October 22, 2010

Leslie F. Seidman, Acting Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Sent via email to director@fasb.org

Re: File Reference No. 1820-100

Ms. Seidman,

Blackbaud, Inc. ("Blackbaud") appreciates the opportunity to share our comments regarding the exposure draft, "Revenue from Contracts with Customers." Blackbaud is a provider of software and related services designed specifically for nonprofit organizations. We have been a public company since 2004 and for the year ended December 31, 2009 we generated revenue of $309 million from approximately 22,000 active customers.

Overall, we support the move from a prescriptive, rule-based approach to a more principles-based approach to revenue recognition for software arrangements. In general, we believe this shift will ultimately result in a better and more consistent reflection of the economics of software and related services transactions in the financial statements.

We share below certain key observations we ask that you to consider as you finalize the proposed standard:

**Retrospective adoption approach**

While we acknowledge that retrospective adoption is the best approach to preserve trends and report comparable financial information, we also believe that applying the new standard retrospectively, as currently drafted, will impose significant and costly operational challenges as follows:

- Considering the high volume of transactions we process (4,000 per month), we believe we would be required to maintain dual accounting systems for the two years prior to the year of adoption to capture accurate revenue information under each set of accounting standards.
- We believe that applying the proposed standard requires a significantly greater level of judgment. The application of such judgments retrospectively poses the unique challenge of how to use hindsight and may raise questions and create confusion for users of the financial statements. For example, should companies consider what they know today about the actual outcome of estimates being applied retrospectively?
- The new standard, as drafted, would represent a substantial shift in revenue recognition for the software industry which will, we believe, result in the need for significant modifications to the information systems used to track and

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record revenue. For example, the application of the relative standalone selling price method to a high volume of multiple element arrangement transactions and the resulting elimination of the residual method will require substantial modification to our information systems.

We believe the effort to faithfully apply the standard, as drafted, retrospectively will be extremely costly (both from a systems and resources perspective) and require substantial lead time (e.g. system changes, process implementation, staff training, etc.) prior to a required effective date. We request the Boards reconsider whether the benefits of comparability and trend information to the users of financial statements outweigh the substantial costs to accomplish retrospective application.

We believe that the preferable approach is to allow adoption of the new standard prospectively, accompanied by appropriate disclosure. A second but far less desirable approach would be to allow a cumulative catch-up for the effects of applying the standard as of the balance sheet date. If the Boards commit to the retrospective approach, we request that consideration be given to the substantial system, process and resource changes required in setting an effective date for the proposed standard.

Contract costs
We disagree with the proposal to expense "contract costs" as incurred, and request the Boards reconsider adopting an approach which would be more consistent with the historical concept of matching revenue with expenses; we believe this will result in a more accurate reflection of the economics of a transaction in the financial statements. We believe by expensing immediately contract acquisition costs, such as sales commissions, there would be a significant mismatch of revenue and expense for significant long-term service and multi-year software subscription arrangements which under the proposed model would be recognized "continuously" as the transfer of service occurs.

Further, we believe it is a compromise of the usefulness of the financial statements to reflect a loss in the period the contract is entered. For example, in a 3 year subscription arrangement commission expense is incurred at the time the contract is acquired, but the associated revenue is recognized ratably in future periods. Under the standard the commission expense would be expensed as incurred, at contract signing, and the financial statements would reflect a loss on this contract since the majority of the revenue would be recognized in future periods. We believe that the investment an entity makes in acquiring a long term contract is based on the projected economic recovery over the course of providing the service.

We also believe the capitalization of contract acquisition costs meets the definition of an asset similar to contract-based intangible assets that are recognized through acquisition or a business combination. Similarly, the realizability of the deferred commission asset would be supported by the cash flows of the related contract.

Onerous performance obligations
We believe the onerous performance obligation assessment in multiple element arrangements should be done at the contract level rather than at the performance obligation level. The performance obligation level is at too low a level both administratively and economically. It is common in bundled software transactions for profitability to shift amongst the various deliverables in order to achieve greater value
from entire arrangement. For example, a company may be willing to give a greater discount on the software product than implementation services due to the difference in margins between the two elements. Using the relative standalone selling price allocation methodology, this could result in the recognition of losses for individual performance obligations even if the overall contract is profitable. We do not believe this would reflect the economic substance of such multi-element arrangements. We believe the Boards need to clarify the accounting for onerous performance obligations in profitable contracts and clarify how this requirement enhances the usefulness of the financial statements.

