

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2010-17
April 2010

Revenue Recognition—Milestone Method (Topic 605)

Milestone Method of Revenue Recognition
a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*[™]

Financial Accounting Standards Board
of the Financial Accounting Foundation

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FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published quarterly by the Financial Accounting Foundation. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is \$230 per year. POSTMASTER: Send address changes to Financial Accounting Standards Board, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 346**

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The objective of this Update is to provide guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Research or development arrangements frequently include payment provisions whereby a portion or all of the consideration is contingent upon milestone events such as successful completion of phases in a drug study or achieving a specific result from the research or development efforts. An entity often recognizes these milestone payments as revenue in their entirety upon achieving the related milestone, commonly referred to as the milestone method.

Authoritative guidance on the use of the milestone method did not previously exist. As a result, constituents have raised questions on when and whether the use of this method is appropriate.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect vendors that provide research or development deliverables in an arrangement in which one or more payments are contingent upon achieving uncertain future events or circumstances.

What Are the Main Provisions?

Accounting Guidance

The amendments in this Update provide guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. A vendor can recognize consideration that is contingent upon achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive.

Determining whether a milestone is substantive is a matter of judgment made at the inception of the arrangement. The following criteria must be met for a

milestone to be considered substantive. The consideration earned by achieving the milestone should:

1. Be commensurate with either of the following:
 - a. The vendor's performance to achieve the milestone
 - b. The enhancement of the value of the item delivered as a result of a specific outcome resulting from the vendor's performance to achieve the milestone
2. Relate solely to past performance
3. Be reasonable relative to all deliverables and payment terms in the arrangement.

A milestone should be considered substantive in its entirety. An individual milestone may not be bifurcated. An arrangement may include more than one milestone, and each milestone should be evaluated separately to determine whether the milestone is substantive. Accordingly, an arrangement may contain both substantive and nonsubstantive milestones.

A vendor's decision to use the milestone method of revenue recognition for transactions within the scope of the amendments in this Update is a policy election. Other proportional revenue recognition methods also may be applied as long as the application of those other methods does not result in the recognition of consideration in its entirety in the period the milestone is achieved.

Disclosures

A vendor that is affected by the amendments in this Update is required to provide all of the following:

1. A description of the overall arrangement
2. A description of each milestone and related contingent consideration
3. A determination of whether each milestone is considered substantive
4. The factors that the entity considered in determining whether the milestone or milestones are substantive
5. The amount of consideration recognized during the period for the milestone or milestones.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

GAAP did not previously include guidance on when the use of the milestone method is appropriate. The amendments in this Update improve financial reporting by providing a consistent framework for applying the milestone method, thus eliminating diversity in practice on its application.

When Will the Amendments Be Effective?

The amendments in this Update 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. If a vendor 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. Additionally, a vendor electing early adoption should disclose the following information at a minimum for all previously reported interim periods in the fiscal year of adoption:

1. Revenue
2. Income before income taxes
3. Net income
4. Earnings per share
5. The effect of the change for the captions presented.

A vendor may elect, but is not required, to adopt the amendments in this Update retrospectively for all prior periods.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS does not have specific revenue-related guidance for vendors that provide research or development deliverables in an arrangement in which one or more payments are contingent upon achieving uncertain future events or circumstances. As such, differences may exist in the timing of when revenue is recognized for milestones achieved.

Amendments to the *FASB Accounting Standards Codification*TM

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–9. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~. **Newly added Subtopics and tables are not underlined to enhance readability.**

Amendment to Master Glossary

2. Add the Master Glossary term *Milestone*, with a link to transition paragraph 605-28-65-1, as follows:

Milestone

An event having all of the following characteristics:

- a. There is substantive uncertainty at the date the arrangement is entered into that the event will be achieved. A vendor's assessment that it expects to achieve a milestone does not necessarily mean that there is not substantive uncertainty associated with achieving the milestone.
- b. The event can only be achieved based in whole or in part on either of the following:
 1. The vendor's performance
 2. A specific outcome resulting from the vendor's performance.
- c. If achieved, the event would result in additional payments being due to the vendor.

A milestone does not include events for which the occurrence is either of the following:

- a. Contingent solely upon the passage of time
- b. The result of a counterparty's performance.

Amendments to Subtopic 605-10

3. Amend paragraph 605-10-05-1, with a link to transition paragraph 605-28-65-1, as follows:

Revenue Recognition—Overall

Overview and Background

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 in arrangements that include research or development deliverables.

4. Add paragraph 605-10-25-2A, with a link to transition paragraph 605-28-65-1, as follows:

Recognition

605-10-25-2A See Subtopic 605-28 for guidance on the application of the milestone method of revenue recognition.

