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Technical Director, File Reference No. 1820-100
Financial Accounting Standards Board
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October 22, 2010

Re: Exposure Draft – Revenue from Contracts with Customers

Adobe is pleased to respond to the invitation to comment on your Exposure Draft – *Revenue from Contracts with Customers*.

We strongly support the FASB and IASB's ("the Boards") objective for the development of a single converged model for revenue recognition under both IFRS and US GAAP and urge both the IASB and the FASB to continue to work together during the re-deliberation process to achieve this goal.

With that in mind, we have utilized the remainder of this letter to provide high-level views on certain key areas of the Exposure Draft. The Appendix to this letter includes our detailed responses to the "Questions for Respondents" in the Exposure Draft.

Impact of Collectability on Transaction Price

While we agree that collectability is a factor which should be evaluated with respect to *how much* revenue should be recognized and support the Boards' movement away from the notion that collectability impacts *whether* revenue is recognized, we disagree with certain aspects of the proposed guidance.

Specifically, we do not believe that collectability should be evaluated when determining the transaction price of a contract and we believe such a concept is at odds with the economic principles involved with two parties entering a contract for the exchange of goods or services.

As part of the proposed guidance, the Boards indicate that "the entity shall recognize revenue at the probability-weighted amount of consideration that the entity expects to receive." (Para 43) We argue that upon execution of a contract, an entity owed consideration *expects* that it will receive all consideration promised under the terms and conditions of the arrangement and the obligor fully expects to pay the amount it owes. Any assumption to the contrary would imply that the arrangement should not be executed, that the terms and conditions of the arrangement are not representative of the agreement, or the agreement should be priced differently, not that the transaction amount should be adjusted for a probability weighted calculation based on a customer's credit risk. An analogous treatment may be the current Financial Instruments Exposure Draft, which does not provide for day one impairment of a loan receivable. We believe that similar treatment is appropriate for trade receivables.

The majority of transactions executed during the normal course of business should not be subject to any adjustment for consideration of credit risk. While there may be instances where such an adjustment is appropriate, these are likely to be the exception as opposed to the norm and this requirement would only serve to add an additional, unnecessary operational burden.

Current practice provides a methodology for addressing potential uncollectible accounts and appropriately reflects an expense on the income statement as amounts are estimated to become uncollectible (either as a general reserve or on a customer specific basis). We recommend that the Boards consider expanding on the option to evaluate credit risk adjustments at the portfolio level, as opposed to a contract by contract basis, in order to provide a

methodology that is more consistent with current practice and allows for more efficient, yet equally effective reporting.

Additionally, we believe that changes in the assessments of collectability should not impact "other income." Making adjustments to revenue for changes in collectability would provide financial statement users with a more accurate representation of the impact of credit risk assessment changes and would not provide a potential incentive for companies to be aggressive in their initial assessments of collectability. We believe that recording adjustments to the assessment of credit risk after execution of a contract to revenue will more closely align the recognition of revenue with the cash to be received, resulting in more relevant information for financial statement users.

Present Value of Obligations

We agree with the concept that the time value of money should be considered for transactions which contain a material financing component, however we believe that additional guidance is necessary to facilitate more efficient and consistent adoption practices.

As currently written, implementation of the guidance in the Exposure Draft around the time value of money would likely result in significant operational cost and complexity due to the change in procedures, control environment, and systems which would be required by many entities for non-complex transactions. Recognizing the difficulties related to less complex arrangements, the potential burdens increase further when more complex arrangements involving multiple payments or contingent components are considered. The initial and ongoing calculations for an SEC registrant would result in costs of adoption and continued operation that would outweigh any financial statement user benefit, under most scenarios.

We believe that an exception should be provided for transactions executed during the normal course of business.

Guidance provided by ASC 835-30 *Interest - Imputation of Interest* provides for exceptions to the imputation of interest for payables and receivables in the "normal course of business that are due in customary trade terms not exceeding approximately one year," and we argue that similar guidance should be implemented into the proposed standard.

We also request the Boards provide additional guidance regarding what is considered an implicit material financing component and how the length of such a component would be considered when determining whether to impute interest on the promised payment. Additional guidance around the determination of a material implicit financing would facilitate more consistent adoption of the proposed standard.

