FASB Emerging Issues Task Force

Issue No. 08-9

Title: Milestone Method of Revenue Recognition

Document: Issue Summary No. 1, Supplement No. 2*

Date prepared: May 12, 2009

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Dates previously discussed: March 12, 2008; June 12, 2008; September 10, 2008; November 13, 2008, March 19, 2009

Previously distributed EITF materials: Issue Summary No. 1, dated October 20, 2008; Issue Summary No. 1, Supplement No. 1, dated March 2, 2009; and the following discussion materials related to Issue No. 08-1, "Revenue Arrangements with Multiple Deliverables:" Issue Summary No. 1, dated February 29, 2008; Working Group Report No. 1, dated June 9, 2008; Working Group Report No. 2, dated August 13, 2008; Issue Summary No. 2, dated October 20, 2008

References:

FASB Statement No. 5, *Accounting for Contingencies* (Statement 5)

FASB Statement No. 13, *Accounting for Leases* (Statement 13)

FASB Statement No. 154, *Accounting Changes and Error Corrections* (Statement 154)

FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises* (Concepts Statement 5)

FASB Invitation to Comment, *Accounting for Certain Service Transactions* (Invitation to Comment on Service Transactions)

AICPA Statement of Position 97-2, *Software Revenue Recognition* (SOP 97-2)

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP 81-1)

AICPA Statement of Position 00-2, *Accounting by Producers or Distributors of Films* (SOP 00-2)

SEC Staff Accounting Bulletin No. 104, Topic 13, *Revenue Recognition* (SAB Topic 13A1)

EITF Issue No. 00-21 "Revenue Arrangements with Multiple Deliverables" (Issue 00-21)

EITF Issue No. 08-1, "Revenue Arrangements with Multiple Deliverables" (Issue 08-1)

Background

1. At the March 19, 2009 EITF meeting, the Task Force reached a consensus-for-exposure on this Issue and directed the staff to issue a draft abstract for public comment.

2. A draft abstract was posted to the FASB website on April 7, 2009, with a comment period that ended May 5, 2009. Comment letters received on the draft abstract have previously been distributed to Task Force members and are analyzed below. At the June 18, 2009 EITF meeting, the Task Force will have the opportunity to consider these comment letters as it redeliberates the consensus-for-exposure. The Task Force will then be asked to affirm its consensus-for-exposure on this Issue as a final consensus.

3. Constituents were specifically requested to provide comments on whether the guidance in this Issue is operational and provides a principle that could be applied consistently.

Summary of Comment Letters

4. The five comment letters received on the draft abstract are summarized below.

Respondent Profile	
Type of Respondent	**Number of Letters**
Preparers	2
Industry Organizations	1
User Group	0
Others	2
Total Number of Letters	5

5. The staff has identified and analyzed significant comments in the section that follows. Respondents generally agreed that the guidance in this Issue is operational and provides a principle that could be applied consistently. The staff recommends that the Task Force consider these comments as it redeliberates this Issue.

Comment – Substantial Uncertainty

6. Two respondents requested that the Task Force clarify the term "substantial uncertainty" as used in the draft abstract. Specifically, paragraph 7 of the draft abstract states that "a milestone is defined as an event for which there is substantial uncertainty." One of those respondents agreed that milestones that are not subject to uncertainty (for example, those that are in no way at risk), should not qualify for the milestone method of accounting contemplated in the draft abstract. However, the respondent also stated that the concept of substantial uncertainty may be difficult to interpret in practice and inquired as to whether substantial uncertainty exists in the following example.

> Vendor A is entitled to receive a $10 million milestone payment from a collaborative partner upon the completion of a Phase 2 clinical trial of Compound X. At the time the collaboration agreement is signed, the clinical trial is planned as part of the ongoing development activities for Compound X and the clinical trial is due to be substantially complete (thereby triggering the milestone payment) nine months after the signing of the collaboration agreement. No other clinical trials are expected to be performed before the Phase 2 trial commences although other activities (for example, toxicology trials) are ongoing throughout the period. At the outset of the arrangement, Vendor A fully intends to perform, and essentially has the capability to perform, through utilization of its existing resources and processes.

