



November 17, 2014

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

Attention: Technical Director

RE: Proposed Accounting Standards Update: *Intangibles-Goodwill and Other - Internal-Use Software (Subtopic 350-40) Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* (File Reference No. 2014-230)

Dear Ms. Cospier:

On behalf of salesforce.com, inc (salesforce), we appreciate the opportunity to respond to the Financial Accounting Standard Board's proposed Accounting Standard Update (ASU) regarding *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* and would like to thank the Board for adding the project to its technical agenda.

On December 4, 2013, Graham Smith, CFO, Joseph Allanson, Chief Accounting Officer and Controller, and Alexandra Buldrini, VP Revenue Management met with members of the Board to discuss our letter submitted to the EITF titled "Accounting for the Purchase of Cloud Computing Arrangements". In this letter we explained how the absence of explicit accounting guidance for cloud computing arrangements was resulting in some diversity in practice. Alexandra Buldrini subsequently attended a FASAC meeting in Connecticut on September 11, 2014 to discuss developments in the technology industry and how software is shifting from traditional packaged on-premise software to cloud software solutions.

While we support the Board's Simplification Initiative and its proposal to provide explicit guidance about a customer's accounting for fees in a cloud computing arrangement, we do not agree with the Board's proposal that a cloud computing arrangement should be accounted for as a service contract if the arrangement does not include a software license. We believe that the delivery mechanism, or the customer's ability to take possession of the software, should not determine whether a software element is present in a cloud computing arrangement as the functionality of the underlying software is the same regardless of whether the software is delivered via the cloud or on-premise software license.

We encourage the Board to develop an accounting framework that is based on the economics rather than the form of the software arrangements. The software industry is experiencing a



rapid and significant transformation away from traditional on-premise software to cloud delivery and the multiple variations possible under hybrids of the two models. We believe that the proposed ASU will add complexity to accounting for software arrangements and reduce the comparability of financial statements as a result of the transformation occurring within the industry.

The proposed ASU may encourage customers to purchase software based on financial metrics rather than more pertinent factors around the capabilities of the software. It is our observation, for example, that customers with EBITDA metrics are financially motivated to purchase traditional on-premise arrangements that are capitalized rather than cloud arrangements that are classified as an operating expense. Consistency is important for customers, the software industry and users of financial statements as information technology shifts towards cloud based arrangements and hybrids of the two models.

We also request that the current proposal be expanded to include the accounting for professional services used in cloud computing arrangements. Professional services can entail or include installation, configuration, building interfaces, data migration, or other customization services. Many large IT system implementations include a combination of on-premise software, cloud computing and hybrid solutions. We believe the proposed ASU will complicate which guidance to apply for professional services if the underlying software is accounted for differently based on the inclusion of a software license.

We describe our ideas and rationale below, including our responses to the questions presented in the proposal.

Overview of salesforce.com

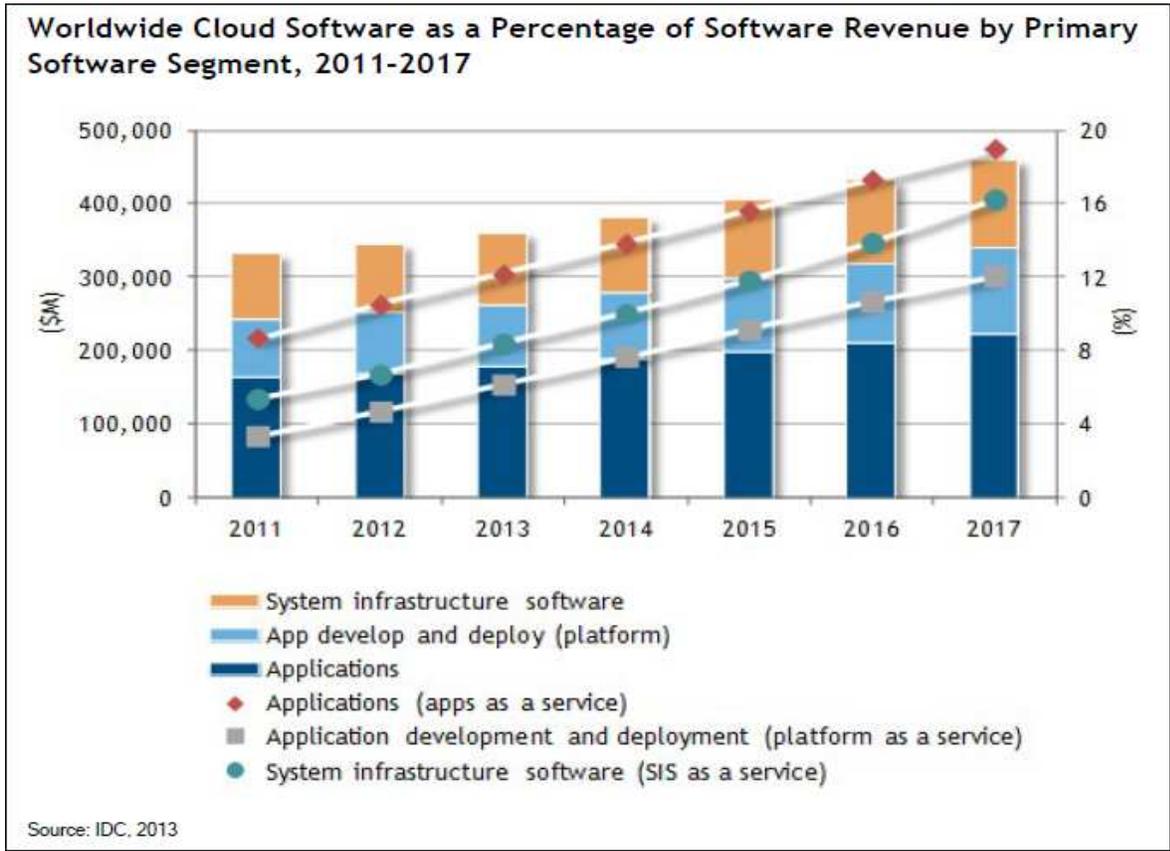
Salesforce is a leading provider of enterprise cloud computing solutions with a strong focus on customer relationship management and is the sixth largest enterprise software company in the world based on annual revenues. Our company was founded on the concept of delivering CRM software applications via the Internet, or “cloud”. We introduced our first CRM solution in February 2000 and we have expanded to four core cloud offerings: sales, service, marketing and salesforce1 platform. Our stock is listed on the New York Stock Exchange. Revenues reported in the Company’s Annual Report for the year ended January 31, 2014 were approximately \$4 billion.

