June 30, 2015

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Comment letter on FASB Proposed Accounting Standards Update, Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing

We appreciate the opportunity to comment on the Board’s proposed ASU, Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licensing. We support the objective of the FASB to clarify certain aspects of ASC Topic 606 to reduce the risk of diversity in practice arising upon the adoption of ASC Topic 606. There are certain aspects of the proposed ASU that we believe require modification to more fully achieve the Board’s objectives.

Licenses of Intellectual Property

The proposed guidance that categorizes intellectual property (IP) as functional or symbolic has the potential to reduce diversity in practice, but there are aspects that may nevertheless result in unintended consequences. These are avoidable with modest modifications to the proposal.

The proposed ASU sets forth criteria that define both symbolic and functional IP. Under the proposed guidance, we believe some licenses of IP may not solely fit into either category, potentially resulting in diversity in practice. We recommend that the Board modify the proposed guidance to include criteria that must be met for the IP to qualify as symbolic (recognized over time) and, if those criteria are not met, then the intellectual property will be categorized as functional (recognized at a point in time). This would both reduce the potential for diversity in practice and also be consistent with a criteria approach taken elsewhere in ASC Topic 606, such as where performance obligations are satisfied over time only if specified criteria are met and otherwise are satisfied at a point in time.

In addition, the proposed guidance conflicts with respect to how or whether an entity should consider past or future activities in determining whether revenue from the license of symbolic IP should be recognized over time. The proposed guidance does not contemplate circumstances where the IP owner decides that it will not support or maintain the symbolic IP, but still licenses the IP thereby allowing the customer to realize the utility of the IP (e.g., logos such as Pan Am and Studebaker, which may appear in “period” film productions). We recommend that the proposed guidance be amended to clarify whether past and future activities, or both, are relevant in determining that a license of IP is symbolic, and clarify the factors that should be considered in determining the nature of relevant activities that significantly affect the IP.
Identifying the Performance Obligations

We understand the concern that some have in light of the financial reporting environment in the U.S. regarding the potential requirement to at least identify and quantity performance obligations of an insignificant nature. We are not convinced that the introduction of a new concept of immaterial in the context of the contract into U.S. GAAP is the most effective means to address this concern. The notion of immaterial in the context of a single transaction does not apply in other areas of U.S. GAAP since materiality is normally assessed at the financial statement level. Furthermore, based on the discussion at the Transition Resource Group (TRG) meeting on January 26, 2015, the concept does not apply to other aspects of the revenue standard, such as the evaluation of whether customer loyalty programs constitute a material right. If the FASB believes that additional guidance is necessary, we believe that the use of inconsequential or perfunctory would be an easier solution in the U.S. marketplace since this concept is well-understood by U.S. preparers, auditors, and regulators. Additionally, the FASB could incorporate existing SEC guidance mitigating the risk of unintended consequences that can result from the introduction of a new concept.

Proposed Examples

Lastly, as described further in Appendix 1, some of the examples included in the proposed ASU are too lengthy and include facts and analysis that are not germane to the point intended to be illustrated or their consequence on the analysis is not clearly described. These examples will add complexity as preparers attempt to determine which example is closer to their fact pattern. In addition, there are circumstances where the conclusions reached either differ or conflict with the proposed guidance.

We look forward to working with the FASB as it continues to work through implementation issues to improve the operability of the new revenue standard and reduce the risk of diversity in practice. Our responses to the Board’s specific questions and our other observations about the proposed ASU are included in Appendix I. If you have questions about our comments or wish to discuss any of the matters addressed herein, please contact Brian Allen at (212) 954-3621 or ballen@kpmg.com, Prabhakar Kalavacherla at (415) 963-8657 or pkalavacherla@kpmg.com, or Paul Munter at (212) 909-5567 or pmunter@kpmg.com.

Sincerely,

KPMG LLP

KPMG LLP is a Delaware limited liability partnership, the U.S. member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.
Appendix 1 – Responses to the Boards’ questions

Question 1 – Should the series guidance be optional

Paragraphs 606-10-25-14(b) through 25-15 include guidance on accounting for a series of distinct goods or services as a single performance obligation. Should the board change this requirement to an optional practical expedient? What would be the potential consequences of the series guidance being optional?

The application of the series guidance for certain entities is expected to be costly to implement as illustrated by the TRG discussion on March 30, 2015. We understand that the series guidance was designed to provide an opportunity for some entities, such as those that provide repetitive services, to simplify their accounting model by eliminating the requirement to identify multiple distinct goods or services, allocate the transaction price to each of the resulting performance obligations on a stand-alone selling price basis, and then recognize revenue when each of those performance obligations are satisfied. We believe that the series guidance does not provide a similar benefit to entities for whom identifying the performance obligations in a single contract is not a difficult judgment. Further, some entities may significantly alter reported revenues and related costs when each distinct good or service in a contract is combined into a single performance obligation.

