

■ Public Company Financial Executive Briefing ■

APPLICATION OF THE MILESTONE METHOD OF REVENUE RECOGNITION FOR CERTAIN TYPES OF RESEARCH AND DEVELOPMENT ARRANGEMENTS

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EXECUTIVE SUMMARY

The FASB has recently issued guidance (ASU No. 2010-17) on the use of the milestone method of recognizing revenue for research and development arrangements under which consideration to be received by the vendor is contingent upon the achievement of certain milestones. Accounting Standards Update (ASU) No. 2010-17, Milestone Method of Revenue Recognition, amends FASB ASC 605-10-05 and FASB ASC 605-10-25 and adds subtopic FASB ASC 605-28 to provide guidance on the criteria that must be met for determining when to apply the milestone method.

ANALYSIS OF THE GUIDANCE:

FASB ASC 605-10 has been amended as follows:

- Adds the milestone method of recognizing revenue for arrangements that include research and development deliverables to the subtopics covered therein.
- Adds payments relating to research and development deliverables accounted for under the milestone method as an exception to the scope of the guidance on recognition of revenue in multiple element arrangements.

The milestone method of recognizing revenue for arrangements that include research and development deliverables:

The new standard establishes that:

- The milestone method applies only to (a) research and development deliverables or (b) units of accounting under which the vendor satisfies its performance obligations over a period of time and some or all of the consideration is contingent upon uncertain future events or circumstances,
- The milestone method may not be the only acceptable revenue attribution model for consideration contingent upon achievement of a milestone, and
- Whichever attribution model is used, it must be applied consistently to similar deliverables or units of accounting.

It also specifies that

- The milestone method is the only acceptable method for recognizing deliverable consideration or unit of accounting consideration contingent upon achievement of a substantive milestone as revenue in its entirety in the period in which the milestone is achieved, and
 - Permits application of a different method resulting in the deferral of revenue relative to the milestone consideration.
- In order to recognize revenue related to a milestone, the milestone must be considered

substantive in its entirety (i.e., milestone consideration may not be bifurcated into substantive and non-substantive components).

■ Requires that (1) determining whether a milestone is substantive should be made only at the inception of the arrangement, and (2) to be substantive, consideration earned from the achievement of a milestone should:

- Be commensurate with the vendor's performance to achieve the milestone or with the enhancement of the value of the delivered items.
- Relate only to past performance (no portion of the milestone may relate to remaining deliverables and no portion may be refundable or adjusted through penalty based on future performance).
- Be reasonable relative to all the deliverables and payment terms of the arrangement.

The standard also updates disclosure requirements related to milestone arrangements.

EFFECTIVE DATE

The new and amended guidance is effective for fiscal years (and interim periods within such years) beginning on or after June 15, 2010, with early adoption permitted. Specific disclosures are required on specific adoption.

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