EXHIBITS K-T
Exhibit K
Portal Software Lowers Third Quarter Revenue and Earnings Estimates

CUPERTINO, Calif., (November 13, 2003) — Portal Software, Inc. (Nasdaq: PRSF) today announced that revenue and earnings for its third quarter ended October 31, 2003 are expected to be below the Company's prior guidance provided in its financial results press release on August 19, 2003.

Revenue for the third quarter is now expected to be in the range of $25 million to $26 million. Both license and services revenue declined on a sequential basis. The Company expects to report a pro forma loss in the range of $0.27 to $0.31 per share for the quarter and a loss on a GAAP basis in the range of $0.36 to $0.40 per share for the quarter. Pro forma amounts in the third quarter of fiscal year 2004 exclude amortization of acquisition-related costs of $0.7 million and a stock option compensation charge of $3.0 million.

"As we continue our evolution from a product to a solutions company, we are working with larger companies on longer-term projects requiring more complex, end-to-end solutions and increasing demands on our solutions delivery capabilities," said John Little, Portal's founder and CEO. "As a result, two factors primarily contributed to revenues and earnings coming in below expectations: timing and services execution. The majority of our shortfall, is due to contract delays and revenue recognition deferrals, particularly with our existing Tier 1 customers. We also experienced some services execution issues that have resulted in a shortfall in services revenues and higher costs that, along with the higher mix toward services is expected to reduce gross margins to around 50%. Nevertheless, we remain confident that we understand the steps needed to improve our execution, that our strategy is the right one, and that we are well-positioned for the future."

Portal will conduct a conference call and an audio webcast today at 3:00 p.m. PST/6:00 p.m. EST. The dial-in number is (800) 289-0496, or (913) 981-5519, passcode 613620. A recording of this call will be available for replay for 12 months beginning at 6:00 p.m. (PST)/9:00 p.m. EST. The number for the replay is (888) 203-1112, or (719) 457-0820, passcode 613620. The web cast can be accessed at www.fulldisclosure.com. For those unable to listen to the live web cast, a replay will be available for 12 months.

About Portal Software, Inc.

Portal Software provides flexible billing and subscriber management solutions to enable organizations to monetize their voice and digital transactions. Portal’s convergent billing platform enables service providers to charge, bill, and manage a wide range of services via multiple networks, payment models, pricing plans, and value chains. Portal’s flexible and scalable product-based solutions enable customers to introduce new value added services quickly, providing maximum business value and lower total cost of ownership. Portal’s customers include thirty-five of the top fifty wireless carriers as well as organizations such as Vodafone, AOL Time Warner, Deutsche Telekom, TELUS, NTT, China Telecom, Reuters, Telstra, China Mobile, Telenor Mobil, and France Telecom. For more information, please visit www.portal.com.

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Statements in this release concerning Portal Software, Inc.’s estimated financial and operating results are forward looking statements for purposes of the Safe Harbor provisions under the Private Securities Litigation Reform Act of 1995, which involve a number of uncertainties and risks. Factors that could cause actual results to differ materially include the completion of the company’s regular quarterly accounting and financial reporting processes, including but not limited to, revenue recognition review of transactions and review of expense accruals. All statements made in this press release are made only as of the date set forth at the beginning of this release. Portal undertakes no obligation to update the information in this release in the event facts or circumstances subsequently change after the date of this press release.

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Exhibit L
Sprint Canada Implements Converged Wireline and Wireless Service Using Portal Software

CUPERTINO, CA (December 2, 2003)—Portal Software, Inc. (Nasdaq: PRSF) today announced that Sprint Canada has implemented Portal’s billing platform for its new home phone and Fido® wireless service bundle. Sprint Canada is a leading Canadian provider of integrated voice and data communications solutions to consumers and businesses.

Sprint Canada selected Portal’s software to seamlessly integrate the billing platform for the home phone, wireless bundle with the Company’s existing billing system. Portal previously worked with Sprint Canada to provide the integrated billing platform for its residential Internet access service.

“We were seeking a high quality cost-effective solution, and Portal offered us the best overall value based on our service needs,” said Ian Pattinson, vice president, Change Integration, Core & Emerging, Consumer Services Group, Sprint Canada. “Portal’s convergent billing platform allowed us to complete the complex implementation while ensuring our aggressive launch deadlines were met.”

Sprint Canada uses the Portal platform to process all charges associated with GSM wireless voice including home and roaming usage, SMS text messaging, GPRS data services, as well as recurring and non-recurring fees such as free minutes, and discounting. In addition, Sprint Canada customer service representatives use Portal’s intuitive graphical Customer Center to assign phone numbers and GSM SIM cards, manage rate plans, and efficiently support customers.

“Providers use our software to streamline the process of delivering new services to help retain existing customers while attracting new ones,” said Kris Nagel, vice president and general manager, Americas, Portal Software, Inc. “Portal’s solution offers providers the flexibility to rapidly launch new converged services, while reducing their ongoing total cost of operations.”

About Portal Software, Inc.

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Media Contact
Kevin Payne, kpayne@portal.com, 408-572-3614

Forward Looking Statement
Statements in this release contain forward looking statements that involve uncertainties and risks. These and other factors are described in detail in our Annual Report on Form 10-K for the fiscal year ended January 31, 2004 and our quarterly reports on Form 10-Q. All statements made in this press release are made only as of the date set forth at the beginning of this release. Portal undertakes no obligation to update the information in this release in the event facts or circumstances subsequently change.

Portal has inserted into several releases links to other parts of the Portal Web site containing related topics. Portal press releases speak only as of the date of their release, and Portal makes no effort to update the content subsequently. No inference should be drawn that the continuing presence of a release in this historical archive means that the information contained in it continues to be accurate or complete.
Exhibit M
Portal Reports Fourth Quarter Results and Results for Fiscal Year 2004


Fourth Quarter Results

Revenues for the quarter totaled $36.8 million, compared to revenues of $25.4 million in the prior quarter, and revenues of $31.1 million for the same period last year. Pro forma net loss for the fourth quarter of fiscal 2004 was $6.1 million, or $0.15 per share. This compares to a pro forma net loss of $11.5 million, or $0.30 per share in the prior quarter, and a pro forma net profit of $0.5 million, or $0.01 per diluted share in the fourth quarter of fiscal 2003. Pro forma amounts in the fourth quarter of fiscal year 2004 exclude amortization and write-off of acquisition-related costs of $0.7 million and a stock option compensation credit of approximately $19.2 million. Pro forma amounts in the third quarter of fiscal year 2004 exclude amortization of acquisition-related costs of $0.7 million and a stock option compensation expense of approximately $3.0 million. Pro forma amounts in the fourth quarter of fiscal year 2003 exclude amortization of acquisition-related costs of $1.2 million and stock option compensation expense of approximately $2.0 million. Net profit for the quarter ended January 30, 2004 was $12.4 million or $0.28 per diluted share, in accordance with generally accepted accounting principles ("GAAP"). This compares with a GAAP net loss of $15.2 million or $0.39 per share in the third quarter of fiscal 2004. GAAP net loss in the fourth quarter of fiscal 2003 was $2.6 million or $0.07 per share.

Continued Customer Growth

Portal's ongoing customer growth continues to demonstrate the value of its product-based billing solutions. These solutions allow service providers to differentiate themselves by introducing new and creatively-bundled voice, data, or content-based services. During the quarter Portal signed deals and expanded relationships with a number of customers including:

-- Orange UK
  Orange UK implemented Portal's convergent content billing solution to drive increased revenue from content, data, and messaging services from more than 13 million customers. Orange, the United Kingdom's most popular mobile service is using Portal's solution to generate additional revenue by rapidly supporting value-based pricing for a wide variety of prepaid and postpaid services as well as quickly increasing the number of third-party partner relationships.

-- Vodafone Spain
  Vodafone Spain selected Portal to provide a solution that enables them to quickly launch a wireless content portal and next generation value-added services such as GPRS, UMTS, MMS and WAP.

-- T-Mobile UK
  Portal was selected by T-Mobile UK to provide a third party partner management and settlements solution. This solution provides T-Mobile UK with a platform that allows them to quickly set up partner agreements, build complex partner pricing and revenue sharing plans, automatically calculate partner settlements, and enable automatic partner invoicing.

"Portal has been focused on expanding our relationships with existing customers, winning Tier 1 customers and delivering converged solutions to our customers," said John Little, founder and chief executive officer of Portal Software. "Our results this quarter demonstrate that our focus and hard work are paying off. Our continued customer wins and the success we have seen in a
number of go-live situations are evidence that our strategy is proving to be the right one.