Question 2 – Immaterial in the context of the contract

Paragraphs 606-10-25-16A specifies that an entity is not required to identify goods or services promised to a customer that are immaterial in the context of the contract. Would the proposed amendment reduce the cost and complexity of applying Topic 606? If not, please explain why.

The concept of immaterial in the context of the contract would introduce a new materiality assessment into U.S. GAAP and may result in unintended consequences unless the FASB provides factors for a preparer to consider in making this judgment. In current practice, some entities elect to not apply certain provisions in U.S. GAAP, such as not capitalizing small dollar equipment purchases or accounting for certain items on a cash basis rather than the accrual basis. Entities evaluate whether the effect of these accounting policies are material to the financial statements taken as a whole. The concept of immaterial in the context of the contract does not apply in other areas of U.S. GAAP, and introducing the concept only for one aspect of the revenue model creates a separate standard for evaluating materiality. If the Board believes that amendments are necessary, we recommend the Board consider incorporating the notion of inconsequential or perfunctory that we believe is well-understood by U.S. preparers and auditors. The more closely these factors are aligned with current practice and guidance, the more likely this aspect of adopting the standard will reduce diversity in practice.

Question 3 – Shipping and Handling

Paragraphs 606-10-25-18A permits an election to account for shipping and handling as an activity to fulfill a promise to transfer a good if the shipping and handling activities are performed after a customer has obtained control of the good. Would the proposed amendment reduce the cost and complexity of applying Topic 606? If not, please explain why.
We believe that the proposed accounting policy election to account for shipping and handling activities performed after a customer has obtained control of the good as a fulfillment cost rather than a separate performance obligation is unnecessary. The proposal would create a difference between U.S. GAAP and IFRS, would not reduce diversity in practice, and would not reduce the cost of implementing the standard. The genesis of this proposed guidance is based on the belief by some that in a circumstance where title transfers to the customer upon shipment but the seller retains the responsibility for delivery and risk of loss during transit (synthetic FOB destination), control of the goods nonetheless transfers to the customer at shipping point. We do not agree with this premise in all circumstances. We believe that the ASU, as written, may cause some arrangements with synthetic FOB destination circumstances to conclude, based on the indicators of control transfer, that control of the goods transfers upon arrival at their destination while other arrangements will lead to an appropriate conclusion that control transfers at shipping point. We do not view this outcome as resulting in diversity in practice because the accounting difference is a consequence of different fact patterns. Therefore, we recommend that the Board not adopt this proposal. Alternatively, if the objective is to reduce diversity and ensure that all entities with synthetic FOB destination terms account for the transfer of control consistently then we would suggest the Board reconsider the indicators of transfer of control and weight certain indicators (e.g., risk of loss) to ensure this outcome.

Question 4 – Examples on identifying performance obligations

Would the revisions to paragraph 606-10-25-21 and the related examples improve the operability of Topic 606 by better articulating the separately identifiable principle and better linking the factors to that principle? If not, what alternatives do you suggest and why?

We appreciate that the proposed revisions to the indicators of “distinct in the context of the contract” were intended to better articulate the separately identifiable principle. We believe that the rearticulated principle and related indicators are an improvement from the existing standard. The examples, however, do not always clearly illustrate how to implement the revised indicators and some of the examples are unnecessarily lengthy and complex. As a result, we found instances where the conclusions reached were difficult to understand, conflicting with the standard, and potentially different from the guidance in other examples. Below is a summary of observations for the examples related to identifying the performance obligations:

- Example 10, Case B (606-10-55-140A through 140C) – The example is meant to illustrate a significant integration service for multiple items, but unnecessarily concludes that the goods are highly interrelated and highly interdependent. We recommend removing the conclusion that the goods are highly interrelated and highly interdependent, and clarifying the fact pattern to more clearly illustrate how the entity is providing a significant integration service.

- Example 10, Case B (606-10-55-140A through 140C) – The example describes normal activities for a manufacturer and concludes that these activities are an important factor in determining that a significant integration service exists for highly customized goods. It is unclear whether every manufacturer of a series of customized goods should conclude that it is providing a significant integration service. We recommend clarifying the fact pattern to more clearly illustrate the nature of the promised goods and services and the Board’s view of those activities that constitute significant
integration services, including whether a manufacturer of any series of customized goods is providing a significant integration service.

- Example 10, Case C (606-10-55-140D through 140F) – There appears to be two separate thresholds to describe the customer’s ability to benefit from a software license (the upfront license only provides a minor portion of the economic benefit from the overall arrangement versus the customer’s ability to benefit from the software declining significantly). We recommend that the example be clarified to focus on the nature of the promised good, a protection-like service, rather than the value of the license.