For the purpose of this letter, we believe it is important to describe industry trends and the delivery models for software.



Market Data – Recent Trends in Software Industry – Shift to the Cloud is Big and is Happening Fast

According to a December 2013 market analysis report by International Data Corporation (IDC) titled “Worldwide SaaS and Cloud Software 2013-2017 Forecast and 2012 Vendor Shares”, the cloud software market reached \$28.0 billion in revenue in 2012, a 28.4% year-over-year growth rate. IDC expects cloud software will grow to \$76.1 billion by 2017 at a compounded annual growth rate of 22.1% and that cloud delivery will significantly outpace traditional software product delivery, growing nearly five times faster than the software market as a whole and becoming the significant growth driver to all functional software markets. By 2017, nearly \$1 of every \$6 spent on packaged software will be consumed via the cloud:





The shift among all major software vendors to provide cloud solutions and the rapid influx of new vendors entering the market are substantially impacting the software industry. Leading industry analysts have stated the following:

“The software industry is in the middle of a generational shift from software installed “on-premise” to one running in the Cloud, and from perpetual licenses paid upfront to smaller, recurring subscriptions.” – Brent Thill, USB

“The trend is away from legacy software towards more user-friendly, more mobile, more flexible cloud applications that also offer a lower TCO (Total Cost of Ownership).” – Steve Ashley, Robert W. Baird

Software Models

Software solutions are typically delivered three ways:

On-premise software: is a type of software delivery model that is deployed and managed from a customer's in-house server and computing infrastructure. It utilizes an organization's native computing resources and requires a licensed copy of software from an independent software vendor. The software vendor usually provides ongoing support including updates and upgrades to the software.

On-premise software arrangements are structured as licenses rather than sales in order to protect vendors from the possibility of unauthorized usage and redistribution of their software. The software license itself is a legal device created to protect intellectual property under US copyright law. The software license inhibits unauthorized duplication and distribution of software. The distinguishing feature of software licenses is that the software vendor grants the right to use one or more copies of the software under the license arrangement but *ownership of those copies remains with the software vendor*, as well as intellectual property rights.

Cloud Computing Software: is a type of software delivery model that is deployed and managed on a vendor's cloud computing infrastructure and accessed by users over the Internet. Under a cloud computing arrangement, the buyer has a right to use or benefit from the functionality of the software and shared IT infrastructure but the buyer does not own (i.e., take title to) the assets delivering the underlying functionality. Cloud computing arrangements typically include multiple elements such as the right to use software or hardware in a hosted environment and support and maintenance, including specified and unspecified updates and upgrades. Updates include routine maintenance and bug fixes while upgrades deliver enhanced features and functionality that upgrade the software to the latest product version. The underlying software is highly customizable by end-users.



Depending on the specific terms of the arrangement, cloud computing fees may be fixed, variable, (i.e., based on some measure of usage) or a combination. Fixed fees may be due periodically throughout the term of the arrangement (e.g. monthly or quarterly) or may be due entirely at inception of the arrangement.

