

New Collaborative Arrangement Guidance

The overhaul of revenue recognition under Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, has caused many companies to re-evaluate legacy accounting treatment in other potentially overlapping areas. ASC 606 only applies to customer contracts. For some contracts, the counterparty may not be a customer but rather a collaborator or partner that shares risks and benefits and may not fall under ASC 606's scope. These arrangements—most common in the pharmaceutical, energy and health care fields—are addressed by guidance in ASC 808, *Collaborative Arrangements*. Due to the variety of arrangements, existing guidance does not address recognition or measurement for transactions between collaborative partners. Accounting is frequently based on an analogy to other accounting guidance or an accounting policy election, and, not surprisingly, diversity in practice has arisen.

The Financial Accounting Standards Board (FASB) sought to reduce diversity in practice by clarifying the interaction between ASC 808 and 606 and refining presentation requirements. FASB recently issued Accounting Standards Update (ASU) 2018-18, which makes the following targeted improvements to existing guidance:

- Add unit-of-account guidance in ASC 808 to align with ASC 606, *i.e.*, a distinct good or service. The unit of account only applies to assessing Topic 606's scope and not recognition or measurement requirements. Today, some entities view all transactions between the collaborative participants as a single unit of account because of their continuing obligation to participate. Others view each transaction between collaborative participants, such as an upfront payment or cost reimbursement payment, as a separate unit of account. By explicitly providing unit-of-account guidance in the context of assessing ASC 606's scope and aligning the unit-of-account guidance to ASC 606, FASB hopes to eliminate future diversity in determining units of account when assessing whether an arrangement is partially within the scope of ASC 606 or other topics.
- Clarify that revenue guidance in ASC 606 should be applied if the collaborative participant is a customer in the context of a given unit of account. In these situations, all guidance in Topic 606 should be applied, including recognition, measurement, presentation and disclosure requirements.
- Clarify that in a transaction not directly related to third-party sales, presenting the transaction as revenue would be precluded if the collaborative counterparty is not a customer. An entity may still analogize to ASC 606—or if there is not an appropriate analogy, as a policy election—without requiring an entity to apply all of ASC 606's guidance, as long as the entity does not present the transactions as revenue. Examples of transactions with a collaborative arrangement participant that are directly related to sales to third parties of either participant may include sales of production inputs or other items to a collaborator that are eventually sold to a third party or profit share receivables from collaborators for sales to third parties.
- Overhaul the illustrations in ASC 808 to add clarity and eliminate ambiguity.

The ASU is narrowly focused and does not provide recognition and measurement guidance for nonrevenue transactions in a collaborative arrangement.

For public business entities (PBE), the ASU is effective for fiscal years beginning after December 15, 2019, including interim periods. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2020, and interim periods beginning after December 15, 2021. Early adoption is permitted, including adoption in any interim period for which financial statements have not yet been issued or made available for issuance. An entity may not adopt the amendments earlier than its adoption date of ASC 606.

The ASU should be applied retrospectively to the date of initial application of ASC 606. An entity should recognize the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained

earnings of the later of the earliest annual period presented and the annual period that includes the date of the entity's initial application of ASC 606.

An entity may elect to apply the ASU retrospectively either to all contracts or only to contracts that are not completed at the date of ASC 606's adoption. Disclosure is required if this option is elected.

An entity may elect to apply the practical expedient for contract modifications that is permitted for entities using the modified retrospective transition method in ASC 606.



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