Additionally, consideration of time value of money should be reflected in the transaction price in instances where payment is significantly deferred after the point at which the performance obligations have been satisfied. An example of a prepayment which we do not believe represents a financing would be PCS in software arrangements. While PCS may be prepaid for an annual PCS term, we do not believe that this represents a material financing component to such an arrangement and should not be evaluated for the impact of the time value of money.

Presentation and Disclosure

We do not agree that assertions regarding the expected timing of satisfaction of performance obligations or uncertainty of revenue and cash flows should be a disclosure requirement within financial statement footnotes (Para 73). There are several issues presented when placing such forward looking statements within financial statement disclosures, and we believe such statements would be more appropriate for inclusion within management's discussion and analysis (MD&A).

While there are certainly matters of management judgment and assumption disclosed within the financial statements today, making forward looking assumptions related to specific transactions seems to be in conflict with the concept of safe harbor which exists for MD&A, indicating that such discussion may be better suited to MD&A than financial statement disclosures. Currently, management makes determinations regarding expected pattern of revenue recognition, one example of which is the split between long term and short term deferred revenue. Given the changes in other areas of the proposed guidance, specifically with respect to changes in identification, estimation, and recognition of performance obligations, the level of judgment involved in assessing future revenue and cash flows becomes increasingly complicated.

Forward looking statements are currently included in MD&A and excluded from financial statement footnotes, protecting management from unnecessary liability around uncertain future events and maintaining the backward-looking framework of financial statements and associated disclosures. Incorporating forward looking statements into financial statement disclosures would blur this line, resulting in unnecessary liability for companies and ultimately, less useful financial statements for users.

Additionally, consideration should be given to the ability to audit such forward looking statements. Making determinations about the future satisfaction of performance obligations or cash flows, based on anything other than historical information, would be difficult, if not impossible to audit. We propose that as opposed to making specific statements within the financial statements with respect to future cash flows and satisfaction of performance obligations, management discuss the factors considered when determining the remaining performance obligations and whether those obligations are considered short term or long term.

With regard to disaggregation of revenue, we request that the Boards provide additional guidance around the level of disaggregation proposed. While we agree with the proposed principle, there are additional considerations that should be given to the cost-benefit of increased disaggregation in disclosure. We believe that the way management, specifically the Chief Operating Decision Maker (CODM), evaluates financial performance should be given large weighting in the determination of how revenue should be disaggregated, as these measurements provide the most meaningful information as to how the business is managed.

We question the cost-benefit of providing significant additional disclosures which are not currently supported by an entity's systems and which are not leveraged by management for any purposes other than reporting.

Transition

While we recognize the Boards' desire that financial statements presented under the proposed guidance be as consistent and comparable as possible, the current proposed requirement for full retrospective adoption would likely place a very significant, and in some cases impracticable, burden on entities upon adoption.

Many entities will need a minimum of three years to determine the transition adjustment and restate comparative periods, resulting in a volume of historical transaction and data analysis that should not be underestimated.

We expect that the use of internal and external resources required during the period of adoption will be significant and that the availability of external resources due to increased demand will further drive costs up. Furthermore, the expected changes necessary to internal policies, control environment, modifications to systems, as well as review and audit of retrospective financial statements will place a significant time and expense burden on adopters.

We propose that the Boards consider providing alternative options for adoption, similar to the recently issued Accounting Standards Updates (2009-13 and 2009-14) around revenue recognition, where relief from full retrospective adoption is permitted. Such an approach may result in less comparability of financial statements upon initial adoption, but will allow for a much more efficient, and ultimately effective, adoption process while still providing financial statement users with comparative information for the most recent fiscal periods.

We have expanded on the above and responded to the specific questions raised in your Exposure Draft in the appendix to this letter. If you have any questions or would like to discuss our responses further, please contact me at (408) 536-2087.

Sincerely,

Marc Seymer
Senior Director for Revenue Assurance
Adobe Systems, Inc.

Appendix: Response to Detailed Questions

Recognition of revenue (paragraphs 8–33)

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?

