



FASB Flash Report

No. 2010-05

To	All Assurance Professionals	Date	June 1, 2010
Re	Milestone Method of Revenue Recognition	From	National Assurance

Entities may enter into arrangements to provide research or development services that include payment provisions whereby a portion or all of the consideration is contingent upon milestone events such as successful completion of a phase of a drug study or achieving a specific result. These entities had often recognized these milestone payments as revenue in their entirety as the related milestones were achieved. This practice has been called the milestone method of revenue recognition. However, authoritative guidance regarding the milestone method did not exist.

To address questions regarding the milestone method and reduce diversity in its application, the FASB has issued ASU 2010-17¹, which amends ASC Topic 605, *Revenue Recognition*. The scope of ASU 2010-17 is limited to arrangements in which research or development² deliverables are provided over a period of time and consideration is contingent upon uncertain future events. While the guidance applies to all companies, biotech companies are most likely to be affected by ASU 2010-17. Under a typical arrangement within the scope of ASU 2010-17, a biotech company may enter into a collaboration agreement to develop a new drug and earn a payment upon successful completion of a phase of clinical trials and another payment upon regulatory approval of the drug.

ASU 2010-17 provides the following guidance regarding the milestone method of revenue recognition:

1. A milestone is an event for which there is *substantive uncertainty* at the date the arrangement is entered into that event will be achieved. If achieved, the event would result in additional payments being due to the vendor.
2. The event can only be achieved based in whole or in part on either the vendor's performance or a specific outcome resulting from the vendor's performance.
3. An entity's assessment as to the probability of meeting a milestone does not impact its assessment as to whether *substantive uncertainty* exists. Rather, *substantive uncertainty* is simply meant to imply that the uncertainty is "real" and not a form of disguised upfront payment. A significant amount of uncertainty is *not* required for one to conclude that *substantive uncertainty* exists. The Task Force decided against a requirement for *substantial* uncertainty to exist because that term could imply a quantitative threshold, rather than conveying the Task Force's intent that the uncertainty should be "real," which is a qualitative consideration.
4. An entity can recognize revenue contingent upon meeting a milestone in its entirety in the period in which a milestone is achieved only if the milestone meets all the criteria to be considered *substantive*.

¹ ASU 2010-17 represents the ratification of EITF Issue No. 08-9, "Milestone Method of Revenue Recognition".

² The terms *research* and *development* are defined in ASC 730-10-20.

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5. For a milestone to be considered *substantive*, the following criteria must be met with respect to the milestone:
 - Be commensurate with either of the following:
 - The vendor's performance to achieve the milestone
 - The enhancement of value of the item delivered as a result of a specific outcome resulting from the vendor's performance to achieve the milestone
 - Relate solely to past performance
 - Be reasonable relative to all deliverables and payment terms in the arrangement
6. Each individual milestone must be considered *substantive* in its entirety and cannot be bifurcated for the purpose of this analysis. However, an arrangement may contain more than one milestone and an arrangement may contain both substantive and nonsubstantive milestones.
7. A milestone does not include events that are contingent solely on the passage of time or as the result of a counterparty's performance. As such, these events do not qualify for the milestone method of revenue recognition.
8. ASU 2010-17 requires the following disclosures:
 - A description of the overall arrangement
 - A description of each milestone and related contingent consideration
 - The factors that the entity considered in determining whether the milestones are substantive
 - The amount of consideration recognized during the period for milestones

The milestone method is considered a proportional performance method of revenue recognition. An entity would first consider the separation criteria in ASC 605-25 (ASU 2009-13) to allocate consideration other than milestones among multiple deliverables in the arrangement. After the arrangement consideration is allocated among the various deliverables, the milestone method could be used to determine the timing of revenue recognition for an individual deliverable that contains substantive milestones.

Although an entity is not required to apply the milestone method, it is the only model permitted for an entity to recognize consideration that is contingent upon the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. Other proportional performance models may be used to recognize revenue in arrangements containing milestones if they result in the deferral of revenue relating to some portion of the milestone consideration.³

An entity that has applied another method may adopt the milestone method as of the effective date of ASU 2010-17 without establishing preferability, as defined in ASC 250, *Accounting Changes and Error Corrections*.

For entities that do not apply the milestone method or that had adopted policies prior to the issuance of ASU 2010-17 that are consistent with its guidance, implementation will not result in any changes.

The amendments in ASU 2010-17 are effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. Thus, for a calendar year end company that does not elect to adopt early, adoption is required as of January 1, 2011.

³ For examples, see Chapter 6 of ARM's interpretive revenue recognition guide for a discussion of the Expected Revenue and Payments Received methods.



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If a company elects early adoption and the period of adoption is not the beginning of the entity's fiscal year, the entity should apply the amendments retrospectively from the beginning of the year of adoption.

A company may elect, but is not required, to adopt ASU 2010-17 retrospectively for all prior periods presented in its financial statements.

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For questions related to matters discussed in this *Flash* report, contact your Regional Technical Director, a member of National Assurance or Ken Gee (at 415-490-3230 (317-3230)).