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Comment letters on Modification of the Limitations on Evidence of Fair Value in Software Arrangements

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A Team AICPA Note



DATE: January 11, 1999
TO: Library
FROM: Fred Gill *F. Gill*
SUBJECT: Comment letters

Enclosed is a complete set of the comment letters received on the July 31, 1998 exposure draft, *Modification of the Limitations on Evidence of Fair Value in Software Arrangements*. They should be made available for public inspection for a period of one year.

List of Respondents to the Proposed Statement of Position “*MODIFICATION OF THE LIMITATIONS ON EVIDENCE OF FAIR VALUE IN SOFTWARE ARRANGEMENTS*”

Letter number

- | | | |
|-----|---------------------|---------------------------------|
| 1. | Kevin Wilson | |
| 2. | Nick Riehle | HAHT Software, Inc. |
| 3. | John J. O’Leary | New York State Society of CPAs |
| 4. | Francis J. O’Brien | |
| 5. | Howard A. Bain III | Symantec Corporation |
| 6. | Alfred Castino | PeopleSoft, Inc. |
| 7. | Firm | Arthur Andersen |
| 8. | Catherine Carroll | Lucent Technologies |
| 9. | Ken Lonchar | Veritas Software |
| 10. | James F. Harrington | PricewaterhouseCoopers |
| 11. | Richard P. Fox | Wall Data |
| 12. | Dennis R. Raney | Novell |
| 13. | Firm | Deloitte & Touche |
| 14. | Firm | Peat Marwick LLP |
| 15. | Firm | Ernst & Young LLP |
| 16. | Joseph Graziano | Grant Thornton |
| 17. | Mark E. Nebergall | Software Publishers Association |

18. Jeffrey Solomon Massachusetts Society of CPAs
19. Verne E. Bragg Florida Institute of CPAs
20. Andy Mintzer California Society of CPAs

#1

Kevin Wilson
26 Pine Street
Tivoli, New York
12583
August 7, 1998

Frederick Gill, Senior Technical Manager
AICPA, 1211 Avenue of the Americas
New York, N.Y. 10036-8775
File 2354.W.G.

Dear Mr. Gill,

Thank you for sending the Exposure Draft regarding Software Revenue Recognition, & proposed amendment to SOP 97-12. I recently read an article in the Hudson River Sampler, a brochure distributed locally. It is regarding computers, using windows 95, or windows 98 to be specific. It was written by Robert Fishman, owner of a computer business, "Hudson Valley Computer Solutions, Inc." in Rhinebeck, New York.

The article indicates Windows 98 is not a new operating system. It is an upgrade to windows 95. It is visually more appealing, supports new programs and the new technologies, and new hardware currently on the market. The new technology, such as USB, will be coming along soon. It costs about \$100 for these improvements. It's more reliable than Windows 95, but it is not bulletproof, (a computer term.)

Windows 98 won't run on a machine slower than 486 DX/66, and requires a minimum of 16 MB Ram, it requires from 195 to 295 million bytes of hard drivespace, and the full version is available only on CD Rom.

On 486 and older Pentium machines at 100 MHZ or less, Windows 95 actually runs faster than Windows 98. So, if you have an older system, as Mr. Fishman indicates, forget it! Windows 98 is not for you. If you have a machine four or five years old, chances are you cannot use

#1

Windows 98 without extensive upgrades to your computer. Rather than paying \$300-\$400 to upgrade your current machine, stay with what you have if you are having a problem, and think about applying that money to a new machine. The plastic box the CD comes in has a 25 digit number that has to be keyed in during the installation process. You need this number if installation ever becomes necessary.

I realize my comments have been limited to Windows 95 and Windows 98, products of the Microsoft Corporation. Although I, personally, am no computer expert, I believe there are competitors to Microsoft's computer products, such as Sun Microsystems and IBM, as well as Compaq, and Hewlett Packard. I think most companies will recognize revenue by the accrual method, that is recording it in the accounting records although it may have not yet been received. Also, on page 11, item d. If the first year of PCS (Postcontract Customer Support) is free, and the software element is \$1,000, as the example shows, my guess would be not to show the product at \$850, which appears discounted, but at the \$1,000. I would add a footnote to the financial statements to show the free PCS. Subsequently, I would report the \$150 PCS in the financial records. Thank You again.

Sincerely
Kevin W. Wilson

#2

9-11-98

Author: MIME:nickr@haht.com at INTERNET
Date: 9/11/98 1:32 PM
Priority: Normal
TO: Frederick R. Gill at AICPA3
Subject: Fair Value in Software Arrangements

Nick Riehle
HAHT Software, Inc.
4200 Six Forks Road
Raleigh, NC 27613

Mr. Frederick Gill Senior Technical Manager AICPA Accounting Standards

Dear Mr. Gill:

We recently had the opportunity to review the Proposed Statement of Position on "Fair Value in Software Arrangements" (SOP 98-4).

We understand that there are significantly complex accounting positions being drawn on this issue and I want to carefully avoid making any comment along those lines. What I do want to make clear is this: Business management and the public in general expect the accounting profession to accurately characterize the essence of business transactions. When we do this poorly, we fail as a profession.

Our company sells software and we sell maintenance on that software. Our pricing of maintenance subsequent to the expiration of the initial maintenance period provides clear, vendor specific evidence of the economic value of a maintenance transaction for that customer and their installed base. Rules that would force us to use artificial analyses to extract a hypothetical maintenance value, while ignoring the consistent pricing of that maintenance service in subsequent years, will rightfully draw disdain from the business community. Forced amortization of software license fees over the contracted maintenance period will draw even greater disdain, grossly distort financial performance and motivate management to reduce the maintenance contract period for no other reason than avoiding a poorly conceived accounting pronouncement.

Despite the complexity of modern accounting rules, the AICPA has been faithful to the goal of fairly representing the nature of business transactions and performance. Please do not get so immersed in technical debates as to lose this perspective.

Regards,
Nick Riehle
CFO, HAHT Software, Inc.

OFFICERS

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#3
9-17-98

NEW YORK STATE SOCIETY
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September 15, 1998

Frederick Gill, Senior Technical Manager, Accounting Standards
File 2354.WG
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of *Position-Modification of the Limitations on Evidence of Fair Value in Software Arrangements*

Dear Mr. Gill:

We are pleased to submit our comments on the above Proposed Statement of Position on behalf of the New York State Society of Certified Public Accountants. The comments were developed by the Society's Financial Accounting and Standards Committee.

The Committee believes the proposed SOP is a reasonable approach to amending SOP 97-2 and supports the document as written.

We hope these comments have been helpful. If you wish to pursue these items further, please let us know and we will have someone from the Committee contact you.

Very truly yours,

John J. O'Leary, CPA
Chair, Financial Accounting Standards Committee

James A. Woehlke, CPA
Director, Professional Programs

cc: Accounting & Auditing Committee Chairs

Author: MIME:FrankOB310@aol.com at INTERNET
Date: 9/30/98 12:44 AM
Priority: Normal
TO: Frederick R. Gill at AICPA3
Subject: No Subject

#4

FRANCIS J. O'BRIEN
30085 AVENIDA ELEGANTE
RANCHO PALOS VERDES
CALIFORNIA 90275-4510
PHONE: 310 541 3042
FAX: 310 541 3728

September 29, 1998

Mr. Frederick Gill
Senior Technical Manager, Accounting Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: File 2354.WG: Proposed Statement of Position "Modification of the
Limitations on Evidence of Fair Value in Software Arrangements (A proposed
amendment to SOP 97-2, Software Revenue Recognition)"

Dear Mr. Gill:

I continue to support efforts to repair the theoretical dilemma posed by the
literal application of the words in SOP 97-2 to the transactions within the
scope of the proposed amendment, and I support the issuance of the proposed
SOP.

