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18 June 2009

Dear Sir / Madam

International Accounting Standards Board and Financial Accounting Standards Board  
Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers  
(the Discussion Paper)

We appreciate the opportunity to respond to the Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers, issued by the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) (together, the Boards). This letter represents the views of KPMG International and its member firms, including KPMG LLP (U.S.), and is being submitted to both the IASB and the FASB.

We support the Boards’ efforts to develop a consistent revenue recognition model that could be applied to transactions across industries, eliminate inconsistent U.S. GAAP guidance, and provide more guidance than currently is provided in IFRSs. We also generally support the broad principles of the model proposed in the Discussion Paper. Establishing those broad principles is an important first step in the development of comprehensive revenue recognition standards and the convergence of IFRSs and U.S. GAAP in relation to revenue recognition. However, the ultimate revenue recognition standards will require a well-developed framework for applying the broad principles in the Discussion Paper in order to achieve consistent application of the principles.

Because the Boards are continuing to develop the proposed model, the Discussion Paper does not include all guidance that would be included in a proposed standard. Issues not yet addressed, such as measurement of rights, are critical to more fully understanding how the proposed model
would be applied in practice and whether the model would be able to meet the Boards’ objectives of providing a model that can be applied consistently across industries and transactions. The Boards also will need to provide further information about the model to enable constituents to understand how the model would be applied to more complex transactions. The examples in the Discussion Paper are relatively simple and further development of the model will be necessary to address real commercial arrangements in which difficulties arise in practice and more complex transactions. Accordingly, in order for constituents to fully evaluate the proposed model, additional information will be necessary about the issues not yet addressed by the Boards and how the model would be applied to more complex transactions. In addition, the FASB will need to address how the proposed model will impact existing revenue recognition standards under U.S. GAAP. Further development of the principles and related standards also is necessary to determine whether a single model will represent faithfully the large number of diverse revenue transactions.

While we support development of a revenue recognition model based on the contract-based model proposed in the Discussion Paper, we have a number of specific comments and concerns, outlined below and in our responses to the Boards’ specific questions. Due to the incomplete status of the proposed model in the Discussion Paper, many of our responses are qualified as the Boards have not yet determined how to apply various aspects of the proposed model. Accordingly, our general support for the broad principles in the Discussion Paper is subject to the Boards’ further development of the model and related standards and implementation guidance. Further development of the model and related standards by the Boards may alter our views.

Legally enforceable rights and obligations

The model proposed in the Discussion Paper focuses on the entity’s contract with the customer and defines the customer contract as an agreement that creates enforceable obligations. We agree that the amount of revenue recognised should be based on the agreement with the customer. However, we believe that the Boards will need to provide a framework and additional guidance on the identification of such obligations and the level of evidence needed to support an assertion that enforceable obligations exist in order to achieve consistent application of the principle. Since legal regimes differ greatly from one jurisdiction to another, the Discussion Paper might be read by some as requiring preparers to obtain legal analyses and support for a conclusion that an agreement has given rise to enforceable obligations.

We agree with the Boards’ conclusion that a contract can have both explicit and implicit rights and obligations that could be enforceable. The Boards should also expand on the role a vendor’s historical practices plays in the analysis of enforceable obligations. For example, a software company may have an historical practice of delivering “when-and-if-available” upgrades on a semi-annual basis even though it has no legal obligation to do so. Would this historic practice be viewed as giving rise to a performance obligation that should be a separate unit of account (see following discussion about performance obligations)? Likewise, an airline might have an historic practice of granting miles to customers who are members of its customer loyalty
programme and may intend to continue to do so; however, the legal terms of the arrangement may give the vendor the right to cancel or discontinue the programme at any time. Would the historic practice give rise to a performance obligation until it has given notification of the programme’s discontinuance? We believe that such practices may give rise to performance obligations and that the Boards should specifically address that issue.

Identification of performance obligations

Consistent with the notion that a contract creates enforceable obligations, the Boards’ model would require that revenue be recognised when the vendor satisfies its performance obligations. This will require that the vendor first identify all the performance obligations in the agreement with the customer. While the Discussion Paper provides examples of performance obligations, it does not provide an overall principle for identifying performance obligations and the examples do not provide a clear explanation of the Boards’ intent. For example, would the notion of “stand-alone value” as articulated in EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables be a sufficient basis for identifying the performance obligations in the agreement, or would some additional analysis be required? The Discussion Paper appears to suggest that it is the Boards’ intention that more performance obligations be identified in comparison to the number of “deliverables” that are identified currently based on the stand-alone value threshold under U.S. GAAP and in practice under IFRSs. However, it is unclear what the additional performance obligations might be and how those would be identified consistently. For example, the Discussion Paper suggests that in a construction arrangement that qualifies as a “continuous delivery” arrangement, each nail, stud, and roof tile is a performance obligation. Additionally, it is unclear how important a role the rebuttable presumption in paragraph 4.56 (asset used in satisfying another performance obligation) is in the analysis or how the presumption might be overcome.