Probability-weighted estimates
The proposed standard requires the use of a probability-weighted technique to determine estimates in several areas (e.g. transaction price, refund liability, costs to satisfy a performance obligation). We believe the requirement to use a probability-weighted technique adds unnecessary complexity and subjectivity. We believe estimates based on a good faith evaluation of the relevant facts and circumstances would achieve the same objective, and would be more operationally practical.

Our responses to the Boards’ specific questions in the exposure draft are attached in the Appendix to this letter. If you have any questions regarding this letter, please feel free to contact me at (843) 654-3900 or tim.williams@blackbaud.com.

Sincerely,

[Signature]

Timothy V. Williams
Blackbaud, Inc.
Senior Vice President and Chief Financial Officer
Proposed Accounting Standards Update Exposure Draft “Revenue from Contracts with Customers”

Question 1: Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:

(a) combine two or more contracts and account for them as a single contract;  
(b) segment a single contract and account for it as two or more contracts; and  
(c) account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

We agree with the price interdependence principle and more specifically, the indicators described in paragraph 13 (a)-(c), for combining contracts and accounting for contract modifications. However, we do not agree with the proposed concept of segmenting a single contract. We believe that identifying separate performance obligations within the contract achieves the same objective and a requirement to segment a single contract would result in unnecessary complexity.

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. Paragraph 23 proposes a principle for determining when a 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 "distinct" principle. However, we disagree with the requirement to have both a distinct function and profit margin. We commonly sell software license and PCS in bundled transactions. We do not believe the requirement to have distinct profit margin is operational for the software industry. The same research and development resources that develop our software products also develop the upgrades and enhancements provided to our customers in our PCS arrangements. As the standard is currently drafted, we believe we may be precluded from separating software license and PCS obligations in bundled transactions since the resources, costs and profit margin would not be separately identifiable. This would result in financial statements that are not reflective of the economics of the transaction. We request the board reconsider the requirement for a distinct profit margin when identifying separate performance obligations.

Question 3: Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

We believe the proposed guidance in paragraphs 25-31 is sufficient. However, we believe more industry specific implementation guidance is needed on the evaluation of whether control transfers on a continuous basis or at a point in time. We believe this will
be an area of significant judgment and change for software companies that engage in consulting arrangements and/or software customization work. We believe in these types of service arrangements a pattern of revenue recognition that is similar to the existing proportional performance or percentage of completion methods most accurately reflects the economics of such transactions in the financial statements.

**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?

We agree with the proposed approach and criteria, with the exception of requiring the use of a probability-weighted estimate. We believe the requirement to us a probability-weighted estimate adds unnecessary complexity. We believe that the use of management’s judgment in reaching an estimate is sufficient. The Boards need not prescribe the manner in which management exercises its judgment.

**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 that customer credit risk should affect how much revenue is recognized and not whether revenue is recognized. However, we disagree with the requirement that subsequent changes in estimates for credit risk be reflected in other income/expense. If the customer ultimately pays the full amount, revenue from the sale of goods or services would be unnecessarily reduced and what is economically and, in substance, revenue from such activities would be classified as income elsewhere in the financial statements. We do not see how this would provide useful information to the user of the financial statements. Further, we believe this is inconsistent with the treatment of changes in estimates as applied to other transactions in the financial statements which require the change in estimate to be reflected in the same financial statement line as the original estimate (uncertain tax positions, loss contingencies, etc.).

**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. However, we request the Boards provide further guidance on the determination of the discount rate, which reflects both time value of money and credit risk and the determination of whether a material financing component exists in service arrangements that are delivered within 12 months of the advance payment. We do not believe there should be a material financing component in annual advance PCS fees (or similar services that are delivered ratably on a continuous basis) and believe the current
standards should be retained which indicate receivables and payables arising from transactions with in the normal course of business which are due in customary trade terms not exceeding approximately one year.

Additionally, we request that the Boards provide further guidance on the application of adjusting consideration to reflect the time value of money in long-term service arrangements where there is continuous transfer of the service. For example, it would be helpful to provide an illustrative example that provides guidance in situations when a company receives advance payment for multi-year software-as-a-service subscription arrangements.

**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 allocation of transaction price using relative standalone selling price.

**Contract costs (paragraphs 57–63)**

**Question 8:** Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 965 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?

We believe the proposed guidance is operational. We request the Boards consider expanding Example 28 in paragraph IG90 to provide an illustration of the application of the criteria in paragraph 57(a)-(c) to the costs of design, migration and testing of the datacenter.