Fiscal Year 2004 Results

Revenue for fiscal year ended January 30, 2004 was $127.5 million, a 5% increase from revenue of $121.1 million for fiscal year 2003. Pro forma net loss for fiscal year 2004 was $22.1 million or $0.58 cents per share, compared to a pro forma net loss of $27.1 million or $0.77 cents per share for fiscal year 2003. Pro forma amounts for fiscal 2004 exclude certain charges including stock option compensation expense of $14.7 million, and amortization of acquisition related costs of $2.7 million. Pro forma amounts for fiscal 2003 exclude certain charges including a write-off for impairment of assets of $1.5 million, a restructuring charge of $36.5 million, the amortization and write-off of purchased licenses of $1.9 million, amortization and write-off of acquisition related costs of $3.1 million, and stock compensation expense of $2.0 million.

Business Outlook

The following statements are based on current expectations and are forward-looking. They are subject to a number of uncertainties and risks, including those discussed below and in our SEC filings, and actual results may differ materially. We undertake no obligation to update any of the information contained in such forward-looking statements.

While Portal has seen excellent customer traction, especially internationally, customers' purchasing decisions continue to be deliberate and constrained by tight capital budgets. There continues to be a high probability that the uncertainties in the capital spending environment in the telecommunications arena will continue for an extended period of time, even though there are some recent indications of improvement. In addition, the significant transactions Portal expects to complete are larger, multi-year deals, which may add to long-term revenue predictability, but dampen near-term revenue growth while also challenging the company's solution delivery capabilities.

-- With continued economic uncertainty and intense market competition Portal currently expects first quarter fiscal 2005 revenue to be in the range of $30-35 million, the approximate run rate we have seen over the last two years.

-- First quarter gross margins are expected to be in the range of 52-57%.

-- Portal currently expects pro forma first quarter operating expenses to be in the range of $23 to $24 million.

-- Pro forma results for the quarter are expected to be a loss in the range of $0.10 to $0.15 per share.

-- Pro forma operating expenses and net income in Q1 of Fiscal Year 2005 are expected to exclude amortization of acquisition-related expense and stock option compensation expense. Portal is unable to provide guidance on a GAAP basis because information relating to stock option compensation expense is currently not quantifiable on a forward-looking basis as it depends on various factors, including the future market price of Portal's common stock.

Information About Pro Forma Presentation

To supplement Portal's consolidated financial statements presented on a GAAP basis, Portal uses additional non-GAAP or "pro forma" measures of operating results, net profit/loss and net profit/loss per diluted share adjusted to exclude certain costs, expenses and losses Portal believes appropriate to enhance an overall understanding of its past financial performance and also its prospects for the future. In addition, these adjusted non-GAAP results are among the primary indicators management uses as a

basis for planning and forecasting of future periods. Because there are no generally accepted industry standards for presenting non-GAAP results, the methods used by Portal may differ from the methods used by other companies. The presentation of this additional information is not meant to be considered in isolation or as a substitute for measures prepared in accordance with GAAP.

Conference Call Information

Portal will discuss its fourth quarter and fiscal year 2004 results and other financial and business information in a conference call and an audio web cast on Tuesday, February 24, 2004 at 5:00 p.m. EST/2:00 p.m. PST. In order to access the call, please dial in to one of the following numbers at 4:50 p.m. EST/1:50 p.m. PST on February 24, 2004: 800-238-9007 (inside the US) or 719-457-2622 (outside of the US). The Portal Software, Inc. Q4 and fiscal year 2004 earnings call will also be simulcast at www.companyboardroom.com. Additionally, an Internet playback will be available an hour following the call until 5:30 p.m. PST on February 24, 2005 at www.companyboardroom.com and on Portal’s investor relations web site at www.portal.com/about.portal/investor_relations/. A tele-replay of the call also will be available until February 24, 2005. The tele-replay numbers are 888-203-1112 or 719-457-0820 and the passcode to access the replay is 721170.

This press release and full company balance sheet and consolidated operations details will be filed as an exhibit to a current report on Form 8-K and will be posted on our web site prior to the conference call described above. For a copy of this press release and the company balance sheet and consolidated operations details, please visit the Investor Relations site at www.portal.com/about.portal/investor_relations.

About Portal Software, Inc.

Portal Software provides flexible billing and customer management solutions to enable organizations to monetize their voice and digital transactions. Portal’s convergent billing platform enables service providers to charge, bill and manage a wide range of services via multiple networks, payment models, pricing plans, and value chains. Portal’s flexible and scalable product-based solutions enable customers to introduce new value added services quickly, providing maximum business value and lower total cost of ownership. Portal’s customers include thirty-five of the top fifty wireless carriers as well as organizations such as Vodafone, AOL Time Warner, Deutsche Telekom, TELUS, NTT, China Telecom, Reuters, Telstra, China Mobile, Telenor Mobil, and France Telecom.

Forward Looking Statement

Statements in this release concerning Portal Software, Inc.’s business outlook, future financial and operating results, future expense reductions, and Portal’s overall future prospects are forward looking statements that involve a number of uncertainties and risks. Factors that could cause actual events or results to differ materially include the following: General business and economic conditions and changes in the amount of technology spending by our customers and prospects; the timing or delay in signing, commencement, implementation and performance of projects or contracts or the delivery of products and services under them and revenue recognition issues related to same; market acceptance of Portal’s products and services; customer and industry analyst perceptions of Portal and its technology vision and future prospects; fluctuations in the market price of Portal stock that can result in unpredictable compensation expense charges; difficulties in implementing or realizing the benefits of cost reduction efforts, such as our ability to sublease or eliminate excess office facilities in a timely and cost effective manner; sales force training and productivity; challenges associated with recruiting, training, and retaining skilled management and other personnel; ability to establish, maintain, and effectively implement relationships with system integrators and other strategic resellers and vendors and to manage large multi-party projects involving system integrators and other parties; rapid technological changes; competitive factors; and unanticipated delays in scheduled product availability. In addition, the significant Tier 1 transactions Portal has closed and is pursuing are larger, multi-year deals, in which revenue may be recognized over multiple periods which may increase long-term predictability and limit near-term visibility and also involve longer sales cycles. These and other factors are described in detail in our Annual Report on Form 10-K for the fiscal year ended January 31, 2003 and our quarterly reports on Form 10-Q. All statements made in this press release are made only as of the date set forth at the beginning of this release. Portal undertakes no obligation to update the information in this release in the event facts or circumstances subsequently change after the date of this press release.

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Pro Forma Statement of Operations
(In thousands, except per share data)

<table>
<thead>
<tr>
<th></th>
<th>Three Months Ended</th>
<th>Year Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>January 30, 2004</td>
<td>January 30, 2004</td>
</tr>
<tr>
<td></td>
<td>(unaudited) (unaudited)</td>
<td>(unaudited) (unaudited)</td>
</tr>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>License fees</td>
<td>$9,679</td>
<td>$11,694</td>
</tr>
<tr>
<td>Services</td>
<td>27,160</td>
<td>19,362</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>36,839</td>
<td>31,056</td>
</tr>
<tr>
<td><strong>Costs and expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of license fees</td>
<td>57</td>
<td>84</td>
</tr>
<tr>
<td>Cost of services</td>
<td>17,738</td>
<td>11,472</td>
</tr>
<tr>
<td>Research and development</td>
<td>7,821</td>
<td>6,680</td>
</tr>
<tr>
<td>Sales and marketing</td>
<td>11,902</td>
<td>10,640</td>
</tr>
<tr>
<td>General and administrative</td>
<td>5,118</td>
<td>2,771</td>
</tr>
<tr>
<td>Amortization of deferred stock compensation</td>
<td>-</td>
<td>23</td>
</tr>
<tr>
<td><strong>Total costs and expenses</strong></td>
<td>42,636</td>
<td>31,670</td>
</tr>
<tr>
<td><strong>Pro forma loss from operations</strong></td>
<td>(5,797)</td>
<td>(614)</td>
</tr>
<tr>
<td>Interest and other income, net</td>
<td>1,193</td>
<td>1,643</td>
</tr>
<tr>
<td><strong>Pro forma income (loss)</strong> before income taxes</td>
<td>(4,604)</td>
<td>1,029</td>
</tr>
<tr>
<td>Provision for income taxes</td>
<td>(1,496)</td>
<td>(493)</td>
</tr>
<tr>
<td><strong>Pro forma net income (loss)</strong></td>
<td>$ (6,100)</td>
<td>$ 536</td>
</tr>
<tr>
<td><strong>Items excluded from pro forma net income (loss)</strong></td>
<td>$ (22,106)</td>
<td>$ (27,137)</td>
</tr>
</tbody>
</table>

Stock option compensation charges: 19,153 (1,977) (14,686) (1,977)
Amortization and impairment of acquired intangibles: (665) (1,152) (2,660) (3,147)
Amortization and impairment of purchased licenses: - - - (1,935)
Restructuring costs: - - - (36,546)
Impairment of assets: - - - (1,470)

<table>
<thead>
<tr>
<th>GAAP net income (loss)</th>
<th>$12,388</th>
<th>$(2,593)</th>
<th>$(39,452)</th>
<th>$(72,212)</th>
</tr>
</thead>
</table>

