Revenue for the aerospace and defense industry

The new standard's effective date is coming.

US GAAP

December 2016

kpmg.com/us/frn

Revenue viewed through a new lens

Again and again, we are asked what's changed under the new standard: what do I need to tweak in my existing accounting policies for revenue? It's just not that simple.

The new standard introduces a core principle that requires companies to evaluate their transactions in a new way. It requires more judgment and estimation than today's accounting and provides new guidance to determine the units of account in a customer contract. The transfer of control of the goods or services to the customer drives the amount and pattern of revenue recognition; this is a change from the existing risks and rewards model. As a result, there will be circumstances in which there will be a change in the amount and timing of revenue recognition.

Less has been said about disclosures, but the new standard requires extensive new disclosures.

Read this to understand *some* of the most significant issues for the aerospace and defense industry – the issues that you should be considering now.

What's inside

- Contract existence
  - Contracts with foreign governments requiring US government approval
  - Unfunded portion of US government contracts
  - Master Service Agreements
- Contract term
- Performance obligations
- Series guidance
- Variable consideration
- Significant financing component
  - Advance payments
  - Payments in arrears
- Timing of revenue
- Measure of progress
- Pre-contract activities
- Cost to obtain a contract
- Pre-production activities
- Contract modifications
- Provision for losses
- Applicable to all industries
  - Expanded disclosures
  - Transition
  - Effective dates
- Some basic reminders
- The impact on your organization
- Keeping you informed
- Contacts

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Contract existence

Determining whether a contract exists can be complicated in the A&D industry where contracts often take a long time to negotiate and may be subject to many approvals.

Under the new standard, a contract is an agreement between two or more parties that creates enforceable rights and obligations – contracts can be written, oral, or implied by an entity's customary business practices. Enforceability is a matter of law.

Demonstrating that a contract exists under the new standard may prove challenging in some circumstances for the A&D industry. Judgment and appropriate evidence, including the potential need for legal advice, may be required to demonstrate that the contract is legally enforceable and meets all of the following criteria:

- the contract has commercial substance;
- rights to goods or services can be identified;
- payment terms can be identified;
- the consideration the entity expects to be entitled to is probable of collection; and
- the contract is approved and the parties are committed to their obligations.

If these criteria are *not* met, the contract does *not* exist for purposes of applying the general model of the new standard. Consideration received from the customer before these criteria are met is generally recognized as a deposit (liability).

Contracts with foreign governments requiring US government approval

A&D contracts with foreign government customers often require regulatory approval from the US government. In these situations, in addition to evaluating the above criteria, an A&D contractor will specifically need to evaluate the likelihood of regulatory approval. Factors to consider in determining the likelihood of regulatory approval may include:

- the contractor's history of obtaining approvals;
- the level of participation that a contractor has in the US government's due diligence process to approve;
- the presence of US government officials advocating on the contractor's behalf;
- recent regulatory approvals of sales of similar goods to the same country; and/or
- clauses in the contract that allow the contractor to recover cost plus a reasonable profit if regulatory approval is not obtained.

If the A&D contractor determines that the likelihood of obtaining the required regulatory approval is virtually certain, it is reasonable for them to begin accounting for the contract under the scope of the new standard.

Unfunded portion of US government contracts

It is common for the US government to award a long-term A&D contract that is only partially funded at inception due to the government's annual budget process. This could cause the contractor to question whether the US government is committed to its obligations, a criterion required to be met for a contract to exist under the new standard (see above).

If an A&D contractor can demonstrate that the US government is committed to paying for the promised goods and services, then the contractor may be able to conclude that a contract exists – for both the funded and unfunded portions of the contract. The contractor would assess the likelihood of a contract cancellation. If the contractor determines that cancellation would only occur on some remote contingency, the contract would be considered non-cancellable, given the parties' intent to complete the contract.

When a contract is deemed to exist, the unfunded portion of this type of contract is considered variable consideration, similar to award or incentive fees. The contractor includes variable consideration in the transaction price to the extent it is probable that a significant reversal of cumulative revenue will not occur when the uncertainty, in this instance the unfunded portion, is resolved (the constraint on variable consideration); see **Variable consideration**.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Master Service Agreements

Some A&D contractors enter into Master Service Agreements (MSAs) with their customers. These MSAs set out the terms and conditions under which the A&D contractors will supply goods and services to their customers. The customer subsequently places purchase orders (POs) to obtain the underlying goods or services – e.g. the PO specifies the quantity and completion date.

If the MSA only establishes the terms under which the orders to purchase goods or services may be placed, it does not create enforceable rights and obligations. That is, the MSA is not itself a contract. In these circumstances, it will normally be the PO that creates enforceable rights and obligations between the A&D contractor and the customer. Therefore, the PO in combination with the MSA will be evaluated to determine whether the criteria for contract existence have been met.

Conversely, some MSAs do create enforceable rights and obligations that make the MSA itself a contract. This may be true, for example, if the MSA requires the customer to purchase a minimum quantity of goods or services. In that instance, a contract exists for the minimum order quantity if the other criteria are met. Similarly, if the MSA requires the customer to pay a substantive penalty if it cancels the contract before a specified date, or before a specified quantity of goods have been purchased, this may indicate that a contract exists for that minimum period or order quantity.

In another example, an MSA may require an A&D contractor to engage in pre-production activities. This may involve the A&D contractor completing design work, assembling a production facility, or producing a mold or tool. If the MSA requires the customer to pay for these activities, this may also indicate that the MSA is a contract.

Contract term

Determining the contract term affects the application of other aspects of the guidance, including the measurement and allocation of the transaction price.

