October 6, 2010

Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

RE: File Reference No. 1820-100: Comment Letter on Revenue Recognition (Topic 605)

We are responding to the Financial Accounting Standards Board’s (“Board”) invitation to comment on the above-referenced exposure draft. We welcome the opportunity to comment on the exposure draft. We agree with the Board’s objective to clarify and simplify the accounting guidance for recognizing revenue.

We are a software company and have not felt the need to comment on exposure drafts in the past. However, given the magnitude of the proposed changes, we felt it was important for us to comment on this draft. As is typical with most software companies, we have a substantial deferred revenue balance and enter into many multi-element arrangements. We recognize the need to simplify the accounting guidance related to revenue recognition. We are very much aware of the current state of revenue recognition, where the rules are scattered throughout many different pieces of accounting literature, and we look forward to being guided by one piece of literature to resolve our revenue recognition questions. However, because we, like many others, have always operated under a detailed rule-based revenue recognition method, the transition to principle-based accounting guidance will be difficult and will require a complete cultural shift.

Implementation Guidance

As we reviewed the exposure draft, we walked through how we would implement its guidance. In those areas of the exposure draft where we were used to prescriptive rules and we did not find any, we found ourselves falling back on the present methods of accounting, and applying this understanding to the proposed rules. Examples include using vendor specific objective evidence of fair value (“VSOE”) for estimated selling prices, and our current definition of multiple elements for distinct performance obligations. We are confident that other entities would follow a similar pattern. As this is an all-encompassing cultural shift, if the Board wants to truly achieve a change to revenue recognition, we will need significant guidance to complete this transformation. We would greatly appreciate much more implementation guidance and examples so that we can truly grasp what the Board is hoping to achieve. If we do not find those examples, we would likely fall back to our current methods, which may not necessarily be what the Board intended.
Retrospective Application

Of all the proposals under the new rules, the one that we find the most daunting is the requirement to retrospectively adopt these rules. As a software company, we question if the benefits to the users will outweigh the costs to the company. We do believe that this requirement will likely be more difficult for those in the software industry, due in part to our large deferred revenue balances, many multi-element contracts, and the prevalent use of the residual method. While we recognize the need for trended information for financial statement users, we do not believe that the cost of accounting for most of our transactions under two separate accounting standards for a minimum of a two-year period is worth the benefit to our financial statement users. As we walked through how we would report our revenues under two different sets of accounting rules for a minimum of a two-year period, some of the complications and additional costs that we would face include:

- developing and maintaining two revenue recognition systems;
- training and operating two revenue recognition processes;
- keeping the two revenue recognition systems in sync when there are invoicing and other adjustments;
- implementing and testing the necessary SOX controls during the dual reporting period;
- additional audit fees, as our auditors will need to review the two retrospective years of revenue transactions twice during the dual reporting period; and
- increased manpower needed to operate the two revenue recognition systems.

We understand the importance of preserving trends; however, we do not believe that the new guidance would materially impact trends. Yes, it would provide different results, but the general revenue trends would still be the same. It is highly unlikely that if a company’s revenues were trending downward prior to the adoption of the new rules, that they would now flatten or trend upward. Granted, the starting points may be different (i.e. revenues for one of the duplicated historical years may now be $950 million as opposed to $930 million under the current rules), but we believe that providing two years of historical information will not significantly help the investor. Furthermore, we question the investor who bases an investing decision on the mere fact that a company has better or worse revenue numbers merely from a change in accounting principle.

As our company is currently struggling to maintain operating margins in challenging economic times, we question if it is in the best interest of our shareholders and investors to incur additional cash expenses and jeopardize profits solely to restate historical revenue numbers.