Pro forma earnings (loss) per share

<table>
<thead>
<tr>
<th>Pro forma net income</th>
<th>$ (0.15)</th>
<th>$0.02</th>
<th>$(0.58)</th>
<th>$(0.77)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Shares used in computing</th>
<th>41,840</th>
<th>35,598</th>
<th>38,163</th>
<th>35,278</th>
</tr>
</thead>
</table>

Diluted pro forma net income (loss) per share

<table>
<thead>
<tr>
<th>Shares used in computing</th>
<th>41,840</th>
<th>37,287</th>
<th>38,163</th>
<th>35,278</th>
</tr>
</thead>
</table>

GAAP earnings (loss) per share

<table>
<thead>
<tr>
<th>Basic net income</th>
<th>$0.30</th>
<th>$(0.07)</th>
<th>$(1.03)</th>
<th>$(2.05)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Shares used in computing</th>
<th>41,840</th>
<th>35,598</th>
<th>38,163</th>
<th>35,278</th>
</tr>
</thead>
</table>

Diluted net income (loss) per share

<table>
<thead>
<tr>
<th>Shares used in computing</th>
<th>44,477</th>
<th>35,598</th>
<th>38,163</th>
<th>35,278</th>
</tr>
</thead>
</table>

Condensed Consolidated Balance Sheets
(In thousands)

|--------|------------------|------------------|

<table>
<thead>
<tr>
<th>Current assets</th>
<th>$85,460</th>
<th>$53,752</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and short-term investments</td>
<td>29,749</td>
<td>22,467</td>
</tr>
<tr>
<td>Deferred contract costs</td>
<td>103</td>
<td>-</td>
</tr>
<tr>
<td>Prepaid expenses and other current assets</td>
<td>3,926</td>
<td>4,026</td>
</tr>
</tbody>
</table>

Total current assets 119,238  80,245
Property and equipment, net 20,848  22,798
Purchased developed technology, net 1,995  4,655
Restricted long-term investments 13,164  13,412
Other assets 2,910  2,624

Total assets $ 158,155 $ 123,734

Liabilities and Stockholders' Equity

Current liabilities
Accounts payable $ 5,390 $ 4,699
Accrued employee benefits 8,829  8,821
Current portion restructuring costs 9,193  13,418
Other accrued liabilities 12,826  8,421
Current portion of capital lease obligations - 11
Deferred revenue 28,152  23,955

Total current liabilities 64,390  59,325

Long-term accrued restructuring costs 18,791  26,903
Long-term notes payable and other liabilities 1,704  1,687

Total liabilities 84,885  87,915

Stockholders' equity
Common stock 42  36
Additional paid-in capital 618,966  541,136
Accumulated other comprehensive income (loss) (647)  294
Notes receivable from stockholders (61)  (69)
Accumulated deficit (545,030)  (505,978)

Total stockholders' equity 73,270  35,819

Total liabilities and stockholders' equity $ 158,155 $ 123,734
Portal Software to Restate Previously Filed Fiscal 2005 Quarterly Results and Provide Update on Business; Investor Conference Call Scheduled for Wednesday, November 30

CUPERTINO, Calif.--(BUSINESS WIRE)--Nov. 28, 2005--Portal Software, Inc. (Pink Sheets: PRSF), the premier provider of billing and Revenue Management solutions for the global communications and media markets, today announced that it will restate its financial results for its first, second and third quarters for fiscal 2005. The company also provided an update regarding its third quarter of fiscal 2006. Portal will hold an investor call on Wednesday, November 30 to discuss today's news.

Restatement and SEC Filing Update

The company reports that significant progress has been made in the year-end audit of Portal's fiscal 2005 financial results. In connection with the work completed to date on the company's fiscal year-end 2005 audit, management has identified adjustments that will be made to previously disclosed financial results. These adjustments will result in the restatement of previously filed results for the first, second and third quarters of fiscal year 2005. The company will also revise the preliminary results reported for its fourth quarter of fiscal year 2005 through the second quarter of fiscal 2006.

The adjustments that give rise to the restatements and adjustments to the previously reported preliminary unaudited financials fall into four categories:

- The accounting for revenue on certain complex multi-element contracts. The largest of the changes results from the company's application of certain paragraphs of SOP 97-2 on one large multi-element contract where Vendor Specific Objective Evidence (VSOE) of fair value for consulting services was not present;
- The accounting for deferred costs on certain long term projects. The company had incorrectly deferred costs on certain large fixed price services contracts;
- The accounting for certain international withholding and payroll taxes. The company had over accrued for certain international withholding taxes and had not accrued properly for international payroll taxes in international countries where the company had small operations. This adjustment relates to a material weakness previously disclosed in the company's press release dated June 30, 2005; and
- The impact of a number of individually insignificant adjustments.

Based on the expected adjustments, revenue for the first through third quarters of fiscal 2005 will be decreased by approximately $100,000 in the aggregate compared with the amounts reported on the company's Form 10Qs for the respective quarters. These adjustments relate to material weaknesses previously disclosed. Individual quarterly revenue is expected to change as follows:

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Increase/(Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1FY2005</td>
<td>($900,000)</td>
</tr>
<tr>
<td>Q2FY2005</td>
<td>$400,000</td>
</tr>
<tr>
<td>Q3FY2005</td>
<td>$400,000</td>
</tr>
<tr>
<td>Q1-Q3 FY2005 Total</td>
<td>($100,000)</td>
</tr>
</tbody>
</table>

Based in part on interpretations of recent relevant accounting pronouncements, the company has revised its application of revenue accounting on certain multiple element contracts which principally impacted the third and fourth quarter of fiscal 2005 and subsequent quarters. Compared with previously disclosed preliminary unaudited financial results, revenue for the fourth quarter of fiscal 2005 is expected to be reduced by $6.2 million. Approximately 90 percent of the $6.2 million revenue adjustment relates to changes in the application of certain paragraphs of SOP 97-2 on one large customer contract where VSOE for consulting services was not present. Adjustments to the previously disclosed preliminary unaudited revenue for the first and second quarters of fiscal 2006 are being calculated and will be reported at a later date. The net reduction in fiscal 2005 revenue as a result of the
aforementioned adjustments are expected to be recognized in future periods.

As a result of these changes, deferred revenue is expected to increase by $6.2 million as the company exited fiscal year 2005.

The net loss for the first through third quarters of fiscal 2005 will be increased by an aggregate of $1.5 million compared with the amounts reported on the company's Form 10Qs for the respective quarters. These adjustments include the impact of the foreign tax withholding and foreign payroll tax accruals of $0.5 million. Also included is the impact of the change in accounting for deferred costs on certain long term contracts. The individual quarterly net loss is expected to change as follows:

\[
\begin{array}{cccc}
\text{Quarter} & \text{Deferred Cost} & \text{International Taxes} & \text{Other Cost of Revenue} & \text{Total} \\
Q1FY2005 & ($1,500,000) & ($800,000) & ($800,000) & ($3,100,000) \\
Q2FY2005 & $2,500,000 & $500,000 & $100,000 & $3,100,000 \\
Q3FY2005 & ($1,400,000) & ($200,000) & $100,000 & ($1,500,000) \\
Q1-Q3 FY2005 Total & ($400,000) & ($500,000) & ($600,000) & ($1,500,000) \\
\end{array}
\]

Compared with previously disclosed preliminary unaudited financial results for the fourth quarter of fiscal 2005, the net loss is expected to be increased by $5.0 million. Adjustments to the previously disclosed preliminary unaudited net loss for the first and second quarters of fiscal 2006 are being calculated and will be reported at a later date.

"Portal is continuing to make significant progress in this complex and ongoing audit and, as a result, the company has decided to restate certain portions of our previously released financial information," said Dave Labuda, Portal's chief executive officer. "Portal remains committed to concluding this process as quickly as possible in order to file our Form 10-K for fiscal 2005."

Third Quarter Fiscal 2006 Bookings and Cash Results

- Third quarter 2006 bookings were $20.8 million compared to bookings of $32.3 million for the same period last year and $29 million for the second quarter of fiscal 2006.
- Cash and investments at October 28, 2005 were $44.6 million (including restricted cash of $13.2 million). Total cash usage during the third quarter of fiscal 2006 was $9.7 million compared to $12.4 million for the third quarter of fiscal 2005.

Material Weaknesses in Internal Controls

As previously disclosed in Portal's Form 10-Q for the quarter ended October 29, 2004 and in its press releases dated June 30, 2005 and August 31, 2005, at the end of the company's fiscal year ended January 28, 2005 and as of the date of this press release, Portal has identified multiple material weaknesses in its internal controls over financial reporting (the company's "internal controls").