Paragraph 4.b. would change Example 3, but require deferral of all revenue in
a circumstance where management has determined the maximum, but not the
minimum price for which an upgrade will be offered. This conclusion is unduly
conservative, and one need look no further than paragraph 10 of the Exposure
Draft to see an excellent discussion of undue conservatism. The situation in
the example may leave room for manipulation of the financial reporting, but
that possibility should not lead to an error in the design of an accounting
principle. In practice, sound judgments can require intense analysis and
healthy skepticism, and if management and their auditors can make those sound
judgments they should not be precluded from applying them because of
artificially conservative barriers in financial reporting rules. The
conclusion in Example 3 should be changed to require recognition of \$100 of
revenue (the \$300 selling price of version 1.0, minus the \$200 maximum price
of version 2.0).

* * * * *

I would be pleased to discuss my comments, or other aspects of the proposed
SOP, with AcSEC or the Working Group.

Very truly yours,

Francis J. O'Brien

September 29, 1998

5

Mr. Frederick Gill
Senior Technical Manager
Accounting Standards
File Reference 2354.WG
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

**Proposed Statement of Position, "Modification of the Limitations on
Evidence of Fair Value in Software Arrangements"
(File Reference No. 2354.WG)**

Dear Mr. Gill,

We are pleased to provide comments on the proposed Statement referred to above. We support AcSEC's proposed rescission of certain portions of SOP 97-2 ("SOP") which limit what is considered Vendor-Specific Objective Evidence ("VSOE") of the fair value of the various elements in a multi-element arrangement. We concur that such limitations on VSOE would potentially result in overly conservative revenue recognition practices.

Our comments and recommendations relate to AcSEC's proposed amendments to certain examples included in the SOP and the expressed intent to provide no additional guidance on what is considered VSOE.

Amendments to Certain Examples

Based on our review of the Exposure Draft under "Conclusions Item 4. d. Multiple-Element Arrangement-Products and PCS-Example 1", we believe that AcSEC has interpreted the SOP to require the establishment of VSOE for the total arrangement fee. We do not agree with this interpretation. These types of arrangements are negotiated at arm's length under current market conditions. Accordingly, we support differential pricing for those transactions that do not lend themselves to a standard pricing structure.

We believe certain transactions do not lend themselves to a consistently applied pricing model; therefore VSOE for the total arrangement may not exist. In such cases, the accounting result may be to defer revenue until all elements are delivered or over the term of the arrangement, even though the undelivered elements have VSOE. An example is illustrated by a two element arrangement--the license of source code with PCS. In such a scenario, a company has VSOE for its PCS, but due to the differing value propositions of the source code for different customers, the fair value (and accordingly the amount charged) of the source code will vary. Reasons for the variability between transactions could include the extent of the customers' efforts in developing the source code themselves, the size of the market that particular customer is attempting to penetrate with the benefits from the acquired source code, current market conditions, etc. In such transactions, to recognize the value of the source code over the PCS period does not reflect the economic substance of delivering the source code at the commencement of arrangement. We do not agree that revenue recognition should be precluded for the delivered element in this example when VSOE has been established for the undelivered element. We believe that requiring VSOE for the total arrangement may produce an overly conservative pattern of revenue recognition, potentially resulting in results of operations not reflecting the economic substance of delivering valuable technology.

Symantec Corporation

15220 NW Greenbrier Pkwy
Suite 200
Beaverton, Oregon
97006-5798
503/690-8088

Additional Guidance

We do not believe that sufficient guidance has been provided for other acceptable methodologies for the determination of VSOE beyond those indicated in the first two sentences of paragraph 10 of SOP 97-2. To minimize diversity in practice, we strongly believe every effort should be made to develop and issue specific implementation guidance and examples of VSOE.

Conclusion

In summary, we recommend that the examples included in the proposed SOP "Modifications of the Limitations on Evidence of Fair Value in Software Arrangements" be modified to eliminate the requirement for the establishment of VSOE for total arrangement fees and accordingly allow for the differential calculation of a single element of a total arrangement when VSOE is known for all the undelivered elements. Additionally, we recommend that guidance and examples be provided of other acceptable methodologies for the determination of VSOE.

We appreciate the opportunity to present our views on the Exposure Draft. If you have any questions concerning our comments, please contact Howard Bain, Vice President, Worldwide Operations and Chief Financial Officer at (408) 446-7431.

Sincerely,



Howard A. Bain III
VP, Worldwide Operations and CFO
Symantec Corporation

Phone: 925-694-2854
Fax: 925-694-8088

PeopleSoft, Inc.

6

Fax

To: Mr. Frederick Gill

From: Al Castino

Fax: 212-596-6064

Date: September 29, 1998

Phone:

Pages: 4

Re: File 2354.WG, SOP 97-2

CC:

Urgent **For Review** **Please Comment** **Please Reply** **Please Recycle**

•Comments: This is a comment letter in response to the SOP entitled: Modification of the Limitations on Evidence of Fair Value in Software Arrangements

PeopleSoft

**4305 Hacienda Drive
P.O. Box 8015
Pleasanton, California 94588-8615**

Alfred J. Castino
Vice President of Finance and Chief Accounting Officer
PeopleSoft Inc.
Phone: (925) 694-2854

76

September 29, 1998

Mr. Frederick Gill
Senior Technical Manager, Accounting Standards
File 2354.WG
AICPA
Accounting Standards
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Gill:

On behalf of PeopleSoft Inc., I wish to respond to the exposure draft of the SOP entitled: *Modification of the Limitations on Evidence of Fair Value in Software Arrangements*, that would amend SOP 97-2, *Software Revenue Recognition*.

I agree with the overall conclusions of the draft in regards to the new examples and the provisions regarding establishing vendor specific objective evidence of value for PCS. However, I believe the draft needs to clarify the meaning of "consistent pricing for software", a term used a number of times in the document starting with **Multiple-Element Arrangements—Products and Services—Example 3**, and again in **Multiple-Element Arrangement—Products and PCS—Example 1**.

I believe the use of this term may lead to unintended interpretations throughout the accounting profession. I am already hearing interpretations from accounting firms that "consistent pricing for software" refers to the rigid pricing model I mentioned in my letter to you dated February 24, 1998. Here is an excerpt from that letter (shown in *italics*):

- *A recent verbal interpretation states that a vendor cannot establish vendor specific objective evidence of value unless it adheres to a rigid pricing model which can establish the price charged to any customer down to the dollar, including the discount rate from list price. Such a pricing model would be based upon whatever factors the company considers in determining the price. If such a precise pricing model cannot be established, then vendor specific objective evidence of value cannot be established, leading to most revenue being deferred. I believe the vendor specific objective evidence must allow for a reasonable range of variation from the model's computed price, reflecting the value the customer receives from the product and the competitive situation. I see no reference in the SOP whatsoever that seems to require a "down to the dollar" pricing model, including paragraph 103 in the basis for the conclusions.*
- *In the case of enterprise software, customers usually buy a suite of modules rather than simply one product. For example, a customer typically would not buy only a general ledger product; they also would usually buy a few others such as accounts payable, accounts receivable, fixed assets, etc. The recent verbal interpretation we are hearing is that a firm can never establish vendor specific objective evidence of value if a product is sold with another product, regardless of the correlation of the pricing model and pricing history, since the module is not sold separately.*

6

February 19, 1998

I believe that if individual products are within a group of products, which are sold for a price that clearly correlates to the prices of the individual components in the pricing model, the vendor can indeed establish fair value for each module. This is the case since the vendor can show that the pricing for the group of products does indeed vary based upon the inclusion or exclusion of individual modules. I believe the vendor's evidence supporting this correlation of fair value should constitute vendor specific objective evidence of fair value.

