EITF ABSTRACTS

Issue No. 07-1

Title: Accounting for Collaborative Arrangements

Dates Discussed: March 15, 2007; June 14, 2007; September 11, 2007; November 29, 2007

References:
- FASB Statement No. 2, Accounting for Research and Development Costs
- 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
- AICPA Accounting Research Bulletin No. 51, Consolidated Financial Statements
- AICPA Statement of Position 00-2, Accounting by Producers or Distributors of Films
- 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)"
- EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor"

Objective

1. The objective of this Issue is to define collaborative arrangements and to establish reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties.

All paragraphs in this Issue have equal authority. Paragraphs in bold set out the main principles.
Background

2. Entities may enter into arrangements to participate in a joint operating activity to, for example, jointly develop and commercialize intellectual property, a drug candidate, software, computer hardware, or a motion picture. For example, a joint operating activity involving a drug candidate may include research and development, marketing (including promotional activities and physician detailing), general and administrative activities, manufacturing, and distribution.

3. The participants may conduct the activities associated with these arrangements without the creation of a separate legal entity (that is, the arrangement is operated as a "virtual joint venture"). In some arrangements, a legal entity may be utilized for specific activities or for a specific geographic location. The arrangements generally provide that the participants share, based on contractually defined calculations, the profits or losses from the associated activities.

4. Questions have arisen in practice as to the appropriate income statement presentation and classification for these activities and payments between the participants, as well as the sufficiency of the disclosures related to these arrangements.

Scope

5. This Issue applies to participants in a collaborative arrangement. A collaborative arrangement is a contractual arrangement that involves a joint operating activity. These arrangements involve two (or more) parties who are both (a) active participants in the activity and (b) exposed to significant risks and rewards dependent on the commercial success of the activity.
6. A collaborative arrangement within the scope of this Issue is not primarily conducted through a separate legal entity created for that activity. However, in some situations part of a collaborative arrangement may be conducted in a legal entity for specific activities or for a specific geographic location. The existence of a legal entity for part of an arrangement does not prevent an arrangement from being a collaborative arrangement as defined in this Issue. The part of the arrangement that is conducted in a separate legal entity should be accounted for under ARB 51, Statement 94, Opinion 18, Interpretation 46(R), or other related accounting literature. However, the disclosures included in paragraph 21 below apply to the entire collaborative arrangement, notwithstanding that a portion of the collaborative arrangement may be conducted in a legal entity.

7. The scope of this Issue does not include arrangements for which the accounting is specifically addressed within the scope of other authoritative accounting literature. Furthermore, this Issue does not address recognition or measurement matters related to collaborative arrangements, for example, determining the appropriate units of accounting, the appropriate recognition requirements for a given unit of accounting, or when the recognition criteria are met.

8. Participants should evaluate whether an arrangement is a collaborative arrangement at its inception based on the facts and circumstances specific to the arrangement. However, a collaborative arrangement can begin at any point in the life cycle of an
endeavor.¹ Participants should reevaluate whether an arrangement continues to be a collaborative arrangement whenever there is a change in either the roles of the participants in the arrangement or the participants' exposure to significant risks and rewards dependent on the ultimate commercial success of the endeavor. For example, the exercise of an option could change a participant's role in the arrangement or its exposure to risks and rewards.

**Joint Operating Activity**

9. The joint operating activities of a collaborative arrangement might involve joint development and commercialization of intellectual property, a drug candidate, software, computer hardware, or a motion picture. For example, a joint operating activity involving a drug candidate may include research and development, marketing (including promotional activities and physician detailing), general and administrative activities, manufacturing, and distribution. However, there may also be collaborative arrangements that do not relate to intellectual property. For example, the activities of a collaborative arrangement may involve joint operation of a facility, such as a hospital. A collaborative arrangement may provide that one participant has sole or primary responsibility for certain activities or that two or more participants have shared responsibility for certain activities. For example, the arrangement may provide for one participant to have primary responsibility for research and development and another participant to have primary responsibility for commercialization of the final product or service.