The Discussion Paper notes the importance of the distinction between a good and a service and its correlation to the timing of revenue recognition (i.e., a good is transferred to a customer as of a point in time and a service typically is transferred to a customer over a period of time). However, it is difficult to determine from the Discussion Paper all of the factors that may need to be considered and the significance that should be given to each factor in distinguishing between a good and a service.

In order to achieve an appropriate level of consistency in practice, the Boards should articulate more clearly the underlying principle, supported by an overall framework that articulates the factors to consider and the level of importance of those factors when identifying performance obligations and whether a performance obligation is a good or service.

Customer control versus satisfaction of performance obligation

The Discussion Paper proposes that revenue be recognised when the customer obtains control over the good or service provided by the vendor. This notion of customer control also calls into question the role of legal ownership by the customer in determining when revenue should be
recognised. Additionally, the Discussion Paper is not clear about the role that the customer’s perspective plays in the identification of performance obligations and whether those obligations have been satisfied.

Paragraph 4.25 states “The customer’s intended use of the promised goods and services is another factor that might affect an entity’s assessment of when assets are transferred to a customer. However, the customer’s intent in and of itself does not determine when a customer has an asset.” Paragraph 4.27 goes on to provide an example in which the vendor sells three pieces of equipment to a customer that it does not sell separately and delivers two of the three pieces. The customer cannot use the two delivered items until the third piece is received and installed. The Discussion Paper concludes that there are three separate performance obligations based on a conclusion that the three pieces of equipment could be sold separately; it is unclear from the example how this conclusion was reached. Paragraph 4.30 states that it does not matter that the customer cannot use the two pieces received until the third is received. This example appears to imply that customer intent is not a factor in determining whether the vendor has satisfied its performance obligation, which would seem to conflict with the statement in paragraph 4.25 that customer intent is a factor in the analysis. The Boards should provide a framework for making those determinations that addresses the factors to consider and the relative importance of those factors in order to achieve an appropriate level of consistency in practice.

**Right of return, sales incentives, customer acceptance, cancellation clauses**

Consistent with our concerns stated above about the role that legal analysis might play in the model, the Discussion Paper discusses a number of somewhat similar provisions of agreements and appears to express potentially inconsistent conclusions about whether those provisions are performance obligations or measurement of rights issues. For example, the Discussion Paper specifies that a right of return is a performance obligation that should be accounted for separately, with an alternative proposal for a “failed sale” model. In contrast, the Discussion Paper states that goods transferred to the customer under a consignment arrangement or trial period do not represent sales with a separate performance obligation for a right of return. The Discussion Paper does not explain adequately the difference between a sale of a good subject to a 30-day right of return versus a 30-day trial period after which the customer must either pay for the good or return it.

The distinction between sales incentives that would be accounted for as performance obligations and those that would be accounted for in the measurement of rights under the proposed model also needs to be clarified. There are various types of sales incentives or rights of return in practice today, including:

- volume rebates
- point-of-sale rebates
• free future products
• discounted future products
• rights of return
• price protection
• rights of exchange.

The Boards should establish a clearer framework to better explain which incentive arrangements would give rise to performance obligations as compared to those that would be reflected in measurement of rights, and what the distinguishing features are between those forms of customer incentives.

A transfer of cash to the customer could occur pursuant to return rights, cancellation rights or certain sales incentives. Even though the delivery of cash could meet the Discussion Paper's definition of a performance obligation, we question whether a promise to transfer cash should be considered a performance obligation.

Onerous contracts

We agree with the Boards’ conclusion that agreements that are onerous to the vendor should give rise to the recognition of a loss. However, we believe that an onerous test at a level below the contract level may be difficult to apply in practice and result in information that is not decision-useful in many situations. Additionally, we believe that the Boards will need to address when it is necessary or appropriate to aggregate contracts in determining whether an agreement or a group of similar agreements are onerous.

Relationship with the Boards’ other projects

We encourage the Boards to address and provide an explanation of their conclusions about the conceptual linkage between different projects of the Boards. One of the areas in the Discussion Paper that may have implications for other projects is the satisfaction of performance obligations (Chapter 4). The model in the Discussion Paper focuses on when the customer controls the promised good or receives the promised service. The control of an asset is relevant to a number of other projects:

• In Phase B of the Conceptual Framework project, the Boards have tentatively adopted the following working definition of an asset: "...a present economic resource to which the entity has a right or other access that others do not have”.