- Example 44 (606-10-55-309) – It is unclear what factors are being used to conclude that the training service is material, or what change in the fact pattern would be necessary to conclude that it is immaterial in the context of the contract. We recommend amending the example to clarify the basis for concluding that the training services are material.

**Question 5 – The nature of an entity’s promise in granting a license**

Would the revisions to paragraph 606-10-55-54 through 55-64, as well as the revisions and additions to the related examples, improve the operability of the implementation guidance about determining the nature of an entity’s promise in granting a license? That is, would the revisions clarify when the nature of an entity’s promise is to provide a right to access the entity’s intellectual property or to provide a right to use the entity’s intellectual property as it exists at the point in time the license is granted? If not, what alternatives do you suggest and why?

We believe clarification to the license implementation guidance is necessary to ensure more consistent conclusions in determining when the nature of an entity’s promise is to provide a right of access or right to use the entity’s intellectual property. However, we believe the proposed revisions should be modified to improve the operability of the licensing implementation guidance. Generally, under U.S. GAAP and the new revenue standard, criteria are set forth that result in a particular accounting outcome when the criteria are met and a different outcome when the criteria are not met. The proposed guidance that defines symbolic and functional IP does not address licenses of IP that may possess characteristics of either definition, increasing the potential for diversity in practice. We recommend that the proposed guidance define symbolic IP (and the revenue is recognized over time) and state any intellectual property that does not meet the definition for symbolic be considered functional (and the revenue is recognized at a point in time).

We also believe enhancements to the current definition and implementation guidance of symbolic IP would improve the operability of the proposed guidance, as noted below:

- In subparagraph 606-10-55-59(b), the definition of symbolic IP states that “substantially all of the utility of symbolic intellectual property is derived from its association with the entity’s past or ongoing activities….” Paragraph 606-10-55-60 states that “a customer’s ability to derive benefit from a license to symbolic intellectual property depends on the entity continuing to support or maintain the intellectual property.” We believe this guidance is contradictory and may result in diversity in practice. There are circumstances in which IP retains utility and has no standalone functionality, yet its owner does not intend to support or maintain it.

- The guidance in subparagraph 606-10-55-60(a) is not unique to symbolic IP and should not be a criterion in determining whether the nature of the promise is satisfied over time or at a point in time.
We recommend that the proposed guidance be amended to clarify whether both past and future activities are relevant in determining the nature of a license of symbolic IP. We recommend that subparagraph 606-10-55-60(a) be deleted, and that the Board clarify which factors should be considered in determining the nature of relevant activities that significantly affect the IP.

Finally, the provisions in paragraph 606-10-55-62 create a second threshold for over-time revenue recognition for a license of functional IP, which the Board expects to be met “only infrequently, if at all”. Based on that expectation and consistent with our earlier point on the distinction between symbolic and functional IP, we recommend that this guidance be removed, and that all functional IP constitutes a right to use the IP. The theoretical concern that the Board is addressing in this paragraph is adequately addressed elsewhere in the model.

We believe the examples could be improved if certain revisions are made to more clearly articulate the Board’s views with respect to the license guidance. Our recommendations to the licensing examples are as follows:

- Example 55 (606-10-55-364 through 366) – The example is unnecessary given the changes to Example 11. We recommend deleting the example.
- Example 59 (606-10-55-389 through 394) – We recommend adding a discussion that the costs should be expensed as incurred, despite the fact that revenue will be recognized under the sales-based royalty exception.

**Question 6 – Licensing implementation guidance**

The revisions to paragraph 606-10-55-57 that state an entity should consider the nature of its promise in granting a license of intellectual property when accounting for a single performance obligation. Does this revision clarify the scope and applicability of the licensing implementation guidance? If not, why?

The revisions to paragraph 606-10-55-57 adequately clarify that a combined performance obligation that includes the license of intellectual property should apply paragraphs 606-10-25-25 through 25-37 to determine whether a combined performance obligation is satisfied at a point in time or over time. However, we believe the requirement for an entity to “consider the nature of its promise in granting a license” is not adequately described and that it is unclear how an entity should consider the nature of recognizing revenue for the combined performance obligation. Without clarifying the guidance, an entity could conclude that it is appropriate to determine the recognition pattern provided for under the license implementation guidance to the license portion of the combined performance obligation rather than use paragraphs 606-10-25-25 through 25-37 on the entire performance obligation, even when the license constitutes a relatively small amount of the overall value of the arrangement to the customer. Whereas other entities might conclude that the license guidance should be applied when the license is predominant or apply some other threshold.