¹For this Issue, the term **endeavor** refers to the activity that the participants collaborate on; for example, in a biotechnology or pharmaceutical environment the endeavor may be the development and commercialization of a drug candidate. In the entertainment industry, it may be production and distribution of a motion picture.
Active Participation

10. Whether the parties in a collaborative arrangement are active participants will depend on the facts and circumstances specific to the arrangement. Examples of situations that may evidence active participation of the parties in a collaborative arrangement include, but are not limited to, the following:

- Directing and carrying out the activities of the joint operating activity
- Participating on a steering committee or other oversight or governance mechanism
- Holding a contractual or other legal right to the underlying intellectual property.

11. An entity that solely provides financial resources to an endeavor is generally not an active participant in a collaborative arrangement within the scope of this Issue.

Significant Risks and Rewards

12. Whether the participants in a collaborative arrangement are exposed to significant risks and rewards dependent on the commercial success of the joint operating activity depends on the facts and circumstances specific to the arrangement, including, but not limited to, the terms and conditions of the arrangement.

13. The terms and conditions of the arrangement might indicate that participants are not exposed to significant risks and rewards if, for example:

- Services are performed in exchange for fees paid at market rates.
- A participant is able to exit the arrangement without cause and recover all (or a significant portion) of its cumulative economic participation to date.
- Initial profits are allocated to only one participant.
- There is a limit on the reward that accrues to a participant.
14. Other factors that should be considered in evaluating risks and rewards include:

- The stage of the endeavor's life cycle
- 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.

15. Many collaborative arrangements involve licenses of intellectual property, and the participants may exchange consideration related to the license 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.

**Other Presentation Matters (Income Statement Classification)**

16. Participants in a collaborative arrangement shall report costs incurred and revenue generated from transactions with third parties (that is, parties that do not participate in the arrangement) in each entity's respective income statement pursuant to the guidance in Issue 99-19. An entity should not apply the equity method of accounting under Opinion 18 to activities of collaborative arrangements.

17. For costs incurred and revenue generated from third parties, the participant in a collaborative arrangement that is deemed to be the principal participant for a given transaction under Issue 99-19 should record that transaction on a gross basis in its financial statements.

18. Payments between participants pursuant to a collaborative arrangement that are within the scope of other authoritative accounting literature on income statement classification should be accounted for using the relevant provisions of that
literature. If the payments are not within the scope of other authoritative accounting literature, the income statement classification for the payments should be based on an analogy to authoritative accounting literature or if there is no appropriate analogy, a reasonable, rational, and consistently applied accounting policy election.

19. An entity shall evaluate the income statement classification of payments between participants pursuant to a collaborative arrangement based on the nature of the arrangement, the nature of its business operations, the contractual terms of the arrangement, and whether those payments are within the scope of other authoritative accounting literature on income statement classification. If the payments are within the scope of other authoritative accounting literature, then the entity shall 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 classification for the payments should be based on an analogy to authoritative accounting literature or if there is no appropriate analogy, 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 be classified as research and development expense in the payor's financial statements pursuant to Statement 2.

20. Examples that illustrate the application of the consensus in this Issue are presented in Exhibit 07-1A.
Disclosure

21. In the initial period (which may be an interim period) and all annual periods thereafter, a participant to a collaborative arrangement should disclose the following:

   a. Information about the nature and purpose of its collaborative arrangements
   b. Its rights and obligations under the collaborative arrangements
   c. The accounting policy for collaborative arrangements in accordance with Opinion 22
   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.

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

Transition

22. This Issue shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. This Issue shall be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. If it is impracticable to apply the effects of a change in accounting principle retroactively pursuant to the guidance in paragraph 11 of Statement 154, an entity should disclose 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.

23. Upon initial application of this Issue, an entity shall disclose the following:

   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.

The provisions of this Issue need not be applied to immaterial items.

Board Ratification

24. At its December 12, 2007 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

25. No further EITF discussion is planned.
Exhibit 07-1A

Illustrative Examples

The following examples illustrate potential application of this Issue for payments between participants in a collaborative arrangement based on the limited facts presented. The evaluations following each of the example fact patterns are not intended to represent the only manner in which the guidance in this Issue could be applied. These illustrative examples do not address recognition or measurement matters related to collaborative arrangements. For example, the appropriate units of accounting, the appropriate recognition requirements for a given unit of accounting, or when the recognition criteria that are met are addressed in other authoritative accounting literature. Additional facts would most likely be required in order to fully evaluate the accounting and presentation issues related to these arrangements (in other words, to evaluate the possible impact of other literature).