Also, as we reviewed how we would apply the new rules retrospectively, we recognized a need for more guidance from the board. One area where we feel more guidance is needed is in the usage of estimates for the retrospective periods. For the retrospective periods, would we use the estimates that would have been used at that time, or would we update those estimates and report those periods based on actual history? An example of this would be in the area of collections. For the retrospective periods, would we reduce revenue for the nonpayments that actually occurred, or would we use the estimates that we otherwise would have made? Under the proposed rules, changes in estimates to collections do not flow through revenue, therefore, for the retrospective periods it would benefit a company to base their “estimate” on actual results, especially if their estimates for collection are lower than what is ultimately collected, therefore maximizing the impact to revenue for that period. If we took advantage of the hindsight that would be available to us, wouldn’t that impact the trend information that the Board appears interested in having us prepare?
The new rules are pervasive enough that we are concerned that the Board has underestimated the effort to go back and review each of our contracts and record the necessary adjustments not only for potential new performance obligations at different estimated selling prices, but that we would also need to potentially adjust this new revenue amount for collectibility, warranty, and time value of money issues. This would require a significant amount of additional labor on each contract in addition to what is currently required to properly record revenue under the current accounting rules during the dual reporting period.

Not only does retrospective application have the operational issues as discussed above, but it also creates the potential for a portion of our current deferred revenue to never be recognized in the income statement. For example, revenue on multi-year deals greater than three years that was deferred under current revenue recognition rules, but is recognized up front under the proposed rules would never be recognized in the income statement. This would happen primarily as a result of the elimination of the residual method.

**Alternative Methods to Retrospective Application**

We have noted that the Board has in the past utilized other transition methods that distort trends. For example, we have noted that with Accounting Standards Update (“ASU”) 2009-13, “Multiple Deliverable Revenue Arrangements” and ASU 2009-14, “Certain Revenue Arrangements that Includes Software Elements” the prospective method was used for transition with the option to use the retrospective method.

We believe that the cumulative effect of change in accounting principle would be a viable option as it would be necessary to adjust deferred revenue balances to the new guidance, but would allow us to avoid having to account for two years worth of transactions under two different sets of accounting rules. Disclosures could then be required to provide the impact to deferred revenue, and high level estimates could also be required showing the impact to revenue in the current period. This would provide financial statement users with a sense of the impact.

**Summary**

Overall, we look forward to a single set of revenue recognition guidance that includes a robust set of implementation guidance and applaud the Board for its efforts in making these monumental changes. We also recognize the difficulties the Board faces in trying to satisfy all constituents.

Our answers to certain of the specific questions in the exposure draft provide more detail on the views expressed above and are attached in the Appendix to this letter.

Again we welcome the opportunity to respond to the exposure draft. If you have any questions in relation to this letter please do not hesitate to contact Greg Steinkopf at (801) 861-4244.

Sincerely,

Greg Steinkopf, CPA
Director Corporate Accounting
Novell, Inc.
Appendix

Comments on Proposed Revenue Recognition Accounting Standards

Question 2

The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

We agree with the principles outlined in paragraphs 22 and 23 regarding separating distinct performance obligations. However, additional examples or clarification would be helpful in determining if certain types of software-related performance obligations are “distinct.” For instance, how would the following types of performance obligations be accounted for under the new model?

- Unspecified upgrade rights – considered part of Post Contract Support (“PCS”) under current US GAAP;
- Specified upgrade rights – considered a separate element under current US GAAP;
- Unspecified future product – considered a “subscription” under current US GAAP; and
- Specified future product (product roadmaps) – considered a separate element under current US GAAP.

Should the above be considered “distinct” performance obligations or would they all be part of a broader performance obligation (i.e. PCS)? More clarity is requested beyond the broad definition of “distinct” as described in the proposed guidance.

Question 5

Paragraph 43 proposes that the transaction price should reflect the customer’s credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

We agree with the proposed principle that a customer’s credit risk should affect how much revenue is recognized as opposed to whether the entity recognizes any revenue. However, we disagree with the concept that future adjustments to the credit risk estimate should flow through other income and expense. It seems that in most, if not all other accounting literature, when updated information is received, the change in estimate is updated through the same line item as the original estimate. We question why revenue would be different. We do not believe recording adjustments to credit risk to other income and expense provides meaningful information to financial statement users, other than it would show the variance from our original estimates, especially since this is an item that is difficult to estimate. A customer with a bad credit rating may still pay 100%.