An example might be useful. Let's assume the following facts (these are not PeopleSoft actual factors, but simply an example of how a pricing model could work):

Product	List Price <100MM Sales	Uplift per Additional \$100MM Sales	Industry X	Industry Y	Industry Z
			Uplift	Uplift	Uplift
Financials Suite	\$1,000	\$100	25%	0%	-30%
Distribution Suite	\$800	\$150	-40%	10%	45%
Analytical Applications Suite	\$500	\$200	15%	-35%	0%
Manufacturing Suite	\$2,000	\$100	35%	-40%	10%
Multiple Product Discounts					
One Suite	0%				
Two Suites	10%				
Three Suites	15%				
Four Suites	20%				

Range of Variation Allowed From Pricing Model: + or - 10% (allows for competitive bidding)

The company sizing factor (uplifts per additional \$100 million in sales) and industry uplift factors are both designed to approximate the value of our software based upon the individual customer circumstances. For example, a small plastics manufacturer typically derives less total value from our manufacturing suite than would a multinational automobile manufacturing company. The multinational processes much higher volumes through the system and takes advantage of a considerably broader array of product features due to the greater complexity of an automobile manufacturing business operating across many countries.

The multiple product discount is a volume discount that encourages customers to use our products in an integrated fashion throughout the enterprise.

Based upon the above factors, the price to be charged a customer in one of the above industries can be determined by the model, give or take a 10% range that allows for reacting to competitive factors for the individual sales situation. For example, a company in industry X with \$800 million in sales buying both the Financials and Distribution Suites would be charged as follows:

Financials: (\$1000 + ((\$800 MM - 100MM)/100MM) x \$100) x 125% = \$2125

Distribution: (\$800) + ((\$800 MM - 100MM)/100MM) x \$150) x 60% = \$1110

Total:
\$3235

February 19, 1998

6

Less two suites discount of 10% = \$2911.50

The actual price charged can be as low as \$2620.35 (10% lower) or as high as \$3202.65 (10% higher to allow for competitive factors individual to each sales negotiation).

While the above model is only an example, it does illustrate the complexity inherent in large enterprise software sales. An enterprise company can use a model such as the one above to both control its sales force and to establish vendor specific objective evidence of fair value. The final price from the model is a range of plus or minus 10% rather than a "to the dollar result", allowing the sales force to react reasonably to specific competitive factors in each transaction. I would also suggest that a reasonable approach to valuing elements which must be accounted for as deferred revenue would be to use either the midpoint of the pricing model range or use the high point of the pricing model range (a more conservative approach).

Again, as I stated in my prior letter, I do not believe adherence to a rigid pricing model is practical for the enterprise software business. If the working group intends such an interpretation, I believe that most software transactions in the enterprise software industry would result in deferred revenue, and the deferrals would be for a period of time that has no clear boundary. If the working group does not intend to require a rigid pricing formula, then I believe the document needs to clarify this point and allow for a more flexible model such as the one I illustrated above.

Please feel free to call me if you have any questions.

Sincerely



Alfred J. Castino

Author: MIME:scott.a.taub@us.arthurandersen.com at INTERNET
Date: 9/29/98 3:56 PM
Priority: Normal
TO: Frederick R. Gill at AICPA3
Subject: Software Exposure Draft

Below please find a comment letter from Arthur Andersen LLP on the Exposure Draft (ED) of a Proposed Statement of Position, Modification of the Limitations on Evidence of Fair Value in Software Arrangements. Hard copy will follow.

September 28, 1998

7

Mr. Frederick Gill
Senior Technical Manager
Accounting Standards
File 2354.WG
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Gill:

We are pleased to have the opportunity to comment on the Exposure Draft (ED) of a Proposed Statement of Position, Modification of the Limitations on Evidence of Fair Value in Software Arrangements.

Overall, we support issuance of the ED as a final SOP. The factors and considerations that resulted in the issuance of SOP 98-4, Deferral of the Effective Date of a Provision of SOP 97-2, "Software Revenue Recognition", are still relevant, and we believe that making the guidance in SOP 98-4 permanent is appropriate at this time.

Suggested Modifications

Paragraph 4a of the ED rescinds the second sentence of paragraph 10 of SOP 97-2, Software Revenue Recognition, including the bullet point that limits vendor-specific objective evidence (VSOE) of fair value for an element not yet being sold separately to the price established by management having the relevant authority. However, paragraph 4b of the ED adds an example that indicates that VSOE of fair value does not exist because the vendor's pricing committee has not yet established a price for an element that has not yet been introduced. The proposed example refers to paragraph 101 of SOP 97-2 for support. Paragraph 101 indicates that a price established by a pricing committee can represent VSOE of fair value an element not yet ready for sale. However, paragraph 101 does not limit VSOE of fair value in this situation to a price set by a pricing committee.

We have not been able to identify any evidence of VSOE of fair value for an element not yet being sold separately other than a price established by management with the relevant authority. Therefore, we propose the following changes to the ED:

Delete the language following the comma in final sentence of the "Facts" section of paragraph 4b of the ED.

Change paragraph 4a of the ED to read:

The second sentences of paragraphs 37, 41, and 57 of SOP 97-2 are rescinded. The second sentence of paragraph 10 of SOP 97-2 is replaced with the following:

Vendor-specific objective evidence of fair value for an element not yet being sold separately is limited to the price established for that element by management having the relevant authority; it must be probable that the price, once established, will not change.

7

If AcSEC does not wish to keep the limitation on VSOE of fair value in paragraph 10 of SOP 97-2, an alternative to address the inconsistency noted above would be to make the following changes:

Add the phrase "and no other vendor-specific evidence of fair value of version 2.0 exists" immediately before the comma in the second sentence in the "Discussion" section of paragraph 4b, and

Add a sentence to paragraph 101 of SOP 97-2 stating that "Although AcSEC elected not to limit vendor-specific objective evidence of fair value for elements not yet introduced to the marketplace to a price established by management having relevant authority, AcSEC has not been able to identify any other evidence that it believes would be sufficient in such a situation."

We would be pleased to discuss any of our comments with AcSEC or the AICPA Staff.

Very truly yours,

Arthur Andersen LLP

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Lucent Technologies
Bell Labs Innovations



September 28, 1998

American Institute of Certified Public Accountants
Accounting Standards, File 2354.WG
1211 Avenue of the Americas
New York, NY 10036-8775
Attention: Mr. Frederick Gill
Senior Technical Manager

Lucent Technologies Inc.
Network Systems
283 King George Road
Warren, NJ 07059

8

Re: Modification of the Limitations of Evidence of Fair Value in Software Arrangements

Dear Mr. Gill:

Lucent Technologies Inc. (Lucent) is pleased to submit its comments on the AICPA's Proposed Statement of Position entitled *Modification of the Limitations of Evidence of Fair Value in Software Arrangements (A proposed amendment to SOP 97-2, Software Revenue Recognition)* (Exposure Draft). Lucent is one of the world's leading designers, developers, and manufacturers of telecommunications systems, software, and products. Lucent had total assets of approximately \$24 billion as of September 30, 1997, and total revenues of approximately \$26 billion for the year then ended.

Lucent agrees with the objective of the Exposure Draft which is to rescind the second sentences of paragraphs 10, 37, 41, and 57 of SOP 97-2 which limited what is considered vendor-specific objective evidence of fair value of the various elements in a multiple-element arrangement. We also agree with the conclusion of the Exposure Draft that the requirement to defer recognition of revenue related to a delivered element when there is sufficient "other evidence of fair value" to support the allocation of the overall arrangement fee is overly conservative and may result in the inaccurate reporting of revenue.

Lucent agrees that the best evidence of fair value of an element is the price charged for that element when it is sold separately and other evidence of fair value would be utilized as a secondary option for the allocation of the overall arrangement fee to individual elements. However, Lucent believes additional guidance should be provided on what is considered "other evidence of fair value" in order to address multiple element arrangements whereby the objective evidence for more than one element cannot be inferred from the differential methodology as suggested in the examples of the Exposure Draft.

