June 30, 2015

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

Re: File Reference No. 2015-250 – Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licenses

Technical Director, Board Members and Staff:

EMC Corporation appreciates the opportunity to respond to the FASB’s Exposure Draft, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licenses.

We commend the FASB for considering the many comments and questions related to ASU 2014-09 and for performing continued research projects to respond to concerns raised by constituents about the revenue standard. We further commend the FASB for the extensive outreach activities that have been conducted and we are appreciative of the opportunities we have had to participate in these activities. We have included below responses to questions 4, 5 and 6 included in the Exposure Draft.

**Question 4: Would the revisions to paragraph 606-10-25-21 and the related examples improve the operability of Topic 606 by better articulating the separately identifiable principle and better linking the factors to that principle? If not, what alternatives do you suggest and why?**

We consider the revisions to the language in the exposure draft related to promises an improvement. They clarify the distinction between a promise and a performance obligation. The clarification has resonated with us and has aided in our evaluation of the promises in a contract and how to consider them in the context of the requirements of the standard. The expansion of the examples also clearly lays out how to evaluate arrangements by first identifying the promises and then performing an evaluation as to whether the promises are both distinct and distinct within the context of the contract in order to determine if they meet the performance obligation criteria.

The revised language in paragraph 606-10-25-21 in the proposed amendment improves the operability and application of the standard by more clearly defining how companies must determine whether promises are separately identifiable by cross referencing, and thereby linking, the factors to apply. Companies must focus on the intent of the promise when determining whether they are separate, distinct or a combined item within the context of the contract. Furthermore, the examples provided further clarify the focus on inputs for a combined output in determining whether the nature of the overall promise in the contract is to transfer each of those separate goods or services or a combined item (or items) to which the promised goods or services are inputs.

Our first comment pertains to the evaluation of performance obligation indicators when a promise is distinct within the context of a contract. Determining whether goods and services are highly interdependent and highly interrelated will continue to be an area of significant judgment. We believe it would be useful for the FASB to include additional indicators for companies to consider when applying this judgment. Example 10 – Case C illustrates one way to view the interrelated nature of a software license and the related updates, which is indeed helpful. The example indicates that interrelated could be shown by the criticality of software updates and that a customer entering a three year arrangement would not do so without the updates because the software would have limited benefit over the entire three-year term. However, there remains a significant amount of judgment as to what comprises “critical updates”.

**2015-250**

**Comment Letter No. 33**
In the rapidly changing technological marketplace, software development is transitioning to a more agile process where customers expect technology to be updated on a more frequent basis with more meaningful and rapid enhancement. One could argue that many of today’s software products substantively change over a three year license period and that the initial functionality is limited compared to the functionality over the three year development period. For many software licenses, this agile development process and frequency of technology updates, feature adds and support could be seen as critical components to the offering.

Example 55 in the exposure draft illustrates a scenario in which the entity’s promise in granting a license to the customer is inseparable from the entity’s promise to provide updates and upgrades “that may be developed” to the customer. In this example, the two promises are deemed to be a single performance obligation because the updates to the IP are considered essential to the customer’s ability to derive benefit from the license. In this case the customer operates in an industry in which technologies change rapidly. Given a major shift in the IT industry with the development of new technologies, new ways to virtualize IT systems and new methods to access applications on the internet through web based applications in the cloud, we expect most use cases to be more similar to Example 55, than not. This transformation of the industry is changing the way customers want to consume the technology, how companies are doing business and the type of offerings being developed.

When evaluating whether goods and services are highly interdependent or highly interrelated, there are many other considerations beyond how critical the updates are and the nature of the industry and pace of technological change. We believe that other factors for consideration might include contract terms, payment terms, customer expectations, pricing, research and development efforts, form and utility of updates, how updates are installed, whether or not payment for updates are necessary to maintain license rights and the nature and type of software. It would be helpful to have an expanded set of indicators which companies could use when determining whether promises are highly interdependent and or interrelated, but ultimately this will, and should, remain a matter of judgment for vendors.

Our second comment pertains to evaluating whether items form performance obligations from the customer’s or entity’s perspective. Although the revisions to the paragraph improve and clarify the standard, the language is still very entity-focused with an emphasis on the intent of the promise. The standard specifies that the assessment of whether a promise is created to transfer a good or service to the customer should be evaluated from the customer’s perspective (for example, ASC 606-10-25-16 includes a reference to the evaluation of implied promises based on the expectations of the customer); however, there still seems to be a lack of clarity on how to apply this guidance through the lens of a customer. There also seems to be a lack of explicit language as to what portions of the guidance should be applied through the lens of a customer (i.e. the performance obligation or license guidance). We think it would be beneficial to include further clarity on when and how companies might evaluate this through the lens of a customer such as the evaluation of the criticality of updates, as discussed in Example 10 – Case C above, from a customer’s perspective as this might result in a very different accounting treatment than evaluating them from an assessment of the software functionality.

Question 5: Would the revisions to paragraphs 606-10-55-54 through 55-64, as well as the revisions and additions to the related examples, improve the operability of the implementation guidance about determining the nature of an entity’s promise in granting a license? That is, would the revisions clarify when the nature of an entity’s promise is to provide a right to access the entity’s intellectual property or to provide a right to use the entity’s intellectual property as it exists at the point in time the license is granted? If not, what alternatives do you suggest and why?