Response:

Yes, we agree with the proposed principle, but encourage the Boards to provide additional guidance around specific aspects of the principle.

With respect to segmentation of a single contract, paragraph 15 indicates that goods and services should be accounted for as separate contracts if they are priced independently. Independent pricing is then defined as,

- a) the entity or another entity regularly selling identical or similar goods and services separately and,
- b) the customer does not receive a significant discount for buying some goods or services together with other goods or services within the contract.

With respect to item 'b,' we believe that more guidance is required to appropriately define what the Boards consider to be a significant discount. Determining what constitutes a "significant" discount is an area of considerable judgment and may vary widely between entities. For example, it may be an entity's standard practice to provide discounts up to and including 90 percent of the stated list price. By all standards, 90 percent would be considered a significant portion of the product list price, however with respect to the particular entity, a discount of 90 percent may not be considered significant. Similarly, if discounts are rarely or never given by a particular entity, a discount of 20 percent may be considered significant.

As a result, interpretation and practice between entities may vary significantly.

Given that these considerations are highly judgmental and dependent on specific arrangements and entities, we suggest that additional implementation guidance and examples be provided by the Boards, to provide a more consistent and concrete methodology for adoption and provide a means to address customary business practices.

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?

Response:

We agree with the concept of accounting for performance obligations separately based on whether a promised good or service is distinct.

We believe that additional implementation guidance is required around what the Boards consider distinct, in order to facilitate efficient and effective implementation. Paragraph 23b, ii indicates that in the absence of a good or service being sold separately, one of the required factors for separation is that the good or service has a distinct profit margin. Determining the distinct profit margin for goods or services which are rarely, if ever sold separately may result in inconsistent outcomes in practice under the proposed guidance.

One example of such a scenario may be a software license which is usually sold with post contract customer support (PCS). In such an instance, establishing that the resources used to develop the software license and

provide PCS are distinct would be difficult, however the customer is clearly receiving two separate identifiable benefits for the software license and the PCS.

This issue is additionally complicated by the fact that the meaning of "distinct" from the vendor's perspective may not align with the distinct benefit which the customer may receive from a specific obligation.

We believe that the Board's intent with regard to performance obligations was that, in general, items that are considered deliverables under today's revenue guidance would represent performance obligations under the new model and that, in general, there would be the same number or more deliverables being considered performance obligations under the new model. However, we are concerned that some may interpret the guidance around the definition of distinct as being more restrictive than current guidance.

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?

Response:

Yes, we agree that the proposed guidance in paragraphs 25-31 and associated implementation guidance are sufficient for determining transfer of control.

We would also request that the Boards consider including clarifying language in the final standard, which addresses transfer of services performed on a time and materials basis to a customer. The criteria outlined in paragraph 30 d specifies that the "design or function" of the service be customer-specific. For many time and materials contracts within the software industry, a detailed statement of work (SOW) outlines the services to be provided and this SOW is based on the goals of the specific customer. We believe this may represent sufficient evidence of the services being customer-specific; however as described in the proposed guidance, this determination is difficult to apply and may require additional guidance for practical application.

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?

Response:

We understand the conceptual principle regarding variable consideration, though we are concerned that there will be significant practical challenges in applying the model in practice. We are further concerned regarding the comparability as preparers of financial statements determine whether they believe that they can make reasonable estimates given their facts and circumstances. We also question whether the currently proposed model will always provide decision useful information to users. For example, consider a simple situation where software is licensed for an initial fixed fee and then a royalty stream based upon shipments of a product containing the software by the customer. Up-front recognition of all future royalty revenue without further reporting in the future (except for changes in estimate) may not provide decision useful information to financial statement users that are trying to assess future royalty cash flows.

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?

Response:

Please refer to our response in the body of the main letter.

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?

Response:

Please refer to our response in the body of the main letter.

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?

Response:

We agree that an entity should allocate transaction price to performance obligations based on the standalone selling price of the associated good or service.

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 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?

Response:

Yes, we consider the proposed guidance on accounting for costs of fulfillment of a contract to be sufficient.

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?