Portal has performed a significant portion of its internal control assessment process and has conducted incremental procedures where necessary to verify the accuracy of its financials. The company expects that its external auditors will not provide an opinion on the effectiveness of the company's internal controls or on management's opinion regarding the internal controls, as required by Section 404 of the Sarbanes-Oxley Act of 2002 as part of the filing of its Form 10-K due to the fact that the company does not anticipate being able to complete its assessment prior to filing its Form 10-K. Rather, the company is focused on completing the year-end audit, filing its Form 10K, and remediating material weaknesses.

Investors should refer to the company's Form 10-Q for the fiscal quarter ended October 29, 2004, which was filed with the Securities and Exchange Commission on April 25, 2005, its previous 8-K filings, and to its press releases dated June 30, 2005 and August 31, 2005, for further detail as to the nature of these material weaknesses and control deficiencies.
As disclosed previously, as a result of the extended financial close process as well as the assessment of its internal controls as required by Section 404 of the Sarbanes-Oxley Act of 2002, Portal is currently delinquent in filing its Form 10-K for the fiscal year ended January 28, 2005 and in filing its Forms 10-Q for the fiscal quarters ended April 29, 2005 and July 29, 2005. Although the company and its auditors continue to work diligently through the audit, no final date has been provided at this time for the completion and filing of the Form 10-K, nor the filing of Forms 10-Q for the first three quarters of fiscal year 2006.

Investor Call Information

Portal will hold an investor call at 4:30pm EST on Wednesday, November 30. To access the Portal investor call, please dial one of the following numbers at 4:20 p.m. Eastern (1:20 p.m. Pacific): 1-800-706-3415 (inside the U.S.) or +1-706-634-1314 (outside of the U.S.). The conference ID is 2943691. The teleconference can also be accessed via the web by visiting Portal’s investor relations website at http://investor.portal.com.

Additionally, an archive of the call will be available for seven days, commencing two hours following the live call on November 30, 2005, at Portal’s investor relations web site at http://investor.portal.com. A tele-replay of the call will also be available for one year by dialing 1-800-642-1687 (inside the U.S.) or 1-706-645-9291 (outside the U.S.). The pass code for the tele-replay is 2943691.

About Portal Software, Inc.

Portal Software is the premier provider of billing and Revenue Management solutions for the global communications and media markets. The company delivers the only platform for the end-to-end management of customer revenue across offerings, channels, and geographies. Portal’s solutions enable companies to dramatically accelerate the launch of innovative, profit-rich services while significantly reducing the costs associated with legacy billing systems. Portal is the Revenue Management partner of choice to the world’s leading service providers including: Vodafone, AOL Time Warner, Deutsche Telekom, TELUS, NTT, China Telecom, Reuters, Telstra, China Mobile, Telenor Mobil, and France Telecom.

Forward Looking Statements

Statements in this release concerning Portal Software, Inc.’s bookings and cash are preliminary, unaudited financial information for the third quarter fiscal year 2006. These statements, as well as statements regarding the adjustments management expects to make in previously filed SEC reports for the first three quarters of fiscal year 2005, and to the preliminary financial results for the fourth quarter of fiscal 2005 and the first two quarters of fiscal year 2006, as well as statements regarding the completion of the audit of our fiscal year 2005 financial statements and completion of Sarbanes Oxley Section 404 requirements, as well as the remediation of our material weaknesses, are forward looking statements that involve a number of uncertainties and risks. Factors that could cause actual events or results to differ materially include the following:

Portal’s auditors have not completed their audit of our fiscal 2005 results, nor commenced their review of the first three quarters of fiscal 2006 results disclosed here and in previous releases. Consequently, our Audit Committee has not had an opportunity to complete its review of the preliminary financial results contained herein. During the course of completing these respective reviews and audit, we may determine we need to further revise materially the preliminary results reported herein, further adjust results reported for the first three quarters of fiscal year 2005 or further restate the results reported for previous periods. The material weaknesses in our internal controls significantly increase the risk that the preliminary financial results reported herein, including results reported as specific numbers or within ranges, as well as our previously issued financial results, may need to change. For instance, we may discover errors in determining these results or additional information that has a material impact upon them. In addition, customers are engaging in greater due diligence before making commitments and, as a result, some orders have been delayed and we may not reach our expected level of sales required to become operating cash flow positive in the fourth quarter of fiscal 2006.

Significant consequences could result from one or more of these general or specific events occurring, particularly if they result in a material impact to our financial results. We would likely be further delayed in filing our Form 10-K for fiscal year 2005 and our Forms 10-Q for the first three quarters of fiscal year 2006. In addition, we may incur additional costs, experience delays or the loss of new and existing business, as well as management distraction, private litigation, regulatory inquiries or enforcement action, and employee attrition. These consequences, if they materialize, would have a material adverse impact on our business and operations.
Other factors which could cause actual results to differ from those discussed in this press release are described in detail in our Annual Report on Form 10-K for the fiscal year ended January 30, 2004, our subsequent quarterly reports on Form 10-Q, and our current reports filed on Form 8-K. All statements made in this press release are made only as of the date set forth at the beginning of this release. Portal undertakes no obligation to update the information in this release in the event facts or circumstances subsequently change after the date of this press release.

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SOURCE: Portal Software, Inc.
Exhibit O
Event Transcript

PRSF - Portal Software Lowers Third Quarter Revenue and Earnings Estimates

Event Date/Time: Nov. 13. 2003 / 6:00PM ET
Event Duration: 22 min

OVERVIEW

PRSF expects revenue to be below prior guidance of $33m. Now expect to report $25-26m revenues. More complete analysis in upcoming call. Experienced delayed recognition of revenues, and some execution problems with projects requiring additional resources. Q&A focus: timing issues, accounting changes.
Before we move on, I would like to remind you that several of the statements we will make during today's call, including statements regarding expected financial results for the quarter ended October 31, 2003 and other statements about future financial and operating results, including revenues and expenses, profitability and business prospects, industry and general economic trends, results of relationships with customers and partners and product and operating plans, are all forward-looking statements. Actual results of these matters could, of course, differ materially for a variety of reasons, including those described in the press release made earlier today and in our most recently filed Form 10-K. Portal undertakes no obligation to update the information in this conference call in the event facts or circumstances subsequently change.

Several pro forma or non-GAAP financial measures will be mentioned on this call. Information relating to the corresponding GAAP measures and a reconciliation of the pro forma and GAAP items can be found on our press release in the investor relations website at www.portal.com.

I would also like to remind you that we will be announcing our third quarter results next Thursday, November 20th. We will be holding a conference call and webcast that afternoon. Details for participation in that call, which we encourage you to attend, can be found on our investor relations section of our website.

I will now turn the call over to John Little.
to be recognized until the entire project has been completed; delayed closing and recognition of additional license sales to existing customers; delayed acceptance of services already performed and delivered; and delayed negotiation of service engagements with customers (technical difficulty). We're confident that most of the missing revenue will be recognized in future periods.

The second factor, services execution, was smaller but still significant. We had to allocate additional resources to a few projects last quarter and this allocation not only delayed revenue, but also contributed to a lower gross margin, which we expect to be around 50 percent.

There were a few other issues around execution which were smaller, but the vast majority of the revenue shortfall can be explained by these two reasons. Obviously, a miss of this magnitude is not a trivial event. We're very concerned about the results and take them very seriously.

Before we move to Q&A, I would like to make three points. First, our business is increasing in complexity as we migrate towards providing more comprehensive solutions. This complexity shows up in many places, including the scope of our services engagements and the rules for revenue recognition. Second, we did have execution issues. We are not trying to minimize the importance of what happened. We're all very disappointed in our results and we're already taking steps to address the issues we have identified. We have an intense effort underway to track down the root causes and deal with them effectively. And third, we believe that our core business remains strong. We have some growing pains, but our customers continue to buy from us and to maintain a close working relationship. We remain confident in our long-term strategy, but, again, we have to address the short-term issues that we previously identified.

I'm aware that many of you have questions, including some which we will be unable to answer in the call today. We will tell you what we know today and provide much more detailed in our earnings call on November 20th. I apologize in advance if our answers seem brief or incomplete, but we are not yet done with our detailed analysis and we want to be as accurate as possible with our answers.

Operator, we would like to open the call for questions.

PRSF - Portal Software Lower Third Quarter Revenue and Earnings Estimates

Operator

(OPERATOR INSTRUCTIONS) Mike Latimore, Raymond James.

Mike Latimore - Raymond James - Analyst

Good afternoon. On the deferrals, you have had a couple of quarters now where (inaudible) some of these (technical difficulty) and have had experience (technical difficulty) recognition around him. What was new this quarter that (technical difficulty)

John Little - Portal Software - CEO

Let me take an initial cut. The call was cutting in and out, so I think I got the question. If we didn't get it quite right please come back.

I think two things have changed. And both of these were subtle, but both of them tended to hit. The first is we continue to do these big deals and understand more and more how those deals are working in the context of the customer. And so there's a more detailed understanding of the way transactions are come conducted, the way they need to be analyzed.