Amendments to Subtopic 605-25

5. Amend paragraph 605-25-15-2A, with a link to transition paragraph 605-28-65-1, as follows:

Revenue Recognition—Multiple-Element Arrangements

Scope and Scope Exceptions

605-25-15-2A The guidance in this Subtopic does not apply to:

- a. Arrangements that include vendor offers to a customer for either of the following addressed in Subtopic 605-50:
 - 1. Free or discounted products or services that will be delivered (either by the vendor or by another unrelated entity) at a future date if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period
 - 2. A rebate or refund of a determinable cash amount if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period.
- b. Arrangements involving the sale of award credits by broad-based loyalty program operators (see Subtopic 605-50)~~(see Subtopic 605-50).~~
- c. Payments relating to research or development deliverables that are accounted for under the milestone method of revenue recognition (see Subtopic 605-28).

Addition of Subtopic 605-28

6. Add Subtopic 605-28. All paragraphs in this new Subtopic are linked to transition paragraph 605-28-65-1.

Revenue Recognition—Milestone Method

Overview and Background

605-28-05-1 This Subtopic specifies the accounting for research or development deliverables or units of accounting that include **milestones** that are accounted for under the milestone method of revenue recognition.

Scope and Scope Exceptions

> Entities

605-28-15-1 The guidance in this Subtopic applies to all entities.

> Transactions

605-28-15-2 The guidance in this Subtopic applies to research or development deliverables or units of accounting under which a vendor satisfies its performance obligations over a period of time, and when a portion or all of the 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.

605-28-15-3 The guidance in this Subtopic is not the only acceptable revenue attribution model for research or development deliverable consideration or unit of accounting consideration contingent upon achievement of a **milestone** (whether or not the milestone is substantive). A vendor's policy for recognizing deliverable consideration or unit of accounting consideration contingent upon achievement of a milestone shall be applied consistently to similar deliverables or units of accounting.

605-28-15-4 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. See Subtopic 605-25 for guidance on allocating consideration other than milestones in a multiple-element arrangement.

Recognition

605-28-25-1 The guidance in this Subtopic shall be met in order for a vendor to recognize deliverable consideration or unit of accounting consideration that is contingent upon the achievement of a substantive **milestone** in its entirety in the period in which the milestone is achieved. Other methods that result in the recognition of milestone consideration in its entirety in the period the milestone is achieved are precluded. Even if the criteria in this Subtopic are met, a vendor is not precluded from making an accounting policy election to apply a different

policy that results in the deferral of revenue relating to some portion of the milestone consideration.

605-28-25-2 Determining whether a milestone is substantive is a matter of judgment; that assessment shall be performed only at the inception of the arrangement. The consideration earned from the achievement of a milestone shall meet all of the following for the milestone to be considered substantive:

- a. It is commensurate with either of the following:
 1. The vendor's performance to achieve the milestone
 2. The enhancement of the value of the delivered item or items as a result of a specific outcome resulting from the vendor's performance to achieve the milestone.
- b. It relates solely to past performance.
- c. It is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

605-28-25-3 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). To recognize the milestone consideration in its entirety as revenue in the period in which the milestone is achieved, the milestone shall be substantive in its entirety. Milestone consideration shall not be bifurcated into substantive and nonsubstantive 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 consideration from an individual milestone is not considered to relate solely to past performance, the vendor is not precluded from using the milestone method for other milestones in the arrangement.

Disclosure

605-28-50-1 An entity shall disclose its accounting policy for the recognition of **milestone** payments as revenue in accordance with Subtopic 235-10.

605-28-50-2 For each arrangement that includes milestone consideration accounted for in accordance with the guidance in this Subtopic, an entity shall disclose all of the following in the notes to financial statements:

- a. A description of the overall arrangement
- b. A description of each milestone and related contingent consideration
- c. A determination of whether each milestone is considered substantive
- d. The factors that the entity considered in determining whether the milestone or milestones are substantive

- e. The amount of consideration recognized during the period for the milestone or milestones.

Transition and Effective Date Information

> Transition Related to Accounting Standards Update No. 2010-17, *Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition*

605-28-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-17, *Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition*:

- a. The pending content that links to this paragraph shall be applied prospectively to **milestones** achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010, unless the vendor elects to adopt the pending content on a retrospective basis in accordance with (d) below.
- b. Earlier application is permitted.
 - 1. If a vendor elects earlier application and the period of adoption is not the first reporting period in the vendor's fiscal year, the pending content that links to this paragraph shall be applied retrospectively from the beginning of the vendor's fiscal year.
 - 2. A vendor shall disclose at a minimum for all previously reported interim periods in the fiscal year of adoption:
 - i. Revenue
 - ii. Income before income taxes
 - iii. Net income
 - iv. Earnings per share
 - v. The effect of the change for the captions presented.
- c. In the year of adoption, a vendor shall disclose information in accordance with paragraphs 250-10-50-1 through 50-3 to enable users of the financial statements to understand the effect of the change in accounting principle if the pending content that links to this paragraph is adopted prospectively.
- d. A vendor may elect, but is not required, to adopt the pending content that links to this paragraph through retrospective application applying the guidance in paragraphs 250-10-45-5 through 45-10. If a vendor elects retrospective application, the vendor shall provide the disclosures in paragraphs 250-10-50-1 through 50-3.

