

October 19, 2010

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

File Reference No. 1820-100

Via email: director@fasb.org

Re: FASB's Proposed Accounting Standards Update—*Revenue Recognition (Topic 605): Revenue from Contracts with Customers* (hereinafter referred to as the "Proposal").

Dear Ladies and Gentlemen:

On behalf of salesforce.com, inc. (the "Company"), we appreciate the opportunity to share our views on the above referenced proposal. Our views are limited to the discussion of selling costs (specifically sales commissions) as described in paragraph 59(a), which says:

"An entity shall recognize the following costs as expenses when incurred:

(a) costs of obtaining a contract (for example, the costs of selling...)"

We take exception to the Board's views on this topic, and we think that the better alternative is for the Board to establish a narrow framework similar to that for the costs of fulfilling a contract in determining when it is appropriate to recognize an asset upon the incurrence of costs such as sales commissions.



Background

We appreciate the Board's consideration of the accounting for Contract Costs. As many realize, the accounting literature has been relatively silent on when it is appropriate to capitalize contract costs. This has forced companies over the years, particularly those in the service industry like salesforce.com, to analogize to existing accounting rules that were issued years ago and which had a narrow focus.

The preliminary document on "Revenue from Contracts with Customers" that the Board issued in December 2008 suggested that absent specific rules that allowed for the costs to be treated as an asset, all contract costs should be expensed as incurred. We expressed our views to the Board in our letter dated July 29, 2009 and explained why it would be appropriate to capitalize sales commissions. A copy of that letter can be found at http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1660-100 and is attached in the appendix to this letter.

Since the preliminary document, the Board has made significant progress. The current June 2010 Proposal indicates that costs of fulfilling a contract can be capitalized and amortized, provided certain criteria are met. However, there has been no change to the Board's views on the costs of obtaining a contract (e.g. sales commissions).

We think that it is unfortunate that the Board in its current Proposal did not include any questions to respondents on the subject of costs of obtaining a contract.

We ask the Board to re-consider its views on the costs of obtaining a contract (e.g., sales commissions) and we recommend that the Board establish a narrow framework similar to that for the costs of fulfilling a contract for use in determining when it is appropriate to capitalize and amortize selling costs.



Overview of salesforce.com and its accounting practice

Salesforce.com, inc. is a leading provider of enterprise cloud computing applications. The Company was incorporated in February 1999 and provides a comprehensive hosted customer and collaboration relationship management service to businesses of all sizes and industries worldwide, and provides a technology platform for customers and developers to build and run business applications.

The Company's stock is listed on the New York Stock Exchange and the Company's stock is included in the Standard & Poor 500 Index. Since the Company's initial public offering in June 2004, the Company's market capitalization has increased from approximately \$1.1 billion to \$14.6 billion as of September 30, 2010. The Company's market capitalization places it within the 200 most valuable companies in the Standard & Poor 500 Index.

Substantially all of the Company's revenues are from subscription fees paid by customers who are accessing the Company's enterprise cloud computing application service. Subscription revenues are recognized ratably over the contract terms beginning on the commencement date of each contract. The typical subscription term is 12 to 24 months, although terms range up to 60 months. The subscription contracts are noncancelable. The Company capitalizes and amortizes its sales commissions, which are based on the value of the committed deal and are paid the month after the execution of the customer contract.

In the notes to its consolidated financial statements, the Company discloses the following:

“Deferred commissions are the incremental costs that are directly associated with non-cancelable subscription contracts with customers and consist of sales commissions paid to the Company's direct sales force. The commissions are deferred and amortized over the non-cancelable terms of the related customer contracts, which are typically 12 to 24 months. The commission payments are paid in full the month after the customer's service commences. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. The Company believes this is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be recorded as an asset and charged to expense over the



same period that the subscription revenue is recognized. Amortization of deferred commissions is included in marketing and sales expense in the accompanying consolidated statements of operations.”

The Company’s external auditors issued a preferability letter prior to the Company’s June 2004 initial public offering supporting the Company’s accounting described above.