The second thing is that the interpretations of the best way to do these in terms of our outside auditors is continuing to change in approach. And in fact, revenue recognition rules change suddenly over time and that is also affecting the specific ways we're recognizing the deals.

So I think those are the two primary external things that are happening. As you know, the business we have is growing in complexity, and I think that I would chalk these both up to things that we're definitely learning from our mistakes from this (indiscernible) to correct the problem.

Howard, did you have anything to add?

Howard Bain - Portal Software - CFO

I think in Portal what we're going to see in a lot of cases here, while we have not closed the books finally, what we are going to see is some increases in deferred revenues as a result. And I think as we get a lot of these contracts and the service agreements nailed down, what we find is that there are sometimes repercussions in what our forecasted revenue recognition was as a result of the detailed service agreement that come in later.
after the initial agreement signing with the customer. So clearly we have some issues to address here in terms of how we forecast these things.

And also, I think as you know, I think most of you know, is that revenue recognition rules are an evolving thing. What might have been fine six months ago, you find in the current context all of a sudden presents you with a different kind of an issue. In the old days of accounting, if you will, there was a publication and notice period for changes in rules. The environment today is very much one where the public accounting firms are engaged with the SEC on a day-to-day basis in reviews with filings that are being done and so on. So the rules now are evolving almost on a daily basis. And given that we want to ensure that we're conservative and we don't recognize revenue that we might have to correct in the future period, our bias is to defer them when we see rules that might have an impact like that. So we do take a pretty conservative approach that also contributes to this.

Mike Latimore - Raymond James - Analyst

Lastly, what kind of change should we kind of expect in deferred this quarter?

Howard Bain - Portal Software - CFO

We will talk about that next week.

Mike Latimore - Raymond James - Analyst

Thanks.

Mike Latimore - Raymond James - Analyst

Do you expect to cut back on any expenses at this point?

Howard Bain - Portal Software - CFO

We always, I think as you know, we continue to manage looking for higher efficiencies in the business at all times. But we do not anticipate here that there's any change that would indicate that we would have to do any kind for structuring or anything like that.

Howard Bain - Portal Software - CFO

The majority was due to timing, but we will talk about this in more detail next week.

Marianne Wolf - Susquehanna - Analyst

In acceptance by existing customers or timing of closing new transactions?

Howard Bain - Portal Software - CFO

Largely existing customers.

Marianne Wolf - Susquehanna - Analyst

I guess that really gets to the heart of my question. You have been doing a.... of business with sort of a concentrated group of larger customers; I was wondering if you could discuss with us any issues regarding customer satisfaction or customers' overall budgets for these projects that may have changed that would
make us look at the overall potential from these large contracts as different than what we once thought?

Howard Bain - Portal Software - CFO
There have been no such changes whatsoever. We're still wonderfully engaged with these customers. These are more details that reflect how the revenue rolls in. So we're not seeing any signs of that kind of behavior whatsoever. Our basic business and engaging with our customers and their satisfaction has not changed one iota.

In terms of the detailed breakdown that you're looking for, I will be able to provide you with more of that next week.

Marianne Wolf - Susquehanna - Analyst
Just to make sure again, I'm sure you had a certain number of people on-site at Vodafone in particular. Can you tell me whether that number has been growing or whether that number has been cut back recently?

Howard Bain - Portal Software - CFO
There have been no cutbacks of any kind.

Marianne Wolf - Susquehanna - Analyst
And lastly, given the guidance of 25 to 26 million in revenues, can you give me the license mix in that figure?

Howard Bain - Portal Software - CFO
I really do need to defer to next week. There was an increase in OpEx, but we haven't finished closing the books and scrubbing at yet. But it wasn't particularly large. At you know, with the reverse split relatively small changes in dollar amounts now affect pennies per share, if you will. So the weighted average number of shares that was used is about 39 million. I don't know what number you might be using.

Marianne Wolf - Susquehanna - Analyst
I was using 39 million. It looks like OpEx must have grown more than I thought. Thanks.

Operator

Michael Turits - Prudential Equity Group - Analyst
Are these issues at project, at two or three projects, at many projects? And if possible can you tell us which projects?

John Little - Portal Software - CEO
There were issues of varying size at different projects. Due to a number of reasons, including customer confidentiality. I can't tell you which projects. But they were, for example, not concentrated at one account; they were not spread over every single one of our customers either.

Michael Turits - Prudential Equity Group - Analyst
So is it three or four large deals, or what are we talking about here?

John Little - Portal Software - CEO
This is a dozen situations that led to this miss and that dozen is not at any one customer.

Michael Turits - Prudential Equity Group - Analyst
A dozen situations at how many different customers -- two, three? Give us some idea of what we're talking about here.
John Little - Portal Software - CEO

Probably a dozen because essentially, as we talked about, this is an execution issue that we're really trying to dig into and understand at a great depth. But this is not anything that is resulting in any concern about the state of our market, our customer relationships, or that type of thing. But you get execution levels in those many different places, part of the execution, quite frankly, is my ability to forecast some elements like around this revenue recognition. So there are issues here that we have and address to get resolved that we're treating very seriously. But I would reiterate, this does not indicate in any way any weakening of our base business, or that our strategy is incorrect, or that our customer relationships and their spending plans have changed any whatsoever.

Michael Turits - Prudential Equity Group - Analyst

I'm sorry to do this, but John you just went through your remarks pretty quickly. Maybe the other guys got it, but I just didn't. Can you go through those issues a little bit more carefully -- or Howard -- on what the timing issues were and services issues, just detail them as best you can for us a little bit more slowly?

John Little - Portal Software - CEO

I gave four examples of timing issues, and we're going to get into these in more detail at the earnings call next week. But the four that I mentioned were delayed revenue of licenses on already existing contracts where we find out, for example, that under current rules we would not be able to recognize the revenue until the entire project is delivered in some future quarter. The second was --

Michael Turits - Prudential Equity Group - Analyst

You could recognize it until the project was done?

Unidentified Speaker

Right. You could recognize services on an ongoing basis, but a license revenue may not be recognizable until the entire project is delivered and accepted.

Unidentified Speaker

Why is that? Aren't these supposed to be product you're doing on a percentage completion basis? That is how I understood how you were doing these projects.

Unidentified Speaker

The revenue recognition rules are increasingly complex on this.

Michael Turits - Prudential Equity Group - Analyst

Simple thing -- my understanding, the way you guys have been talking about these projects were that you're doing them on a percentage completion basis. Has that changed?

Unidentified Speaker

No.

Michael Turits - Prudential Equity Group - Analyst

So you're still doing it on a percentage completion basis but you are telling us that you can't recognize until the projects are done?

Unidentified Speaker

With percentage of completion based on milestones, so that's important you understand that; it's not based on cost input, but milestones. If milestones are accepted by customers there's no revenue recognition.

Michael Turits - Prudential Equity Group - Analyst

So were the milestones not accepted?

Unidentified Speaker

But that also does not apply to the license revenue recognition component. They're treated independently.

Michael Turits - Prudential Equity Group - Analyst

So now you're saying that the license couldn't get recognized on percentage of completion deals until the entire deal is done or on milestones. Which is it?
Unidentified Speaker
Different projects are done in different ways.

Michael Turits - Prudential Equity Group - Analyst
So in some cases it was milestones; some until the projects were done?

Unidentified Speaker
That's correct. Unfortunately it is very complex. But we are having those kinds situations — each of those kinds of situations.

Michael Turits - Prudential Equity Group - Analyst
What was the second timing issue?

Unidentified Speaker
The second timing issue we talked about delayed closings the recognition of additional license sales to existing customers for expansion of their projects or things of that sort.

Michael Turits - Prudential Equity Group - Analyst
Why was there an issue there?

Unidentified Speaker
Because we had forecast the deal would be closed in the quarter and it was not closed.

Michael Turits - Prudential Equity Group - Analyst
So this is not accounting issue; this is just pushing out of closings.

Unidentified Speaker
Correct.

Unidentified Speaker
These are timing issues.

Michael Turits - Prudential Equity Group - Analyst
But this is a business issue that got pushed into the next quarter. The deal got pushed out.

Unidentified Speaker
But the situation I brought up here is that these are existing customers with whom we have a successful relationship and who need to expand their business; it's just the timing of when it's going to happen was different than we forecasted.

Michael Turits - Prudential Equity Group - Analyst
And when do you expect those to now get closed?

Unidentified Speaker
For the most part — let's talk about that more next week. We might actually have some of them closed by then. So let's wait till then.

Michael Turits - Prudential Equity Group - Analyst
And the third timing issue?

Unidentified Speaker
The third timing issue was the acceptance of services performed and delivered. We did not get — we talked about this. We need a specific acceptance document from our customers around services delivery and those did not show up within the quarter.

Michael Turits - Prudential Equity Group - Analyst
And why didn't they show up?

Unidentified Speaker
A variety of reasons and the specific details of those we will have to defer to next week.
Operator

Sam Doctor, JP Morgan.