The contractual period is the duration of the contract in which the parties to the contract have presently enforceable rights and obligations. If a contract includes a termination penalty clause or a clause with similar economic characteristics, judgment will need to be applied to the facts and circumstances of the clause to determine whether it affects the enforceability of the rights and obligations in the contract. If the termination payment would be considered substantive or cancellation would only occur on some remote contingency, then the entity would *not* assume cancellation in determining the scope/term of the contract.

Generally in the A&D industry, termination for convenience clauses with the US Government, or a clause with similar economic characteristics, will be considered substantive because the rights and obligations under those clauses are akin to a termination penalty.

For contracts that do not contain termination for convenience clauses with the US government or clauses with similar characteristics, judgment will need to be applied to each termination provision to determine the enforceable term. If the termination provision is non-substantive, the contract period will be shorter than the stated term and instead the contract contains options to renew.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Performance obligations

The unit of account (performance obligation) must be determined on a contract-by-contract basis.

A&D contracts are typically tied to the lifespan of A&D programs, meaning that they are generally long and complex and provide for multiple goods and services – e.g. engineering and design, manufacturing, after-market parts and maintenance.

Under the new standard, promised goods and services represent separate performance obligations if the good or service is distinct. If a promised good or service is not distinct, a contractor is required to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. This may result in accounting for all the goods and services promised in a contract as a single performance obligation.

A good or service is distinct if it meets both of the following criteria.

— It is capable of being distinct – can the customer benefit from the good or service on its own or together with other readily available resources?

— It is distinct within the context of the contract – is the entity's promise to transfer the good or service separately identifiable from other promises in the contract?

It is typical in A&D contracts that the finished deliverable consists of a number of subcomponents that normally provide benefit to the customer on their own or together with other readily available resources. Therefore, the evaluation will likely depend more on whether the subcomponents are distinct within the context of the contract.

The objective when assessing whether an entity's promises to transfer goods or services are distinct within the context of the contract is to determine whether the nature of the promise is to transfer each of those goods or services individually, or whether the promise is to transfer a combined item or items to which promised goods or services are inputs.

The following indicators are designed to assist in evaluating whether two or more promises to transfer goods or services to a customer are *not* separately identifiable – i.e. not distinct within the context of the contract and therefore not separate performance obligations.

— The entity provides a significant service of integrating the goods or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output(s) for which the customer has contracted.

— One or more of the goods or services significantly modifies or customizes, or is significantly modified or customized by, one or more of the other goods or services promised in the contract.

— The goods or services are highly interdependent or highly interrelated, with the result that each of the goods or services is significantly affected by one or more of the other goods or services.

Additionally, contractors will need to evaluate whether the promises under the contract meet the criteria to be accounted for as a series; see **Series guidance**.

Example – Single performance obligation

AD Company agrees to design and manufacture a new propulsion system and integrate it into a missile for Customer X during the coming year. Customer X expects AD Company to update the propulsion system design while the missile is in production and concurrently modify the missile for changes in the propulsion system design. The propulsion system design is an iterative process that incorporates information learned from the production/manufacturing process. The design for the new propulsion system will be provided to Customer X in addition to the missile, which includes the new propulsion system.

AD Company determines that there are two promises in the contract: the design for the new propulsion system and the manufacturing component (i.e. the missile, inclusive of the new propulsion system). The manufacturing components and the propulsion system design are highly interdependent and highly interrelated, meaning that each of the goods is significantly affected by the other. Additionally, one good modifies and customizes the other good promised in the contract.

Customer X could purchase the design and benefit from the new propulsion system separately from the manufacturing components and have another entity build the manufacturing components (i.e. 'capable of being distinct'). However, the fact that AD Company is providing a significant integration service of the design and manufacturing components (i.e. *not* 'distinct in the context of the contract') results in the two promises identified in the contract being a single performance obligation.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Example – Significant integration service

AD Company has entered into an agreement with a US government agency to deliver 10 highly complex specialized helicopters. The agency provides AD Company with design plans for the helicopters to be delivered, which include the unique and tailored size, weight and speed requirements of the helicopters. AD Company is responsible for the overall management of the contract, requiring the performance and integration of various activities such as procuring materials, identifying and managing subcontractors, and performing manufacturing, assembly and testing.

AD Company assesses the promises in the contract and determines that each of the promised helicopters is capable of being distinct. This is because the customer can benefit from each helicopter on its own – i.e. each helicopter can function independently of the other helicopters.

AD Company next assesses whether the helicopters are distinct within the context of the contract, and observes that the nature of its promise is to establish and provide a service of producing and delivering the full complement of 10 helicopters in accordance with the agency's design plans.

As a result of AD Company's responsibility for overall management of the contract and for providing a significant service of integrating various goods and services (the inputs) into its overall service and the resulting helicopters (the combined output), AD Company concludes that the helicopters and the various promised goods and services inherent in producing those helicopters are *not* 'separately identifiable' and therefore *not* 'distinct in the context of the contract'. Further supporting this conclusion is the nature of AD Company's performance; in particular, the significant integration service of the various activities means that a change in one of AD Company's activities to produce the helicopters has a significant effect on the other activities required to produce the highly complex specialized helicopters. In effect, AD Company's activities are highly interdependent and highly interrelated.

As a result, AD Company accounts for all of the goods and services promised in the contract as a single performance obligation.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Series guidance

A&D contractors in the scope of the series guidance may see an acceleration in the timing of revenue, cost and margin recognition.

Under the new standard, if goods and services promised in an A&D contract are distinct, substantially the same, meet the over-time criteria (see **Step 5: Recognize revenue**) and have the same pattern of transfer, those goods and services are in the scope of the series guidance; application of the series guidance is not optional. This means that fulfillment of the contract is a single performance obligation.