We believe that the revisions to paragraphs 606-10-55-54 through 55-64 do help in determining the nature of an entity’s promise in granting a license by clarifying the distinction between symbolic and functional IP. However, at the same time, it further complicates the interoperability of paragraph 606-10-55-58 (right to use versus right to access) with the performance obligation guidance in paragraphs 606-10-25-14 through 606-10-25-22. Additionally, we believe that views expressed concluding that software
license arrangements are more likely to be viewed rights to use an entity's functional IP as it exists at a point in time (versus over time) may be misleading. This is particularly troubling in the comment referencing paragraph 606-10-25-62 in Basis of Conclusion 47 (“BC47”). While this may be an appropriate revenue recognition pattern for traditional perpetual license models, it does not take into account the many other methods of delivery which are increasing in prominence and popularity in the current marketplace. More and more, companies are moving to subscription and software-as-a-service sales models. In many cases, while a technology vendor’s intellectual property may be made available to customers in some form of a software license arrangement, they are often done so in a manner that provides customers with wrap-around services comprising a “solution” based on agile technical updates, periodic payments or contractual requirements to pay for, accept and/or install updates to maintain license rights and expected functionality. It is unclear as to where these software availability arrangements fit within the proposed performance obligation and license guidance.

Large technology vendors offer a wide array of software-based products and solutions ranging from security to big data storage to converged infrastructure to application development for server, mobile and web applications. Many are offered in on-premises, virtualized and/or cloud infrastructure environments. These offerings are increasingly benefiting from virtualization and cloud computing capabilities in the modern marketplace. Offerings are structured as platform-as-a-service, software-as-a-service and infrastructure-as-a-service for private, hybrid and full cloud solutions and are delivered through a variety of sales, pricing and delivery models including perpetual licenses, term licenses, enterprise-wide licenses, utility-based usage models and subscription services. Consideration paid for such solutions can be at times fixed and at others, variable; with some paid upfront and at others over a schedule. Vendors also allow access or grant rights to intellectual property through various models, often with a similar type of software sold in different ways. Furthermore, many key business metrics that management use to evaluate business success differ based on the nature and variety of such offerings. The bright line distinction included in the exposure draft does not fit clearly with the wide-array of solutions that many software vendors offer or the way in which they goal and compensate their employees and managers.

We believe that further modification is needed to provide companies with an opportunity to record revenue recognition in a manner that align with business models that include highly interdependent or highly interrelated software and support solutions. Furthermore, we believe that the criteria in paragraph 606-10-55-62 for granting a right to access an entity’s IP over time will be met frequently and not infrequently as suggested in BC47. We recommend that the FASB more clearly define when functional IP meets the indicators of a right to access license arrangement and consider offering a clearly organized practical expedient.

**Question 6:** The revisions to paragraph 606-10-55-57 that state an entity should consider the nature of its promise in granting a license of intellectual property when accounting for a single performance obligation. Does this revision clarify the scope and applicability of the licensing implementation guidance? If not, why?

In the current standard and proposed exposure draft, there is significant ambiguity as to when companies should employ the specific implementation guidance for determining transfer of control in licensing arrangements versus when they should employ the guidance on promises and distinct performance obligations. The language in paragraph 606-10-55-57 in 2014-09 is not explicit regarding whether a company would need to consider the nature of its promise in granting a license to a customer (i.e. right to use or right to access) when the license is not distinct and is combined with another good or service. The proposed revisions to paragraph 606-10-55-57 now provide a direct reference to the licensing guidance and it is explicitly stated that an entity should consider the nature of its promise according to the license guidance (paragraphs 606-10-55-59 through 55-64). This has created confusion for arrangements with licenses which are not distinct and whether entities should evaluate promises through the performance obligation guidance or whether they would need to evaluate them using the license guidance.

We believe that this new reference has created an interoperability challenge with the performance obligation guidance and implementation guidance for licensing arrangements - something of a circular
reference. The guidance leads one to understand that if a promise to deliver a license was granted in an arrangement, then one should first use the implementation guidance for licensing arrangements to determine the nature of the entity’s promise (paragraphs 606-10-55-59 through 55-64). We question whether we should be applying the implementation guidance for transfer of control in license arrangements rather than the guidance related to promises and distinct performance obligations.

In addition, this paragraph references entities to the license implementation guidance in considering the nature of promises. Should we not need to first determine whether the license of IP and related goods and services are distinct performance obligations or are inputs to a combined output performance obligation? Doesn’t the five step model have us first identify performance obligations before determining the transfer of control? It would be helpful for the FASB to clarify whether we are applying the license guidance to promises or performance obligations.

We do not believe that it is the FASB’s intent that if an agreement includes a license, the license implementation guidance should first be applied to determine the nature of the promise, performance obligations and the resulting transfer of control. In fact there are numerous examples provided in the guidance in both the performance obligation and licensing sections which include a license but which are not accounted for strictly by the symbolic versus functional criteria in paragraphs 606-10-55-59-64. For instance, Example 10 - Case C includes a license and updates with a conclusion that they are a combined performance obligation. The example indicates that this combined performance obligation would be recognized over time based solely on the performance obligation guidance and not be subject to the functional versus symbolic classification. Example 11 - Case B also addresses an offering which includes an IP license among other goods and services and concludes that the license and installation services comprise one performance obligation. The example also states that the entity should apply 606-10-25-23 through 25-30 to the performance obligations to determine whether each performance obligation is satisfied at a point in time. Nowhere in these examples is the requirement to assess the combined performance obligation using paragraphs 606-10-55-59 through 55-64. We also note the same patterns and language in Example 55 and Example 56 – Case A.

Perhaps the FASB should consider removing the implementation guidance for licensing arrangements, paragraphs 606-10-55-54 through 55-64, from Topic 606 or limiting such discussion to examples only. This would allow organizations to use and adopt the guidance for determining and satisfying performance obligations in licensing arrangements with fewer, more orderly considerations.

We appreciate the opportunity to comment on the proposed changes. Please do not hesitate to contact us with any questions or to discuss this proposal further.

Respectfully,

Thomas A. Austin
Vice President
Global Revenue Assurance
EMC Corporation