7. The respondent suggests that since the activities are already planned, the resources are already available, and there are no other significant influencing events, there is seemingly very little to prevent the trial from at least concluding (with the outcome of the trial being irrelevant). Accordingly, in this case, the respondent suggests that substantial uncertainty may not exist as to the earning of the milestone. Conversely, the respondent also suggests that significant uncertainty may in fact exist because the drug development process is itself inherently uncertain and not exclusive of factors related solely to the clinical trial itself (for example, the results of the toxicology trials, internal financing decisions based upon the progress of other compounds, external market conditions, and competitor trial results).

Staff Recommendation

8. The staff believes that the respondent's example illustrates the typical decision making process a vendor would perform when assessing contingent consideration. The respondent indicates that because the vendor can reliably predict its performance under the arrangement, substantial uncertainty may not exist regarding its achievement of the milestone. However, the respondent also suggests that factors not in the control of the vendor may also prevent the vendor from achieving the milestone.

9. The staff considers each of the factors listed by the respondent to be relevant to a decision on whether substantial uncertainty exists regarding the vendor's achievement of the milestone. For example, while there appears to be little risk that the entity will not achieve the milestone in the illustration, the vendor would need to consider how the inherent uncertainty related to clinical trials affects the likelihood of it achieving the milestone. The vendor may conclude that there is such little uncertainty in the arrangement that it can reliably predict achievement of the milestone and may consider the contingent consideration to be fixed or determinable. Conversely, the inherent uncertainty of clinical trails may cause the vendor to conclude that it cannot reliably predict achievement of the milestone. However, the uncertainty may not be sufficient to cause the vendor to conclude that substantial uncertainty exists, which might be the case if the clinical trial was required to result in achievement of a specific outcome.

10. The staff believes that there are three possible conclusions from the assessment of the achievement of the milestone under this Issue:

a. The vendor may conclude that it can reliably predict achievement of the milestone and may consider the contingent consideration fixed or determinable
b. The vendor may conclude that the uncertainty of achievement is sufficient to conclude that substantial uncertainty exists as to whether the vendor will achieve the milestone
c. The vendor may conclude that uncertainty of achievement exists but that it is not sufficient to conclude that substantial uncertainty exists as to whether the vendor will achieve the milestone.

11. The staff believes that the assessment of whether arrangement consideration is fixed or determinable or whether substantial uncertain exists, is a matter of judgment based on the specific facts and circumstances. Clearly, the more reliably the vendor can predict achievement of a milestone, the less likely substantial uncertainty exists. The staff believes that the term *substantial uncertainty* appropriately conveys the message that a considerable degree of uncertainty must exist. The mere presence of uncertainty would not qualify for the application of this Issue.

12. Because of the numerous facts and circumstances that can be encountered in practice, the staff recommends that the draft abstract not be revised to add additional clarification around when substantial uncertainty may exist in the achievement of a milestone.

Question 1: Does the Task Force agree with the staff recommendation not to clarify the term *substantial uncertainty*?

Comment – Alternative Accounting Policies

13. One respondent questioned whether the milestone method should be required for all milestones determined to be substantive. The respondent's comment is in reference to paragraph 11 of the draft abstract that indicates that the milestone method is not the only acceptable revenue attribution model for consideration contingent upon the achievement of a milestone. The respondent noted that allowing the use of the milestone method as a policy election is inconsistent with recommendation 1.7 of the August 1, 2008 final report of the SEC's Advisory Committee on Improvements to Financial Reporting (CIFR). That recommendation stated that new projects should include the elimination of existing alternative accounting policies in relevant areas as a specific objective of those projects, except in rare circumstances.

Staff Recommendation

14. As noted above, CIFR recommended that similar activities should be accounted for in a similar manner, that any exception to that model should be based on the business activities rather than the industry, and that the use of scope exceptions should be kept to a minimum. However, as discussed at a prior EITF meeting, there are many factors an entity must consider in

establishing its revenue recognition policies and consideration of those factors is required every time a product is delivered or a service is performed. As a result, the Task Force reached a tentative consensus that the application of the milestone method should be a policy election. Furthermore, as noted at the March 19, 2009 EITF meeting, it is not the purpose of this Issue to create a new alternative but to codify existing practice.

Question 2: Does the Task Force wish to reconsider its tentative decision not to make application of the milestone method required for substantive milestones?