Current US GAAP offers no similar concept to the series guidance.

When evaluating whether an A&D contractor has promised goods or services that are substantially the same, the contractor considers the nature of its promise. If the nature of the promise is to deliver a specified quantity of a good or service, the evaluation considers whether each good or service is substantially the same. If the promise is for the act of standing ready or providing a single service for a period of time, the evaluation considers whether each time increment, rather than the underlying activities, is distinct and substantially the same.

Example

Company C agrees to construct 50 identical customized wings for a prime contractor that is producing aircraft for an end customer. Each customized wing meets the criteria for the revenue to be recognized over time. In particular, the wings have no alternative use and Company C has an enforceable right to payment for performance completed to date (see **Timing of revenue**).

Company C concludes that the contract does not include a significant integration service – i.e. the 50 customized wings do not represent a single, combined output of the contract, and each wing is considered a distinct good.

Because the contract calls for delivery of similar wings that meet the criteria for the revenue to be recognized over time, the series guidance applies and the 50 customized wings form a single performance obligation. Consequently, the transaction price for all 50 customized wings is recognized over time using an appropriate measure of progress. This outcome may differ from allocating a fixed amount to each wing if each one was a separate performance obligation.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Variable consideration

The accounting for variable consideration, including but not limited to award fees, claims, incentives and penalties may differ from today.

Under current US GAAP, award fees, incentives and penalties are included in contract revenue if a contractor determines that it is probable it will be entitled to consideration and the amount can be reliably measured. A claim is recorded as contract revenue when it is probable and can be estimated reliably, but generally only to the extent of contract costs incurred.

The new standard requires contractors to estimate the amount that they expect to be entitled to, including variable consideration, to determine the transaction price. Contractors are required to estimate variable consideration using either the expected value method (e.g. probability weighted estimates) or the most likely amount method. The method selected depends on which is the better predictor for the particular uncertainty.

The amount of variable consideration included in the transaction price, however, is constrained to the amount that is probable that a significant reversal in cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Variable consideration is estimated (including use of the constraint) and included in the transaction price at contract inception and updated at each subsequent reporting date.

The accounting under the new standard may be different from current US GAAP in certain circumstances because of the constraint on variable consideration guidance. For example, under current US GAAP, the maximum penalty under the contract is used as the estimated penalty if the contractor is unable to make a reasonable estimate. The new standard does not default to the maximum penalty, but instead an entity evaluates the probability and significance of a potential reversal of revenue to determine the estimated penalty.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Significant financing component

The amount of revenue recognized for long-term contracts may be affected by a significant financing component.

A&D contractors will need to evaluate whether their contracts include a significant financing component. If the period between performance and payment for that performance (whether advance payments or payments in arrears) is one year or more, significant financing may exist between the parties. The financing component may be explicitly identified in the contract or may be implied by the contractual payment terms.

A contract does not have a significant financing component if the difference between the amount of promised consideration and the cash selling price of the promised goods or services arises for reasons other than the provision of financing. For example, many contracts with the US government are governed by the Federal Acquisition Regulation. Contracts governed under these provisions often provide for progress payments based on a percentage of costs incurred and a final liquidation payment on completion. The withheld final payment provides the customer the opportunity to perform a quality assessment before the completion of the contract and the ability to withhold payment if the quality is not satisfactory. Generally, the intention of the withheld final payment is to provide assurance to the customer that the contractor will perform, rather than to provide financing to the customer.

Contractors will be required to adjust the promised amount of consideration for the time value of money if a contract contains a significant financing component.

The new standard provides a practical expedient, whereby an entity is not required to account for the significant financing component if it expects that the period between when it transfers a promised good or service to the customer and when the customer pays for that good or service will be less than one year. In many A&D contracts, revenue will be recognized over time, often for periods in excess of one year. The customer may make progress payments at various points throughout the contract term. Although the contract itself is for a period greater than one year, an entity may apply the practical expedient when progress payments are being made – i.e. the timing between the transfer of control and the progress payment for that transfer is not expected to exceed one year.

Advance payments

The requirements for advance payments under the new standard are a change from current practice. The changes may particularly affect contracts in which payment is received significantly earlier than the transfer of control of goods or services. For example, contractual payment terms may be aligned with payment schedules to third party suppliers, but the payments may not align with the measure of progress for the transfer of control of goods or services to the customer.

Under current US GAAP, advance payments that do not require repayment in the future, but that will instead be applied to the purchase price of the goods or services involved, are excluded from the requirement to impute interest. This is because the liability (i.e. deferred revenue) is not a financial liability. Examples include deposits or progress payments on A&D contracts and advance payments to acquire resources and raw materials.

Under the new standard, when the advance payment is significant to a contract and an entity concludes that it is receiving financing from the customer, the entity increases the contract liability and recognizes a corresponding interest expense for the customer payments received before the delivery of the good or service. When it satisfies its performance obligation, the entity recognizes more revenue than the cash received from the customer, because the contract liability has been increased by the interest expense that is accreted. Accordingly, this accounting will result in an increase in revenue and an increase in interest expense compared with current US GAAP.

Payments in arrears

Under current US GAAP, when an entity is not in the scope of 'accounting for performance of construction-type and certain production-type contracts', payments in arrears (i.e. extended payment terms) may result in a conclusion that revenue is not fixed or determinable, which precludes revenue recognition. In those circumstances, the entity defaults to a due-and-payable revenue model and does not account for a financing element.