• The Discussion Paper Leases focuses on the right of a lessee to use the asset, i.e., legal ownership is not relevant.
In its Exposure Draft *Derecognition* the IASB comments (BC28) that “The proposed derecognition approach for financial assets is similar to the approach proposed by the Board in the recently published exposure draft ED 10 *Consolidated Financial Statements* (albeit derecognition is applied at the level of assets and liabilities, whereas consolidation is assessed at the entity level).” However, The Boards’ Discussion Paper Preliminary Views on an improved Conceptual Framework for Financial Reporting – The Reporting Entity explains that control over an entity and control of an asset are distinct concepts (paragraphs 51 to 62).

The Boards should address how these different projects and the conclusions in those projects regarding the recognition or derecognition of an asset relate to one another. See also our response to Question 8.

Similarly, since revenue is a key indicator of an entity’s financial performance (changes in economic resources and claims on them), how does the contract-based revenue recognition model in the Discussion Paper relate to the broader issue of financial performance, which is not necessarily contract-based, as well as to the broader concept of income?

Appendix A to this letter provides our responses to the specific questions raised in the Discussion Paper. Appendix B provides comments specific to the application of U.S. GAAP.

If you have any questions about our comments or wish to discuss any of these matters further, please contact Mary Tokar or Julie Santoro with KPMG’s International Financial Reporting Group in London at +44 (0)20 7694 8871, or Mark Bielstein or Paul Munter with KPMG LLP in New York at +1 (212) 909-5419 or +1 (212) 909-5567, respectively.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited
Appendix A: Responses to the questions set out in the Discussion Paper

Chapter 2: A contract-based revenue recognition principle

Q1. Do you agree with the Boards’ proposal to base a single revenue recognition principle on changes in an entity’s contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

KPMG Response: Generally we support the contract-based revenue recognition principle as articulated in the Discussion Paper. We believe that focusing on changes in an entity’s contract asset or contract liability may provide a basis on which to develop a model that has the potential to result in more consistent revenue recognition under U.S. GAAP and to provide more robust guidance under IFRSs. However, there are numerous areas that are yet to be addressed by the Boards that may be important to our overall support for a model. Appendix C of the Discussion Paper highlights many of these areas, including the measurement of rights in a contract. The development of an approach to address the accounting for the measurement of rights within the proposed model is critical to understanding whether the proposed principles and resulting model will meet the Boards’ objectives of providing consistency and improving comparability. The Boards also will need to address how the net contract position is to be recognised and displayed in the financial statements (i.e., gross or net). In addition to addressing those areas needed to complete the basic model, the Boards also will need to develop frameworks for the application of the principles of the model in order to achieve an appropriate level of consistency in the application of the principles. For example, as discussed in more detail in our responses below, well-developed frameworks for applying the principles around identifying performance obligations and determining when performance obligations are satisfied will be important elements of any final standards on revenue recognition based on the proposed model. Upon further development of the model and the frameworks necessary to apply the model, it may become apparent that a single model for revenue recognition may not be appropriate for all revenue-producing transactions.

Q2. Are there any types of contracts for which the Boards’ proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

KPMG Response: We support the Boards’ efforts to develop the principles for a single revenue recognition model that can be applied to all contracts with a customer, and we believe that the principles of the proposed model are an appropriate starting point. However, the Boards will need to complete the development of the model and frameworks for applying the model before concluding on whether the proposed principles would provide decision-useful information for all types of revenue-producing contracts. The examples included in the Discussion Paper are relatively simple and it will be necessary for the Boards to further develop the model and address how it would be applied to real-life, more complex and varied transactions in order to evaluate the practicability and accounting consequences of the proposed principle and model to
those more complex transactions and various industries. For U.S. GAAP, the FASB will need to address how the model will change existing authoritative literature for specific transactions in order to complete that evaluation.

We believe that it is appropriate to develop the model with the goal of including all contracts with customers and to limit scope exceptions to the model. However, the Boards' consideration of scope exceptions for financial instruments and lessor accounting is reasonable at this point in the project. We encourage the Boards to consider the interaction of the revenue recognition project as they develop standards applicable to financial instruments, leases, and insurance contracts and then determine whether it is appropriate to include contracts with those elements within the scope of the proposed model.

The proposed model will need to address how to account for arrangements that include both deliverables that are within the scope of the Discussion Paper and deliverables that could potentially be excluded (e.g., financial instruments, leases, insurance). For instance, many arrangements include both financial and non-financial elements and the Boards will need to address the interaction of their conclusions on financial instrument accounting with their conclusions on revenue recognition. For example, in banking deposit arrangements, the bank receives cash from a customer and has a financial obligation (i.e., deposit liability) but also may have non-financial performance obligations (e.g., free checking, transaction processing and ATM services). Contracts with customers that contain both a financial performance obligation and a non-financial performance obligation will need to be considered under the proposed model and will need to be addressed explicitly.