Comment – Transition

15. One respondent questioned whether the adoption of the milestone method by an entity that has previously made an alternate accounting policy election should be considered a change in accounting principle. The respondent noted that requiring a company to justify preferablity implies that the milestone method was an acceptable method prior to issuance of this Issue. The respondent also notes that while many companies have used the milestone method, they do not believe that there was any clear justification in the accounting literature. Therefore, the respondent does not believe that it is fair to assume that a company that currently uses an alternate policy made a policy election rather than applying the method that it determined to be the correct application of U.S. GAAP. The respondent included several facts that it believes support its position. First, Issue Summary No. 1 to Issue 08-1 includes several statements that indicate that there is disagreement as to whether the milestone method is currently viewed as an acceptable method. Second, the CCH Revenue Recognition Guide contains a strong warning that the SEC often disagrees with the application of the milestone method when applied to milestones that are part of a single unit of accounting.

Transition Alternatives

16. Presented below are four transition alternatives for Task Force consideration.

Alternative A: Retrospective application.

> *Entities who have previously applied an alternate accounting policy for substantive milestones and who wish to adopt the milestone method may do so on the effective date of*

this standard without demonstrating preferability of the milestone method over its previous policy. Entities choosing to adopt the milestone method who had previously applied an alternate accounting policy must adopt the milestone method as follows: The consensus should be applied retrospectively to all prior periods presented. The cumulative effect of the change in accounting principle on periods prior to those presented should be recognized as of the beginning of the first period presented. An offsetting adjustment should be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period, presented separately.

Alternative B: Entities should recognize the effect of the change on all arrangements outstanding during the period that includes the effective date through a cumulative-effect adjustment.

Entities who have previously applied an alternate accounting policy for substantive milestones and who wish to adopt the milestone method may do so on the effective date of this standard without demonstrating preferability of the milestone method over its previous policy. Entities choosing to adopt the milestone method who had previously applied an alternate accounting policy must adopt the milestone method as follows: The consensus should be applied to all outstanding arrangements as of the beginning of the fiscal year in which the consensus is initially applied. The cumulative effect of the change in accounting principle should be recognized as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately.

Alternative C: Entities should recognize the effect of the change on a prospective basis to arrangements entered into or materially modified after the effective date.

Entities who have previously applied an alternate accounting policy for substantive milestones and who wish to adopt the milestone method may do so on the effective date of this standard without demonstrating preferability of the milestone method over its previous policy. Entities choosing to adopt the milestone method who had previously applied an alternate accounting policy must adopt the milestone method as follows: The consensus should be applied only to those revenue arrangements entered into or modified after the effective date.

Alternative D: The application of the milestone method of revenue recognition is an accounting policy election.

> *The application of the milestone method of revenue recognition pursuant to the guidance in this Issue is an accounting policy election. Adoption of the milestone method by an entity that has previously made an alternate accounting policy election shall be considered a change in accounting principle and be recognized in accordance with Statement 154, including justifying a change in the method of applying an accounting principle on the basis of preferability as specified by paragraphs 12–14 of that Statement.*

17. If the Task Force concludes that entities that had previously adopted an alternate accounting policy for substantive milestone payments should be provided with an opportunity to change their policy when this Standard becomes effective, the staff considers Alternative A to be consistent with paragraph 7 of Statement 154, which requires retrospective application to changes in accounting principles. In addition, retrospective application is the transition method that best achieves consistency of financial information between periods and facilitates comparability of accounting data. If it is impracticable to apply retrospective application, paragraph 9 of Statement 154 allows for the new accounting principle to be applied on a prospective basis.

18. Alternative B carries the benefit of consistency and comparability for the current year and future years without the burden of recasting prior years' amounts. Alternative B requires entities to evaluate only the arrangements in effect at the effective date of this Issue. The staff acknowledges that with the reduced costs and burdens of Alternative B comes less consistency and comparability for years prior to the year of adoption.

19. Alternative C would eliminate the need to reassess existing and prior arrangements. However, Alternative C could result in revenue transactions entered into prior to the effective date of this Issue being accounted for in a manner inconsistent with the consensus reached. Alternative C would allow for a vendor to have multiple policies for revenue recognition for some period of time after this Issue is finalized, as arrangements entered into before its effective

date would follow the vendor's historic policy and arrangements entered into after the effective date would follow the guidance in this Issue. Also, Alternative C would be consistent with the consensus-for-exposure on Issue 08-1.