Under the new standard, the transaction price is estimated and a separate evaluation is performed to determine whether the payment terms provide financing to the customer. As a result, the accounting for financing in arrangements when the customer pays in arrears will likely arise more frequently than in current practice. Doing so will result in a decrease in revenue and an increase in interest income compared with current US GAAP.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Timing of revenue

A&D contractors that currently recognize revenue at the point in time when products are shipped or delivered may be required to recognize revenue over time.

Under the new standard, an A&D contractor evaluates criteria at contract inception to determine whether it will transfer control of goods and services and therefore satisfy the performance obligation over time. Only if none of the over-time criteria are met, will the A&D contractor recognize revenue at a point in time; see **Step 5: Recognize revenue**.

If one of the following criteria is met then over-time revenue recognition is applicable:

1. the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
2. the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
3. the entity's performance does not create an asset with alternative use to the entity *and* the entity has an enforceable right to payment for performance completed to date (e.g. a right to recover cost incurred plus a reasonable profit margin).

When evaluating "a right to recover cost incurred plus a reasonable profit margin" in the third criterion, the amount to which the entity is entitled does not need to equal the contract margin percentage; instead, it must be based on either a reasonable proportion of the entity's expected profit margin or a reasonable return on the entity's cost of capital. However, if an entity would only recover its costs, then it would not have the right to payment for performance completed to date and this criterion would not be met.

While an A&D contractor may meet any of the over-time criteria, it is likely that the third criterion will be the most frequent cause for the company to recognize revenue over time in non-US government production contracts. For defense contracts with the US government to produce arms, the second criterion is met as a matter of law. For services contracts, A&D contractors will generally meet the first criterion.

Example

AD Company enters into a contract with a customer to build a specialized satellite for a commercial customer. One clause in the contract provides that if the customer terminates the contract for reasons other than AD Company's failure to perform, the customer is required to compensate AD Company for its cost incurred plus a 15% margin; 15% is evaluated to be a reasonable margin.

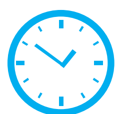
AD Company builds satellites for various customers. However, the design and construction of each satellite differs substantially based on each customer's needs and the type of technology that it incorporates in the satellite.

At contract inception, AD Company assesses whether the satellite, in its completed state, will have an alternative use. Although the contract does not preclude AD Company from directing the completed satellite to another customer, AD Company would incur significant costs to rework the design and functionality of the satellite for use by another customer.

The customer-specific design of the satellite restricts AD Company's practical ability to readily direct the satellite to another customer resulting in the satellite not having an alternative use to AD Company. Additionally, the contract terms give AD Company an enforceable right to payment for its performance completed to date (costs incurred plus a reasonable margin). Therefore, AD Company meets the third criterion to recognize revenue over time.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Measure of progress



Revenue will be recognized earlier for many A&D contractors that currently use the units-of-delivery method under current US GAAP.

Many A&D contractors currently apply a percentage of completion model to their contracts, and the new standard could bring some change to the measurement of progress. Progress should depict performance in transferring control of goods or services to the customer. If a performance obligation meets the over-time criteria, it is not acceptable to defer all revenue and expense items until the contract is completed.

We expect that many A&D contractors will measure their over-time progress using an input method, such as the cost-to-cost method. Output methods, such as units-of-production or units-of-delivery, unless modified to account for a measure of progress for work-in-process (WIP) and finished goods would not depict the transfer of control of goods to the customer.

A&D contractors should apply the method to measure over-time progress consistently to similar performance obligations and in similar circumstances.

This change means that revenue will be recognized earlier for many A&D contractors that currently use the units-of-delivery method under current US GAAP.

In addition, related costs that are currently accounted for as WIP will generally be expensed as incurred. Depending on when control of standard materials is transferred to the customer – e.g. by being integrated into products with no alternative use to the contractor – the new standard may have a significant effect on both the income statements and balance sheets of A&D contractors.

Example

AD Company enters into a contract to manufacture and deliver 10 units to Customer A for $10 million. AD Company assesses that the contract contains a single performance obligation that is satisfied over time. The cost to manufacture and deliver the 10 units is $8 million. AD Company historically recognized revenue using the units-of-delivery method, but believes under the new standard that the cost-to-cost method best depicts performance in transferring the units to the customer.

The financial statement effect shown below assumes that none of the units have been completed and delivered, and costs of $3.2 million have been incurred (i.e. 40% complete) as of the reporting date.

	Current GAAP: Units-of-delivery method	New standard: Over-time, cost-to-cost method
Revenue	$0	$4,000,000[1]
Cost of goods sold	$0	$3,200,000[2]
Gross margin	$0	$800,000
Inventory	$3,200,000	$0[2]

Notes:

1. Calculated as $10,000,000 x 40%.
2. All materials have been integrated into the units and have no alternative use.

The change to the over-time, cost-to-cost method from the units-of-delivery method has the effect of accelerating revenue, cost of goods sold and gross margin, and eliminating WIP and finished goods inventory in this example.

An entity applying an input method must exclude the effects of any inputs that do not depict its performance in transferring control of goods or services to the customer. Examples include:

— when an incurred cost does not contribute to an entity's progress in satisfying the performance obligation – e.g. unexpected amounts of wasted materials, labor, or other resources; these costs are expensed as they are incurred and are not used in a cost-to-cost measure of progress; or

— when the cost is not proportionate to the entity's progress in satisfying the performance obligation – e.g. uninstalled materials.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

However, many A&D contracts are complex and the estimated costs to complete often include some estimate of rework or other costs that are considered in the initial estimate of contract costs. They are not considered wasted costs because they are part of the expected process of designing and completing highly complex and specialized goods.