As the Boards further develop the model, they also may need to consider whether other models would be appropriate for certain transactions. For example, long-term construction arrangements that are deemed to be the delivery of a good may result in accounting under the proposed model, which is similar to “completed contract” accounting under existing U.S. GAAP standards. Other long-term contracts may be considered the continuous delivery of goods or services under the proposed model that might result in something similar to percentage-of-completion accounting under existing standards. However, further development of a framework for making those determinations under the proposed model will be necessary in order to evaluate whether such significantly different accounting would be appropriate for substantially similar contracts. Based on the information in the Discussion Paper, it is not yet clear that the different contractual terms of arrangements in long-term contracts would justify such dramatic differences in revenue recognition. In addition, such changes could raise significant implementation issues.

For example, an aircraft manufacturer might be manufacturing two aircraft, one for a governmental customer and another for a commercial customer. The terms of the contract might transfer ownership of the aircraft on a continuous basis for the governmental customer, but only transfer ownership for the commercial customer upon delivery. In each case, progress payments might be made by the customer and the customer may have no reasonable alternative other than having the vendor complete the aircraft even though one customer (governmental customer)
may have the legal right to take over the work in progress. It is unclear whether the differences in those arrangements are sufficient to result in recognising revenue on a continuous transfer basis for one aircraft and yet recognising revenue only upon completion for the second.

For those arrangements that would qualify for a continuous delivery approach under the proposed model, it may be necessary to identify numerous performance obligations. That might require significant changes to systems and data collection as well as a need to estimate selling price for many performance obligations that are not sold separately. Additionally, the evaluation of onerous performance obligations at a level below the contract and the allocation of consideration based on an estimate of the separate price for each performance obligation may not be practicable for long-term contracts under a continuous delivery approach.

Q3. Do you agree with the Boards’ definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

KPMG Response: We generally support the Boards’ definition of a contract, i.e., an agreement between two or more parties that creates enforceable obligations. However, additional information about what establishes enforceability is needed to clarify the Boards’ intent. We note the following potential issues and questions related to “enforceability”:

- How do contingent or conditional rights and obligations align with enforceability? For example, are “when-and-if-available” deliverables considered to be enforceable performance obligations that require separate measurement under the proposed model at inception of the contract?

- How is enforceability assessed for implicit obligations or those obligations established by past practice? Would preparers be required to make a legal determination of the enforceability of each performance obligation?

- Does the existence of return rights or cancellation rights within a contract contradict the notion of enforceability?

- How do customer acceptance provisions interact with the notion of enforceability of the contract?

In addition to these issues about the definition of a contract, additional consideration should be given to the definition of a customer to ensure that the application of both definitions results in the inclusion of all revenue transactions. The Discussion Paper defines a customer as a party that has contracted with an entity to obtain an asset (such as a good or a service) that represents an output of the entity’s ordinary activities. The definition may not be broad enough to capture arrangements in which the customer contract may not provide all the consideration that the vendor will receive for the product or services it provides. For example, the amount of revenue earned by a healthcare facility is not based solely on the contract that the healthcare facility has with its customer (i.e., the patient), but is also based on agreements with physicians and
insurance carriers and other third-party payors. The scope of “contracts with customers” does not address scenarios in which multiple contracts with multiple parties may need to be considered to determine the amount of revenue earned by an entity as a result of providing the output of its ordinary activities.

Chapter 3: Performance obligations

Q4. Do you think the Boards’ proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

KPMG Response: We believe that further clarification of the definition of a performance obligation and a framework of factors to consider and the relative importance of those factors are needed to enable entities to consistently identify the deliverables in (or components of) a contract. The Discussion Paper defines an entity’s performance obligation as a promise in a contract with a customer to transfer an asset (such as a good or service) to that customer. Greater clarity is needed for issues such as:

- What is the role of the customer perspective in determining the performance obligation?
- What framework is applied when distinguishing between goods and services?

The guidance in the Discussion Paper on the role of the customer perspective in determining the performance obligation is not clear. The Discussion Paper gives an example of the sale of a manufacturing process consisting of three pieces of equipment (paragraph 4.27). The example concludes that each piece of equipment is a separate performance obligation because they are separate assets stated in the contract even though the customer cannot use the individual pieces of equipment without all three pieces of equipment. Given that example, it would appear that the identification of performance obligations would not depend on what the promised asset is from the customer’s perspective. In this arrangement, the customer may believe that they are acquiring a single asset (i.e., the manufacturing process) rather than three individual assets. From that example, it appears that the Boards intend that a separate performance obligation would exist when a separate, promised asset is identified in the contract. If that is the Boards’ intention, then the model may give rise to structuring opportunities by having the contract separately identify numerous “assets”.