20. Alternative D is the transition guidance included in the draft abstract. Proponents of View D acknowledge that an entity may not have previously elected to adopt the milestone method because of the questions that existed regarding whether it was an acceptable method of revenue attribution. However, because the milestone method is a policy election, as highlighted by the respondent's comment on alternative accounting policies, use of the milestone method is not the only acceptable revenue attribution model for arrangement consideration contingent upon the achievement of a milestone. Therefore, proponents of Alternative D believe that it is important, except for an entity that has not previously applied the milestone method, that any change in existing accounting policies comply with the preferability requirements of Statement 154.

Question 3: Does the Task Force want to keep the transition included in the draft abstract? If no, what transition method does the Task Force want to include in the abstract?

Transition Disclosures

21. Transition disclosures to be addressed only if the Task Force selects a transition alternative other than View D.

22. If the Task Force decides to include a transition alternative other than View D, the staff recommends that the following transition disclosures, which are consistent with Statement 154 disclosure requirements, be included in the Issue.

> *Entities shall disclose the following in the fiscal period in which a change in accounting principle is made:*
>
> *The nature of and reason for the change in accounting principle. The method of applying the change, and:*

a. *A description of the prior-period information that has been retrospectively adjusted, if any.*

b. *The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of changes in the applicable net assets or performance indicator) is not required.*

c. *The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.*

In the fiscal year of adoption, financial information reported for interim periods after the date of adoption shall disclose the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), and related per-share amounts, if applicable, for those post-change interim periods.

Financial statements of subsequent periods need not repeat the disclosures required by this paragraph. If a change in accounting principle has no material effect in the period of change but is reasonably certain to have a material effect in later periods, the disclosures shall be provided whenever the financial statements of the period of change are presented.

Question 4: Does the Task Force want to add transition disclosures to the abstract?

Effective date

23. Effective date to be addressed only if the Task Force selects a transition alternative other than Alternative D.

24. The Working Group did not provide a specific recommendation regarding the effective date. However, Working Group members did support allowing entities to have the ability to early adopt the guidance included in this Issue. Working Group members also indicated that they understand early adoption is normally precluded because users prefer, for consistency reasons, that all entities adopt a new standard at the beginning of a fiscal year. However, as previously discussed, this Issue does not create a new revenue recognition alternative but only codifies existing practice. Therefore, because the milestone method is already in use in practice, the following staff recommendation includes a provision to allow an entity to early adopt the guidance in this Issue.

25. The following staff recommendation is drafted to be effective for fiscal years that begin after December 15, 2009.

> *The guidance in this Issue is effective immediately for entities adopting an initial accounting policy for substantive milestones. For all other entities, the guidance in this Issue will be effective as of the beginning of the entity's first fiscal year beginning after December 15, 2009.*

Question 5: Does the Task Force agree with the staff's effective date recommendation?

Revisions to the Draft Abstract

26. At the November 13, 2008 EITF meeting, the Task Force tentatively agreed that the assessment of whether a milestone is substantive should only be performed at the inception of the arrangement. However, this tentative agreement was not reflected in the draft abstract. Changes to the draft abstract to reflect the Task Force's tentative agreement and other drafting suggestions received from respondents are included in the draft abstract at Appendix 08-9A (additions are underscored and deletions are ~~struck through~~).

Question 6: Does the Task Force agree with the suggested amendments to the draft abstract?