The proposed guidance to consider the nature of the license of intellectual property is different than the approach taken in the sales-based and usage-based royalty exception, which is applied when the license is predominant. In considering the nature of the license, it is unclear whether the predominance of the license to the combined performance obligation is a factor to consider. We recommend updating the proposed guidance to apply the same threshold as the sales-based and usage-based royalty exception, such that the license guidance should apply to all licenses of IP when they are individual performance
obligations or the predominant item in a performance obligation with two or more promised goods or services.

Question 7 – The impact of contractual attributes and contractual restrictions on the nature of an entity’s promise

Would the revisions to paragraph 606-10-55-64 adequately communicate the Boards’ intent (a) that restrictions of time, geographical region, or use in a license of intellectual property are attributes of the license (and therefore, do not affect the nature of an entity’s promise in granting a license or its assessment of the goods or services promised in a contract with a customer) and (b) about determining when a contractual provision is a restriction of the customer’s right to use or right to access the entity’s intellectual property? If not, what alternatives do you suggest and why?

We believe that the proposed changes clarify the Board’s intention that contractual attributes and restrictions define the scope of a customer’s right to use or right to access intellectual property and that they do not define whether the entity satisfies its performance obligation at a point in time or over time. We believe that portions of the examples are not fully aligned with the guidance in the proposed ASU.

In Example 61A, it is unclear from the facts provided why each episode is not a performance obligation. Subparagraph 606-10-55-64(a) provides that restrictions of time, geographical region or use do not affect how many goods or services are promised in the contract. Assuming the distinct good or service is an individual episode, we believe this example contradicts the conclusions that revenue from the software license or its renewal cannot be recognized until the start of the license period. We recommend clarifying the guidance and examples to consistently illustrate how time-based restrictions should be considered in determining the timing of revenue recognition.

In Example 61B, the conclusion is that an exclusive license with a black out period would be one performance obligation, whereas a non-exclusive license with a black out period would be two performance obligations. We believe the distinction in these circumstances might affect the transaction price negotiated between the parties rather than the identification of performance obligations. We also believe that the entity’s ability to license the IP during an intervening period does not represent the relinquishment of rights by the customer. We do not believe that restrictions of time should determine whether separate performance obligations exist.

Question 8 – Sales-based and usage-based royalties

Would paragraphs 606-10-55-65 through 55-65B and the related example clarify the scope and applicability of the guidance on sales-based and usage-based royalties promised in exchange for a license of intellectual property? If not, what alternatives do you suggest and why?

We believe the proposed guidance would clarify the scope and applicability of the sales-based and usage-based royalty exception if further discussion and guidance is included to define the meaning of predominant. The current discussion in paragraph 606-10-55-65A may cause confusion as it provides an example of when the customer would ascribe significantly more value to the license than to the other goods or services to which the royalty relates. It is unclear whether predominance is determined based solely on the value of the license, how qualitative factors should be considered or whether predominance should be determined relative to the other performance obligations in the contract. We recommend adding incremental guidance to describe how the Board expects an entity to assess predominance and how to
determine the value ascribed to each promised good or service in a performance obligation subject to the royalty exception in evaluating the predominant component.

We believe Example 60 is useful to illustrate a basic set of facts and circumstances. We recommend that the proposed guidance be expanded also to include a more complex fact pattern. For example, an entity that licenses software and provides telephone support in exchange for consideration that includes a $1.0 million upfront payment and royalties of 5% for the license and 2% for the telephone support services.

The proposed guidance does not provide an example that clearly illustrates the pattern of revenue recognition for a license satisfied over time that is subject to the royalty exception when the performance obligation is only partially satisfied. Under the proposed guidance, it is unclear the period over which the royalty should be recognized when the performance obligation is only partially satisfied. Example 57 concludes by applying the practical expedient in paragraph 606-10-55-18, and purports that the pro rata portion of the upfront fee plus royalties earned to date approximates the value transferred to the customer. Because the amount invoiced to date is not equal to the value to the customer, we do not believe this is the appropriate application of the practical expedient. We recommend the FASB amend Example 57 to simply state that the royalty should be recognized as the sales occur for a license satisfied over time that is subject to the royalty exception when the performance obligation is only partially satisfied.

Lastly, in example 57 (606-10-55-379), we do not believe that paragraph 606-10-32-40 is relevant as the entity would apply the sales-based royalty exception to the license under the proposed guidance in paragraph 606-10-55-65A. We recommend modifying this paragraph in the example.

Other Matters

In the Appendix to ASU 2014-09, Revenue from Contracts with Customers, the Board included a comprehensive description of the minor differences with IFRS 15. We understand the IASB is undertaking efforts to amend IFRS 15, but that their amendments may differ from those of the FASB. We recommend that the FASB work with the IASB to minimize differences between their respective standards and consider updating the comparison of ASC Topic 606 and IFRS 15 at an appropriate time.