Executive Summary -- why the Board should allow for the capitalization of selling costs

We believe that the Board should reconsider its current view on costs of obtaining a contract for these reasons:

1. The capitalization and amortization of selling costs allows for a better method of describing a service vendor’s operating results from quarter to quarter.
2. The August 2010 Exposure Draft on lease accounting, the IASB’s proposal on insurance contracts and the final consensus reached in EITF Issue No. 09-G, “*Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*” do not require costs of obtaining a contract to be expensed as incurred. We believe that the basis for the conclusions in those documents is sound and should be consistently applied to other contracts.
3. From a conceptual point of view, the incurrence of selling costs does give rise to an asset since these costs represent the cost to acquire a contract, and the income stream from the binding service contracts have value to the company, an investor and market participant.

Rather than making a blanket statement that unless specific rules allow for the creation of an asset, we recommend that the Board establish a narrow framework for capitalization similar to the costs for fulfilling a contract. We believe that capitalizing costs of obtaining a contract is appropriate in certain circumstances.



Each of these points is described in more detail below.

Detailed discussion of our views

- 1. The capitalization and amortization of selling costs allows for a better method of describing a service vendor's operating results from quarter to quarter.*

We believe this is case for the following reasons:

- a) A material distortion in trended operating results will occur if service companies are required to expense selling commissions in full when incurred. For example, if we were to expense selling commissions in full when incurred, our operating results will be negatively impacted in periods when we obtain new customers and positively impacted in periods where no new customers are obtained. This causes a disconnect between the financial results reported to investors and the operations of the company, and does not create decision-useful information for our investors.
- b) Independent Researchers have expressed a similar viewpoint that investors are not well served in situations where the vendor has a large revenue deferral and costs are expensed immediately.
- c) Analysts believe that in salesforce's situation, the current practice of capitalizing and amortizing sales commissions helps them assess the Company's operating results and extent of new customer activity in a given period.

1(a). The Material Distortion in Trended Results that will occur

If the Board's Proposal is ratified, companies that enter into long-term service arrangements and pay sales commissions based on the terms of those arrangements will reflect large operating losses at the time of contract origination, with subsequent quarters reflecting large operating gains.



We believe the following example helps illustrate the distortion that would result. As discussed above, we recognize subscription revenue ratably over the life of our contractual arrangements. We do not believe our revenue recognition practices for subscription contracts will substantially change under the Proposal. The typical subscription term is 12 to 24 months. The commission payments to our sales representatives are paid in full in the month after service commences and are generally based on the total contract values of the arrangements.

Example. On the last day of the fourth quarter of fiscal 20XX, Vendor A signed two large customer contracts. The two 24-month non-cancelable subscription contracts had a combined value of \$9.6 million over their terms. The commissions due to the sales representatives were \$990,000.

Had Vendor A expensed the commissions, Vendor A would have recorded in the fourth quarter a \$990,000 expense against recognized revenue of only \$13,000, which is equivalent to one day of revenue. Over the next several quarters, Vendor A would record zero commission expense and \$1.2 million of quarterly revenue. If this were the only activity, an investor would see a significant loss in the fourth quarter of fiscal 20XX and significantly higher operating profits in the first quarter of the subsequent fiscal year and in later quarters.

We believe that expensing the commission when the liability is incurred would result in a material distortion in any service company's quarterly trend of results of operations (i.e., a loss in the period when the service contract is signed and increased profitability in the future throughout the terms of the contracts).

The distortion would be particularly acute if Vendor A experienced seasonality when large customer contracts are signed.



We believe that the capitalization and amortization model is more appropriate. The commission amount paid is based on the terms of the customer subscription service arrangement, including the length of time the customer has a contractual right to use our service. As such, to recognize all of the expense at the onset of the arrangement does not align with the revenue recognition pattern for which the commission relates to.

1(b). An Independent Researcher's Finding Underscores our View

In August 2010, two business school professors (Dr. Prakash from the College of William and Mary and Dr. Sinha from Boston University) jointly published a paper entitled: "Deferred Revenues and Matching of Revenues and Expenses." A copy of their independent research paper can be found on the Social Science Research Network: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1316286 Below is an abstract from their research paper. We have underscored certain text to provide emphasis.