7. Amend paragraph 605-10-00-1 as follows:

605-10-00-1 ~~No updates have been made to this subtopic.~~ The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
605-10-05-1	Amended	2010-17	04/28/2010
605-10-25-2A	Added	2010-17	04/28/2010

8. Amend paragraph 605-25-00-1, by adding the following items to the table, as follows:

605-25-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
605-25-15-2A	Amended	2010-17	04/28/2010

9. Add paragraph 605-28-00-1 as follows:

605-28-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
Milestone	Added	2010-17	04/28/2010
605-28-05-1	Added	2010-17	04/28/2010
605-28-15-1 through 15-4	Added	2010-17	04/28/2010
605-28-25-1 through 25-3	Added	2010-17	04/28/2010
605-28-50-1	Added	2010-17	04/28/2010
605-28-50-2	Added	2010-17	04/28/2010
605-28-65-1	Added	2010-17	04/28/2010

The amendments in this Update were adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force consensus when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force or Board members gave greater weight to some factors than to others.

Background Information and Conclusions

BC2. Research or development arrangements frequently include payment provisions in which a portion or all of the consideration is contingent upon milestone events such as successful completion of phases in a drug study or achieving a specific result from the research or development efforts. An entity often recognizes these milestone payments as revenue in their entirety upon achieving the milestone, commonly referred to as the milestone method.

BC3. Guidance on the use of the milestone method does not exist in current GAAP. As a result, constituents raised questions on when and whether the use of this method is appropriate. That is, constituents asked when it is appropriate, if ever, to recognize a contingent payment in its entirety upon achievement of a milestone.

BC4. At the March 19, 2009 EITF meeting, the Task Force reached a consensus-for-exposure on EITF Issue No. 08-9, "Milestone Method of Revenue Recognition." A draft abstract was issued on April 7, 2009, with a comment period that ended on May 5, 2009. Five comment letters were received from respondents to the draft abstract.

Scope

BC5. The Task Force had several discussions to determine the scope of the amendments in this Update and created a Working Group to assist it in making that determination. The Task Force decided to limit the scope of the amendments to arrangements that include milestones relating to research or development deliverables; that is, the amendments would include activities that involve at least one of those phases. The Task Force considered whether the amendments in

this Update should apply more broadly than to just research or development arrangements or whether the amendments should address how contingent consideration should be allocated in a multiple-element arrangement. The Task Force ultimately decided not to expand the scope because it was concerned that the amendments would inadvertently affect transactions that were not intended to be addressed by the practice issues the Task Force was attempting to resolve. The Task Force noted that the current Board project on revenue recognition is better suited to develop broad guidance on how to recognize contingent consideration in an arrangement and that the amendments in this Update should be limited to addressing the practice issue raised.

Milestone Method

BC6. The Task Force concluded that the principles in the amendments in this Update for recognizing a milestone payment as revenue in its entirety result in a reasonable pattern of revenue recognition reflective of the economics of such transactions. The Task Force expects that considerable judgment will be needed in applying the milestone method but that the amendments in this Update provide a reasonable principle to use in applying that judgment.

BC7. Respondents generally agreed with the Task Force's proposed milestone method; however, some respondents questioned the proposed requirement that there be substantial uncertainty of achieving the milestone to qualify for this method. Some respondents thought the term substantial uncertainty was unclear and may reflect a higher threshold than was being applied in practice when applying the milestone method. The Task Force agreed and revised the term *substantial uncertainty* to *substantive uncertainty* to clarify its intent that there need not be a specified amount of uncertainty about achieving an event for the event to be considered a milestone. The Task Force also added guidance to indicate that a vendor's assessment that it expects to achieve a milestone does not necessarily mean that there is not substantive uncertainty associated with achieving the milestone. The Task Force noted that this guidance was necessary to clarify its intent that substantive uncertainty is meant to imply that the uncertainty is "real" and not a form of disguised upfront payment or other nonsubstantive provision.

