Case 14-10
In-Process Research & Development

Bust-A-Knee Inc. (Bust-A-Knee) is a medical device company that specializes in developing knee replacement hardware. In 2020, Bust-A-Knee acquired 100 percent equity ownership of MD International (MD) for a purchase price of $15 million. MD is a pharmaceutical company that is developing two drugs: (1) a drug to cure cancer, Drug X, and (2) a pain medication, OuchX. Bust-A-Knee acquired the entity to expand into a new sector within the medical field.

Bust-A-Knee concluded the acquisition of MD was a business acquisition. In purchase accounting, Bust-A-Knee recognized intangible assets for the in-process research and development (IPR&D) related to the ongoing development of Drug X and OuchX, among other acquired intangible assets. Drug X and OuchX had an acquisition-date fair value of $4 million and $3 million, respectively.

During 2021, Bust-A-Knee determined its operations could not support the continued development of Drug X because significant efforts were being put forth in the development of OuchX. Since the date of acquisition, Bust-A-Knee had not invested any additional funding in the development of Drug X. Bust-A-Knee determined that there was no change in the carrying amount recorded at the date of acquisition.

Rather than abandon the development project, Bust-A-Knee entered into an agreement with Pharmers Company (Pharmers) to transfer its ownership interests in the IPR&D for Drug X. Pharmers, the market's largest pharmaceutical company, will use Drug X's IPR&D to continue its development, and obtain FDA approval to sell the drug on the open market. The transfer of the IPR&D from Bust-A-Knee to Pharmers is known as an out-license transfer, which is essentially a sale agreement.

In return, Pharmers will pay Bust-A-Knee (1) a nonrefundable fixed fee of $2 million at contract execution; (2) the ability to earn a contingent future payment of $500,000, when Drug X is FDA approved; and (3) a 10 percent royalty fee based on the annual sales earned by Pharmers for the sale of Drug X in each of the subsequent five years following FDA approval.

At the date of transfer, Bust-A-Knee estimates the fair value of the total consideration (nonrefundable fixed fee and contingent future fees) to be $5.5 million, which assumes FDA approval is granted. Pharmers transfers $2 million for the ownership of the IPR&D of Drug X.

Required:

- At the date of transfer to Pharmers, how should Bust-A-Knee record the transaction?