Sam Doctor - JP Morgan - Analyst

I had a couple of questions for you. How much would deferred revenue be up this quarter? Do you have any kind of an estimation?

Unidentified Speaker

We will provide you that information next week.

Sam Doctor - JP Morgan - Analyst

Is there any idea what was (indiscernible) shortfall of the recognition in the next quarter? Just and an approximation would we be looking at something like half of that? Or what are we looking at here?

Unidentified Speaker

I don't understand question.

Sam Doctor - JP Morgan - Analyst

Of the deferred revenue, what percentage is likely to fall into the next quarter and what percentage would be deferred more indefinitely than that?

Unidentified Speaker

I think we can discuss that next week in more detail.

Sam Doctor - JP Morgan - Analyst

Any idea how much cash burn you are expecting for the quarter?

Unidentified Speaker

Once again, let's defer that to next week.

Sam Doctor - JP Morgan - Analyst

Thank you.
PRSF - Portal Software Lowers Third Quarter Revenue and Earnings Estimates

Operator
Duke True (ph), Wachovia Securities.

Duke True - Wachovia Securities - Analyst
I'm just wondering if you can tell me when you return to profitability.

Unidentified Speaker
Once again, we will talk next week about our outlook for the future and any other guidance adjustments that we might make.

Unidentified Speaker
I think we have time for one more question.

Operator
Peter Jacobson (ph), Hoffman Brothers.

Peter Jacobson - Hoffman Brothers - Analyst
My questions were already addressed. Thank you.

Operator
This will conclude the question and answer session. I will now turn the call back over to Mr. Little for closing comments.

John Little - Portal Software - CEO
Let me conclude by saying that we're very focused on understanding the things that we need to improve, building the plans to make it happen and most important mobilizing the entire company. We mentioned we're in a transformation becoming a total solutions company. They're not easy; they take time. With focused execution we will make this transformation to becoming a total solutions provider.

Again, let me apologize for the lack of detail around certain questions. Please tune in next Thursday, November 20th and we will give you much more detail, not only into what happened this quarter, but the plans and steps we're taking in future quarters to address the issues. Thanks for calling.
Exhibit P
OVERVIEW

PRSF missed its 3Q04 revenue guidance with results that the company described as 'a major disappointment.' PRSF reported a 3Q04 pro forma net loss of $11.3m on revenues of $25.3m. 3Q04 GAAP net loss was $15m. Q&A Focus: Guidance, 3Q04 shortfall, & 4Q04 visibility.
Before we move on, I would like to remind you that several of
the statements we will make during today's call, including
statements regarding expected financial results for the quarter
ending January 30, 2004, and other statements about future
financial and operating results— including revenues and
expenses, profitability and business prospects, industry and
general economic trends, results of relationships with customers
and partners, and product and operating plans— are
forward-looking statements. Actual results of these matters could,
of course, differ materially for a variety of reasons, including
those described in the press release made earlier today and in
our most recently filed Form 10-Q. Portal undertakes no
obligation to update the information on this conference call in the
event facts or circumstances subsequently change. Several
pro forma non-GAAP financial measures will be mentioned on
this call. Information relating to the corresponding GAAP
measures and a reconciliation of the pro forma and GAAP items
can be found in our press release and the investor relations site
at www.com. So with that, I will turn the call over to John.

John Little - Portal Software - CEO

Thank you Howard, and thanks for joining us today on our
earnings call. My comments will be divided into three parts—
first I will discuss Q3, what happened and what we are doing
about it; second, I will discuss the dynamics of our business, as
this pretty much relates to what happened in Q3. We are in the
midst of a transformation at Portal, and I want to make sure that
you understand our business and the various implications; and
finally, I will describe our more positive accomplishments for
the quarter and how they give credence to our position in the
market and our long-term strategy; Howard will continue with
a more in-depth look at the financials, and we'll wrap up the
Q&A.

Turning to the quarter, obviously our financial results were a
major disappointment. I am sure you are anxious to learn what
happened, here's what we'll do — we will present the key
numbers for the quarter; show you that we understand what
really happened and why; describe the root causes of the
(indiscernible) and describe our processes that are in
place, as well as how we've accelerated our actions to address them.

Now for the results. Revenue for the quarter was $25.3 million,
down from $33.2 million in the previous quarter. License revenue
for the quarter was $5.7 million. Services revenue for the quarter
was 19.6 million. Our net loss for the quarter was 11.3 million
on a pro forma basis. We had about 104 million in cash and
investments at the end of the quarter. Pro forma earnings came
at a loss of 29 cents per diluted share. What happened? The basic fact — our actual revenue did not achieve our forecast for the quarter. We guided to flat revenues of 33.2; we came in roughly $8 million below that. There are two primary causes for this discrepancy — timing and services execution.

Starting with timing, here is a breakdown of the deals. Approximately 20 percent of the shortfall was related to two deals that did not get signed before the end of the quarter. Both were dependent either on an independent SI (ph) commitment or the timing of project completion by an SI. One is a follow-on deal with an existing customer and one is a transaction with a new customer. Both deals are still in our forecast for future periods and being actively pursued, and we believe the odds of closing both deals are quite high. About 70 percent is related to deferred revenue from six deals now in the Company’s backlog. All of these are related to contracts signed with customers where the revenue will be recognized in future quarters. There were a variety of reasons for the deferral, mostly related to the combination of services with our licenses; but again, these are all deals with signed contracts or commitments from our customers. Approximately 10 percent represents two service contracts where our milestones were not met in the third quarter but are expected to be completed in the fourth quarter, about 60 to 90 days behind schedule. The Company expects to account for this revenue over subsequent quarters.

As we previously discussed, customers remain very deliberate in their purchasing decisions, which, naturally, has an effect on timing. The other primary factor was services execution. As I just mentioned, about 10 percent of this discrepancy was due to services engagements where we did not get customer acceptance of deliverables by the end of the quarter. Our revrec policy is not to recognize the services revenue unless the customer has explicitly accepted the milestones. Again, we expect to recognize most of this in Q4. The problems related to only two projects, both of which were delayed around 90 days.

And we also could have done a better job in selling services engagements. Our services revenue was down sequentially; it should have been up. Part of this was due to our repredemption of (indiscernible) people to address the 2 customer issues I just mentioned; part of this was due to milestone timing at one large engagement; and the balance was, quite frankly, due to failure to add to our near-term services pipeline. Even a moderate growth in services revenue would have greatly improved our overall results.

What does this mean for Portal? Let me share a few statistics that may help you with your analysis. 95 percent of the shortfall relates to the existing customers in the transformational challenge of moving from a product company to a solutions company. Timing and execution issues with existing customers are much easier to fix than lost deals, and we are already working on the execution issues. 70 percent of the revenue is future revenue for deals that have already been signed. The revenue did not go away, it just moved into our backlog. There may be uncertainty about the timing of when the revenue will be recognized, but we have a great deal of confidence that it will eventually drop through to the bottom line.

I also want to point out what did not happen. We did not miss our forecast due to problems with our core strategy or product platform solution. As you will see, we continued to generate positive results that confirm our direction is sound. I will review some of those positive developments in the third quarter later. And we did not miss our forecast because our customers were decreasing their commitments or moving to other solutions. In many ways, their commitments to us are growing stronger, not weaker, particularly given our ability to deliver engineered solutions out of our new solution center. I will talk about that later. We did not miss our forecast due to losses to a competitor. We continue to win targeted new business and expand our footprint with existing customers. And we did not miss our forecast due to deteriorations in market conditions. The market is still watching its spending quite closely, and telecom billing evaluations clearly involve a lengthy selecting cycle, but we are seeing increased willingness to spend money with Portal.

As you know, Portal is in the process of evolving our business from selling product platform to providing more comprehensive solutions to our customers. I plan to discuss the business dynamics later, but the forecast miss, while unfortunate, is consistent with the (indiscernible) of the transformation providing total solutions to the global market leaders. The pipeline has remained steady, although we are seeing some geographic shifts.

Now that we have answered the question what happened, let’s turn to the question what are we doing about it. Any successful program will be a combination of many efforts both large and small, so I will limit my discussion to the major points. I will divide our efforts into three areas — forecasting, selling and solution delivery, and will address the immediate steps we are taking. In the next section, I will describe the longer-term changes we are making to our business.
First, it is very clear that we need to be better at forecasting. We developed a robust forecasting system for the historical license part of our business; we are in the process of expanding it to more accurately reflect the total solution that we sell. Here are a few key specifics. Our bookings forecast now includes a more detailed look at the major revenue components of our solution, including license consulting, and we are in the process of incorporating forecasting from our solution center and improving maintenance forecasting. We are in the process of applying a modified version of our 8 step sales process to the sale of services, as well as globally implementing this process. And we’ve enlarged our weekly forecast reviews to include all major booking items, including services. The entire management team is (indiscernible) with this – charged with tracking this every week, and in accordance with this, we have continually improved our weekly management reporting.