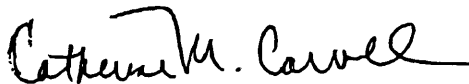
8

Considering current marketing practices whereby software companies bundle individual elements that are not always sold separately into a single arrangement, it may be difficult to infer objective evidence of fair value for all elements. We propose that AcSEC consider providing additional guidance on what qualifies as other evidence of fair value (e.g. cost of each element plus a reasonable mark-up) in order to ensure consistent application of SOP 97-2 and provide for more accurate reporting of revenue related to delivered elements.

We appreciate your consideration of the points discussed in this comment letter. If you would like clarification of any points referred to in this letter, please feel free to call me at (908) 559-3160 or Robert Owens at (908) 559-7705.

Thank you for your consideration of our comments.

Sincerely,



Catherine M. Carroll
Financial Vice President &
Assistant Controller



September 30, 1998

#9

Mr. Frederick Gill
Senior Technical Manager, Accounting Standards
File 2354.WG
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Via Fax: 212-596-6064

Dear Mr. Gill:

By this letter, VERITAS Software Corporation is responding to the Exposure Draft on Proposed Statement of Position, *Modification of the Limitations on Evidence of Fair Value in Software Arrangements* (the "Exposure Draft"). If adopted, the Exposure Draft would amend or rescind certain provisions of SOP 97-2, *Software Revenue Recognition* ("SOP 97-2") and SOP 98-4, *Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition* ("SOP 98-4").

SOP 98-4 deferred for one year the effective date of the second sentence of paragraph 10 of SOP 97-2, which limited what is considered vendor-specific objective evidence ("VSOE") of the fair value of the various elements in multiple element arrangements, and passages of SOP 97-2 that reflect the conclusion in the second sentence of paragraph 10 of SOP 97-2. In the Basis for Conclusions, AcSEC indicated that several examples were brought to their attention "in which the application of the limitations on VSOE of fair values in paragraph 10 of SOP 97-2 would not allow "unbundling" and, as a result, may produce an unduly conservative pattern of revenue recognition. Those examples included situations where software is sold only in combination with PCS or other services and there is VSOE for one of the elements and the total arrangement but not necessarily for all of the elements.

Accordingly, subsequent to the issuance of SOP 98-4, VERITAS Software Corporation believes that there was a general understanding that what has become known as the "differential" method could be applied whereby VSOE of fair value for an element which was sold separately could be subtracted from VSOE for the total arrangement, as evidenced by the actual sales price of the total transaction, to derive VSOE for the element which was not sold separately. For example, the renewal rate for PCS in subsequent years could provide VSOE of fair value for the PCS which could be subtracted from the total transaction price of the bundled software and VSOE in the initial transaction, to obtain VSOE for the software.

#9



The Exposure Draft appears to add a significantly more restrictive new concept by indicating that if there is no "consistent pricing" for the total software bundled with another element then the fair value of the unknown element cannot be "inferred" by having VSOE of fair value for the other element. However, the term "consistent pricing" is not defined. If this term is interpreted to be that sales are a consistent dollar amount from customer to customer, VERITAS Software Corporation believes that such a definition would be unduly restrictive especially for enterprise software companies.

Enterprise software companies typically have large sales to end users consisting of a relatively large number of different software modules. The total price to the customer depends on many qualitative factors such as the size of the customer, the industry in which the customer conducts business, the customers intended use of the software, particular competitors in this transaction and specific negotiations between VERITAS Software Corporation and the customer. VERITAS Software Corporation believes that such arms-length transactions represent valid objective evidence of fair value. In fact, it appears that such actual selling prices would be the best example of VSOE of fair value for the bundled package. In addition, PCS is always priced on a consistent basis at 15%-17% of the total transaction value, which also gives recognition to the various specific customer factors as mentioned above. This amount is also the renewal rate after the first year of the arrangement. Finally, services are generally priced on a "time and materials" basis at a standard rate per hour. Additional services can be purchased beyond any bundled amount at the specified rate per hour, which VERITAS Software Corporation believes establishes VSOE of fair value for such services.

As a result, VERITAS Software Corporation believes that it has sufficient VSOE of fair value of the total arrangement, PCS and services such that the amount attributable to the software can be inferred objectively. VERITAS Software Corporation believes that, to require deferral in such situations, will result in the accounting that AcSEC stated in SOP 98-4 that should be avoided when quoting from Statement of Financial Accounting Concepts No. 2 that, "Conservatism no longer requires deferring recognition of income beyond the time that adequate evidence of its existence becomes available or justifies recognizing losses before there is adequate evidence that they have been incurred". VERITAS Software Corporation believes that, in the situations described above, adequate evidence exists to justify recording of income and a deferral would be unduly conservative.

For these reasons, VERITAS Software Corporation does not support the issuance of the Exposure Draft.

Very truly yours,

VERITAS Software Corporation

A handwritten signature in black ink, appearing to read "Ken Lonchar".

Ken Lonchar

Vice President, Chief Financial Officer

PricewaterhouseCoopers LLP
101 Hudson Street
Jersey City NJ 07302
Telephone: (201) 521 3000
Facsimile: (201) 521 3333
Direct phone: (201) 521-3038
Direct fax: (201) 521-3083

Fax cover sheet

To: Frederick Gill
Company: AICPA
Addressee fax No.: 212-596-6064

#10

From: James F. Harrington
Return fax number: (201) 521-3083

Date: September 30, 1998
No. of pages: 2
(incl. this page)

If this fax is incomplete or illegible please telephone (201) 521 3000

This facsimile transmission is intended for the addressee indicated above. It may contain information that is privileged, confidential, or otherwise protected from disclosure. Any review, dissemination, or use of this transmission or its contents by persons other than the addressee is strictly prohibited. If you have received this transmission in error, please notify us immediately by telephone, and mail the original to us at the above address.

Urgent

Mr. Gill:

Attached is the PricewaterhouseCoopers comment on the AICPA 7/31/98 ED of Proposed Statement of Position, *Modification of the Limitations on Evidence of Fair Value in Software Arrangements*.

A hard copy has been sent to you for your receipt Tuesday, October 1.

#10

September 29, 1998

Mr. Frederick Gill
Senior Technical Manager
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Gill:

We are pleased to comment on the AICPA's July 31, 1998 Exposure Draft of its Proposed Statement of Position, *Modification of the Limitations on Evidence of Fair Value in Software Arrangements (A proposed amendment to SOP 97-2, "Software Revenue Recognition")* (the ED).

We support the proposals in the ED and would like to offer the following comment:

- In paragraph 4(d), Facts, the word "substantially" is used to describe the number of sales of product A at \$1000. We suggest that the discussion be expanded to include a brief explanation of how to account for the sales that fall outside of this group, the outliers. It is our belief that the outliers would be compared to the \$1000 as this would be considered VSOE and an appropriate discount would be applied and allocated to all the elements.

We appreciate the opportunity to express our views. If you have any questions regarding our comments, please contact James F. Harrington at (201) 521-3039, H. John Dirks at (415) 393-8735, or Bart F. Catmull at (201) 521-3710.

Very truly yours,



PricewaterhouseCoopers LLP

September 30, 1998

Mr. Frederick Gill
Senior Technical Manager, Accounting Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

#11

Subject: File 2354.WG

Dear Mr. Gill:

As a software producing company, we want to express our concerns and perspective, regarding the Exposure Draft dated July 13, 1998 to modify SOP 97-2. We agree with the need to standardize and increase the consistency in recognizing revenues in the software industry. We also agree with the use of vendor-objective specific evidence (VSOE) in the allocation of revenue in a multiple-element arrangement. At Wall Data we produce corporate network and Internet software products. Customers usually purchase post-contract customer product support (PCS) for some products. These products are often sold on a bundled basis. We are in agreement with the Exposure Draft's effort to allow the use of a 'differential method' to obtain VSOE for elements of bundled products to obtain VSOE for an unknown product when the VSOE of the other elements is available.