Appendix 08-9A

EITF ABSTRACTS (DRAFT[*])

Issue No. 08-9

Title: Milestone Method of Revenue Recognition

Dates Discussed: March 12, 2008; June 12, 2008; September 10, 2008; November 13, 2008; March 19, 2009; ~~[~~June ~~17~~ 18, 2009~~]~~

References: FASB Statement No. 5, *Accounting for Contingencies*

FASB Statement No. 13, *Accounting for Leases*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

APB Opinion No. 22, *Disclosure of Accounting Policies*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

AICPA Statement of Position 00-2, *Accounting by Producers or Distributors of Films*

SEC Staff Accounting Bulletin No. 104, Topic 13, *Revenue Recognition*

EITF Issue No. 00-21 "Revenue Arrangements with Multiple Deliverables"

EITF Issue No. 08-1, "Revenue Arrangements with Multiple Deliverables"

FASB Invitation to Comment, *Accounting for Certain Service Transactions* (1978)

Objective

1. **The objective of this Issue is to define a milestone and clarify whether a vendor may recognize arrangement consideration earned from the achievement of a milestone in its entirety in the period in which the milestone is achieved.**

[*] ~~**This draft abstract is being exposed for a public comment period that will end on May 5, 2009.**~~

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

Background

2. The ultimate objective of attributing arrangement consideration is to determine when the arrangement consideration should be recognized as revenue. As set forth in Concepts Statement 5, paragraph 83, "recognition involves consideration of two factors, (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important consideration." Generally, revenue is considered both realizable and earned when each one of the following four conditions is met:

a. Persuasive evidence of an arrangement exists
b. The arrangement fee is fixed or determinable
c. Delivery or performance has occurred
d. Collectibility is reasonably assured.

3. The issue of when and if a vendor will receive additional arrangement consideration that is not considered initially fixed upon consummation of the arrangement (for example, arrangement consideration contingent upon achievement of a certain event), relates to whether the arrangement consideration is fixed or determinable and whether collectability is reasonably assured. This Issue does not address the topic of whether collectability is reasonably assured.

4. Typically, contingent arrangement consideration becomes fixed or determinable only after the contingency is resolved. At the time the contingency is resolved or the event is achieved, a vendor must determine how to allocate the additional consideration. For arrangements comprising a single deliverable or unit of accounting under which a vendor satisfies its performance obligations to a customer over a period of time, the determination as to whether the additional arrangement consideration relates to past performance, future performance, or both can be very difficult. The purpose of this Issue is to examine the use of the milestone method as one possible method for determining how to allocate the contingent arrangement consideration once it becomes fixed or determinable. Under the milestone method, arrangement consideration earned from the achievement of a milestone may be deemed to be related to the portion of the performance period dedicated to achieving that specific milestone.

Scope

5. **This Issue may be applied to a single deliverable or unit of accounting arising from arrangements under which a vendor satisfies its performance obligations to a customer over a period of time, and when a portion or all of the arrangement consideration is contingent upon uncertain future events or circumstances, except when the guidance in this Issue conflicts with other authoritative literature that provides revenue recognition guidance for the single deliverable or unit of accounting.**

Recognition and Measurement

6. **A vendor may make an accounting policy election to recognize arrangement consideration that is contingent upon the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved.**

7. For purposes of this Issue, a milestone is defined as an event for which there is substantial uncertainty at the date the arrangement is entered into that the event will be achieved when that event can only be achieved based in whole or in part on the vendor's performance or a specific outcome resulting from the vendor's performance and, if achieved, would result in additional payments being due to the vendor.

8. To be considered a milestone, an event must be achieved based in whole or in part on the vendor's performance or a specific outcome resulting from the vendor's performance; therefore, a milestone does not include events for which the occurrence is contingent solely upon the passage of time or the result of a counterparty's performance.

9. The determination of whether a milestone is substantive is a matter of judgment; the assessment of which shall be performed only at the inception of the arrangement. However, the following principle shall be used in making a determination as to whether a milestone is substantive:

> **The consideration earned from the achievement of a milestone is commensurate with either the vendor's performance to achieve the milestone or the enhancement of the value of the delivered item(s) as a result of a specific outcome resulting from the vendor's performance to achieve the milestone. The consideration earned from the**

achievement of a milestone relates solely to past performance and is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

~~9~~10. A milestone shall not be considered substantive if any portion of the associated milestone consideration relates to the remaining deliverables in the unit of accounting (that is, it does not relate solely to past performance). In order to recognize the milestone consideration in its entirety as revenue in the period in which the milestone is achieved, the milestone must be substantive in its entirety. It is not appropriate to bifurcate milestone consideration into substantive and non-substantive components. In addition, if a portion of the consideration earned from achieving a milestone may be refunded or adjusted based on future performance (for example, through a penalty or clawback), the contingent consideration is not considered to relate solely to past performance and thus the related milestone cannot be considered substantive. If the arrangement consideration from an individual milestone is not considered to relate solely to past performance, the vendor would not be precluded from using the milestone method for other milestones in the arrangement.

