

October 21, 2010

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

File Reference No. 1820-100 – Comments to Exposure Draft of Proposed Accounting Standards
Update of Topic 605 – Revenue Recognition

Dear Staff,

Thank you for the opportunity to comment on the proposed revenue recognition standards. As a multinational entity, with more than 40% of our sales generated outside of the U.S., we are encouraged by the FASB and IASB efforts to converge to a single set of accounting standards. We are hopeful that your deliberations, which include our input, will result in standards that are truly global and high quality.

Following are our comments to a selection of questions provided in your exposure draft:

Issue – Measurement of revenue (paragraphs 34-53)

Question 4: The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

Red Hat, Inc.'s comments to question 4: *We agree that an entity should recognize revenue on the basis of an estimated transaction price. However, after reading the implementation examples in paragraphs IG75-IG77, we are uncertain how we would practically apply a probability-weighted estimate of volume-based discounts – at the performance obligation level – for each reporting period. We do not believe increasing the number of estimates for factors such as volume-based discounts will provide additional transparency to financial statement users. We recommend that you expand the implementation guidance to include examples in which the consideration varies due to anticipated volume discounts.*

Question 6: Paragraphs 44 and 45 propose that an entity should adjust the amount of consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Red Hat, Inc.'s comments to question 6: *While we agree in theory with the Board's preference to require management to assess whether the effects of the time value of money are material to a contract, we are concerned that, in practice applying such a materiality assessment without some "safe-harbor"¹ exceptions could be cost prohibitive.*

For entities that sell maintenance and support subscriptions, it is customary business practice to receive payment either in advance or annually on the anniversary of the subscription contract. The timing of such payments, coupled with ratable recognition of the subscription revenue, would result in a gross up of revenue, operating income, and interest expense while having no effect on net income. Because individual contracts can vary widely in the number of per-unit-subscriptions sold, larger contracts with otherwise identical terms (i.e., same underlying economic substance) may be treated differently for accounting purposes under the proposed standard.

Further, the additional administrative cost of developing, implementing, maintaining, reconciling, auditing and SOX 404 testing the required processes for measuring and recognizing the time value of money – at the contract level – with customer specific discount rates – would not be offset by the benefit of providing such bifurcation to financial statement users.

Rather, we suggest entities be given the option to provide qualitative disclosure regarding customary business practice, along with appropriate stratified quantitative disclosures related to the timing of the underlying performance obligations, thereby enabling financial statement users to approximate an overall financing element if they so choose.

Question 7: Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the goods or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

Red Hat, Inc.'s comments to question 7: *We agree with the Board that entities should allocate the contract price to all separate performance obligations in proportion to a standalone selling price. We are encouraged that expanding the available objective measures beyond the current Vendor Specific Objective Evidence ('VSOE') requirement in ASC 605-985 Software Revenue will result in a better match with the underlying economic substance of the transaction resulting in improved transparency for financial statement users.*

Issue – Contract Costs (paragraphs 57-63)

Question 8: Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an

1 A safe harbor exception would include contracts with payment terms of 1 year or less and without explicit financing terms.

asset eligible for recognition in accordance with other standards (for example Topic 330 or IAS 2; and Topic 985 on software or IAS 38, *Intangible Assets*), an entity should recognize an asset only if those costs meet specified criteria.

Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

Red Hat, Inc.'s comments to question 8: *We do not foresee any operational issues with immediately recognizing more costs associated with contract fulfillment. However, where the timing of expense recognition and the timing of related revenue recognition diverge significantly, for example where entities have significant deferred revenue balances, we believe the disconnect between the recognition of revenue and the recognition of directly related expenses, such as commissions, will render financial statements less transparent not more.*

We suggest that certain direct costs such as commissions be deferred as allowed under current standards. Deferring commissions would ensure continued matching of direct expenses to their related revenues. Further, we suggest that any proposed changes to accounting for expenses be addressed separately under an exposure draft focusing on expenses, thereby allowing more thorough consideration by the Board and constituents.

Issue – Effective date and transition (paragraphs 84 and 85)

Question 13: Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve the trend information about revenue but at a lower cost? If so, please explain the alternative and why you think that it is better.

Red Hat, Inc.'s comments to question 13: *Due to the broad scope of proposed changes, we disagree and do not recommend that the proposed guidance be applied retrospectively. Unless the transition period mirrors the anticipated overall convergence road map (that is, three plus years), thereby allowing entities to consider the proposed changes when executing new contracts, we believe the administrative burden of reviewing essentially 5 years of contracts², would outweigh any perceived benefits of having comparable financial statements.*

We recommend application of the transition guidance outlined in ASC 605-25-65 Multiple-element Arrangements. We believe the disclosures required under ASC 605-25-65 will provide adequate information for financial statement users to assess the impact of the change in accounting principle without creating significant incremental costs for the financial statement preparers.

² Because we have subscription terms up to three years, five years of contracts would need to be reviewed to produce required prior year comparable financial statements.

Issue – Onerous performance obligations (paragraphs 54-56)

Red Hat, Inc.'s comments: *We do not agree that the onerous contract assessment should be performed at the performance obligation level. In our industry, like others, deals are occasionally bundled to induce diverse customers, often with contrasting perceptions of relative product values, to procure more products or services than they otherwise would have had we priced and sold the items separately. Moreover, certain contract arrangements incorporate multi-elements--strategically tying products and services---in order to extend market share. We believe that requiring entities to assess onerous contracts at the performance level, rather than the overall contract level, will result in accounting considerations outweighing economic considerations resulting in suboptimal contract negotiations.*

We suggest that onerous contract assessment be performed at the contract level consistent with the current guidance under IFRS.

Thank you again for the opportunity to comment on the proposed revenue recognition standard. If you have any questions regarding our comments, please contact either Paul Bailey or Mark Huebeler at 919-754-4007.

Paul G. Bailey,
Director Technical Accounting and SEC Reporting
Red Hat, Inc.
1801 Varsity Dr
Raleigh, NC 27606

Mark Huebeler,
Senior Manager Revenue Accounting
Red Hat, Inc.
1801 Varsity Dr
Raleigh, NC 27606