"If revenues are deferred but some of the associated expenses are recognized as incurred, revenue deferrals will affect reported profit margins in current and future periods. This paper shows that if deferred revenue is associated with incremental period costs, small changes in the deferred revenue liability have a disproportionately large impact on current and future profitability. Changes in current deferred revenue are negatively associated with current margins and positively associated with future operating margins. The results also show that revenue deferrals make current margins poor predictors of future margins. Due to this increased complexity in predicting earnings, neither analysts nor investors are able to fully incorporate the future performance implications of changes in the deferred revenue liability. As a result, changes in the deferred revenue liability are associated with significant errors in analyst forecasts of both sales and earnings and with significant future abnormal returns."

While their report was not specific to a type of cost, due to the lack of publicly available information, their research finding underscores our viewpoint. If service companies had to expense sales commissions when incurred, current margins would be poor predictors of future margins, and analysts and investors would be left with increased



complexity in predicting earnings and measuring the health and growth potential of the vendor's business.

1(c). The Analysts' Viewpoint

Over 40 Wall Street firms monitor and evaluate the Company's financial results and growth prospects.

The Company's financial model is relatively simple to understand: revenue is recognized ratably over the term of the subscription contracts and expenses such as selling costs are deferred and amortized over the underlying terms of the specific customer contracts. Leading analyst firms have expressed the following viewpoints, which underscore our perspective:

According to UBS (Brent Thill -Analyst and Managing Director of Software Research): "When evaluating a subscription business, it is critical to understand the ongoing profitability of the recurring stream of revenue. We believe that recognizing all acquisition costs as period expenses will meaningfully distort both near and long term operating results. In the near term, revenue streams will appear less profitable than they are in pure economic terms, and over the long term they will appear more profitable."

According to Goldman Sachs (Sarah Friar- Technology Business Unit Leader and Managing Director at Goldman Sachs): "The FASB proposal on recognizing all sales costs upfront creates a number of potential issues in our view: (1) This represents a departure from the matching principle and, in our view, distorts the real operating performance of the businesses. While it could be construed as prudent, in the majority of cases these companies have a long track record of strong performance and there is little/no ongoing concern issues; and, (2) The proposed FASB rules for subscription business will result in depressed margins in the year of the revenue deferral and inflated margins in the year of revenue recognition. As a result, we believe that high growth companies will be unintentionally penalized for the expected margin pressure of growing sales. Further, earnings may appear to be strongest in



recessionary conditions and weakest in economic booms. These contra-indicators of performance will make evaluating and providing investor clarity on the subscription model more challenging.

Our preference would be to remain with the status quo where a bookings margin can already be calculated from the sales P&L cost combined with the deferred commission cost on the balance sheet put against the full quarterly booking (revenue plus change in deferred revenue).”

* * *

Additionally, some analysts and investors use the capitalized commission asset as a proxy of new business, the health of the existing business and future revenue growth. While that information can partially be gleaned from changes in deferred revenue, the understanding is enhanced by also considering capitalized commission costs. For example:

Using the example above: On the last day of the fourth quarter of fiscal 20XX, Vendor A signed two large customer contracts. The two 24-month non-cancelable subscription contracts had a combined value of \$9.6 million over their terms. The commissions due to the sales representatives were \$990,000. Assume that the two customers are paying in semi-annual installments. On the last day of the quarter, Vendor A invoiced both customers collectively \$2.4 million.

Under the current accounting model, Vendor A on the last day of the quarter would have a deferred commission asset of \$990,000 and a deferred revenue balance of only \$2,387,000 (\$2.4 million in billings less \$13,000 which is one day of revenue). The remaining \$7.2 million value of the customer contracts (\$9.6 million less the first billing installment of \$2.4 million) is not reflected on the balance sheet.

Under this current accounting model, the analyst or investor would be able to determine that Vendor A entered into sizable customer arrangements during the quarter because of the size of its capitalized commission asset in relation to the deferred revenue balance.

Had Vendor A fully expensed the commissions when incurred, the analyst or investor would face increased challenges in assessing the extent of new business activity during the period.

- 2. The accounting for contract acquisition costs should be consistent with the conclusions reached in the August 2010 Exposure Draft for Leases, the IASB's proposal on the accounting for insurance contracts, and the final consensus reached in EITF Issue No. 09-G, "Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts."*

We believe the bases for the conclusions described in the guidance referenced above are sound. We ask that the Board in its deliberation of selling costs provide consistent application of accounting across other contracts.

