EITF 08-9: Milestone Method of Revenue Recognition

RevenueRecognition.com Staff

New method of revenue recognition defines milestones and permits recognition of entire contingency payments in the periods in which the milestones are achieved.

On April 7, 2009 the EITF published a draft abstract of EITF 08-9, "Milestone Method of Revenue Recognition." If approved, EITF 08-9 will introduce a new method of revenue recognition that allows vendors to recognize the revenue associated with a contractual incentive or bonus at the time that obligation is fulfilled instead of systematically over the time of the contract. EITF 08-9 will be applied only to revenue under the following criteria:

- The milestone must be defined as an event for which there is substantial uncertainty as to its achievement at the time of the contract signing. For example, a biotech company under contract for drug development to a pharmaceutical company receives FDA approval for a new drug – a milestone that is by no means guaranteed. The contingent revenue is essentially additional compensation: it's a contractual bonus for a pre-specified success.
- The milestone must be substantive in its entirety.
- The milestone must relate solely to past performance and can not be considered substantive if any portion of the milestone consideration is tied to future deliverables.
- 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.

The Issue

EITF 00-21 provides little guidance on the subject of when and how to recognize revenue for arrangements that involve multiple payment streams for single units of accounting wherein the elements can't be separated. For instance, service providers may receive up-front payments upon signing with a customer and then receive additional payments as services are provided. When may those additional payments be recognized and is it permissible to use multiple attribution methods to account for those multiple payment streams?

In the absence of clear guidance on the subject, many companies were using a "milestone" method in which additional payments for services were recognized as milestones were achieved. This was essentially an example of proportional performance accounting, which is standard in contract accounting (81-1) but has little support elsewhere in the official literature. As the practice expanded, concerns arose about its legitimacy. Milestones so-used had the potential to be arbitrary, without a direct relationship to value or effort.

EITF 08-9 deals in essence with how and when to allocate revenue that is not "fixed or determinable" upon initial signing of the contract, and earned only if specific criteria are met. This "contingent arrangement consideration" is additional compensation – a bonus – for achieving a specified event whose outcome is uncertain. The Task Force's view is that contingent consideration becomes fixed or determinable only after the contingency is resolved. At that time the vendor must determine how to allocate the extra consideration.

Making the determination as to whether the contingent consideration relates to past or future performance, or both, can be very difficult. Some examples can be extremely complex - such as Research and Development arrangements between biotechnology and pharmaceutical companies that may involve multiple deliverables, up-front payments, payments for specific services and payments upon achievement of certain clinical milestones. Under the new milestone method, the bonus earned from achieving a specific milestone may be considered related to the portion of the performance period that was dedicated to achieving the milestone.

Recognition and Measurement

If this guidance is adopted, it will be permissible for a vendor to "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."

"Substantive" is a key concept, as it is the view of the Task Force that determination of whether or not a milestone is substantive is a matter of judgment. Therefore, the proposal lays out a principal to be used as the benchmark: the consideration earned must be commensurate with either the vendor's performance to achieve the milestone or to the added value of the delivered item(s) resulting from the achieved milestone. In addition, the milestone consideration must relate solely to past performance, be reasonable within the arrangement, must not be subject to any sort of future penalty or "clawback", nor be based on the passage of time or a counterparty's performance.

Scope

The milestone method may be applied to a single deliverable or unit of accounting arising from contractual arrangements under which a vendor satisfies its performance obligations over a period of time. That is, unless the unit of accounting that includes the milestone should be accounted for under literature with higher authority, e.g. EITF 00-21, SAB104, SOP 97-2 or SOP 81-1.

Transition and Disclosure

Application of the milestone method of revenue recognition is an accounting policy election in accordance with FASB Statement 154. Companies that elect to apply this guidance must disclose certain information related to the milestone(s) and associated consideration in notes to the financial statements for each arrangement that includes a material milestone payment.

Sources

FASB Emerging Issues Task Force; Draft Abstract; EITF Issue 08-9: Milestone Method of Revenue Recognition; 04/07/2009: http://www.fasb.org/eitf/0809DA.pdf

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