The Discussion Paper explains how both goods and services are assets to the customer. In many contracts it will not be difficult to determine whether an entity promises to transfer a good or a service, but it can be more difficult to make this determination in many construction-type contracts. The Discussion Paper distinguishes between goods and services by providing two examples of the construction of girders (paragraphs 4.39 - 4.44). In one example the girders are determined to be a performance obligation to transfer a good, and in the other example the girders are determined to be a performance obligation to provide a service.
The differences in the examples that result in one being considered a service that is transferred over time rather than a good transferred at a point in time appear to be the customisation of the product, customer payments made throughout the manufacturing process, and the fact that the customer has the unconditional right to take over the work in progress at any time. There are various factors that are provided in the girder examples but it is difficult to determine from the Discussion Paper all of the factors that may need to be considered and the significance that should be given to each factor in the assessment to distinguish between a good and a service and identify the performance obligations. For example, in the girder case if there is no clause that provides the customer with the right to take over the work in progress, then are the customisation and payments enough to conclude that the assets are being transferred over time?

Further, some examples in the Discussion Paper refer to the concept of stand-alone value, but the Discussion Paper does not state that it is a criterion for determining a performance obligation. What is the significance of stand-alone value in the identification of performance obligations? Since there is no comprehensive discussion of factors to consider, other factors might be relevant to the analysis. Further, while customisation is described as a significant characteristic in the determination of whether the performance obligation is a good or a service, it is unclear whether or how the customer’s practicable ability to take over the work (as contrasted with its legal right) would affect the analysis.

Given the lack of clarity in the Discussion Paper on distinguishing between goods and services, a well-developed framework that identifies factors to consider and the relative importance of those factors will be needed to achieve an appropriate level of consistency in the determination of whether the obligation is related to a good or a service. That framework should provide sufficient distinctions between contracts requiring the delivery of a good as compared to a service to justify the potentially significantly different accounting.

The definition of a performance obligation is based on an asset (good or service) that is transferred to the customer. Given this definition, it is difficult to determine whether various customer “rights” within a contract represent performance obligations for the vendor. For example:

- Do exchange rights represent a service that is provided to the customer and therefore are performance obligations or do these rights represent a modification to a contract if exercised?

- Would exclusivity rights or a promise not to do something be considered a performance obligation?

- Even though cash is an asset and the delivery of cash could meet the Discussion Paper’s definition of a performance obligation (e.g., a right to a cash refund with a return period), we question whether a promise to transfer cash should be considered a performance obligation. A transfer of cash could occur pursuant to return rights, cancellation rights, or
certain sales incentives. See Questions 6 and 7 for additional comments on return rights and sales incentives as performance obligations.

- How does the proposed definition help to identify performance obligations when goods or services to be delivered may be uncertain or at the discretion of the customer (e.g., customer options)? In particular, how are performance obligations identified in fixed fee arrangements with uncertain deliverables? For example, would each expected deliverable under a “when-and-if-available” arrangement be considered a separate performance obligation to deliver a good?

- When the continuous delivery model is deemed to be applicable, how are the performance obligations identified when many, if not most, of the activities needed to complete the vendor’s obligation are never sold separately and may not be transferable independently?

A principles-based framework should be developed that identifies the factors to consider and the relative importance of those factors to identify performance obligations and determine whether a performance obligation is a good or service.

Q5. Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

KPMG Response: Conceptually we agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer. However, in some situations it may not be clear when an entity transfers promised assets to the customer, i.e., when the customer has control. While the Discussion Paper appears to use customer control and the satisfaction of performance obligations interchangeably, those two concepts may result in different conclusions about the timing of revenue recognition for the vendor. See our response to Question 8 for additional considerations related to determining when “control” transfers to the customer.

It is also difficult to apply the concept of transferring promised assets to the customer when services are being provided. When services are being provided, it is unclear how to identify the “assets” that are being transferred and when that asset has been transferred from a vendor to a customer.

Q6. Do you think an entity’s obligation to accept a returned good and refund the customer’s consideration is a performance obligation? Why or why not?

KPMG Response: No, we do not believe that an entity’s obligation to accept a returned good and refund the customer’s consideration is a performance obligation. As noted in our response to Question 4, we question whether a promise to transfer cash should be considered a performance obligation. Although there is inherent value given to the customer by having a return right included in the contract, we do not believe that a customer’s right to cancel the
transaction should be considered a separate performance obligation. There are a number of customer “rights” provided in contracts and there is inherent value given to the customer by having these various “rights” included in the contract also. However, we believe that not all customer “rights” necessarily represent performance obligations to the vendor; nor does the Discussion Paper specifically identify these other customer “rights” (e.g., acceptance provisions) as performance obligations. In addition to the customer “rights” discussed in our response to Question 4, we also question how the economics of a physical return right differ from a price protection clause. If return rights are determined to be a performance obligation, the Boards should provide the distinguishing factors between return rights and other customer “rights” that would not be considered performance obligations.