For uninstalled materials, an entity recognizes revenue only to the extent of the cost incurred – i.e. at a zero percent profit margin – if it expects all the following conditions to be met:

- the good is not distinct;
- the customer is expected to obtain control of the good significantly earlier than it receives services related to the good;
- the cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation; and
- the entity is acting as the principal, but procures the good from a third party and is not significantly involved in designing and manufacturing the good.

Some A&D contractors are significantly involved in designing and manufacturing the products that they procure. This means that the condition in the fourth bullet is not met and the cost of procurement would be a faithful depiction of an entity's performance and therefore a valid cost in measuring progress toward completion of the contract.

Example

In November, Contractor P entered into a contract to provide a product to Customer Q.

The following facts are relevant:

- Providing the product is a single performance obligation satisfied over time.
- The transaction price is $21 million.
- Total expected cost is $18 million ($12 million purchased materials and $6 million other costs).
- Contractor P is not involved in designing or manufacturing the purchased materials, but is acting as the principal. Under its contracts with its suppliers, the purchased materials cannot be returned in the event Customer Q cancels its contract with Contractor P.
- Customer Q obtains control of the purchased materials in December.
- The assembly and installation of all the purchased materials is not expected until June.
- Contractor P uses an input method based on costs incurred to measure its progress toward complete satisfaction of the performance obligation.

Contractor P concludes that including the costs of procuring the materials in the measure of progress would overstate the extent of its performance. Consequently, it adjusts its measure of progress to exclude these costs from the costs incurred and from the transaction price, and recognizes revenue for the transfer of the purchased materials at zero margin.

By December 31, other costs of $2 million have been incurred (excluding purchased materials) and Contractor P therefore determines that its performance is 33% complete ($2 million / $6 million). Consequently, it recognizes revenue of $15 million ($9 million[1] x 33% + $12 million) and costs of $14 million ($2 million + $12 million).

Note:

1. Calculated as the transaction price of $21 million less the cost of the purchased materials of $12 million.

A&D contractors should also carefully consider whether control of an asset has transferred to a customer when evaluating whether a particular cost has been incurred in satisfying an over-time performance obligation. Consideration of the new standard's point-in-time revenue recognition indicators may be helpful in analyzing whether control has transferred to the customer; see **Step 5: Recognize revenue**. If the A&D contractor still controls the asset (i.e. it has alternative use to the A&D contractor), then it is inventory and not uninstalled materials.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Pre-contract activities

The timing for recognizing cost and revenue related to activities before the existence of a contract may change.

Often A&D contractors will incur pre-contract costs or carry out activities before a contract exists (e.g. assembling some parts to manufacture highly customized products before a purchase order is received) to meet anticipated or forecasted demand from customers.

Revenue – If the criteria in **Step 1: Identify the contract** have not been met, any consideration received from the customer is generally recognized as a deposit (liability). When the criteria for contract existence under the new standard are met and performance obligation(s) in that contract meet the over-time transfer of control criteria, revenue for the portion of performance obligation(s) satisfied through the pre-contract activities is recognized on a cumulative catch-up basis on the date it is determined that a contract exists.

Costs[1] – If the pre-contract costs incurred in fulfilling a contract (or anticipated contract) with a customer are outside the scope of other guidance – e.g. inventory, intangibles, research and development, or property, plant and equipment – then an entity recognizes an asset only if the fulfillment costs:

— relate directly to an existing contract or specific anticipated contract;

— generate or enhance resources that will be used to satisfy performance obligations in the future; and

— are expected to be recovered.

Costs to obtain a contract

A&D contractors will no longer have the choice to expense commissions as incurred if certain criteria are met.

Under the new standard, a contractor is required to capitalize costs to obtain a contract (e.g. sales commissions or bounties) if those costs are only incurred as a result of obtaining a contract and the entity expects to recover them – unless it elects the practical expedient for costs with amortization periods of one year or less.

Costs that will be incurred regardless of whether the contract is obtained (including costs that are incremental to *trying* to obtain a contract) are expensed as they are incurred, unless they meet the criteria to be capitalized as fulfillment costs or other assets.

This will be a change for A&D contractors that currently either capitalize bidding costs and/or expense sales commission costs.

A contractor that currently capitalizes the costs to obtain a contract will need to assess whether its current capitalization policy is consistent with the new requirements. For example, a contractor that currently capitalizes incremental bid costs will need to identify those costs that are incremental to obtaining the contract, and exclude bid costs that are incurred irrespective of whether the contract is obtained. Likewise, a contractor that capitalizes both incremental and allocable costs of obtaining a contract will need to revise its policy to capitalize only the incremental costs of obtaining a contract.

1. This cost guidance is from Subtopic 340-40, which is new guidance developed in conjunction with the new revenue standard.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Pre-production activities

Pre-production activities may be a separate performance obligation.

A&D contractors may incur pre-production costs related to long-term supply arrangements with their customers. Current US GAAP (Subtopic 340-10) requires the A&D contractor to expense design and development costs related to:

— products that will be sold under long-term supply arrangements; or

— molds, dies and other tools ('tooling') that it will not own, but that it will use to manufacture products under those arrangements.

However, capitalization of those costs is required if the A&D contractor has a:

— legally enforceable contractual guarantee for reimbursement that can be objectively measured and verified; or

— non-cancellable right to use the tooling during the supply arrangement.

Under the new standard, an A&D contractor evaluates whether tooling and other pre-production activities will result in the transfer of control of a good or service for which it is entitled to consideration. For example, where the A&D contractor lacks a non-cancellable right to use the tooling (because both title and control transfer to the customer), and has a contractual guarantee of reimbursement from the customer, it may be reasonable to conclude that tooling is a separate performance obligation. The A&D contractor will consider the guidance in Subtopic 340-10 to account for the related costs. Costs within the scope of Subtopic 340-10 will not be eligible for capitalization as fulfillment costs under Subtopic 340-40.