Our concern is the addition of the concept 'consistent pricing' as referred to in the examples 4.c and 4.d. of the Exposure Draft. Our concern is that the consistency requirement may not be met for VSOE if the price of the bundled arrangement varies significantly. Because of the competitive nature of the software industry, Wall Data's pricing from customer to customer may vary greatly depending on the nature of our customer's requirements, our relationship with the customer, the quantity of product purchased, and numerous other factors in each license agreement. To gain market share, we sometimes allow a special discount on a bundled package for a customer currently using a competitive product. Each sale is separately negotiated with the customer and the resulting prices are not disclosed to the public. To require consistency to obtain VSOE of bundled products could prevent the recognition of revenue on delivered products on some sales.

Consistency should not be an impediment to recognizing revenue. SOP 97-2 has explained the method to allocate the discount in a multiple-element arrangement. Although there may be a wide range of pricing for a bundled package, we can obtain a mean price for classes and types of customers. After applying the differential method to the mean price of the bundled package we can obtain the fair value of the unknown element. Using these two amounts we can obtain the ratio of product to PCS. This ratio can be used to determine the allocation of product and PCS in sales that may not be consistent with regular pricing.

I hope that you will give serious consideration to either the elimination of the consistency requirement or flexibility in the application of consistency to allow us to recognize product revenues on a realistic basis.

Sincerely,

Richard P. Fox
Chief Financial Officer

RPF:dc

#12

September 30, 1998

Mr. Frederick Gill
Senior Technical Manager
Accounting Standards
File 2354.WG
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

(Sent via e-mail to FGILL@AICPA.ORG)

Dear Mr. Gill:

As a preparer and user of financial statements we are pleased to respond to the invitation to provide comments as requested in the July 31, 1998 notice which accompanied the exposure draft of a proposed statement of position (SOP), *Modification of the Limitations on Evidence of Fair Value in Software Arrangements*.

Following are specific comments on the July 31, 1998 exposure draft:

1. The two criteria stated in the second sentence of paragraph 10 are good examples of what might qualify as Vendor-specific objective evidence of fair value. However, we concur with the exposure draft that these do not constitute the only objective evidence of Vendor-specific fair value (VSOE) and therefore VSOE should not be limited to these two criteria. The sentence could be modified to read,

Vendor-specific objective evidence of fair value may include the following:

** The price charged when the same element is sold separately.*

**For an element not yet being sold separately, the price established by management having the relevant authority; it must be likely that the price, once established, will not change significantly before the separate introduction of the element into the marketplace.*

2. Consistent with the above, the second sentence of paragraph 37 could be modified to read, *The fee to be charged to existing users of the software product being updated or in the absence of such a fee other objective factors may be considered vendor-specific objective evidence of fair value.*

3. Paragraph 41 could be modified to read, *The allocation should be based on all*

#12

appropriate evidences including the relative sales prices (determined pursuant to paragraphs .10 and .11 of this SOP) of the products.

Mr. Frederick Gill
September 30, 1998
Page Two

4. Paragraph 57 could be modified to read, *The fair value of the PCS may be determined by reference to various factors including the price the customer will be required to pay when it is sold separately (that is, the renewal rate).*

5. The example at 4.c. provides that without *consistent pricing* there can be no inference as to fair market value of the implementation service. The use of consistent is too restrictive; the use of *usual or customary* would be more appropriate.

6. We make the following observation regarding the example added by 4.d. of the exposure draft which is entitled Multiple-Element Arrangements --- Products and PCS:

This example suggests that the SOP is interpreted to require the establishment of vendor-specific objective evidence for the total arrangement fee even though specific elements of the arrangement have vendor specific objective evidence. We believe a more workable interpretation would call for deferral only for the un-delivered elements that have separate objective evidence. In summary, revenue deferral for other than undelivered products should not be required when vendor-specific evidence is available for all undelivered elements. In such cases, VSOE for the undelivered products should be deferred for the arrangement and revenue recognized as the undelivered products are delivered. Should the sum of VSOE for the undelivered products exceed the aggregate arrangement fee, the fee is allocated to the undelivered products based on VSOE and all revenue for the arrangement is initially deferred.

This current example doesn't account for the reality that companies have different pricing arrangements with different groups or classes of customers.

7. Finally, with respect to SOP 97-2 and this exposure draft, we would like to see more examples and practical guidance as to the implementation issues related to the entire SOP, and specifically, those factors companies can consider when determining vendor-specific objective evidence. For example, companies should be able to look at their pricing history, usual and customary arrangements, historical ratios of pricing arrangements, industry practices and

#12

competitive influences and other factors in developing objective evidence for the elements of any arrangement. A detailed implementation guide with examples would be helpful. In addition, we believe it would be extremely helpful to have the minutes (both prior and future) of

Mr. Frederick Gill
September 30, 1998
Page Three

the working group published within a reasonable time period of its meetings. Companies should be aware of and able to respond to the topics and conclusions of this group.

We appreciate the opportunity of providing these comments and observation. If you have any follow-up questions please contact the undersigned or Cliff Simpson, Vice President Finance at 801-222-2680 or via e-mail at csimpson@novell.com.

Very Truly Yours,

Dennis R. Raney
Senior Vice President and
Chief Financial Officer

**Deloitte &
Touche LLP**

Ten Westport Road
P.O. Box 820
Wilton, Connecticut 06897-0820

Telephone: (203) 761-3000
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13

October 1, 1998

Mr. Frederick Gill
Senior Technical Manager
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of Americas
New York, NY 10036-8755

File Reference: 2354.WG
Modification of the Limitations on Evidence of Fair Value in Software Arrangements

Dear Mr. Gill:

We are pleased to comment on the AICPA's Exposure Draft of a proposed Statement of Position, *Modification of the Limitations on Evidence of Fair Value in Software Arrangements* (the "proposed SOP"), dated July 31, 1998, that would amend Statement of Position 97-2, *Software Revenue Recognition* (SOP 97-2). We support the issuance of the proposed SOP as a final SOP. However, we would suggest that AcSEC consider making the modifications discussed below.

Consistent with SOP 97-2, the proposed SOP would require the allocation of the arrangement fee based on the relative fair values of the separate elements in the arrangement. It may be helpful to state explicitly in the Basis for Conclusions that AcSEC believes that in the absence of consistent pricing of the total arrangement, it is unacceptable to allocate the arrangement fee using the fair values of all elements but one and a residual value for the remaining element (the residual value method), such that the entire discount is allocated to the residual element. This methodology was initially proposed as an alternative to the SOP 97-2 approach and was widely discussed during the development of the proposed SOP. In addition, it was common practice under SOP 91-1, in particular for arrangements that included software and first year postcontract support (PCS). The point is made in the example in paragraph 4(d) of the proposed SOP; however, more explicit discussion in the Basis for Conclusions may be warranted. This discussion could be similar in style to the discussion in the Basis for Conclusions of the rolling twelve months method for arrangements that provide for extended payment terms.

**Deloitte Touche
Tohmatsu
International**

October 1, 1998
Mr. Frederick Gill
Page 2

#13

With the proposed modification of the limitations on evidence of fair value, there have been questions in practice as to what constitutes vendor specific objective evidence of fair value. We would hope that the new Task Force that has been formed to address SOP 97-2 implementation issues would provide additional guidance in this area. Accordingly, we recommend deleting paragraph 14 from the proposed SOP because it appears to conclude that such guidance would not be helpful.

Illustrative examples are provided for the first two types of multiple-element arrangements discussed in paragraph 11 of the proposed SOP. We believe an example of multi-year PCS arrangements, the third type of arrangement discussed in paragraph 11, would be helpful as well.

Because the first sentence of paragraph 117 of SOP 97-2 makes reference to the second sentence of paragraph 37, we believe this sentence also should be rescinded.

If you have any questions concerning our comments, please contact Naomi Erickson at (203) 761-3138 or John Smith at (203) 761-3199.