Treating the right of return as a performance obligation would potentially result in the recycling of revenue and the amount of revenue reported being in excess of the amount of net cash collected by the vendor from its customers. This would result in an increase in revenue compared to current practice without an increase in the output of the entity’s ordinary activities with the customer. For example, if a right of return is a performance obligation, then the consideration that the customer pays for the product is allocated between the product and the return right. The revenue allocated to the return right would be recognised as revenue over the return period or upon the customer’s return of the product as the performance obligation would be satisfied upon return. The revenue related to the right of return would not be reversed even when the product is returned and a full refund is provided to the customer. This would result in the recognition of revenue that exceeds the cash collected from the customer. The approach outlined in the Discussion Paper also raises questions about how to account for unlimited return rights when, in theory, the performance obligation may never be satisfied.

Accordingly, we believe that a “failed sale” accounting approach that provides the ability to recognise revenue for the proportion of transactions that are not expected to fail results in a more faithful representation of the economics of return rights.

Q7. Do you think that sales incentives (for example, discounts on future sales, customer loyalty points, and “free” goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

KPMG Response: We generally support the view that sales incentives give rise to performance obligations if they are provided in a contract with a customer. However, as noted in our responses to Questions 4 and 6, we question whether a promise to transfer cash should be considered a performance obligation or whether it might be considered as an adjustment to customer consideration. We believe that cash rebates such as volume rebates would be best reflected as an adjustment to the transaction price of an arrangement and therefore would be addressed in the measurement of rights under the proposed model. Because sales incentives may take a number of different forms, there needs to be a framework to determine which sales incentives represent a performance obligation and which represent an adjustment to the transaction price.
For example, sales incentives can include one or a combination of:

- free goods and services
- cash rebates
- discounts on future sales.

All of these types of sales incentives can provide the customer with similar values and the Discussion Paper is not clear on how to distinguish among these types of sales incentives. Without providing a framework for making this distinction, there would be inconsistent accounting treatments across economically similar transactions, which could lead to inconsistency in the application of the model or in structuring to achieve a desired accounting result.

The Discussion Paper addresses sales incentives provided in a contract with a customer. Some sales incentives may not be provided to the customer. For example, entities may provide sales incentives to the end customer and not necessarily the entity’s customer (e.g., retailer). Given that these arrangements currently result in adjustments to revenue under existing standards, which we believe is appropriate, they need to be addressed as part of the revenue recognition project.

**Chapter 4: Satisfaction of performance obligations**

**Q8.** Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

**KPMG Response:** We believe that the Boards should clarify how the customer control of a promised good aligns with the vendor’s satisfaction of its performance obligation. The proposed model should include a framework for the vendor to determine when control of the good or service is transferred to the customer, including how the customer’s perspective affects the analysis. Currently, the Discussion Paper cites various factors to consider in different examples. The factors may or may not indicate that control is transferred to the customer and it is difficult to determine which factors are more significant in the assessment without an overall framework that identifies the factors to be considered and the relative importance of the factors. The framework could include many of those items cited in the examples, including:

- physical possession of the good by the customer (4.5 and 4.6)
- enforceable rights (4.12)
- customer acceptance (4.20)
• customer intent (4.25)
• customer payment terms (4.32)
• asset is constructed on the customer’s land (4.47)
• legal title (4.55)
• whether an asset is used in satisfying another performance obligation (4.56)
• contract terms or operation of law (4.57).

As noted earlier (e.g., see our response to Question 3), the notion of customer control articulated in the Discussion Paper may necessitate a legal analysis. In particular, the Boards should clarify whether they intend for “control” to be evaluated based on legal ownership or whether physical control also can result in “control” of the good or service by the customer. For example, the Discussion Paper notes that a sale of goods subject to a right of return constitutes a sale (with the right of return constituting a separate performance obligation) whereas the transfer of goods for a trial period or on consignment was not a sale. The Boards should clarify how the arrangements differ in terms of the control that the customer has over the transferred good, other than through legal ownership. An overall framework would help establish a basis for the application of the control concept that is principles-based. This framework also should provide guidance on how the different factors impact the assessment of transfer of control of the good or service to the customer.

We also note that as part of the Boards’ Conceptual Framework project on Elements and Recognition, the Boards agreed that the current frameworks’ existing asset definitions had shortcomings, including that some misinterpret the term “control” and use it in the same sense as that used for purposes of consolidation accounting. The Boards are in the process of clarifying that the term “control” should focus on whether the entity has some rights or privileged access to the economic resource. The Boards’ tentatively adopted the working definition of an asset as “An asset of an entity is a present economic resource to which the entity has a right or other access that others do not have.” If the Boards’ revenue recognition model is to be based on the transfer of control of an asset to the customer, then the guidance on the transfer of control in the revenue recognition model should be consistent with the concept of an asset. However, applying that concept to revenue recognition will raise further questions. For example, in a non-exclusive licensing arrangement (e.g., software licenses), how does the customer obtain access that others do not have?