A&D contractors that apply the cost guidance in Subtopic 340-10 should monitor the FASB's activities because it intends to perform outreach with companies and auditors to determine whether additional changes to the cost guidance are necessary. KPMG's **Defining Issues No. 16-33** elaborates on the decision and effect of the FASB's retention of current guidance on pre-production costs related to long-term supply arrangements.

Contract modifications

The previous revenue recognition guidance did not include a general framework for accounting for all contract modifications – that has now changed.

Change orders are a common form of contract modification for A&D contractors. US GAAP currently provides guidance on contract modifications for long-term construction- and production-type contracts. However, current revenue recognition guidance does not include a general framework for accounting for contract modifications.

Current US GAAP on those contracts includes guidance for unpriced change orders, contract options and additions, and claims. Unpriced change orders are reflected in the accounting if recovery is probable; and a claim is included in contract revenue if it is probable that the claim will result in additional contract revenue that can be reliably estimated. Under this guidance, modifications of long-term construction- and production-type contracts are generally accounted for on a cumulative catch-up basis – i.e. A&D contractors update their measure of progress under the contract for the effect of the modification. Because no contract modification guidance exists for arrangements other than long-term construction- and production-type contracts, there is diversity in practice for arrangements outside the scope of this guidance.

Under the new standard, all modifications are accounted for when they are approved using the same contract modification guidance. A contract modification can be accounted for on a cumulative catch-up basis or prospectively depending on the type of modification made to the contract. If the modification does not promise additional distinct goods or services, it will generally be accounted for on a cumulative catch-up basis. If the modification adds distinct goods or services to the arrangement, it will generally be accounted for prospectively, with a reallocation of remaining revenue under the original contract if the additional goods or services are not priced at their stand-alone selling prices.

If the scope but not the price of the modification is agreed upon, then the A&D contractor would apply the guidance on **Variable consideration**.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Provision for losses

Accounting for onerous contracts is largely unchanged under the new standard.

Current US GAAP requires a provision for the entire loss on a construction- or production-type contract to be made when the current estimate of total anticipated contract revenue is less than contract cost. This accounting is unchanged under the new standard.

However, the FASB has proposed a technical correction to clarify that under the new standard a contractor may use either the contract or the performance obligation as the unit of account for measuring the loss.

Allocated contract general and administrative (G&A) costs can be included in the cost bases when calculating whether a contract is in a loss position. That is, an A&D contractor who is including G&A costs today in its loss calculation can continue that practice under the new standard. However, if an A&D contractor wants to change its practice to exclude G&A, the FASB staff has said that this will be acceptable.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Applicable to all industries

Expanded disclosures

The new standard contains both qualitative and quantitative disclosure requirements for annual and interim periods. The objective of the disclosures is to provide sufficient information to enable users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Specifically, the new standard includes disclosure requirements for:

— disaggregation of revenue;

— contract balances, including changes during the period;

— performance obligations;

— significant judgments; and

— assets recognized to obtain or fulfill a contract, including changes during the period.

An entity should review these new disclosure requirements to evaluate whether data necessary to comply with the disclosure requirements are currently being captured and whether system modifications are needed to accumulate the data.

Internal controls necessary to ensure the completeness and accuracy of the new disclosures should be considered – especially if the required data was not previously collected, or was collected for purposes other than financial reporting.

Also, SEC guidance requires registrants to disclose the potential effects that recently issued accounting standards will have on their financial statements when adopted[2]. The SEC expects the level and specificity of these transition disclosures to increase as registrants progress in their implementation plans. The SEC has also stated, when the effect is not known or reasonably estimated, that a registrant should describe its progress in implementing the new standard and the significant implementation matters that it still needs to address.

Transition

An entity can elect to adopt the new standard in a variety of ways, including retrospectively with or without optional practical expedients, or from the beginning of the year of initial application with no restatement of comparative periods (cumulative effect method).

Entities that elect the cumulative effect method, are required to disclose the changes between the reported results of the new standard and those that would have been reported under current US GAAP in the period of adoption.

For transition purposes, the new standard introduces a new term – completed contract. A completed contract is a contract for which an entity has recognized all or substantially all of the revenue under current US GAAP as of the date of adoption of the new standard. The concept of a completed contract is used when applying:

— certain practical expedients available during transition under the retrospective method; and

— the cumulative effect method coupled with the election to initially apply the guidance only to those contracts that are not complete.

This will require careful analysis particularly where there is trailing revenue after delivery has occurred (e.g. revenue was not fixed or determinable, collectibility was not reasonably assured, royalty arrangements). In those circumstances, the contract would not be considered complete if substantially all of the revenue had not been recognized before adoption. Applying the standard to these types of contracts at transition may result in revenue being pulled into the opening retained earnings adjustment.

Entities should consider the potential complexities involved with calculating the opening retained earnings adjustment and the recast of comparative periods (if any) when planning their implementation. It may be prudent for entities to perform transition calculations before the adoption date to ensure all potential complexities are identified.

Effective dates

Type of entity	Annual reporting periods after
Public business entities and not-for- profit entities that are conduit bond obligators	**December 15, 2017 including interim reporting periods within that reporting period.** Early adoption permitted for annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.
All other US GAAP entities, including SEC registrants that are Emerging Growth Companies	**December 15, 2018 and interim reporting periods within annual reporting periods beginning after December 15, 2019.** Early adoption permitted for annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period or interim reporting periods within the annual period subsequent to the initial application.