Our customers tend to either pay 100% or not at all and generally revenue recognized will ultimately equate to cash received, with the revenue recognition principles determining the timing of that revenue. Using a probability model will force us to do so at a homogenous group level in accordance with the
guidance in paragraph IG80 of the exposure draft. Otherwise, if we were to apply the probability model at the individual customer level, we guarantee ourselves that our estimate would be incorrect as we will have recorded revenue at something other than 100% or zero and which will never equate to the cash ultimately received from the customer and not reflect the economic substance of the transaction. Since we will have to adjust revenue as a group, our estimate will have little to do with individual customer’s behavior but more to do with our estimation process. To record updates to those group level estimates as something other than revenue is not reasonable.

We feel that an improved model would be to have the subsequent adjustments to the credit risk estimate flow through revenue. If needed, disclosures could be made to state how much revenue was received for subsequent adjustments to credit risk.

Furthermore, we would not want to mislead our customers into believing that it is common practice to not pay 100%. If a customer had knowledge that only $80 of revenue was typically recorded on a $100 transaction, it could motivate the customer to pay the lower amount.

**Question 6**

*Paragraphs 44 and 45 propose that an entity should adjust the amount of promised 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?*

We agree with the principle to reflect the time value of money. We noted the examples in the exposure draft on how to account for the time value of money for payment in arrears and in advance. However, we would like an example for when the payment is made in advance for services that are performed over time, such as with PCS in a software contract. In a five-year PCS arrangement, would there be a requirement to adjust the discount rate on a quarterly or annual basis? Or, would an adjustment to the discount rate only be required when the impact becomes material?

We would also like additional clarity on how to adjust the discount rate for estimating credit risk. We are unsure of how to translate a probability model credit risk into a discount rate.

**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 good 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?*

We agree with the principle that the transaction price should be allocated to all separate performance obligations in proportion to the standalone selling price (estimated if necessary). In the implementation guidance, it would be useful to have more examples clarifying how to support estimated selling price, in particular the use of observable inputs. Additionally, it would be helpful if included in the implementation
guidance was a discussion on how vendor specific objective evidence of fair value ("VSOE") relates to estimated selling prices.

**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 trend information about revenue, but at a lower cost? If so, please explain the alternative and why you think it is better.*

We understand the desire to preserve trend information, especially for the users of financial information. However, we do not agree that it should be mandated across the board that an entity should apply the proposed guidance retrospectively. We are concerned about the costs and challenges of having to prepare two years of revenue under two different revenue models. The software industry, in which companies hold large deferred revenue balances, results in some special challenges that will not likely be faced by other industries (although we assume that other industries will also have their own unique challenges). As we have considered how we would perform retrospective application, we have identified the following complexities:

- Given the pervasiveness of the changes, we will likely need dual systems to account for our revenue during the transition period (the two years of restated information prior to the first year of adoption). Our current usage of the residual method for accounting for software, plus the proposed changes for collectibility and the time value of money, as well as new performance obligations that did not exist under the old multiple element model, will require us to track our revenue under two separate systems to be compliant with each of the differing set of rules. The usage of dual systems creates added complexities, including the following:
  - the potential for disconnects between the two systems (i.e., a correction in one system not performed in the other);
  - potential increases of internal control and other errors, resulting from the corresponding dual requirement to ensure that both systems are correct and compliant with internal controls; and
  - ensuring that the two systems reconcile, as well as the cost of maintaining two systems, among other complications.
- Retrospective application will be extremely costly, in terms of time, money and other company resources. Additional costs include:
  - additional audit fees as our revenue will be audited twice during the transition period, once under existing rules and a second time under the new rules;
  - costs of establishing, training, operating, maintaining and reconciling two separate revenue systems during the transition period;
  - costs of establishing, performing, and auditing SOX controls related to the dual systems, such as for maintaining and using different selling prices (VSOE under the current model and estimated selling costs under the proposed model), using different performance
obligations, different consequences for collectibility issues, warranties, time value of money, etc.; and
  o potential additional manpower required to review and account for our revenue contracts under both sets of accounting rules during the transition period.

- The challenges of using estimates for the transition period, especially as it pertains to collection and warranty issues. For example, for the two years of historical information, would we take advantage of hindsight with respect to collectibility and warranty issues, or use the estimates in place at the time of the original reporting? We would welcome some implementation guidance on this issue.
- Not getting “credit” from our analysts and investors for revenue that will be recognized in previously reported periods. Trend information may help them in their analysis of us, but we believe, this information is not likely to change their decision making process. It does not seem likely that an investing decision would change based on the application of different accounting standards.
- Having two separate sets of revenue numbers will create confusion, not only for internal users, but possibly external users as well.