Response:

We do not have any specific concerns with the costs specified. However, we do not agree with the conceptual logic that could result in an entity recording a liability for an onerous performance obligation within an overall profitable contract. We are concerned that the economics of certain transactions will not be reflected, particularly when an individual performance obligation is not profitable but the overall contract is profitable.

We recommend if the onerous performance obligation guidance is retained in the revenue standard, the assessment of whether a liability should be recorded be performed at the contract level. We believe this would provide a better reflection of the underlying economics of the transaction.

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?

Response:

We agree with the objectives of the Boards' proposed disclosure requirements; however we believe that the proposed disclosure requirements may provide superfluous information to the stated objectives.

We believe that a roll forward of contract balances would provide limited incremental benefit to financial statement users while resulting in potentially significant costs incurred by adopters. The level of information necessary to provide such disclosures is likely not available through companies' current systems, as this information is not used by management to evaluate performance of a company. Given the incremental cost and inconsistency of the information proposed for disclosure and information used by management, we believe that the roll forward of contract balances should be removed from the final guidance.

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?

Response:

Please refer to our response in the body of the main letter.

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?

Response:

We agree that entities should disaggregate revenue in a manner that is consistent with the way which financial information is used to manage the business. Please also refer to our discussion in the body of the letter.

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

Response:

Please refer to our response in the body of the main letter.

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?

Response:

We believe that additional implementation guidance may be required by the Boards around the separation criteria used to identify separate performance obligations. Without additional guidance around the application of using a distinct profit margin for determining whether a performance obligation is distinct, there may be large variances in practice. Similarly, guidance around the identification of resources to establish that a good or service is a distinct obligation may result in complications such as those described with respect to PCS, discussed in our response to Question 2, above.

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?

Response:

We believe that the proposed distinction is extremely difficult to apply in the software industry. While we understand the underlying concept, we believe it is more practical to follow the performance obligation model. The distinction between product warranties 'a' and 'b' noted above becomes difficult to make, when considering the nature of software license deliverables. For example, software often ships to customers with what may be considered "latent defects" under item 'a' above, also known as "bugs." These bugs may or may not impact the ultimate operation of the software license, but are addressed through the provision of ongoing maintenance of the product.

Providing a warranty under item 'b' above is not a concept that translates to the software industry, as a software license, distributed as executable binary code, will not have faults after transfer of the license to the customer. Those faults either existed in the software at the time of transfer or did not. Any such faults are similarly covered by maintenance, which is typically purchased or provided with the license purchase.

Moving to a quality assurance model in the software industry could lead to excessive deferrals for relatively minor bug fixes, resulting in accounting which does not reflect the underlying economics of the transaction and make ongoing use of the model onerous.

We recommend that the Board retain existing guidance on how to account for warranty obligations that are incurred in connection with the sale of goods and services. We do not believe there are any weaknesses or inconsistencies with either the conceptual basis or application of current GAAP. We believe that this guidance, rather than the defined proposals included in the Exposure Draft, is more representative of the economic substance of the revenue transaction and promotes the project's core principle that revenue should be recognized to depict the transfer of goods or services to customers.

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?

Response:

No, we do not agree that the pattern of revenue should depend on whether a license is exclusive. This principle appears to be inconsistent with the underlying theory of performance obligations.

In a scenario where an exclusive license is given for a fixed period of time, there does not appear to be a performance obligation on the part of the vendor, other than delivery of the license. Under other guidance provided in the exposure draft, revenue should be recognized when a promised good or service has been transferred to the customer. In the case of an exclusive or non-exclusive license, there does not appear to be a justification by the Boards as to why these two scenarios represent fundamentally different types of performance obligations. While the argument could be made that the obligation by the vendor is to maintain the exclusivity of the licensing to that particular customer, this does not appear to be a substantive performance obligation which would require deferral of revenue and recognition over the license term.

Once the exclusive license has been delivered, the customer obtains all benefits associated with that license, and as such the vendor's performance obligation has been fulfilled upon delivery of the license and revenue should be recognized accordingly.

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?

Response:

We agree with the Boards' proposed guidance for gains and losses of some nonfinancial assets.