The Discussion Paper includes the notion of a continuous transfer of assets with respect to services and construction-type contracts. Although the continuous transfer of assets notion results in the recognition of revenue over time, which we believe is appropriate in many service and construction-type contracts, the Discussion Paper does not provide a sufficient explanation on how such arrangements meet the requirement for “control” to transfer. Further, how does the
continuous transfer of assets notion reconcile with the rebuttable presumption that the 
recognition of revenue related to one performance obligation is deferred if that performance 
obligation is being used in the satisfaction of another performance obligation? In a construction-
type contract, most performance obligations would be used in the satisfaction of another 
performance obligation.

In arrangements subject to continuous transfer, the Discussion Paper does not appear to provide 
for a level-margin approach as currently may be the case for percentage-of-completion 
arrangements; rather, each unit of account with its specific margin would be recognised as the 
good or service is transferred. The Discussion Paper does not provide sufficient clarity on the 
level of granularity needed when identifying the performance obligations for such arrangements.

Q9. The Boards propose that an entity should recognise revenue only when a performance 
obligation is satisfied. Are there contracts for which that proposal would not provide decision-
useful information? If so, please provide examples.

KPMG Response: Generally, we agree that an entity should recognise revenue only when a 
performance obligation is satisfied. However, as noted in our response to Question 8, the Boards 
should provide greater clarity on the identification of performance obligations and when a 
performance obligation is satisfied. Therefore we support the Boards’ intention to provide 
application guidance:

• to help entities identify performance obligations;
• to help entities assess when performance obligations are satisfied; and
• on how an entity should determine stand-alone selling prices for the purpose of allocating 
the transaction price to separate performance obligations.

The guidance that the Boards intend to develop will be necessary in order to determine whether 
there are contracts for which the revenue recognition proposal would not provide decision-
useful information. For example, does the revenue recognition proposal provide decision-useful 
information when a contract includes a promise not to do something (i.e., an exclusive 
agreement or noncompete agreement)? Until the model is further developed and additional 
guidance is provided, it is difficult to determine if there are contracts for which the model would 
not provide decision-useful information.
Chapter 5: Measurement of performance obligations

Q10. In the Boards’ proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

KPMG Response: We agree that performance obligations should be measured initially at the transaction price because it would result in more consistency in application and the recognition of revenue that is more representationally faithful since it would be based on the negotiated arrangement between the customer and the vendor.

While we support the model proposed in the Discussion Paper, the issue of measurement of rights, which is not addressed in the Discussion Paper, will require additional guidance; this is particularly relevant when there is uncertainty regarding the timing and/or amount of consideration to be received.

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity’s expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

KPMG Response: We agree that more decision-useful information could be provided if there is remeasurement to the entity’s expected cost of satisfying the performance obligation(s) when the performance obligation(s) is deemed to be onerous. In doing so, the determination of the onerous provision should be based on an entity’s expected costs in excess of the carrying amount of the performance obligation(s). We do not believe that the onerous contract provision should be based on a current price test. Remeasurement using a current price trigger, which includes expected costs plus a margin, would increase the frequency of remeasurement and would result in accounting that is overly complex for most transactions. A current price trigger also would result in profit recognition when an onerous obligation is satisfied.

There are, however, significant challenges in developing a model that can be implemented for a variety of different arrangements. The Boards highlighted a number of such challenges and issues to address, including where a margin would act as a buffer to absorb adverse changes in the performance obligation, what costs to include in the onerous test, whether to include margin in the remeasurement, and when there is a high degree of variability in outcomes.

In addition to the issues identified in the Discussion Paper, defining the unit of account is an important matter to address. We believe that the onerous evaluation generally should be made at the contract level or, as discussed below, for multiple related contracts rather than at the performance obligation level within a contract. The contract level generally is appropriate because this is the level at which the overall price was negotiated and the overall economics of
the arrangement are established. For instance, under SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, and IAS 11 *Construction Contracts*, an onerous provision generally is determined at the contract level. In addition, IAS 37 *Provisions, Contingent Liabilities, and Contingent Assets* states that “an onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.” [Emphasis added]

Other challenges exist in establishing an effective onerous remeasurement model. For example, there may be multiple performance obligations that are related but included in multiple different contracts, such as tickets to a sporting or entertainment event, where revenue is derived from multiple sources (advertising and sponsors, ticket sales, concession and parking sales at the event). If the onerous test were applied at the individual contract level (i.e., each ticket sold), then a vendor could conclude that it has an onerous provision; this could result in the recognition of all related costs immediately, and the resultant revenues being recognised when the performance obligation is satisfied.

Other situations that may require further consideration are when an entity enters into an onerous contract as part of a broader business strategy. This might be the case in situations such as loss leader products, arrangements with significant upfront or set-up costs such as a product or service that has a significant learning curve, or a product, such as software, that may require significant upfront research and development costs.