Yours truly,

Deloitte & Touche LLP

September 30, 1998

#14

Mr. Frederick Gill, Senior Technical Manager
Accounting Standards, File 2354.WG
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Gill:

We appreciate the opportunity to comment on the AICPA's Exposure Draft of the Proposed Statement of Position, *Modification of the Limitations on Evidence of Fair Value in Software Arrangements* (the ED), that would amend Statement of Position 97-2, *Software Revenue Recognition* (SOP 97-2).

We support the concept contained in SOP 97-2 that revenue should be allocated to the elements in multiple-element arrangements based on the fair values of the elements and that evidence of fair value should be specific to the vendor. However, we believe that additional guidance should be provided on what constitutes vendor-specific objective evidence of fair value (VSOE) to ensure that the concept is applied consistently in practice. We do not believe that the guidance provided in the ED is sufficient to achieve consistency in practice. Therefore, we do not support the conclusions reached in the ED.

The second sentence of paragraph 10 of SOP 97-2 provides specific guidance on what constitutes VSOE. If SOP 97-2 is amended based on the provisions of the ED, no definition of what constitutes VSOE would exist. The examples in the ED focus on whether VSOE can be determined based on consistent pricing for the elements and the total arrangement. If VSOE is intended to be limited to evidence of consistent pricing, that guidance should be included in the provisions of the SOP. If VSOE is not limited to evidence of consistent pricing, guidance should be provided on what other evidence may constitute VSOE.

 Peat Marwick LLP

Mr. Frederick Gill
September 30, 1998
Page 2

14

The example in paragraph 4(d) of the ED indicates that revenue would be recognized for the delivered element in a multiple-element arrangement when there is VSOE for the undelivered element and the total arrangement. We believe that revenue recognition for the delivered element also is appropriate when the vendor has VSOE for all of the undelivered elements but does not have consistent pricing for the entire arrangement. The amount of revenue recognized in that case should be the difference between the total arrangement fee and the fair value of the undelivered elements. Under this approach, any discount in the arrangement is allocated entirely to the delivered elements and the deferred revenue represents the fair value of the undelivered elements.

Very truly yours,

HPMG Peat Marwick LLP

September 30, 1998

#15

Mr. Frederick Gill
Senior Technical Manager
Accounting Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Proposed Statement of Position
“Modifications of the Limitations on Evidence of Fair Value
in Software Arrangements”
File 2354.WG

Dear Mr. Gill:

Because the limited definition of vendor-specific objective evidence (VSOE) in SOP 97-2 may lead to illogical revenue recognition, we support the issuance of the above-referenced proposed Statement of Position (SOP). However, we believe that the proposal should provide meaningful guidance on what evidence is sufficiently objective to achieve comparable and consistent application of the vendor-specific objective evidence criterion. Absent such guidance, it will continue to be unclear as to what, if anything, would constitute VSOE in situations where items are never sold separately or where items sold separately are sold at widely varying prices. This concern and several other suggestions are discussed below.

Consistent Pricing

Paragraph 4.c. introduces the concept of “consistent pricing” of the bundled arrangement in determining VSOE of one of the elements using the “differential method.” The “consistent pricing” criteria was not explicitly included in SOP 98-4, and the meaning of “consistent pricing” is unclear. Further, paragraph 4.d. refers to situations when “the price of the bundled arrangement varied significantly.” Accordingly, we recommend that AcSEC provide additional guidance to enhance consistent and comparable application of the criteria in practice. Such guidance should discuss, among other matters, how to apply the consistent pricing criteria during the product life cycle as prices generally decline and how the consistent pricing criteria should interact with paragraphs 102 and 103 of SOP 97-2 relating to other factors in the vendor’s pricing structure, as well as, situations where discounts are offered.

Mr. Frederick Gill

7/15

Page 2
September 30, 1998

We support the use of the differential method for determining the VSOE of one element of a multiple-element arrangement when that element is not sold (or offered for sale) separately. We recognize that use of the differential method may attribute all of the discount in the arrangement to the element for which VSOE is inferred. The “consistent pricing” criteria is an effort to comply with paragraph 11 of SOP 97-2 and to ensure that a reasonable fair value is allocated to the element for which VSOE is inferred. We recommend that the Basis for Conclusion explain why consistent pricing is important in applying the differential method (e.g., adherence to paragraph 11 of SOP 97-2).

However, we believe AcSEC should consider an alternative application of the differential method that omits the “consistent pricing” criteria when determining the VSOE of a *delivered* element. For example, assume a vendor, for valid but not objectively determinable reasons, licenses software Product A for prices that are not consistent from transaction to transaction. The license arrangement for product A always includes one year of “free” PCS. The annual renewal price of PCS is typically \$150 and therefore VSOE of fair value for annual PCS exists. In two different arrangements, the arrangement fee would be allocated to the delivered element, Product A, as follows:

	Arrangement 1	Arrangement 2
Arrangement Fee	\$1,000	\$800
VSOE of PCS	\$150	\$150
Revenue Allocated to Product A	\$850	\$650

This method allocates all of the discount, if any, in the arrangement to the delivered element and avoids overly aggressive revenue recognition, but permits revenue recognition upon delivery of the delivered elements thus avoiding an unduly conservative pattern of revenue recognition. As discussed in paragraph 11 of the Exposure Draft, the main basis for concluding that the differential method is an acceptable method to determine VSOE is because failure to do so may produce an unduly conservative pattern of revenue recognition. While using this differential method seems an acceptable alternative when solving for the delivered element, we do not believe that using the differential method to solve for the undelivered element is appropriate.

The last sentence of paragraph 13 states “In the absence of *consistent* selling prices, vendor-specific objective evidence may not exist” (italics added). Because paragraph 13 is not limited to determining VSOE using the differential method, this sentence appears to apply a higher hurdle to determining VSOE in all situations, not just when using the differential method. Accordingly, we recommend that the last sentence of paragraph 13 be changed to read “In the absence of *separate* selling prices, vendor-specific objective evidence *may* not exist” (italics added). If the concept of consistent pricing is maintained

Mr. Frederick Gill

#15

Page 3
September 30, 1998

in the final SOP, we recommend that additional discussion be added to the Basis for Conclusion indicating that when the differential method is used, vendor-specific objective evidence *would not* exist in the absence of consistent selling prices and then go on to elaborate (possibly with some examples) on what is meant by “consistent pricing.”

We have the following comments on specific paragraphs of the Exposure Draft:

Paragraph 4.b.

The “Facts” section of the example states “The vendor’s pricing committee has not yet decided whether version 2.0 will be offered to existing users of version 1.0 for \$100 or \$200, and no other vendor-specific objective evidence of the fair value of version 2.0 exists at the balance sheet date.” The example as currently drafted indicates that a maximum price for version 2.0 is known. This could lead people to believe that because they know the maximum price for the upgrade and that upgrades are not discounted, then deferral of the maximum price of \$200 in this example is the appropriate accounting treatment. We believe that this could be clarified by inserting the words “but has not determined the final price” immediately following “...to existing users of version 1.0 for \$100 or \$200,...” in this sentence.

The Discussion section of this same example states “Because the vendor’s pricing committee has not yet decided whether version 2.0 will be offered at \$100 or \$200, sufficient vendor-specific objective evidence does not exist supporting the fair value of the undelivered software.” We recommend adding “no other vendor-specific objective evidence of the fair value of version 2.0 exists” in the preceding sentence just following “...will be offered at \$100 or at \$200,...” in order to clarify the discussion for reaching the conclusion that sufficient VSOE of fair value does not exist.

The “Facts” section of the example states “A vendor announces that version 2.0 of its existing version 1.0 software product will be available in several months. The announcement states that any customer who purchases version 1.0 at the current \$300 price before the release of version 2.0 will receive 2.0 at no additional cost when it becomes available.” SOP 97-2, paragraph 36 states that an “upgrade right may be evidenced by a specific agreement, commitment, or the vendor’s established practice.” The Discussion in this example provides no basis to support why the announcement represents an upgrade right. We recommend that the reasoning be explained.

