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March 29, 2002

Mr. Timothy S. Lucas
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401 Merritt 7
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Dear Mr. Lucas:

## Comments on the FASB Proposal for a New Agenda Project, Issues Related to the Recognition of Revenues and Liabilities

As stated in our September 2001 response to the 2001 FASAC survey of the projects and priorities of the FASB, we believe that issues surrounding revenue recognition should be among the Board's highest priorities for new projects. While we continue to hold that view, we are concerned about the scope of the proposed project as it is defined in the FASB proposal, Issues Related to the Recognition of Revenues and Liabilities. It is not clear to us why this proposed project must address the issues related to both liability recognition and revenue recognition. We understand that any resolution of revenue recognition issues likely will require some analysis of liability issues, but we do not believe that those issues must be considered fully to resolve revenue recognition issues. In addition, a bifurcation of the broad issues between revenue recognition and liability recognition would permit a more expedient resolution of revenue recognition issues, which we believe deserve the Board's immediate attention. We are willing to accept a partial solution to liability recognition, which can be enhanced when the Board has additional resources available. Furthermore, we believe that any standard that the Board develops should clearly set forth the principles or concepts that the Board is addressing, and provide implementation guidance to elaborate on those principles.

The remainder of this letter responds to the specific questions that the Board raised in its proposal.

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# Question 1: Is there a need for the FASB or others to comprehensively address issues associated with the recognition of revenues and liabilities? If yes, should the FASB take on such an effort or defer to others? If so, to whom?

Yes, there is a need for the FASB to address general principles about revenue recognition. The FASB should undertake this project—it should not delegate the project to AcSEC or the EITF. However, the FASB should use members of AcSEC and EITF on project task forces and working groups as it develops the standard. The FASB should use those resources more extensively than it has in the past to ensure that it gains sufficient knowledge about current practice issues and transactions. Also, since the FASB standard may become a basis for developing specific guidance for specialized industries, it would be appropriate to invite AcSEC members or industry representatives to assist in this project.

Our views on the need for the FASB to address issues associated with recognition of liabilities are included in our response to Question 2 about the scope of the project.

## Question 2: Is the proposed scope of such a project as described in this proposal insufficient, appropriate, or too ambitious?

We believe that the scope described in the project proposal (i.e., addressing both revenue and liability recognition) is too ambitious. As we understand the proposal, the Board plans to:

- Develop a general standard on revenue recognition that applies to business entities generally.
- Issue narrower recognition standards, if necessary, to provide needed guidance in the interim.
- Amend FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, to improve the criteria for recognizing revenues.
- Refine and clarify the definition of liabilities in FASB Concepts Statement No. 6, Elements of Financial Statements, and refine the definition of assets to the extent that it parallels the definition of liabilities.
- Amend, as necessary, existing standards on liability recognition to make them
  consistent with the proposed general standard on revenue recognition.
- Issue (eventually) a general standard on liability recognition.

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We are concerned that while the appendix of the proposal identifies examples of *issues to be addressed*, the proposal does not articulate clearly the theoretical or practical problems that the Board is setting out to solve, nor does the bullet-point list above. The closest that the proposal comes to articulating a problem is the statement, "The proposed project would develop a general standard to close the gap between the broad guidance at the concepts level and the detailed guidance for particular industries or transactions." We believe that articulating the specific practice problem that the Board believes each bullet point above intends to solve would help to further define the scope of the project.

Except for that caveat, the proposed scope of the project as it relates to revenue recognition issues seems appropriate, that is, "develop a general standard on revenue recognition that applies to business entities generally." We believe that a FASB project should result in a standard that embodies broad general principles, which then could be used to address specialized industries and other specific issues. We believe that the FASB's project should focus on the threshold revenue recognition questions of when and how much.

We do not believe that the Board necessarily would need to amend the existing standards on specific revenue transactions, such as sales of real estate, leasing, percentage of completion, etc., as part of this project because those specialized rules may be appropriate due to the nature of the transactions. If changes were necessary as a result of the Board's deliberations, the Board or AcSEC could consider the need for additional specialized rules or potential amendments to existing specialized rules after the Board establishes the general principles.

We believe that the FASB should attempt to address the revenue recognition issues without reconsidering the definition of liabilities as part of this project. It is not clear to us how this proposed project would interact with the Board's existing agenda project on distinguishing between liabilities and equity instruments. Specifically, how do (a) the need to revisit the definition of a liability to provide clarity about whether liabilities include constructive as well as legal obligations and (b) the need to make other amendments to the definition of liabilities as a result of addressing the issues listed in the Appendix to the proposal affect the amendment to the definition of a liability that the Board proposed in its October 2000 Exposure Draft?

Furthermore, the proposal states, "This proposed project is closely related to the Board's agenda project on financial performance reporting by business enterprises, and certain issues could be addressed in either project." We find that statement confusing as we understood the scope of the project on reporting financial performance to focus on form and content, classification and aggregation, and display of specified items and summarized amounts on the face of all basic financial statements. The description of that project on the FASB's Web site explicitly states "the project will not address... matters

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of recognition or measurement of items in financial statements." Because the proposed project on revenues and liabilities appears fundamentally to be a recognition and measurement project, the nature of the close relationship to the financial performance reporting project that the Board identifies in the proposal is not apparent to us.

