A 50 percent of the net profits from European and Asian distribution to Studio A. The studios are responsible for initially funding all distribution costs in their respective locations. On a quarterly basis, Studio A and Studio B provide financial information about the production and distribution under the joint production and distribution agreement, and one participant is required to make a payment to the other participant for a proportionate share of the excess of the parties' combined operating results pursuant to the joint production and distribution agreement.

At the completion of the production process, the total production costs of the film amounted to $50 million for which Studio B had paid Studio A $25 million. In Year 1 of the film's release, the net profits were $75 million in the U.S. and $30 million in Europe and Asia. Accordingly, Studio A pays Studio B $22.5 million (50 percent of the total net profits of $105 million less Studio B's net profits of $30 million). In Year 2 of the film's release, the net profits were $25 million in the U.S. and $60 million in Europe and Asia. Accordingly, Studio B pays Studio A

$17.5 million (50 percent of the total net profits of $85 million less Studio A's net profits of $25 million).

Evaluation: During (or at the completion of) production, Studio A records the cash received from Studio B as a reduction of capitalized film costs. Thus, at the end of production, Studio A only has $25 million in capitalized film costs reflected on its balance sheet for the project. Studio A has determined that, considering the guidance in Issue 99-19, it is the principal for the revenue generated in the U. S. Accordingly, it characterizes all of the $75 million in Year 1 net profits as revenue in its income statement and likewise records all of the associated distribution costs for distribution in the U. S. In addition, Studio A records its payment of $22.5 million to Studio B as cost of sales. Studio A also characterizes the $25 million in Year 2 net profits as revenue in its income statement. Consistent with its policy with respect to the net profits payment, Studio A records the receipt of $17.5 million as a reduction of costs of sales in Year 2.

During production, Studio B records payments to Studio A as capitalized film costs. Thus, at the end of production, it has $25 million in capitalized film costs reflected on its balance sheet for the project. Studio B has determined that, after considering the guidance in Issue 99-19, it is the principal for the revenue generated in Europe and Asia. Accordingly, it characterizes all of the $30 million in Year 1 net profits as revenue in its income statement and likewise records all of the associated distribution costs for distribution in Europe and Asia. In addition, Studio B records the receipt of $22.5 million from Studio A as revenue. Studio B also characterizes the $60 million in Year 2 net profits as revenue in its income statement. Consistent with its policy with respect to the net profits payment, Studio B~~A~~ records the payment of $17.5 million as a reduction of revenues in Year 2.

Exhibit 07-1B

EITF ABSTRACTS (DRAFT[1])

Issue No. 07-1

Title: Accounting for Collaborative Arrangements

Dates Discussed: March 15, 2007; June 14, 2007; September 11, 2007; [November 28-29, 2007]

References: FASB Statement No. 2, *Accounting for Research and Development Costs*

FASB Statement No. 68, *Research and Development Arrangements*

FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

APB Opinion No. 22, *Disclosure of Accounting Policies*

EITF Issue No. 88-18, "Sales of Future Revenues"

EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent"

EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"

ISSUE

1. Entities may enter into an arrangement to jointly develop and commercialize intellectual property or otherwise participate in some type of joint operating activity. For example, in the biotechnology and pharmaceutical industries, because the development of a drug candidate into a commercially viable product may take many years, and because of the considerable amount of resources required to develop a product and the financial risks involved, companies often enter into arrangements to jointly develop, manufacture, distribute, and market a drug candidate. Other industries that may utilize these types of arrangements include, but are not limited to, the motion picture, software, and computer hardware industries.

[1] **This draft abstract is being exposed for a public comment period.**

2. The activities associated with these arrangements may be conducted by the participants without the creation of a separate legal entity. In some arrangements, a legal entity may be utilized for specific activities or for a specific geographical location. In arrangements in which a separate legal entity is not utilized, generally the participants will share, based on contractually defined calculations, the profits or losses from the associated activities.

3. The types of activities conducted under a collaborative arrangement to jointly develop and commercialize intellectual property may include research and development, marketing (including promotional activities and physician detailing), general and administrative activities, manufacturing, and distribution. The arrangement may provide that one participant has sole or primary responsibility for certain activities or that one or more participants have shared responsibility for certain activities. For example, a collaborative arrangement may provide for one participant to have primary responsibility to perform research and development related to the drug candidate and the other participant to have primary responsibility for commercialization of the drug candidate.

4. The issues are:

Issue 1— How to determine whether an arrangement constitutes a collaborative arrangement within the scope of this Issue

Issue 2— How costs incurred and revenue generated on sales to third parties should be reported by the participants to a collaborative arrangement in each of their respective income statements.

Issue 3— How an entity should characterize payments made between participants in a collaborative arrangement in the income statement

Issue 4— What participants should disclose in the notes to the financial statements about a collaborative arrangement.

Scope

5. This Issue applies to collaborative arrangements that are conducted without the creation of a separate legal entity for the arrangement. The scope of this Issue is not limited to specific industries, such as the biotechnology and pharmaceutical industries, or arrangements that involve intellectual property. This Issue does not address recognition matters related to these arrangements (for example, determining the appropriate units of accounting; when the recognition criteria are met; or the appropriate recognition convention for a given unit of accounting).

6. If an arrangement is conducted through a legal entity in which the participants are shareholders or other interest holders, the activities conducted by the legal entity would be subject to Statement 94, Opinion 18, Interpretation 46(R), or other related accounting literature.[2]

[2] A collaborative arrangement may include a legal entity in some portion of the arrangement for legal, tax, or regulatory purposes. Any consensus on this Issue does not affect the accounting for that legal entity under Statement 94, Opinion 18, Interpretation 46(R), or other related accounting literature.