Mr. Frederick Gill

Page 4
September 30, 1998

#15

Paragraph 11

Each of the three bullets in this paragraph refer to revenue recognition over the period in which PCS "obligations are discharged." SOP 97-2 does not provide for revenue recognition over periods that "obligations are discharged." We recommend that these words be changed to refer to the periods described in paragraph 58 of SOP 97-2 (e.g., "the period during which the PCS services are provided").

Paragraph 13

The next to last sentence of paragraph 13 refers to "established discounts." We recommend that the word "established" be replaced with "objectively determinable." We believe these words are more consistent with the concept of vendor-specific objective evidence.

Paragraph 117 of SOP 97-2

The first sentence of this paragraph indicates what is said in the second sentence of paragraph 37 in SOP 97-2. Therefore, the first sentence of paragraph 117 should be modified to reflect that the second sentence of paragraph 37 of SOP 97-2 has been rescinded.

* * * * *

We appreciate the opportunity to present our views on the proposal and would be pleased to discuss our letter with AcSEC or the AICPA staff at your convenience.

Very truly yours,

Ernst + Young LLP

#16
Rec'd 10-8-98

October 8, 1998

Mr. Frederick Gill
Senior Technical Manager
Accounting Standards
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036

Dear Mr. Gill:

We are pleased to have the opportunity to comment on the Exposure Draft of the proposed Statement of Position (SOP), *Modification of the Limitations on Evidence of Fair Value in Software Arrangements*.

We support issuance of the SOP as an amendment of SOP 97-2, *Software Revenue Recognition*, but suggest certain revisions and clarifications, as discussed below.

Summary

To clarify and emphasize that the criterion to allocate the fee of a multiple-element arrangement using vendor-specific objective evidence of fair value continues to apply, we suggest deleting the last sentence of the Summary and adding the language in paragraph 5 of the proposed SOP as a second Summary paragraph.

Deletion of Second Sentence of Paragraph 41

Paragraph 41 of SOP 97-2 discusses the allocation of the fee for an arrangement that includes future delivery of additional software products. Instead of deleting the second sentence of paragraph 41 as provided in paragraph 4(a) of the proposed SOP, we suggest retaining the sentence, but modifying it by changing the term *sales prices* to *fair value*. The change would provide helpful guidance by explicitly stating that the fee should be allocated to the software products based on their relative fair values. Although SOP 97-2 implies that the fee should be allocated based on relative fair value, that term is not used in the conclusions section of the SOP. It is, however, used in the example in SOP 97-2 that illustrates paragraph 41 (Appendix A, Multiple-Element Arrangements — Products — Example 1).

Example of Inferred Vendor-Specific Objective Evidence of Fair Value

In paragraph 4(d), the last sentence of the Discussion states that if “the price of the bundled arrangement varied significantly, vendor-specific objective evidence of the fair value of the arrangement would not exist.” We are unclear about the meaning of this sentence. Does it mean that if an entity sells the bundled arrangement for a consistent price of \$1,000, but on one occasion sells the bundled arrangement for a significant discount, say \$750, that vendor-specific objective evidence of the fair value of the elements of the arrangement would not exist for that discounted arrangement? Or does it mean that if the bundled arrangement is sold for different prices that vary significantly from each other, then a consistent price for the arrangement would not exist. If this is the meaning, then presumably the arrangement could be sold for various prices that do not differ significantly from each other (prices within a reasonable range of, say, \$1,000), and the entity could determine the vendor-specific objective fair value of the arrangement. However, this would seem to differ from the assumed facts of the example, which provide that “[s]ubstantially all sales of product A with one year of PCS are for \$1,000.”

#16

The example in paragraph 4(d) illustrates how vendor-specific objective evidence of fair value for an element can be inferred by taking the difference between the fair value of the total fee and the fair value of the element for which vendor-specific objective evidence of fair value is available. Using that method, the inferred amount includes the entire discount, if any, in the arrangement. However, paragraph 11 of SOP 97-2 requires that the discount be allocated proportionately to the elements of the arrangement.

We suggest including an example illustrating the allocation of discount in an arrangement that has an inferred vendor-specific objective evidence of fair value for one element. For example, assume an entity consistently sells the software separately for \$800, and consistently sells it for \$1,000 when it is bundled with installation services. Installation services are not sold separately. However, if a particular arrangement provides that software with installation services are sold for \$950, the revenue recognized for the software should not be \$800, with the difference between \$950 and \$800 deferred as the fee for installation services. The example would illustrate inferring the fair value of the installation services from the undiscounted \$1,000 price and then allocating the discount between the software and installation services.

Multi-Year Postcontract Customer Support

The third bullet in paragraph 11 suggests that one example of why the proposed SOP is needed would be situations in which an arrangement bundles software with multi-year PCS when multi-year PCS is never sold separately. It is not clear to us how such situations would be resolved by the proposed SOP. Assume an entity sells software for \$900 and software with two years of PCS for \$1,100. The annual PCS renewal rate is \$200. Two-year PCS is not sold separately. We are unclear about which of the following allocations of the \$1,100 fee would be appropriate based on the guidance in the SOP:

- basing the price allocated to the two-year PCS on the difference between the total arrangement fee and the fair value of the software (\$1,100 - \$900), thereby allocating all of the apparent discount to the deferred PCS revenue

determining the relative fair value of the software and the two-year PCS based on fair value of \$900 for the software and \$400 (2 x \$200) for the PCS, and then allocating the discount proportionately to the software and the PCS.

As noted previously, the proposed SOP does not address discounting in conjunction with situations that involve inference of vendor-specific objective evidence of fair value.

We would welcome the opportunity to discuss any of our comments with members of AcSEC or the AICPA staff. Please feel free to contact Joseph Graziano at (212) 599-0100.

Very truly yours

Grant Thornton LLP



October 12, 1998

Mr. Fred Gill
Senior Technical Manager, Accounting Standards
File 2354.WG
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

#17

Re: Exposure Draft on Software Revenue Recognition

Dear Mr. Gill:

**Software
Publishers
Association**

I am writing on behalf of the Software Publishers Association to voice our support for the exposure draft (ED) on proposed "Modification of the Limitations of Evidence of Fair Value in Software Arrangements." We thank you for following the suggestion made in our letter dated February 25, 1998, regarding paragraph 10 of SOP 97-2, that use of the differential method was appropriate for determining the fair value of all elements of a multiple-element software arrangement. We believe that this approach comports with the principle of conservatism set forth in Financial Accounting Concept 2. We firmly believe SOP 97-2, as amended by the proposed ED, provides preparers of financial statements with a logical methodology to recognize revenue and sufficient flexibility to meet changing circumstances, and gives users of those financial statements comfort that reported results are appropriate, consistent, and comparable.

SPA is the principal trade association of the computer software industry, representing the leading publishers as well as start-up firms in the business, home-office, consumer, entertainment and educational markets. SPA supports companies that develop and publish software applications and tools for the desktop, client-server networks, and the Internet. SPA's 1,200 member companies account for 85 percent of U.S. revenues for packaged and on-line software.

We are aware that you have received several comment letters criticizing the approach of the exposure draft focusing on the "consistent pricing" language of the proposed new examples. The software industry opposes the inclusion of any further examples clarifying what language of a previous example means. The "consistent pricing" language does not appear in flush language of the existing Statement of Position, it only would appear in the new example. We believe that the "consistent pricing" language merely is illustrative of what constitutes vendor specific objective evidence in a certain situation and probably construes the "objective" part of the standard.

We have heard questions from some of our members regarding the application of the "consistent pricing" concept in the context of a volume discount pricing scheme where the size of the discount varies depending on the volume of software included in the transaction or the number of "seats" involved. The concern is that the "consistent

#17

pricing" concept may preclude the recognition of any revenue at the time of the sale because there is no one "consistent" price.