Finally, we are concerned because the proposal does not identify the timeframe in which the Board expects to complete each stage of the project. We believe that a clear vision of timing is essential to the satisfactory resolution of the issues. We urge the Board to articulate how its project timeline would satisfy the objectives of the recent proposal by the Trustees of the Financial Accounting Foundation to streamline the FASB's standard-setting process. We believe that a project on revenue recognition, which would be a highly visible project in its own right, also would be used by the Board's constituents to measure the Board's and the Trustee's commitment to and success in fundamentally overhauling the pace of the standard-setting process. We believe that success in stepping up the pace depends heavily on staying focused on a concepts-based approach to revenue recognition rather than developing detailed rules.

Question 3: Should specific issues identified above or in the appendix be excluded from the scope of the proposed project? If yes, for each specific issue, please indicate whether it should be addressed as part of another FASB project, by others, or not at all and why.

With the exception of issues related to the definition of a liability, we would find it difficult to rule out any of the issues in the proposal until the Board further refines the scope of the project. Our suggestion to separate liability issues from the broad project on revenue recognition is a practical expedient to resolving revenue recognition issues. However, we recognize that to deal effectively with those issues, the Board inevitably will have to determine when an obligation that would preclude revenue recognition exists. We could accept recognizing that obligation as deferred revenue (even though it might not meet the current definition of a liability in Concepts Statement 6) to facilitate the Board's ability to resolve the broader revenue recognition issues. The Board could later expand or otherwise amend as necessary the definition of a liability to include deferred revenue, and to make other conforming amendments as necessary as a result of the revenue recognition project.

Our comments below identify the most significant practice questions that we have addressed since the SEC staff issued Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, and provides our assessment of whether and how the Board's proposal seems to encompass the issues. (These comments build on our earlier comment that the Board should focus on the threshold revenue recognition questions of when and how much.)

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#### Fixed and Determinable Arrangement Fee Issues

- What does it mean for an arrangement fee to be fixed and determinable? If cancellations, returns, etc. are estimable, but are subject to some variability, is the fee fixed or determinable? Same for unit pricing? The proposal seems to be addressing these issues in numbers 6 and 7 of the issues relating to revenues.
- Broadly, how should revenue be recognized in multiple-element arrangements in which performance crosses multiple periods? We note that in EITF Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, the FASB staff is developing an approach to accounting for revenue arrangements with multiple deliverables that would be based on broad concepts rather than detailed rules. We support such an approach and urge the Board to build on the work of the EITF (and the FASB staff) on Issue 00-21 in its broad project on revenue recognition. The proposal seems to contemplate these issues in Issues 5, 8, and 9 under revenue recognition.

### **Delivery Issues**

At what point is delivery deemed to have occurred? Much focus in the SEC staff's Frequently Asked Questions document on SAB 101 was on the notion of customer acceptance. However, there also is an issue related to shipping terms. For example, when terms are FOB shipping point, companies frequently recognize revenue upon shipment even where realities of modern business are such that goods damaged in transit routinely are replaced free of charge because the risks of damage usually are small and it builds customer goodwill at little incremental cost. The proposal does not include either the customer acceptance issue or issues related to shipping arrangements.

#### Other Issues

Intellectual property is an important aspect of business transactions today (hence, the Board's project on recognition and disclosure of intangibles). Practice issues arise in determining whether revenue should be recognized up front versus over the license term; whether exclusivity or when and if available improvements under a multiple-element arrangement should be deemed to be undelivered elements; and when delivery is deemed complete (for instance if training or phone support is necessary to have an effective transfer of knowledge to the customer). The EITF Agenda Committee agreed to take up an issue to address recognition of revenue from licensing arrangements on intellectual property (excluding fact patterns that are within the scope of Issue 00-21). However, it is a very broad

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area that the Board should consider, even if the EITF resolves the issue in the near term.

- The scope of the accounting literature that applies to revenue recognition in financial statements and the conflicting models in various areas is frequently a source of issues. As stated above, some of the existing specialized rules (for example, sales of real estate, leasing, and percentage of completion) may be appropriate due to the nature of the transactions. However, the Board or AcSEC could consider the need to amend other existing specialized rules after the Board establishes the general principles.
- Question 4: Should specific issues *not* identified above or in the appendix be addressed as part of the proposed project? If yes, please describe the specific issue and indicate why it is sufficiently crucial that it should be addressed as part of the proposed project.

Issue 3 under the "Issues Primarily Related to Revenues" in the Appendix asks whether gains should be defined separately from revenues; however, the body of the proposal does not address that issue. We believe that this is a fundamental issue that the Board would have to address in this project. Finally, none of the lists of issues in the Appendix contemplates specific disclosure requirements as part of the project. We believe that new disclosures would be inevitable as a result of the project.

Question 5: Should the proposed project, in addition to developing a new, general accounting standard on revenue recognition and revising the related guidance on revenues and liabilities in Concepts Statements 5 and 6, develop a new, general accounting standard on liability recognition?

No, as stated above, the FASB should not attempt to develop a standard on liability recognition as part of this project—this project should focus on revenue recognition. While the outcomes of this project may provide useful information for a later project on liability recognition, the Board should not delay a project on revenue recognition while it tries to resolve general liability recognition issues.

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If you have questions about our comments or wish further to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449.

Very truly yours,

KPMG LLP