2. Staff Accounting Bulletin Topic 11.M.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Some basic reminders

Scope

The guidance applies to all contracts with customers unless the customer contract is specifically within the scope of other guidance – e.g. Topic 944 (insurance), Topic 460 (guarantees).

The new standard applies to contracts to deliver goods or services to a customer. A 'customer' is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

The new standard will be applied to part of a contract when only some elements are in the scope of other guidance.

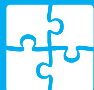
Step 1: Identify the contract

Contracts can be written, oral or implied by an entity's customary business practices, but must be enforceable by law. This may require legal analysis on a jurisdictional level to determine when a contract exists and the terms of that contract's enforceability.

A contract with a customer is in the scope of the new standard when the contract is legally enforceable and all of the following criteria are met:

- the contract has commercial substance;
- rights to goods or services can be identified;
- payment terms can be identified;
- the consideration the entity expects to be entitled to is probable of collection; and
- the contract is approved and the parties are committed to their obligations.

If the criteria are not met, any consideration received from the customer is generally recognized as a deposit (liability).



Step 2: Identify the performance obligations

Performance obligations do not have to be legally enforceable; they exist if the customer has a reasonable expectation that the good or service will be provided. A promise can be implied by customary business practices, policies or statements.

Performance obligations are the unit of account under the new standard and generally represent the distinct goods or services that are promised to the customer.

Promises to the customer are separated into performance obligations, and are accounted for separately if they are both (1) capable of being distinct and (2) distinct in the context of the contract.

An exception exists if the performance obligations represent a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer over time. A series is accounted for as a single performance obligation.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Step 3: Determine the transaction price

Estimating variable consideration will represent a significant departure from current accounting for many entities.

When determining the transaction price, an entity uses the legally enforceable contract term. It does not take into consideration the possibility of a contract being cancelled, renewed or modified.

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer, excluding amounts collected on behalf of third parties – e.g. some sales taxes. This consideration can include fixed and variable amounts, and is determined at inception of the contract and updated each reporting period for any changes in circumstances.

The transaction price determination also considers:

- **Variable consideration**, which is estimated at contract inception and is updated at each reporting date for any changes in circumstances. The amount of estimated variable consideration included in the transaction price is constrained to the amount for which it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty is resolved.
- **Noncash consideration** received from a customer is measured at fair value at contract inception.
- **Consideration payable to a customer** represents a reduction of the transaction price unless it is a payment for distinct goods or services it receives from the customer.
- **Significant financing components** may exist in a contract when payment is received significantly before or after the transfer of goods or services. This could result in an adjustment to the transaction price to impute interest income/expense.

Step 4: Allocate the transaction price

A contractually stated price or list price is not presumed to be the stand-alone selling price of that good or service.

The transaction price is allocated at contract inception to each performance obligation to depict the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

An entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price. However, when specified criteria are met, a discount or variable consideration is allocated to one or more, but not all, performance obligations.

The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. Observable stand-alone prices are used when they are available. If not available, an entity is required to estimate the price using other techniques – even if the entity never sells the performance obligation separately.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Step 5: Recognize revenue

An entity must first determine whether a performance obligation meets the criteria to recognize revenue over time.

If none of the over-time criteria are met, revenue for the performance obligation is recognized at the point in time that the customer obtains control of the goods or services.

Control is the ability to direct the use of, and obtain substantially all of the remaining benefits from the goods or services – or prevent others from doing so.

An entity recognizes revenue when it satisfies its obligation by transferring control of the good or service to the customer.

A performance obligation is satisfied ***over time*** if one of the following criteria are met:

— the customer simultaneously receives and consumes the benefits as the entity performs;

— the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or

— the entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.

If control transfers ***over time***, an entity selects a method to measure progress that is consistent with the objective of depicting its performance.

If control transfers at a ***point in time***, the following are some indicators that an entity considers to determine when control has passed. The customer has:

— a present obligation to pay;

— physical possession;

— legal title;

— risks and rewards or ownership; and

— accepted the asset.

Customer options

Customer options may be accounted for as performance obligations, resulting in more revenue deferral than under current GAAP.

Revenue is allocated to a customer option to acquire additional goods or services, and is deferred until (1) those future goods or services are transferred or (2) the option expires when it represents a material right. A material right exists if the customer is only able to obtain the option by entering into the sale agreement and the option provides the customer with the ability to obtain the additional goods or services at a price below stand-alone selling prices.

Warranties

Warranties do not have to be separately priced to be accounted for as performance obligations.

Assurance-type warranties will generally continue to be accounted for under existing guidance – i.e. Topic 450 (contingencies). However, a warranty is accounted for as a performance obligation if it includes a service beyond assuring that the good complies with agreed-upon specifications. This could require some warranties to be separated between a service element (deferral of revenue which is then recognized as the services are provided) and an assurance element (cost accrual at the time the good is transferred).

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Principal vs. agent

The new standard changes the guidance used to evaluate whether an entity is a principal or an agent. Credit risk is no longer an indicator that an entity is a principal.	An entity identifies each specified good or service to be transferred to the customer, and determines whether it is acting as a principal or agent for each one. In a contract to transfer multiple goods or services, an entity may be a principal for some goods and services and an agent for others. An entity is a principal if it controls the specified good or service that is promised to the customer before it is transferred to the customer. Indicators that an entity has obtained control of a good or service before it is transferred to the customer are having primary responsibility to provide specified goods or services, assuming inventory risk, and having discretion to establish prices for the specified goods or services.