**Question 9:** Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

We agree with the costs specified and would also include contract acquisition costs such as sales commissions. We believe that immediately expensing such contract acquisition costs results in a significant mismatch of revenue and expense in our financial statements for long-term service and multi-year software subscription arrangements which would continuously transfer service (i.e. ratably recognize revenue over the service period). Further, we believe it is inappropriate to reflect a loss in the period the contract is entered. The investment an entity makes in acquiring a long term contract is based on the economic recovery over the course of time of providing the service.

We also believe the capitalization of contract acquisition costs meets the definition of an asset similar to contract-based intangible assets that are recognized through acquisition
or a business combination. Similarly, the realizability of the deferred commission asset would be supported by the cash flows of the contractual relationship.

Disclosure (paragraphs 69–83)

**Question 10:** The objective of the Boards’ proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

**Question 11:** The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

**Question 12:** Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

In response to questions 10-12, we believe the disclosure requirements appear reasonable.

Effective date and transition (paragraphs 84 and 85)

**Question 13:** Do you agree that an entity should apply the proposed guidance retroactively (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.

While we acknowledge that retrospective adoption is the best approach to preserve trend information, we believe that applying the new standard, as currently drafted, retrospectively will impose significant and costly operational challenges. We believe we would be required to maintain dual accounting systems for the two years prior to the year of adoption to capture accurate revenue information under each set of accounting standards. We believe the effort to faithfully apply the standard, as drafted, retrospectively will be extremely costly (both from a systems and resources perspective) and require substantial lead time (e.g., system changes, process implementation, staff training, etc.) prior to a required effective date. We request the Boards reconsider whether the benefits of comparability and trend information to the users of financial statements outweigh the substantial costs to accomplish retrospective application.

We believe that the preferable approach is to allow adoption of the new standard prospectively, accompanied by appropriate disclosure. A second but far less desirable approach would be to allow a cumulative catch-up for the effects of applying the standard as of the balance sheet date. If the Boards commit to the retrospective approach, we request that consideration be given to the substantial system, process and resource changes required in setting an effective date for the proposed standard.
Implementation guidance (paragraphs IG1–IG96)

**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?

The proposed model is a significant shift in revenue recognition for the software industry, which is currently highly rules-based. The elimination of software specific guidance would likely result in adding a greater level of subjectivity and variability in comparability for practitioners who are accustomed to following a prescriptive model. Further, the proposed model generally calls for greater use of judgment. Given the lack of a foundation of practical interpretation of the new standard, we believe the Boards should consider the need for additional implementation guidance specific to the software industry in the following areas:

- In operating environments with a high volume of multiple element arrangement transactions, the exercise of allocating consideration using the relative-selling price method may be challenging. Illustrative examples of determining estimated selling price and allocating consideration using the relative standalone selling price method under hypothetical facts and circumstances that include a vendor with a high volume of multiple element arrangement contracts involving a variety of different types of services would be helpful.

- Further guidance on how value is required to be allocated if a multi-element transaction includes both performance obligations that can be combined (support and updates/enhancements) as well as other obligations (software, services) would be helpful. Additional clarification is needed over whether the estimated standalone selling price on which the allocation of value is based can also be combined when the performance obligations are combined.

- Example 27 suggests PCS renewals in certain circumstances should be valued differently. In this example, the entity expects to provide progressively more maintenance work each year as the customer renews, which results in an option to acquire additional services. We believe it would be helpful to address how other elements of PCS would be considered in allocating value, such as “when and if available” (unspecified) upgrades and enhancements, in situations where there is an expectation of progressively more or less delivery of the various elements of PCS in renewal periods.

- Additional clarity surrounding the interaction between acceptance provisions and transfer of control in long term implementation arrangements would be helpful. If transfer of control is not evident, but customer acceptance takes place, is that sufficient evidence of transfer of control to recognize revenue?

**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 agree with the proposed distinction between the types of product warranties and the respective proposed accounting.

**Question 16:** The Boards propose the following if a license is not considered to be a sale of intellectual property: (a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and (b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license. Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

We agree with the proposed revenue recognition pattern for perpetual and time-based non-exclusive licenses. Our software license transactions are all non-exclusive software licenses and therefore we are not impacted by the introduction of exclusivity in licensing arrangements as a determinant of revenue recognition.

**Consequential amendments**

**Question 17:** The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial assets (for example, intangible assets and property, plant, and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

No comment.

**Nonpublic entities**

**Question 18:** Should any of the proposed guidance be different for nonpublic entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

No. We believe that the objective of a single set of standards is compromised if nonpublic entities are not required to follow the same guidance. The board needs to establish standards that can be followed by any type and size entity. We believe relief from disclosure requirements may be appropriate for nonpublic entities.