For the purpose of these illustrations, assume that all of the arrangements are collaborative arrangements within the scope of this Issue.

Illustration 1

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

**Evaluation:** 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. Pharma has concluded that other authoritative accounting literature does not apply to these payments, either directly or by analogy, and, accordingly, its accounting policy is to evaluate the income statement classification for amounts due from or owed to other participants associated with multiple activities in a collaborative arrangement based on the nature of each separate activity. As a result, Pharma disaggregates its $15 million net payable to Biotech in accordance with the nature of the individual components of the payable and characterizes the profit sharing portion of the payable for 50 percent of the profit related to the sales as cost of sales ($10 million) and characterizes the portion of the payable to Biotech for research and development...
activities as research and development expense ($5 million). Pharma presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales to third parties</td>
<td>$50,000</td>
</tr>
<tr>
<td>COGS (including $10,000 payable to Biotech for profit sharing)</td>
<td>30,000</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>10,000</td>
</tr>
<tr>
<td>R&amp;D (including $5,000 payable as a reimbursement of Biotech's expenses incurred)</td>
<td>5,000</td>
</tr>
<tr>
<td>Net profit</td>
<td>$ 5,000</td>
</tr>
</tbody>
</table>

Biotech records research and development expense ($10 million) for its research and development activities. Licensing intellectual property and performing contract research and development services are part of Biotech's ongoing major or central operations. Biotech has concluded that other authoritative accounting literature does not apply to these payments, either directly or by analogy, and, accordingly, its accounting policy is to characterize the portion of its net receivable from Pharma related to research and development services and the portion of the net receivable for profit sharing as revenue ($5 million and $10 million, respectively) when recognized. 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

This evaluation is not intended to illustrate the appropriate revenue recognition requirements for any of the transactions described above. Such an analysis would include, at a minimum, a determination of the applicable authoritative accounting literature, the identification of the deliverables in the arrangement, a determination of the units of accounting in the arrangement, and the appropriate revenue recognition requirements for those units of accounting.

Illustration 2

Facts: 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 Pharma and Biotech both agree to provide resources during the research and development phase, and 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 Pharma for its proportionate share of the research and development activities and periods in which Pharma must make payments to Biotech. On a quarterly basis, Pharma and Biotech provide financial information about the research and development activities performed by both parties and the commercialization activities performed by Pharma under the joint development and

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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 subsequent to the product launch, Biotech and Pharma incurred research and development expenses of $10 million and $15 million, respectively. Pharma had sales of $75 million, related manufacturing expenses of $22.5 million, and marketing expenses of $20 million. As a result, Pharma owes Biotech $13.75 million, such that each participant realizes $3.75 million net profit from the arrangement (total sales of $75 million, less total expenses of $67.5 million, divided by 2).

**Evaluation:** 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. Pharma has concluded that other authoritative accounting literature does not apply to these payments, either directly or by analogy, and, accordingly, its accounting policy is to evaluate the income statement classification for amounts due from or owed to other participants associated with multiple activities in a collaborative arrangement based on the nature of each separate activity. As a result, Pharma disaggregates the $13.75 million net payable to Biotech in accordance with the nature of the individual components of the payable and characterizes the portion of the payable related to 50 percent of the commercialization activities (sales to third parties less associated manufacturing and marketing costs) as cost of sales ($16.25 million). Pharma characterizes the portion of the net payable related to research and development activities as a reduction of its research and development expenses ($2.5 million), because performing contract research and development services is not part of its ongoing major or
central operations. Pharma presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales to third parties</td>
<td>$75,000</td>
</tr>
<tr>
<td>COGS (including $16,250 payable to Biotech for profit sharing)</td>
<td>$38,750</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>$20,000</td>
</tr>
<tr>
<td>R&amp;D (net of $2,500 due from Biotech as a reimbursement of expenses incurred)</td>
<td>$12,500</td>
</tr>
<tr>
<td>Net profit</td>
<td>$3,750</td>
</tr>
</tbody>
</table>