Hybrid software: is the adoption of both delivery models of software in a single arrangement or IT environment. Hybrid solutions allow an organization to keep specific differentiated software applications either on-premise or in the cloud. For example, in a hybrid solution the customer may deploy the same software application either on the cloud or on-premise with the ability to switch from one to the other as needed. In another example of hybrid solutions the customer may purchase a combination of different cloud and on-premise functionality with both software applications operating together. This example is common if the customer wants specific or sensitive data stored within its firewalls.

Software has evolved to where distinctions between traditional on-premise and cloud software may no longer be relevant because the industry is moving away from licensed software towards hybrid models and cloud.

Recent marketing materials for some of the largest software vendors highlight flexible hybrid models including the ability to purchase under either operating or capital budgets for the same functionality:

An infographic with a light blue gradient background. At the top, the title "Vendors Highlighting Different Delivery and Accounting Options" is written in bold black text. Below the title are three grey callout boxes with white text. The first box on the left says: "When it comes to deployment... go all cloud or use cloud for pilot purposes then move it to on premise after the business case is established". The second box on the right says: "Take a hybrid approach, moving mission-critical productive systems on premise while keeping test and development systems in the cloud". The third box at the bottom center says: "Subscription-based software...has the distinct advantage of a low upfront cost, and being accounted as an operating expense rather than a capital expense with depreciation, yet provides the same functionality as if you purchased the software". A small Salesforce logo is in the bottom right corner of the infographic.

Vendors Highlighting Different Delivery and Accounting Options

"When it comes to deployment... **go all cloud or use cloud for pilot purposes** then move it to on premise after the business case is established"

"**Take a hybrid approach**, moving mission-critical productive systems on premise while keeping test and development systems in the cloud"

"Subscription-based software...has the distinct advantage of a low upfront cost, and being accounted as an operating expense rather than a capital expense with depreciation, **yet provides the same functionality as if you purchased the software**"



As a result, companies may be incented to select a delivery model that is most beneficial to their financial metrics as opposed to basing the purchasing decision on features, functionality, and pricing.

Responses to Questions

Question 1: Should a customer in a cloud computing arrangement evaluate whether the arrangement involves a software license by applying the criteria in paragraphs 350-40-15-4A through 15-4C? If not, what guidance should be applied and why?

Response to Question 1: We do not believe that a customer in a cloud computing arrangement should evaluate whether the arrangement involves a software license by applying the criteria in paragraphs 350-40-15-4A through 15-4C as a customer's ability to take physical possession of the software should not establish whether a software element is present. We believe cloud computing arrangements include a software element as the customer has primarily purchased the non-cancellable right to access and use software.

We acknowledge that in cloud computing arrangements the hosting and software are considered a single unit of accounting as the hosting is essential to the functionality of the software and that industry practice has viewed such arrangements as service contracts. However, the right to access software is what substantially contributes to the value of the arrangement while hosting is simply the mechanism used to deliver such access and therefore should not be the primary driver of the accounting treatment for the entire arrangement. If physical possession is not necessary in order to determine whether a capital asset exists for tangible assets, we do not understand why this criterion determines whether a software element is present for internal-use software arrangements. This criterion was created in order to determine the appropriate guidance for revenue recognition which has been superseded by the new revenue standard.

We believe that the right to access software in a cloud computing arrangement should be evaluated against the criteria in Topic 840 for lease classification which is the guidance used to determine the accounting for on-premise license arrangements. The current guidance under ASC 350-40 only requires analogy to the criteria in ASC 840-10-25-1 in order to determine the asset acquired. It does not require a cloud computing arrangement to meet the definition of a lease in ASC 840.

We further note that the Leases Exposure Draft will allow a buyer to recognize "right to use" assets on the balance sheet. Although paragraph BC351 of the Leases Exposure Draft states it will not address leases of intangible assets, it defines a lease as a "contract that conveys the right to use an asset for a period of time in exchange for consideration."



Question 2: Should an entity be permitted to elect prospective or retrospective transition?

Response: We believe an entity should be permitted to elect either prospective or retrospective transition.

Question 3: Should the amendments in this proposed Update be effective for:

- a. Public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015, with early adoption permitted?
- b. All other entities for annual periods beginning after December 15, 2015, and interim period in annual periods beginning after December 15, 2016, with early adoption permitted?

Response: We believe the amendments in the proposed Update should be effective for the annual periods proposed.

Summary

We thank the Board for the opportunity to share our views.

We welcome the opportunity to discuss any and all related matters, and we also welcome the opportunity to share with you our insights and experience with selling cloud computing arrangements over the past 15 years.

We may be contacted at (415) 901 – 7000.

Sincerely,

/s/ Joseph C. Allanson

Joseph C. Allanson
Chief Accounting Officer
salesforce.com, inc.

/s/ Alexandra Buldrini

Alexandra Buldrini
VP, Revenue Management
salesforce.com, inc.



Appendix

Salesforce whitepaper and EITF submission on September 4, 2013 is incorporated by reference:
Accounting for the Purchase of Cloud Computing Arrangements