

Interpretation of the Emerging Accounting Issues (E) Working Group

INT 08-04: EITF 07-3: Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities

ISSUE NULLIFIED BY SSAP NO. 17 AND SSAP NO. 29

INT 08-04 Dates Discussed

March 29, 2008; May 31, 2008

INT 08-04 References

SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4)

SSAP No. 16R—Electronic Data Processing Equipment and Accounting for Software (SSAP No. 16R)

SSAP No. 17—Preoperating and Research and Development Costs (SSAP No. 17)

SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements (SSAP NO. 19)

SSAP No. 29—Prepaid Expenses (SSAP No. 29)

SSAP No. 73—Health Care Delivery Assets—Supplies, Pharmaceuticals and Surgical Supplies, Durable Medical Equipment, Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities (SSAP No. 73)

SSAP No. 76—Reporting on the Costs of Start-Up Activities (SSAP No. 76)

SSAP No. 82—Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs (SSAP No. 82)

SSAP No. 87—Capitalization Policy (SSAP No. 87)

INT 08-04 Issue

1. *EITF 07-3: Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* (EITF 07-3) was issued in June 2007 to provide guidance on how a research and development entity should account for the nonrefundable portion of an advance payment made for future research and development activities.

2. As noted within EITF 07-3:

1. Entities involved in research and development activities (R&D entities) may make advance payments for goods or services that will be used in future research and development activities. These arrangements often involve one specific research and development project (for example, the development of a drug compound), and the activities to be performed under these arrangements generally do not have an alternative future use at the time the arrangements are executed. Often times, a portion of the advance payment may be refundable; however, it is common for at least some portion of the advance payment to be nonrefundable (that is, if the R&D entity is not able to advance the project to the stage at which the goods or services paid for in advance are necessary, the R&D entity will not be reimbursed for the advance payments). Questions have arisen about how an R&D entity should account for the nonrefundable portion of an advance payment made for future research and development activities.

3. Per EITF 07-3, paragraph 2, the issue is whether nonrefundable advance payments for goods or services that will be used or rendered for research and development activities should be expensed when the advance payment is made or when the research and development activity has been performed.

4. The scope of this issue as defined in EITF 07-3, paragraph 3:

3. The scope of this Issue is limited to nonrefundable advance payments for goods and services to be used or rendered in future research and development activities pursuant to an executory contractual arrangement. Nonrefundable advance payments for future research and development activities for materials, equipment, facilities, and purchased intangible assets that have an alternative future use (in research and development projects or otherwise) should be recognized in accordance with the guidance in Statement 2. Refundable advance payments for future research and development activities are excluded from the scope of this Issue. Entities should not apply the consensus in this Issue by analogy to other types of advance payments.

5. The FASB Emerging Issues Task Force reached the following consensus in paragraph 4 of EITF 07-3:

4. The Task Force reached a consensus that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the related services are performed. Entities should continue to evaluate whether they expect the goods to be delivered or services to be rendered. If an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense.

INT 08-04 Discussion

6. The consensus in EITF 07-3 is that an entity should defer and capitalize nonrefundable prepayments for goods and services that will be used or rendered for future research and development activities. Once the goods or services are received or the related services performed, the items would be expensed.

7. Although existing statutory accounting principles require research and development costs to be expensed when incurred, prepaid expenses are nonadmitted and guidance has been established to allow for the expense of such items when paid, if permitted under the reporting entity's written capitalization policy. As prepaid research and development costs are nonadmitted and will eventually be expensed, there does not appear to be a benefit to defer and capitalize such items in the financial statements until the goods are received. Furthermore, the prepaid cash is nonrefundable, and if capitalized, the amount would not be available to pay policyholder claims. Regardless of the reporting entity's written capitalization policy, the Working Group reached a consensus to reject EITF 07-3 and provide that all nonrefundable advance payments for goods or services that will be used or rendered for research and development activities shall be expensed when the advance payment is made.

INT 08-04 Status

8. No further discussion is planned.