Biotech records research and development expense ($10 million) for its research and development activities. Biotech will characterize the portion of the net receivable from Pharma related to commercialization activities ($16.25 million) as revenue, based on the fact that licensing intellectual property is part of Biotech's ongoing major or central operations. Biotech also considers performing research and development services to be part of its ongoing major or central operations. Biotech analyzes its specific facts and circumstances under Issue 01-9 and determines that the portion of the net receivable that relates to a reimbursement of Pharma's research and development costs ($2.5 million) should be characterized as a reduction of revenue. 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 $13,750
COGS 0
SG&A 0
R&D 10,000
Net profit $ 3,750

This evaluation is not intended to illustrate the appropriate revenue recognition requirements for any of the transactions described above. Such an analysis would include, at a minimum, a determination of the applicable authoritative accounting literature, the identification of the deliverables in the arrangement, a determination of the units of accounting in the arrangement, and the appropriate revenue recognition requirements for those units of accounting.

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 United States, 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 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):

<table>
<thead>
<tr>
<th></th>
<th>Little Pharma</th>
<th>Big Pharma</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales to third parties</td>
<td>$120,000</td>
<td>$90,000</td>
<td>$210,000</td>
</tr>
<tr>
<td>COGS</td>
<td>$30,000</td>
<td>$35,000</td>
<td>$65,000</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>$25,000</td>
<td>$20,000</td>
<td>$45,000</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>$35,000</td>
<td>$20,000</td>
<td>$55,000</td>
</tr>
<tr>
<td>Net profit</td>
<td>$ 30,000</td>
<td>$15,000</td>
<td>$ 45,000</td>
</tr>
</tbody>
</table>

**Evaluation:** 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. Big Pharma has concluded that other authoritative accounting literature does not apply to these payments, either directly or by analogy, and, accordingly, its accounting policy is to evaluate the income statement classification for amounts associated with each separate activity. As a result, Big Pharma disaggregates its $4.75 million net receivable from Little Pharma in accordance with the nature of the individual components of the payable and characterizes the portion of the net receivable related to 30 percent of the profit related to the sales in Europe and Asia as expenses from collaborative arrangement ($10.5 million) and characterizes the portion of the net receivable related to a reimbursement of Little Pharma's research and development costs as research and development expenses ($7.5 million).
Big Pharma concludes that the portion of the net receivable related to Little Pharma's sales in the United States is analogous to a royalty and therefore characterizes the $22.75 million as revenue similar to a royalty. Big Pharma also concludes that any payment from Little Pharma for research and development activities would be characterized as a reduction of its research and development costs because performing contract research and development services is not part of its ongoing major or central operations. Big Pharma presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales to third parties</td>
<td>$90,000</td>
</tr>
<tr>
<td>Revenue from collaborative arrangement</td>
<td>22,750</td>
</tr>
<tr>
<td>COGS</td>
<td>35,000</td>
</tr>
<tr>
<td>Expenses from collaborative arrangement</td>
<td>10,500</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>20,000</td>
</tr>
<tr>
<td>R&amp;D (including $7,500 payable as a reimbursement of Little Pharma's expenses incurred)</td>
<td>27,500</td>
</tr>
<tr>
<td>Net profit</td>
<td>$19,750</td>
</tr>
</tbody>
</table>