We do not think that it is appropriate to provide differing models to different industries where the underlying arrangements do not provide a conceptual basis for this difference. The type of contract acquisitions costs that are being debated under the respective proposals are conceptually no different than the costs incurred in other industries such as cloud computing where the revenue recognition pattern is the same -- revenue is recognized ratably over the contractual terms.

- 3. The Capitalized Amounts are Conceptually an Asset*

We believe that the sales commissions we described above represent the cost to acquire a customer contract, and the full future income stream from the binding service contracts have value to the company and thus represent an asset.



The assets are the completed sales transactions as evidenced by legally binding annual or multi-year service contracts. Further, as per current purchase accounting rules under US GAAP, contracts obtained in a business combination, are generally recorded as an asset, at its initial fair value. Applying the same principle, we believe that, outside of a business combination, costs including directly attributable costs of obtaining a contract should be recorded as an asset at cost.

We recognize that under ASC 805, transaction costs are not considered part of the value of the enterprise to the buyer. We agree with that concept. Clearly, the seller in a business combination receives value, and that value should represent the fair value of the business. Using the “exit value” notion of ASC 820, the transaction costs cannot be part of the fair value of the business that has just been sold.

However, with sales commissions, these costs represent the cost to acquire a customer contract, and the full income stream from the binding service contracts have value to an investor or market participant. The exit value (and the fair value) of such a contract is greater than zero. The sales commission represents the initial cost to creating that value. As we continue to pay sales commissions, the economic value of our enterprise increases. Indeed, capitalizing these costs may be thought of as simply recording the asset acquired at its initial fair value, as an application of the “cost method” of valuation. Under the fair value principles of ASC 820, *Fair value measurements and disclosure*, the measured value of the asset is essentially the amount paid to sales representatives.

We recommend that the Board establish a Narrow Framework for Determining when it is Appropriate to Capitalize and Amortize Selling Costs

We ask the Board to consider establishing capitalization criteria similar to those for the costs of fulfilling a contract.



Below are our thoughts on what the criteria would be for allowing the capitalization and amortization of selling costs. Establishing such criteria, we believe would set a “high bar” and be consistent with the Board’s overall objective of ensuring that capitalized costs meet the definition of an ‘asset.’

Eligible Costs

Leveraging from the conclusions reached in the August 2010 Exposure Draft for Leases, the IASB’s proposal on the accounting for insurance contracts, and the final consensus reached in EITF Issue No. 09-G, only the following costs would be capitalized:

- a. Incremental direct costs of a successful contract acquisition / renewal.
- b. The portion of the employee’s total compensation and payroll-related fringe benefits directly related to time spent performing acquisition activities for a contract that has actually been acquired.

Realizability of the Capitalized Asset

Similar to the guidance described in other proposals and in Issue 09-G, capitalized selling costs would be considered realizable under the following circumstances:

1. A specific contractual arrangement exists related to the origination costs
2. The contractual arrangement is legally enforceable
3. Management intends to and can demonstrate its ability to enforce the contractual arrangement, and
4. Probable and objectively supportable net margins exist during the base term of the contractual arrangements to support the amount of deferrable costs (where net margins represent revenues net of a related direct costs)



Amortization

Additionally, the capitalized costs would be amortized on a systematic basis consistent with the pattern of revenue recognition. We think that companies should use the specific identification method and amortize the capitalized costs over the same period as the underlying contractual arrangement that gave rise to the cost.

Summary

We wish to thank the Board for its careful evaluation of the points in our letter.

We believe that for certain industries like the service industry, investors will be better served by allowing companies to continue their practice of capitalizing and amortizing costs of obtaining a contract.

We strongly believe that capitalizing and amortizing such costs is appropriate in a narrow number of circumstances. We ask the Board to establish a narrow framework and create a “high bar” for capitalization similar to the costs for fulfilling a contract. We welcome the opportunity to discuss any and all related matters. I can be contacted at (415) 901 – 7000.

Sincerely,

/s/ Joseph C. Allanson

Joseph C. Allanson
SVP, Controller
salesforce.com, inc.

Appendix A – Copy of comment letter submitted by the company in response to preliminary proposal issued in December 2008.