~~10. To be considered a milestone, an event must be achieved based in whole or in part on the vendor's performance or a specific outcome resulting from the vendor's performance; therefore, a milestone does not include events for which the occurrence is contingent solely upon the passage of time or the result of a counterparty's performance.~~

11. The guidance in this Issue is not the only acceptable revenue attribution model for arrangement consideration contingent upon achievement of a milestone (whether or not the milestone is substantive). A vendor's policy for recognizing arrangement consideration contingent upon achievement of a milestone shall be applied consistently to similar arrangements.

12. This Issue does not address whether an arrangement comprises one or more deliverables or whether multiple deliverables within an arrangement meet the separation requirements of Issue 08-1.

Disclosure

13. An entity shall disclose its accounting policy for the recognition of milestone payments as revenue in accordance with Opinion 22. For those entities electing to apply the milestone method pursuant to the guidance in this Issue, the following information shall be disclosed in the notes to the financial statements for each arrangement that includes a material milestone payment: (a) a description of the overall arrangement, (b) a description of the individual milestones and related contingent consideration, (c) a determination as to whether the milestones are considered substantive, (d) the factors considered by the entity in making its assessment of whether the milestones are substantive, and (e) the amount of milestone consideration recognized during the period.

Transition

14. The application of the milestone method of revenue recognition pursuant to the guidance in this Issue is an accounting policy election. Adoption of the milestone method by an entity that has previously made an alternate accounting policy election shall be considered a change in accounting principle and be recognized in accordance with Statement 154, including justifying a change in the method of applying an accounting principle on the basis of preferability as specified by paragraphs 12–14 of that Statement.

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

Status

15. No further EITF discussion is planned.

Appendix 08-9B

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™

Introduction

A1. This appendix outlines how this ~~proposed~~ Issue ~~would~~ affects the *FASB Accounting Standards Codification*™.

A2. This ~~proposed~~ Issue ~~would~~ amends Topic 605, Revenue Recognition, and creates a new Subtopic 605-26, Milestone Method.

Amendments to the Codification

~~[Added text is underlined.]~~

A3. Amend paragraph **605-10-05-1**, with no link to a transition paragraph as follows:

605-10-05-1 The Revenue Recognition Topic provides guidance for transaction-specific revenue recognition and certain matters related to revenue-generating activities that are not addressed specifically in other Topics. Other Topics may contain transaction-specific revenue recognition guidance related to transactions in those Topics. This Topic includes the following Subtopics:

a. Overall. The Overall Subtopic provides guidance on the following:
   1. Revenue and gains
   2. Installment and cost recovery methods of revenue recognition.

b. Products. The Products Subtopic provides guidance on the following:
   1. Sales with a right of return
   2. Repurchases of product sold subject to an operating lease.

c. Services. The Services Subtopic provides guidance on the following:
   1. Separately priced extended warranty and product maintenance contracts
   2. Commissions from certain experience-rated or retrospective insurance arrangements
   3. Certain loan guarantee fees
   4. In-transit freight service

5. Advertising barter transactions.

d. Multiple-Element Arrangements. The Multiple-Element Arrangements Subtopic provides guidance on arrangements under which a vendor will perform multiple revenue-generating activities (that is, provide multiple deliverables).

e. Rights to Use.

f. Construction-Type and Production-Type Contracts. The Construction-Type and Production-Type Contracts Subtopic provides guidance on contracts for which specifications are provided by the customer for the performance of contracts for the construction of facilities or the production of goods.

g. Gains and Losses. The Gains and Losses Subtopic provides guidance on miscellaneous gains and losses not addressed in other Topics in the Codification.

h. Principal-Agent Considerations. The Principal-Agent Considerations Subtopic provides guidance on reporting revenue gross or net of certain amounts paid to others.

i. Customer Payments and Incentives. The Customer Payments and Incentives Subtopic provides guidance on accounting by vendors and customers for consideration given by a vendor to a customer.

j. Milestone Method. The Milestone Method Subtopic provides guidance on the application of the milestone method of revenue recognition.