The Discussion Paper gives an example of construction services that represent a continuous transfer of assets. In that example the onerous test is applied to the remaining obligations at the reporting date, but the remaining obligations were profitable so the Discussion Paper does not illustrate how to apply the onerous test. However, if the test is to be applied to the remaining performance obligations, then a situation could exist in which costs increase in one reporting period but because there are certain profitable performance obligations that have not been satisfied, no remeasurement occurs. In a subsequent period when the profitable performance obligations are satisfied, the remaining obligations could require remeasurement, even though the cost changes that necessitate the re-measurement occurred in a prior period. Accordingly, the application of the onerous test may be impacted by the allocation of consideration to the individual performance obligations within an overall contract that would be accounted for under a continuous delivery approach.

The model also may need to address how onerous performance obligations are accounted for when they are deemed to no longer be onerous. For example, an entity may record a loss in one period, and then the entity may become more efficient thereby mitigating the expected loss on the contract.

In measuring the onerous contract provision, we believe that a margin should not be included in the remeasurement. Inclusion of a margin in remeasurement would create complexity and result in reporting a profit when the performance obligation is satisfied.
(c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.

KPMG Response: In general we believe that the Boards should attempt to develop a model that will be applicable to all types of customer arrangements. We acknowledge that arrangements involving financial instruments and insurance contracts, as outlined in 5.90 of the Discussion Paper, may need to be scoped out of the standard. Additionally, the Boards may find that a different model may provide more decision-useful information for other arrangements, such as long-term contracts. We do believe, however, that the Boards should not scope out such arrangements from the project at this point in time; instead, they should continue to consider whether the application of the proposed model might not result in decision-useful information for certain other arrangements.

(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

KPMG Response: We support the development of a model that can be applied to a broad range of performance obligations across all industries. However, the Boards may find that for some arrangements the general model does not result in decision-useful information and, if so, then those arrangements should be subject to a different recognition or measurement model (e.g., financial instruments).

Q11. The Boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (for example, selling costs) are included in the initial measurement of the performance obligations. The Boards propose that an entity should recognise those costs as expenses unless they qualify for recognition as an asset in accordance with other standards.

(a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity’s performance obligations? Why or why not?

KPMG Response: We agree that any amounts that an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity’s performance obligations because customer consideration should not be allocated to, nor revenue derived from, the entity’s activities to obtain the contract. These activities occur before the contract with the customer is established and these activities do not meet the Boards’ definition of performance obligations.
(b) In what cases would recognising the contract origination costs as expenses as they are incurred not provide decision-useful information about an entity’s financial position and financial performance? Please provide examples and explain why.

KPMG Response: We agree that an entity should recognise pre-contract origination, selling, and other costs of obtaining the contract as an expense. However, for “post-contract signing” in which there are other upfront fulfilment costs that are deemed to be recoverable under the contract, capitalisation would be appropriate even though the costs are not addressed directly by another accounting standard. For example, it may be appropriate for certain set-up costs for an outsourcing contract to be capitalised initially and recognised in income over the contract period as the performance obligations are satisfied since those costs are a part of the fulfilment effort by the vendor. Another example of upfront costs that may be appropriate to capitalise is advances against future royalties by a publisher to an author.

We believe that the Boards should provide guidance on the capitalisation of upfront costs and the period over which such costs are allocated to performance obligations and recognised in profit or loss. Such guidance could also provide for greater consistency in financial reporting by not allowing capitalisation to be an accounting policy election, as is the case currently under U.S. GAAP.

Q12. Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity’s stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

KPMG Response: We agree that the transaction price generally should be allocated to the performance obligations on the basis of the entity’s stand-alone selling prices of the goods or services underlying those performance obligations. We believe that this model is less complex and more objective than a current exit price approach. Additionally, we believe that the best evidence of the transaction price of a performance obligation is the stand-alone selling price when an entity sells a good or service separately. However, as noted previously, that allocation may not be appropriate for contracts accounted for using a continuous delivery approach.

Q13. Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

KPMG Response: We agree that if an entity does not sell a good or service separately, then it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price. Additionally, we support the Boards’ approach of not prescribing or precluding any particular methodology as long as the estimate is consistent with the stand-alone selling price notion and is based on the best available evidence of stand-alone selling price and maximises observable inputs.
Appendix B: Other comments specific to US GAAP

The FASB will need to evaluate how the model changes the accounting under all currently-existing revenue recognition literature. Given the volume of authoritative literature including industry-specific guidance under U.S. GAAP, it will be important for constituents to understand the changes that will occur as a result of the proposed model. As a consequence, we believe that the FASB should communicate what existing guidance, if any, would continue to be required, permitted, and no longer applicable. This should help constituents better understand the potential implications of the proposed model to specific industries and types of transactions. We encourage the FASB to begin this evaluation as an integral step in the development of a new revenue recognition standard. Identifying and articulating these changes also could highlight additional issues for consideration during Board deliberations.