EITF DISCUSSION

7. The Task Force reached a [consensus] on Issue 1 that a collaborative arrangement is a contractual arrangement in which the parties are active participants to the arrangement and are exposed to significant risks and rewards that are dependent on the ultimate commercial success of the endeavor.[3] An entity should evaluate all the relevant facts and circumstances when evaluating whether an arrangement is a collaborative arrangement. Many collaborative arrangements relate to the development and commercialization of intellectual property. However, there may also be arrangements that do not relate to intellectual property that qualify as collaborative arrangements.

Active Participation

8. The Task Force observed that evidence of active participation in an arrangement may include, but is not limited to, making significant contributions to directing and carrying out the joint operating activities; participating on a steering committee or other oversight or governance mechanism; or holding a contractual or other legal right to the underlying intellectual property. An arrangement solely involving a financial investor is not within the scope of this Issue.

Significant Risks and Rewards

9. The Task Force observed that the terms of an arrangement may indicate that participants are not exposed to significant risks and rewards including, for example, services performed for fees paid at fair market value rates; the ability of a participant to exit the arrangement without cause and recover a significant portion or all of its cumulative economic participation to date; an allocation of initial profits to only one participant; and a limitation on the reward that accrues to a participant. An arrangement in which the participants are not exposed to variable outcomes dependent on the ultimate commercial success of the endeavor may indicate that the contract is subject to other authoritative accounting literature. Many collaborative arrangements involve licenses of intellectual property, and consideration related to the license may be exchanged at the inception of the arrangement. Such an exchange does not necessarily indicate that the participants are not exposed to significant risks and rewards dependent on the ultimate commercial success of the endeavor. An entity should use judgment in determining whether its participation in an arrangement subjects it to significant risks and rewards.

10. The Task Force also observed that a collaborative arrangement can begin at any point in the life cycle of the endeavor. The stage of the endeavor's life cycle, the terms and conditions of the arrangement, and the expected duration or extent of the participants' financial participation in the arrangement in relation to the endeavor's total expected life or total expected value are all factors to be considered in evaluating whether participants are exposed to significant risks and rewards that are dependent on the ultimate commercial success of the endeavor.

11. Additionally, the Task Force observed that the participants should evaluate whether an arrangement is a collaborative arrangement at the inception of the arrangement based on the facts and circumstances present at that time. An entity should reconsider whether an arrangement is a collaborative arrangement whenever any changes to the facts and circumstances change either the roles of the participants in the arrangement or the participants' exposure to significant risks

[3] For example, the "endeavor" in the biotechnology or pharmaceutical industries could be a drug candidate. In the entertainment industry, it could be a motion picture.

and rewards dependent on the ultimate commercial success of the endeavor. For example, the exercise of an option could change the participant's role in the arrangement or their exposure to risks and rewards, and, thus, the exercise of an option would be an example of a possible reconsideration event.

12. The Task Force reached a [consensus] on Issue 2 that costs incurred and revenue generated from third parties should be reported by participants to a collaborative arrangement in each entity's respective income statement in accordance with the guidance in Issue 99-19. For example, a participant in a collaborative arrangement who is deemed to be the principal for a given transaction would record that transaction on a gross basis in its financial statements. Additionally, the Task Force concluded that the equity method of accounting under Opinion 18 should not be applied to arrangements that are conducted by the participants without the creation of a separate legal entity for the arrangement.

13. For payments between participants pursuant to a collaborative arrangement that are not within the scope of other authoritative literature regarding income statement characterization, the Task Force reached a [consensus] on Issue 3 that the income statement characterization of those payments should be evaluated based on the nature of the arrangement, the nature of each entity's business operations, and the contractual terms of the arrangement. An entity's accounting policy regarding the income statement characterization for the payments should be based on an analogy to authoritative accounting literature when possible and should be reasonable, rational, and consistently applied. For example, if one party to an arrangement is required to make a payment to the other party to reimburse a portion of that party's research and development cost, that portion of the net payment may represent a research and development expense pursuant to Statement 2 in the payor's financial statements.

Disclosure

14. On Issue 4, the Task Force reached a [consensus] that a participant to a collaborative arrangement should disclose annually:

a. Information about the nature and purpose of its collaborative arrangements
b. Its rights and obligations under the collaborative arrangement
c. The life cycle stage of the underlying endeavor's life cycle
d. The accounting policy for collaborative arrangements in accordance with Opinion 22
e. The income statement classification and amounts attributable to transactions between other participants to the collaborative arrangement
f. Amounts due from or owed to other participants under the collaborative arrangements.

Information related to individually significant collaborative arrangements should be disclosed separately.

Transition

15. The [consensus] on this Issue shall be effective for annual periods beginning after December 15, 2007. Entities should report the effects of applying the [consensus] in this Issue as a change in accounting principle through retrospective application to all periods. If it is impracticable to apply the effects of a change in accounting principle retrospectively, disclosure

should be made of both the reasons why reclassification was not made and the effect of the reclassification on the current period pursuant to the guidelines in paragraph 9 of Statement 154. The evaluation of whether transition through retrospective application is practicable should be made on an arrangement by arrangement basis.

16. Upon application of this [consensus], the following should be disclosed:

a. A description of the prior-period information that has been retrospectively adjusted, if any

b. The effect of the change on revenue and operating expenses (or other appropriate captions of changes in the applicable net assets or performance indicator) and on any other affected financial statement line item.

Board Ratification

17. At its [To be determined] meeting, the Board ratified the [consensus] reached by the Task Force in this Issue.

STATUS

18. No further EITF discussion is planned.