A4. Insert paragraph **605-10-25-2A**, with no link to a transition paragraph as follows:

605-10-25-2A See Subtopic 605-26 for guidance on the application of the milestone method of revenue recognition.

A5. Insert Subtopic **605-26**, with no link to a transition paragraph as follows:

605 Revenue Recognition

26 Milestone Method

605-26-05 Overview and Background

05-1 This Subtopic specifies the accounting for arrangement consideration accounted for under the milestone method of revenue recognition.

605-26-15 Scope and Scope Exceptions

> Entities

15-1 The guidance in this Subtopic applies to all entities.

> Transactions

15-2 The guidance in this Subtopic applies to transactions involving a single deliverable or unit of accounting arising from an arrangement under which a vendor satisfies its performance obligations to a customer over a period of time, and when a portion or all of the arrangement consideration is contingent upon uncertain future events or circumstances, except when the guidance in this Subtopic conflicts with the guidance provided elsewhere in Topic 605 for the single deliverable or unit of accounting.

15-3 The guidance in this Subtopic is not the only acceptable revenue attribution model for arrangement consideration contingent upon achievement of a milestone (whether or not the milestone is substantive). A vendor's policy for recognizing arrangement consideration contingent upon achievement of a milestone shall be applied consistently to similar arrangements.

15-4 This Subtopic does not address whether an arrangement comprises one or more deliverables or whether multiple deliverables within an arrangement meet the separation requirements of Subtopic 605-25.

605-26-25 Recognition

25-1 A vendor may make an accounting policy election to recognize arrangement consideration that is contingent upon the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved.

25-2 The determination of whether a milestone is substantive is a matter of judgment; the assessment of which shall be performed only at the inception of the arrangement. However, the following principle shall be used in making a determination as to whether a milestone is substantive:

a. The consideration earned from the achievement of a milestone is commensurate with either the vendor's performance to achieve the milestone or the enhancement of the value of the delivered item(s) as a result of a specific outcome resulting from the vendor's performance to achieve the milestone. In addition, the consideration earned from the achievement of a milestone relates solely to past performance and is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

25-3 A milestone shall not be considered substantive if any portion of the associated milestone consideration relates to the remaining deliverables in the unit of accounting (that is, it does not relate solely to past performance). In order to recognize the milestone consideration in its entirety as revenue in the period in which the milestone is achieved, the milestone must be substantive in its entirety. It is not appropriate to bifurcate milestone consideration into substantive and non-substantive components. In addition, if a portion of the consideration earned from achieving a milestone may be refunded or adjusted based on future performance (for example, through a penalty or clawback), the contingent consideration is not considered to relate solely to past performance and thus the related milestone cannot be considered substantive. If the arrangement consideration from an individual milestone is not considered to relate solely to past performance, the vendor would not be precluded from using the milestone method for other milestones in the arrangement.

605-26-20 Glossary

Milestone

~~A milestone is defined as a~~An event for which there is substantial uncertainty at the date the arrangement is entered into that the event will be achieved when that event can only be achieved based in whole or in part on the vendor's performance or a specific outcome resulting from the vendor's performance and, if achieved, would result in additional payments being due to the vendor. A milestone does not include events for which the occurrence is contingent solely upon the passage of time or the result of a counterparty's performance.

605-26-50 Disclosure

50-1 An entity shall disclose its accounting policy for the recognition of milestone payments as revenue in accordance with Subtopic 235-10. For those entities electing to apply the milestone method pursuant to the guidance of this Subtopic, the following information shall be disclosed in the notes to the financial statements for each arrangement that includes a material milestone payment: (a) a description of the overall arrangement, (b) a description of the individual milestones and related contingent consideration, (c) a determination as to whether the milestones are considered substantive, (d) a list of the factors considered by the entity in making its assessment of whether the milestones are substantive, and (e) the amount of milestone consideration recognized during the period.

605-26-55 Transition

55-1 The application of the milestone method is an accounting policy election. Adoption of the milestone method by an entity that has previously made an alternate accounting policy election shall be considered a change in accounting principle and be recognized in accordance with Subsections 250-10-45-11 through 45-13, including justifying a change in the method of applying an accounting principle on the basis of preferability.