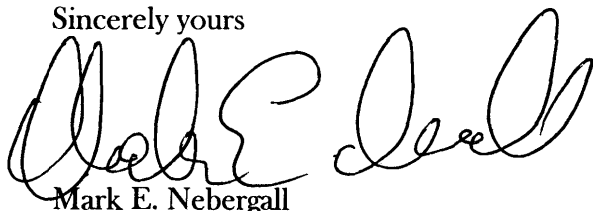
We believe that the concerns of these members are unfounded. The "consistent pricing" concept merely would require that the company develop various tranches of transactions where the discounts are similar and revenue is recognized and/or deferred as appropriate for each tranche.

We strongly urge AcSEC to resist the call for more guidance in this area. Software companies already enjoy the most detailed accounting standards of any industry. We believe that issuance of more detailed guidance would be futile due to the rapid change of practice within the industry. In addition, such further guidance would only serve to reduce the ability of preparers to apply judgment with respect to particular transactions that might not fit neatly into a narrower standard.

Keep in mind that it took AcSEC approximately six years of study and deliberation to arrive at the flexible standard embodied in SOP 97-2. The elimination of the unduly restrictive sentence of paragraph 10 of that SOP represented a stride in improving the standard. We firmly believe that the elimination of restrictions on what constitutes vendor specific objective evidence (VSOE) in the current exposure draft should be adopted. Any attempt to narrowly define VSOE, particularly with a few random examples, is simply not possible in an industry with an endless variety of licensing programs and subject to such rapid change.

SPA is proud of its longstanding working relationship with AcSEC in the area of accounting standards for software companies and look forward to working with you in the future. If you have any questions concerning this matter, please contact Mark Nebergall at (202) 452-1600 ext. 319 or at mnebergall@spa.org.

Sincerely yours



Mark E. Nebergall
Vice President and Counsel
Finance and Tax Policy
Software Publishers Association

#18



MASSACHUSETTS SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS, Inc.
105 Chauncy Street, Boston, MA 02111 (617) 556-4000 FAX (617) 556-4126 Toll Free 1-800-392-6145

October 7, 1998

Rec'd 10-13-98

Mr. Frederick Gill
Senior Technical Manager
Accounting Standards, File 2354.WG
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position
"Modification of the Limitations
on Evidence of Fair Value in
Software Arrangements"

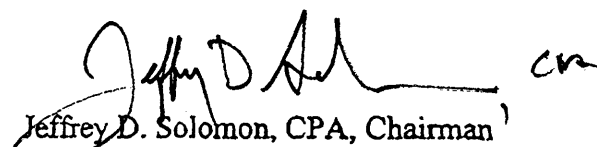
Dear Frederick:

The Accounting Principles and Auditing Procedures Committee is the senior technical committee of the Massachusetts Society of Certified Public Accountants. The Committee consists of over thirty members who are affiliated with public accounting firms of various sizes, from sole proprietorships to international "big six" firms, as well as members in both industry and academia. The Committee has reviewed and discussed the Proposed Statement of Position "Modification of Limitations on Evidence of Fair Value in Software Arrangements" (the proposal). The views expressed in this comment letter are solely those of the Committee and do not reflect the views of the organizations with which the Committee members are affiliated.

We concur with the Proposed Modification of the Limitations on Evidence of Fair Value in Software Arrangements.

We appreciate the opportunity to present our comments and thank you for your consideration.

Very truly yours.


Jeffrey D. Solomon, CPA, Chairman
Accounting Principles & Auditing Procedures
Committee
Massachusetts Society of Certified Public Accountants



FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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September 30, 1998

#19

Rec'd 10-19-98

Mr. Frederick Gill
Senior Technical Manager
Accounting Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: File 2354.WG

Proposed Statement of Position (SOP), *Modification of the Limitations on Evidence of Fair Value in Software Arrangements*

Dear Mr. Gill,

The Accounting Principles and Auditing Standards Committee of the Florida Institute of CPAs, (the Committee), has reviewed and discussed the Proposed Statement of Position (SOP), *Modification of the Limitations on Evidence of Fair Value in Software Arrangements*. A summary of our comments follows.

General Comment

The Committee agrees with the intent of the SOP to eliminate the limitations in paragraph 10 of SOP 97-2, *Software Revenue Recognition*. We concur with your conclusion that more judgment in the "unbundling" of services is appropriate.

Specific Comments

The Committee disagrees with the "Multiple-Element Arrangements—Products - Example 3" in the Exposure Draft. The Committee believes that there is some vendor-specific evidence of the fair value because the pricing committee has a potential pricing range and, therefore, at a minimum, the lower end of the range could be used to separate the products. The Committee suggests that the example would make more sense and be easier to interpret if the potential sales price information was removed.

The Committee also disagrees with the example entitled "Multiple-Element Arrangement—Products and PCS - Example 1." The Committee believes that it would be more appropriate to recognize the entire \$1,000 of revenue at the point of sale and establish a warranty reserve for the future postcontract customer support. The Committee concluded that the \$150 sales price for renewal years probably understated the amount of effort required to support the product during the initial sales period.

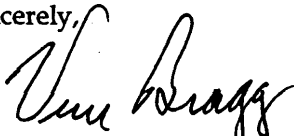
The Committee believed that the example entitled "Multiple-Element Arrangement—Products and Services - Example 3" is appropriate and can be objectively applied. This example seemed better than the others because it excluded reference to any particular dollar amounts.

#19

Mr. Frederick Gill
Page 2
September 30, 1998

The Committee appreciates the opportunity to share our views and concerns and to comment on the Proposed SOP. Members of our Committee are available to discuss any questions you may have about this communication.

Sincerely,



Verne E. Bragg, CPA, Chairman
FICPA Accounting Principles and Auditing Standards Committee
P.O. Box 5437
Tallahassee, FL 32314

Task Force Coordinating this response:
Kathryn M. Means, CPA

October 21, 1998

Rec'd 10-22-98
#20



California
Society
Certified
Public
Accountants

Mr. Frederick Gill
Senior Technical Manager, Accounting Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: File 2354.WG: Proposed Statement of Position "Modification of the Limitations on Evidence of Fair Value in Software Arrangements (A proposed amendment to SOP 97-2, *Software Revenue Recognition*)"

Dear Mr. Gill:

The Accounting Principles and Auditing Standards Committee of the California Society of Certified Public Accountants (AP&AS Committee) has discussed the exposure draft of the proposed Statement of Position, "Modification of the Limitations on Evidence of Fair Value in Software Arrangements (A proposed amendment to SOP 97-2, *Software Revenue Recognition*), dated July 31, 1998 (the "Proposed SOP"), and has comments on it.

The AP&AS Committee is the senior technical committee of our state Society. The Committee is composed of 52 members, of whom 8 percent are from national CPA firms, 63 percent are from local or regional firms, 19 percent are sole practitioners in public practice, 6 percent are in industry and 4 percent are in academia.

The AP&AS Committee supports issuance of the proposed SOP, but strongly recommends, as explained below, that one example therein be amended, along with any corresponding conforming changes needed elsewhere in the Proposed SOP.

Paragraph 4.b. proposes an amendment to "Multiple-Element Arrangements—Products—Example 3." It would require deferral of all revenue in a circumstance where management has determined the maximum, but not the minimum price for which an upgrade will be offered, which is consistent with the example in SOP 97-2. The AP&AS Committee believes that this conclusion is inappropriate because it is unduly conservative, and because sufficient vendor specific objective evidence exists to perform at least a partial allocation that will not cause an overstatement of the revenue to be recognized. Therefore, the conclusion in Example 3 should be changed to require recognition of \$100 of revenue on delivery of version 1.0, equal to the \$300 current price of version 1.0, minus the \$200 maximum price of version 2.0 upgrade.

The AP&AS Committee appreciates the opportunity to respond and would be pleased to discuss our comments further.

Yours very truly,

A handwritten signature in black ink, appearing to read "Andy Mintzer".

Andy Mintzer, Chair
Accounting Principles and Auditing Standards Committee

cc: James R. Kurtz, Society Executive Director
Diana Sanderson, Society President

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