Again, we recognize the desire for trend information, but we believe the costs as outlined above far outweigh the benefits to the financial statement users. Our investors may actually prefer us to save the costs as outlined above and deliver better operating results. We question how valuable this trend information will really be. It seems that the general trend of a company’s revenue stream should still be the same. If a company’s revenue was trending downward under current rules, it should still trend downward under the new rules. The numbers may be slightly different under the two revenue models but the general trends should still remain the same.

Not only does retrospective application have the operational issues as discussed above, but it also creates the potential for a portion of our current deferred revenue to never be recognized in the income statement. For example, revenue on multi-year deals greater than three years that was deferred under current revenue recognition rules, but is recognized up front under the proposed rules would never be recognized in the income statement. This would happen primarily as a result of the elimination of the residual method.

We could not identify another transition method that preserves trends, but we have noted that the Board has in the past utilized other transition methods. For example, we have noted that with Accounting Standards Update (“ASU”) 2009-13, “Multiple Deliverable Revenue Arrangements” and ASU 2009-14, “Certain Revenue Arrangements that Includes Software Elements” the prospective method was used for transition with the option to use the retrospective method.

We wonder if the cumulative effect of change in accounting principle would work as an alternative method as it will be necessary to adjust deferred revenue balances to the new guidance, but would allow us to avoid having to account for two years worth of transactions under two different methods. Disclosures could be made to disclose the impact to deferred revenue and high level estimates could be required of the impact to revenue in the current period so that financial statement users can have a sense of the impact.

We recognize that it will be more challenging for some industries than others to apply the retrospective method. Another alternative is to have the retrospective method stated as the preferred transition method, with the option to use the cumulative effect of change in accounting principle as a less preferred
alternative. For those that elect to use the cumulative effect of change in accounting principle alternative, additional disclosures would be required. These additional disclosures would include statements as to why it was difficult, or not cost effective to apply the retrospective method, including the estimated costs to apply the retrospective method, among other disclosures.

We believe that additional guidance is needed on how to apply the retrospective method, especially when applying estimates to the earlier periods. As noted above, should hindsight be used, or would estimates in place at the time the historical periods ended be used to record items such as collectibility and warranties? If actual results are utilized as opposed to estimates, wouldn’t that distort trends?

**Question 14**

*The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?*

We recognize that one of the goals of this project is to be principles-based as opposed to rules-based. However, as we are accustomed to a rules-based environment we would like to have as much implementation guidance as possible to help us as preparers adapt to this cultural shift in accounting guidance. Specifically, we would like to see additional implementation guidance in the following areas:

- as noted above in question 2, in determining “distinct” performance obligations;
- as noted above in question 6, estimating the discount rate for combined time value of money and collectibility issues;
- as noted above in question 7, support for standalone selling prices and estimated selling prices when used;
- as noted above in question 13, performing the retrospective application, particularly with respect to areas of estimation such as collectibility, variable consideration, where actual information could be used instead of estimates due to the passage of time, and the use of hindsight; and
- as noted below in question 15, additional clarification with regard to any overlap between warranty and software PCS would be appreciated.

**Question 15**

*The Boards propose that an entity should distinguish between the following types of product warranties:*

a) *A warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.*

b) *A warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.*
Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

We do not believe that a separate performance obligation for warranties exists for our standard software products (the vast majority of our sales transactions). Defects are inherent in software generally and it is very common to provide patches, fixes, or other updates when defects become known. Patches, fixes, or other updates are made available to all customers through our standard PCS offerings. We do not believe this creates a “distinct” performance obligation. We also note that a “wear and tear” warranty is typically not an issue with our standard software products and is also covered by our standard PCS offerings. In the event we were to sell a “non-standard” product or service (which is rare in our case) we agree that a separate performance obligation associated with the warranty would possibly exist.

Additional clarification or examples would be helpful in our case. In other words, when would a software warranty be considered a “distinct” performance obligations vs. part of a broader performance obligation (i.e. PCS)?