Second, we had some issues around the selling of our solutions, particularly the services in engineered components from our solution center. We’ve also taken prompt action here. We’ve already completed a global sales training program of solution selling, as well as a global sales process compliance review. We also conducted global training of our entire sales organization to launch the back end service delivery capabilities of our solution center, including an improved process for scoping and quoting complex projects. We’ve already implemented Q4 incentives to focus attention on the services business and accelerate the focus on selling total solutions, and we are in the process of setting the compensation plans for next fiscal year.

Third, we are improving our ability to deliver projects to meet customer required schedules. Three quarters ago, we created the India development center to produce engineered solutions. We continued to increase this capability, and we have now delivered total solutions based on work from the (indiscernible) facility. We have over 200 people in India and the first customer projects are being completed. This also provides us with engineering predictability and process in delivering to customer SI expectations.

We are strengthening the project accounting reporting systems for both field and corporate management. We have weekly reports of key project metrics and milestones that are managed in our geographic regions as well, and monthly financial reviews. We’ve created a process to build joint program management teams with several of our large strategic customers. Two of our customers are already participating in this and we plan to roll this out to others in the future. This helps us ensure that we are close to customer requirements and can currently provide close coordination of deliverables for our Indian solutions center.

To summarize, despite the missed revenues, we are managing the transformation. Again, successful execution requires a number of steps and we are taking prompt, effective action to implement the most important. We understand the problem and know what to do, but I don’t want to minimize the complexity and challenges associated with our transformation.

In this next section, I would like to take a higher level view of the business so that you can put some of my previous comments in the context of our long-term model. We’ve covered these points before in different ways in different calls; this time I will take the perspective of a typical customer project. I will do this by looking at the four phases of our relationship with the customer – selling, ramp up, implementation and partnership. For each, I will describe a typical situation, the implications for our business and our long-term plans for each. The goal is to give you a high-level understanding of our solutions business and how this business can affect our results.

The first phase of the relationship is sales. We are selling an increasingly broad collection of software licenses, extended consulting engagements and engineered product enhancements, in most cases along with significant contributions from our partners. The sum of these equate to the end-user solution. We are frequently part of a complex multi-party engagement where contracts and the timing of which is not under our control. A typical example is a large end to end project with a global SI like IBM or Accenture. This is the way our customers wish to do business. There are several implications. The predictability of our sales process in closing is less than when we (indiscernible) the complete engagement, which means that the upfront revenue, particularly license, is more difficult to forecast. The transaction and resulting terms are much more complicated and there are many parts which are not under our control. This also makes the timing of revenue less certain, and we are more dependent on third parties than before. But, the tier one dealers are significantly larger, increasing backlog. The revenue may not be recognizable for quite some time, but we generally have a good-sized backlog from each major deal. We’re managing this by developing additional expertise in our solutions selling teams through training, selecting hiring and organizational changes, by building a better understanding of the total solution so they can more quickly and effectively present it to the customer, and we are increasingly controlling a larger portion of the end solution through our solution center. This is working, our continued stream of major wins with tier one operators like Vodafone and Telecom Italia Mobile (ph) show that we can
The next major phase is the ramp up. This is the period of time between the signing of the contract and full-scale implementation. Many things happen during this phase — selection of the customer by the customer of one or more system integrators; evaluation and selection of other software components like CRM, provisioning, mediation and such; detailed scoping of the overall solution of vital budgeting, including approvals; and development of an architecture and project plan that divides the work between Portal, the customer and the integrators. This is a relatively recent phenomenon for Portal. It has some significant implications. The time between signing the initial contract and significant revenue being recognized can be long and unpredictable. The ramp time is not fully under our control, and in some cases, completely dependent on the actions of third parties such as system integrators. And the delay between contract signing and significant revenue, both license and services, can be long and unpredictable. We are working to manage this better by getting more involved in the discussions with other parties. This gives us better visibility and somewhat more control over the situation. We are also developing a more elaborate process for managing the ramp time and driving towards conclusion, even though we're still heavily dependent on the prime SIs. We are building a better understanding of how long the ramp can be and how it affects our forecasting, and we are leveraging our specialized capability to deliver product extensions as a subcontractor to the SI customer to put more of the project under our control. This part is also working. Later in our call, I will tell you about several major projects including (indiscernible) that have gone (indiscernible). So we clearly understand how to move through the ramp phase.

The third phase is implementation — the time between the start of a major implementation activity and the day the system goes live. We are playing a much greater role in this stage of projects than ever before. We can provide a broader range of services, we apply more engineering resources to the projects, and our scope commonly increases over the life of the implementation, given our product platform expertise. This phase creates a number of implications, as well. We generally do a lot more work and generate a lot more revenue during this phase. Scope changes and increased capability on our part can increase the total size of the implementation revenue, sometimes significantly, and both license and services revenue during the implementation can be lumpy and dependent on third parties. We are working hard to improve our management at this phase. Since we are getting more involved in the project management phase, we are trying to divide the projects into management segments with quarterly durations, thereby improving the predictability of our revenue recognition. We are also leveraging our unique ability to build out engineered solutions at our Indian center, and we are improving our relationship and sales capabilities during the implementation phase so we can more effectively identify and close follow-on deals, both license and service. The implementation phase is where we have made perhaps the most significant changes to our business, and we can clearly show that we are getting a much better understanding of how to do it.

The final phase of our relationship I call partnership. This is the phase that starts when the customer goes live and continues indefinitely. This phase has some very interesting implications. We will maintain a backlog for each customer for new services, subscriber growth and expansion of our role. If we do a good job of maintaining the relationship (inaudible) selling, we will have a continuous flow of revenue from our customers and customer satisfaction — an area where we score very highly — can be a great predictor of future revenue potential. I think this is one of the most interesting areas to manage long-term. Things we are doing include focusing our account teams on the concept of continuous relationship and revenue, and in particular, building a win-win strategic relationship with our customers. We are orienting our new product development to maintain a continuous flow of new capabilities that can be sold to the customer, as well as augmenting this with our solution center. And we're building an increasingly broad range of expert-oriented services that are of value to our customers. Finally, we can show some significant progress here. France Telecom is a great example. From our initial ISP win in the mid-90s, we've expanded to many parts of their business, including the (indiscernible) go live we were mentioning today. We can do this better and generate more business, but we have shown a very good ability to evolve the business over time and create these partnerships with our customers.

Obviously, the total business is more than a sum of each customer relationship. Looking at the business does, however, provide a great deal of insight into the dynamics and how you can understand the connections between our overall strategy, the activity of each customer and the quarterly results. We are by no means finished or even satisfied with our current situation, but we have shown we have a solid strategy and an increasing ability to implement it.
Now turning to the quarter. While disappointing from a revenue standpoint, it was actually a quarter with a number of good operational and strategic accomplishments. Here are some highlights, divided into three areas. First, we continue our progress with tier one operators. We signed yet another deal with a tier one operator in the quarter, Vodafone Pacific. We are doing a complete replacement of their voice, data and content systems, a transaction which is further validation of our ability to meet the needs of the world's most demanding wireless operators. We went operational for voice rating, a significant project milestone in a major European wireless operator. We went live with Orange (ph) UK, we had many phased solutions going live in places like (indiscernible), Columbia, Mobile and various Vodafone operating companies.

Second, we continued our penetration of the emerging markets. Last quarter, we spoke of the growing opportunity in digital entertainment and content; this quarter, we announced deals with Universal Vivendi Games, where we support their Massively Multiplayer Gains, and Sony Pictures Digital Networks, where we manage the revenue for their premium digital entertainment products. We won 2 cable deals, one in Asia and one in Latin America. We closed a substantial (indiscernible) deal with XM Satellite Radio, and we went live at telematics with Atiix (ph), the service provider for BMW Mercedes.

And third, we achieved significant milestones in our delivery of total solutions. We delivered an interconnect billing solution to Bayan Tel using a solution we built using our standard product and contributions from (indiscernible) Engineering, deal consulting, and most interestingly, our Indian development center. (indiscernible) also played a significant role in the delivery of the solution to our Latin American cable operator. Both expand our vertical solution presence with offerings that can be generally marketed.

Judging from our progress towards achieving strategic goals and meeting the needs of the market, this was actually a good quarter for Portal, in a small way compensating for the disappointing revenue. Now I would like to turn the call over to Howard for a detailed review of the third quarter financial results.

Howard Bain - Portal Software - CFO

Thank you John. I am next going to read an obligatory paragraph, so if you want to take your 7th inning stretch, now is the time to do it. Today's discussion of Portal's third quarter financial results is based on the financial information in the press release issued earlier today and on the financial statements available in the Investor Relations section of our website at Portal.com. Additional metrics and other Company information are also posted on our website at Portal.com. Much of those metrics I am not going to review during this call because I am going to be focusing on the results for the quarter, so I do encourage you to look there as I go through the rest.