Little Pharma concludes that it is the principal on the sales transactions with third parties in the United States and will present 100 percent of the sales, cost of sales, and marketing expenses related to those efforts in its income statement. Little Pharma has concluded that other authoritative accounting literature does not apply to these payments, either directly or by analogy, and, accordingly, its accounting policy is to evaluate the income statement classification for payments associated with each separate activity. As a result, Little Pharma disaggregates its $4.75 million net payable to Big Pharma in accordance with the nature of the individual item and characterizes a portion of the net payable related to 35 percent of the profit related to the sales in the United States as expenses.
from collaborative arrangement ($22.75 million) and characterizes the portion of the net payable to Big Pharma for research and development activities as research and development expenses. Little Pharma concludes that the portion of the net payable related to profit sharing from Big Pharma's sales in Europe and Asia is analogous to a royalty and therefore should characterize the $10.5 million as revenue similar to a royalty. Little Pharma also concludes that any payment from Big Pharma for research and development activities will be characterized as a reduction of its research and development costs ($7.5 million) because performing contract research and development services is not part of its ongoing major or central operations. Little Pharma presents the following information in its financial statements with respect to this collaborative arrangement (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales to third parties</td>
<td>$120,000</td>
</tr>
<tr>
<td>Revenue from collaborative arrangement</td>
<td>10,500</td>
</tr>
<tr>
<td>COGS</td>
<td>30,000</td>
</tr>
<tr>
<td>Expenses from collaborative arrangement</td>
<td>22,750</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>25,000</td>
</tr>
<tr>
<td>R&amp;D (including $7,500 due from Big Pharma as a reimbursement)</td>
<td>27,500</td>
</tr>
<tr>
<td>Net profit</td>
<td>$25,250</td>
</tr>
</tbody>
</table>

This evaluation is not intended to illustrate the appropriate revenue recognition requirements for any of the transactions described above. Such an analysis would include, at a minimum, a determination of the applicable authoritative accounting literature, the identification of the deliverables in the arrangement, a determination of the units of accounting in the arrangement, and the appropriate revenue recognition requirements for those units of accounting.
Illustration 4

Facts: Studio A and Studio B agree to jointly participate in the production and distribution of a major motion picture. Studio A will manage the day-to-day production activities and will be responsible for distribution in the United States. Studio B will be responsible for distribution in Europe and Asia. Even though Studio A will be managing the production, the terms of the arrangement state that both studios will share equally in all production costs incurred. Further, Studio A will pay 50 percent of the net profits (that is, revenues less distribution costs) from the United States distribution to Studio B, and Studio B will pay 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. For purposes of this example, no license to intellectual property has been conveyed to Studio B.

Assume that Studio A and Studio B have the same estimates of ultimate revenue and ultimate participation costs. Both studios estimate that Studio A will owe Studio B net ultimate participation costs of $45 million. Based on the individual-film-forecast-computation method in accordance with SOP 00-2, Studio A's current period participation cost expense (and Studio B's current period participation income) is $7 million in Year 1 following the film's initial release.

Evaluation: During (or at the completion of) production, Studio A records a receivable from Studio B for production costs and a corresponding reduction of its capitalized film costs. Studio A has determined that, considering the guidance in Issue 99-19, it is the principal for the revenue generated in the United States. Accordingly, it characterizes all
of the gross revenue generated in the United States as revenue in its income statement and likewise records all of the associated distribution costs for distribution in the United States. Studio A concludes that other authoritative accounting literature does not apply, either directly or by analogy, regarding the income statement classification of net participation costs owed to Studio B. Studio A's accounting policy with respect to participation costs due from and to its production partners is to record net amounts due from production partners as additional revenue and net amounts due to production partners as a cost of sales. Accordingly, Studio A characterizes its Year 1 participation cost expense of $7 million as cost of sales.

During production, Studio B records amounts payable to Studio A for production costs and a corresponding amount as capitalized film costs. 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 gross revenue generated in Europe and Asia as revenue in its income statement and likewise records all of the associated distribution costs for distribution in Europe and Asia. Studio B concludes that other authoritative accounting literature does not apply, either directly or by analogy, regarding the income statement classification of net ultimate participation costs due from Studio A. Studio B's accounting policy for profit sharing amounts due from and to its production partners is to record those amounts on a net basis in cost of sales. It views those amounts either as additional costs for production and distribution or as a reimbursement of such costs. Accordingly, Studio B characterizes its Year 1 participation cost income of $7 million as a reduction of cost of sales.
This evaluation is not intended to illustrate the appropriate revenue recognition requirements for any of the transactions described above. Such an analysis would include, at a minimum, a determination of the applicable authoritative accounting literature, the identification of the deliverables in the arrangement, a determination of the units of accounting in the arrangement, and the appropriate revenue recognition requirements for those units of accounting.
Suggested Index Entries for Issue No. 07-1, “Accounting for Collaborative Arrangements”

INCOME STATEMENT PRESENTATION
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Collaborative Arrangements 07-1

RESEARCH AND DEVELOPMENT ARRANGEMENTS
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