Contract modifications

A general accounting framework replaces specific contract modification guidance for long-term construction- and production-type contracts. However, outside of these arrangements, an entity will find more guidance in the new standard than under current GAAP.	The new standard requires an entity to account for modifications either on a cumulative catch-up basis (when the additional goods or services are not distinct) or a prospective basis (when the additional goods or services are distinct). If any additional distinct goods or services are not priced at their stand-alone selling prices, the remaining transaction price is required to be reallocated to all unsatisfied performance obligations, including those from the original contract.

Contract costs

More costs are expected to be capitalized under the new standard. An entity cannot elect to expense or capitalize. Capitalization is required when the criteria are met.	The new standard provides guidance on the following costs related to a contract with a customer that are in the scope of the new standard: — incremental costs to obtain a contract; and — costs incurred in fulfilling a contract that are not in the scope of other guidance. Incremental costs to obtain a contract with a customer (e.g. sales commissions) are required to be capitalized if an entity expects to recover those costs – unless the amortization period, which may include anticipated contracts or renewals, is less than 12 months. Fulfillment costs that are not in the scope of other guidance – e.g. inventory, intangibles, or property, plant, and equipment – are capitalized if the fulfillment costs: — relate directly to an existing contract or specific anticipated contract; — generate or enhance resources that will be used to satisfy performance obligations in the future; and — are expected to be recovered. An entity amortizes the assets recognized for the costs to obtain and fulfill a contract on a systematic basis, consistent with the pattern of transfer of the good or service to which the asset relates.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The impact on your organization

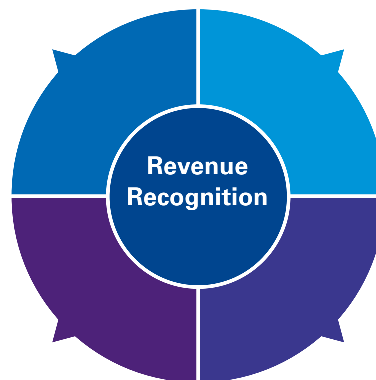
Implementation of the new standard is not just an accounting exercise.

New revenue recognition standard and corresponding accounting changes

- Impact of new revenue recognition standard and mapping to new accounting requirements
- New accounting policies – historical results and transition
- Reporting differences and disclosures
- Tax reporting/planning

Revenue recognition automation and ERP upgrades

- Automation and customization of ERP environment
- Impact on ERP systems
- General ledger, sub-ledgers and reporting packages
- Peripheral revenue systems and interfaces



Financial and operational process changes

- Revenue process allocation and management
- Budget and management reporting
- Communication with financial markets
- Covenant compliance
- Opportunity to rethink business practices
- Coordination with other strategic initiatives

Governance and change

- Governance organization and changes
- Impact on internal resources
- Project management
- Training (accounting, sales, etc.)
- Revenue change management team
- Multi-national locations

As noted in the chart, the new standard could have far-reaching effects. The standard may not only change the amount and timing of revenue, but potentially requires changes in the core systems and processes used to account for revenue and certain costs. Entities may need to design and implement new internal controls or modify existing controls to address risk points resulting from new processes, judgments, estimates and disclosures. The implementation of the new standard will involve a diverse group of parties (e.g. Tax, IT, Legal, Financial Planning, Investor Relations, etc.) and entities should have a governance structure in place to identify and manage the required change. For more information about implementation challenges and considerations, see chapter 14 of KPMG's **Revenue: Issues In-Depth**.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Keeping you informed

KPMG's Financial Reporting Network (FRN) provides a single source for the latest, executive-level financial reporting information, as well as news and activity from standard setters and industry sources – all organized by topic. It has been designed to help executives and accounting professionals stay in front of critical issues in today's evolving financial reporting environment. We not only keep a close watch on the latest financial reporting developments, we report on them and interpret what they might mean for you.

You can find the following and other insightful publications, webcasts, and in-person executive education on FRN.

Visit us at kpmg.com/us/frn

Revenue: Issues In-Depth	Provides you with an in-depth analysis of the new standard, including our additional insights and extensive examples. Additionally, chapter 14 provides implementation considerations. Our Issues In-Depth is supplemented by Defining Issues as new developments occur.
Revenue: Illustrative disclosures	We show how one fictitious company has navigated the complexities of the revenue disclosure requirements.
Revenue: Transition options	This publication will assist you in identifying the optimal transition method.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Contacts

KPMG is able to assist aerospace and defense companies as they navigate the adoption of the new standard.

Philip R Smith
Partner
U.S. Industrial Manufacturing Audit Leader
191 West Nationwide Blvd.
Columbus, OH 43215
Tel: 614-249-1996
philiprsmith@kpmg.com

Michael L Peduzzi
Partner
U.S. Aerospace and Defense Audit
1676 International Drive
Mclean, VA 22102
Tel: 703-286-6795
mpeduzzi@kpmg.com

Prabhakar Kalavacherla ("PK")
Partner
Global Revenue Topic Team Leader
55 Second Street, Suite 1400
San Francisco, CA 94105
Tel: 415-963-8657
pkalavacherla@kpmg.com

Brian K Allen
Partner
U.S. Revenue Topic Team Leader
345 Park Avenue
New York, NY 10154
Tel: 212-954-3621
ballen@kpmg.com

Meredith L Canady
Partner
Department of Professional Practice
345 Park Avenue
New York, NY 10154
Tel: 212-909-5858
mcanady@kpmg.com

Dan Langlois
Partner
Department of Professional Practice
345 Park Avenue
New York, NY 10154
Tel: 212-872-3256
dlanglois@kpmg.com

kpmg.com/socialmedia

KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 155 countries and have 174,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.