BC8. The Task Force decided not to require the use of the milestone method for research or development arrangements that include substantive milestones. An entity may choose to apply the milestone method as a policy election; however, the Task Force clarified that the guidance in the amendments in this Update should be applied if the entity's policy is to recognize the milestone payment as revenue in its entirety in the period the milestone is achieved. One respondent disagreed with the proposal to allow the option of using that model because that option hinders comparability of results from different companies in the same industry. The Task Force acknowledged that diversity in recognizing revenue in similar arrangements will continue to exist because of its decision.

However, it noted that many entities had been applying other proportional performance models that are consistent with general revenue recognition guidance. The Task Force did not want to require those entities to change their accounting policies. The Task Force also noted that the Board's revenue recognition project is currently addressing how and when to recognize contingent consideration and that the Board's current decision in that project generally would not permit a milestone payment to be recognized as revenue in its entirety in the period the milestone is achieved.

Effective Date and Transition

BC9. Under the proposed transition approach, an entity that had previously established an alternative accounting policy would be required to treat the change to the milestone method as a change in accounting policy in accordance with other presentation matters guidance in Topic 250, Accounting Changes and Error Corrections. Under the guidance in that Topic, a change in accounting policy should be considered preferable and should be adopted retrospectively. Some respondents questioned whether preferability should be required.

BC10. In its final deliberations, the Task Force decided to revise the transition method so that the amendments in this Update should be applied prospectively to milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010, with earlier application permitted. Additionally, the Task Force noted that some entities may not have applied the milestone method because of concerns about whether it was an acceptable method of revenue recognition. Therefore, the Task Force decided to align the transition method for all entities regardless of whether or not they had been applying the milestone method or had previously met the requirements of this Update. In reaching that decision, the Task Force noted that some entities may not be able to apply the amendments in this Update retrospectively without the use of hindsight because of the judgmental nature of the guidance. Additionally, the Task Force decided to provide an entity that had previously applied an alternative accounting policy with the opportunity to change its policy as of the effective date without requiring preferability or retrospective adoption.

BC11. The Task Force acknowledges that prospective treatment may result in the application of inconsistent revenue policies in periods before and after adoption. In the Task Force's view, users generally do not put significant emphasis on revenue trends in the industries primarily affected by this guidance. The Task Force decided, however, to provide entities with the option of applying the amendments in this Update retrospectively if desired (for example, when lack of comparability is a concern).

Benefits and Costs

BC12. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC13. The Task Force believes that the amendments in this Update improve financial reporting by providing a consistent framework for applying the milestone method and, therefore, eliminating diversity in practice in its application. The Task Force also believes that users will benefit from the guidance because it improves disclosures relating to information about research or development deliverables that include milestones. The Task Force also believes that the guidance generally is consistent with the considerations currently applied in practice for entities that apply the milestone method, which should limit the situations in which this guidance would result in a change in accounting policy. The Task Force does not expect entities to incur significant costs or system changes to implement the guidance.

Amendments to the XBRL Taxonomy

The following elements are proposed additions or modifications to the XBRL taxonomy as a result of the amendments in this Update. (Elements that currently exist in the 2009 taxonomy are marked with an asterisk* and have been **bolded**. If an existing element was modified, it has been marked to reflect any changes.)

Standard Label [†]	Definition	Codification Reference
Revenue Recognition, Policy [Text Block]*	Describes an entity's accounting policy for revenue recognition. If the entity has different policies for different types of revenue transactions, the policy for each material type of transaction should be disclosed. If a sales transaction has multiple element arrangements (for example, delivery of multiple products, services or the rights to use assets) the disclosure may indicate the accounting policy for each unit of accounting as well as how units of accounting are determined and valued. The disclosure may encompass important judgment as to appropriateness of principles related to recognition of revenue. The disclosure also may indicate the entity's treatment of any unearned or deferred revenue that arises from the transaction.	235-10-50-1 235-10-50-3 235-10-50-4 605-10-S99-1
Revenue Recognition, Research or Development Transactions	Describes an entity's accounting policy for revenue recognition for transactions involving research or development deliverables or unit of accounting arising from an arrangement under which a vendor satisfies its performance obligations to a customer over a period of time,	605-28-15-2

[†]The Standard Label and the Element Name are the same (except that the Element Name does not include spaces). If they are different, the Element Name is shown in *italics* after the Standard Label.

Standard Label [†]	Definition	Codification Reference
	and when a portion or all of the arrangement consideration is contingent upon uncertain future events or circumstances.	
Revenue Recognition, Milestone Method	Describes an entity's accounting policy for the recognition of milestone payments as revenue in accordance with Subtopic 605-28. For each arrangement that includes a milestone payment, this includes (1) a description of the overall arrangement, (2) a description of each milestone and related contingent consideration, (3) a determination of whether each milestone is considered substantive, (4) the factors the entity considered in determining whether each milestone is substantive, and (5) the amount of contingent consideration recognized during the period for each milestone.	605-28-50-2