As John mentioned, revenue for the quarter came in at 25.3 million, down from the 33.2 million seen last quarter. License revenues were 5.7 million and service revenues were 19.6 million. Both were lower compared to the prior quarter. This was about an $8 million shortfall from our guidance last quarter, and largely due to forecast timing differences not being offset by service revenues achieving the growth called for by our strategy. Our strategy requires us to demonstrate increasing skills in both selling and delivering solutions. This also entails effective management of more complex relationships, where other parties beyond the customer are key decision-makers, most specifically systems integrators. While the customer controls when the system integrator is chosen, often 2 to 3 quarters after our selection, the SI controls the ramp upon which the product — project is managed, and influences when service milestones with attached license payments are met — all of which add volatility to Portal's revenue performance.

In addition, our business transition to becoming a solutions provider entails growing services commitments as part of license sales, which is increasing the portion of contract accounting-based revenue recognition, in contrast to historic upfront product-based license revenue recognition. During the quarter, we saw delays in revenue as a result of these factors, which drove virtually all of the timing differences I will now describe. The approximately $8 million forecast shortfall breaks into three categories of revenue, the bulk of which we expect to see in future periods.

The first, approximately $2 million of the shortfall, is attributable to transactions with two customers that did not close during the quarter as anticipated, and are now expected to close during the fourth quarter. In each of these cases, one with an existing customer, an SI is involved in finalizing the contract terms and conditions. The second timing issue, approximately $5 million, is all supported by signed license agreements, a majority of which were received during the last two weeks of the quarter. This is the proverbial hockey stick that we see in enterprise software companies. These contracts represent revenue which will be recognized over periods longer than originally anticipated, as the negotiated terms of the final contracts signed with the customers differed from initial forecast expectations, largely due
to the license being tied to some kind of service or future deliverable.

The remaining $1 million was due to the delay of completion of services milestones for two customers which are now expected to be completed in Q4. In both cases, the delays are expected to be no more than 60 to 90 days later than original commitments, with final resolution around the end of November. Of this $8 million, we expect to see about 40 percent in Q4, about 30 percent in Q3, with the remainder being spread over a number of quarters beyond. As John noted, we are taking appropriate actions to strengthen our business processes to mitigate the hurdles associated with these hybrid deals, as well as growing services at an acceptable rate, including strengthening our services management focus and oversight, continuing our upgrading of staff, as well as having implemented a significant expansion of our enterprise project management software system and processes. We understand the issues and are engaged in their resolution.

The third quarter produced a mix of 22 percent licenses and 78 percent services revenue. Year-to-date, our revenue mix is 34 percent license and 66 percent services, in line with our previously discussed long-term target of 35-65 percent. Support revenue remained stable for the second consecutive quarter. We are confident that our solutions-based strategy will continue to gain traction with our tier one customers, and we will win additional such deals in coming quarters. As John has pointed out, our India solutions center and its capability to deliver productized components should over time improve services revenue predictability and visibility. The resulting trend of all our actions is also expected to provide a further increase in the predictability of our revenue, as the solution offerings layer upon our historical license and services business. With that said, the factors I previously described will continue to provide some volatility risk.

In the quarter, international revenues totaled $18.4 million, or 72 percent of total revenue compared to 76 percent last quarter. Intercontinental, which is made up of Asia-Pacific, Central and Latin America and Japan, was $21.3 million, 21 percent of total revenue versus 26 percent in the prior quarter. And EMEA was $13.1 million, 52 percent of total revenue compared to 50 percent in Q2. Revenues in North America were $6.9 million, or 27 percent of the total. For the third quarter, we expect the bulk of revenues to continue to come from international geographies, as advanced conversion services are rolling out at a quicker pace there than in the North American market. The top 10 customers were 46 percent of total revenue in Q3, flat from the 45 percent last quarter. No single customer represented 10 percent or more of the total revenue for the quarter.

We continue to demonstrate our ability to land new customers since we licensed 5 new customers in the quarter, including GM OnStar (gh), which join us not only Mercedes and BMW, but the GM platform as well in the telematics arena. Importantly, the new customers included major companies engaged in both online digital entertainment, telematics and cable services. Once again, please refer to our website for detailed metrics around our customers' revenue, service and access categories. Our success in the digital media entertainment, cable and satellite markets provides further validation that the Infranet solution platform delivers the fastest time to market and lowest total cost of ownership across diverse service providers and access mediums.

Now I will turn to cost and expenses. Gross margin as a percentage of total revenue was 45 percent, down from 60 percent last quarter, largely because of the drop in total revenue and the mix shift towards services. Services margin was 29 percent, down from last quarter's 34 percent margin. In the quarter, we continued to invest in recruiting and training consultants in anticipation of customer needs, as well as the buildout of our solutions center. This, combined with project delays and missed milestones previously described, resulted in reduced margins. Improved project management and productivity from our investment and service delivery is expected to result in improved margins going forward. Pro forma operating expenses for the quarter were $22.9 million compared to $21.7 million in Q2, an increase of 1.2 million, or 5.5 percent. Sales and marketing expense was approximately 1 million lower than last quarter, due to lower commissions expenses in Q3 and the fact that our annual sales and strategic partner training program was included in the Q2 results.

R&D expenses were $1.3 million higher than last quarter, due to about $400,000 for localization of new products, with the remainder of the increase being costs associated with the ramping of headcount, training and transitioning of work to India. G&A spending increased by $800,000, largely because of severance and recruiting costs as well as higher accounting and legal fees. Net interest and other income was $600,000, up from last quarter's net interest and other expense of $125,000. The change is a result of interest income on higher cash balances and the impact of the weaker dollar. We booked a provision for income taxes of about $765,000, as we pay withholding taxes in some foreign jurisdictions and had taxable income in our foreign marketing subsidiaries. Our resulting pro forma net loss was $13.3 million, or a 29 cent per share based on a share count of 39 million
shares. The share count has been adjusted for the reverse five to one stock split completed on November 29.

The total net loss on a GAAP basis for the quarter was $15 million, or a loss of 38 cents per share, as compared to the pro forma loss of about 11.3 million and 29 cents per share. The additional 3.7 million loss on a GAAP basis was due to a $3 million charge for stock option compensation and amortized acquisition-related costs of 665,000. The $3 million charge for stock option compensation relates to the repricing of employee stock options last year that are now subject to variable accounting treatment. We book a quarterly charge or credit to operations based on a formula driven primarily by the difference between our stock price from one quarter end to the next. For a reference, the reverse for adjusted price on August 1 was $15.90 and the October 31 price was $16.

We ended Q3 with $104 million in cash and investments, up 47 million from the Q2 balance of 57 million. The changes relate to 56.4 million net proceeds from the stock offering completed September 18, 3.1 million used in operations, 5.2 million used for restructuring costs, idle facilities and some severance, and 1.1 million for capital expenditures. Accounts receivable were about flat with Q2, reflecting the level of business activity in Q3 being about flat with the prior quarter. DSO at the end of the quarter was 89 days, essentially higher because of the lower level of Q3 revenues from timing differences. We expect DSO to return to our target range of 60 to 80 days in Q4. Deferred revenue at the end of the quarter was 28.1 million, an increase of 3.3 million from the 24.8 million reported at the end of Q2; once again, a reflection of the basic solidity of the business and the effective revenue being deferred to future periods.

As you may recall, our revenue recognition policies are conservative and we do not record unbilled receivables when milestones are met but customers have not signed off. So note that while this quarter’s financial reporting on the balance sheet, we have now broken out a separate line to indicate deferred costs. These costs are service deliverables and engineered solutions deliverables where we have not yet either delivered the product or met the particular milestone acceptance by the customer, which will be billed in future periods as those milestones become due. There was $2.6 million of deferred costs on the balance sheet as of the end of Q3 compared to 1.4 million at the end of Q2. We ended Q3 with about 626 active employees, up from the 601 employees we had at the end of Q2, essentially because we built additional consulting capabilities to deliver solution services across all geographies. We ended the quarter with 137 sales and marketing people compared to the 132 at the end of Q2.

While we are very disappointed in the quarterly revenue and earnings results, our fundamental business remains strong and our strategy continues to be validated by customers. Our balance sheet is solid, with over 100 million in cash. The bulk of our Q3 revenue miss will be recovered in future quarters. We understand what needs to be done and are engaged in driving our transformation to a solutions company with all the financial benefits that is expected to provide.

I will now turn to the business outlook for Q4. The following statements are based on current expectations and are forward-looking. They are subject to a number of uncertainties and risks, including those discussed below, and actual results may differ materially. Portal undertakes no obligation to update these forward-looking statements.

The underlying business conditions for Q4 have not changed since we last provided guidance for the quarter. However, our experience with Q3 warrants a more conservative approach to our providing guidance currently and in the future. Communications service providers continue to be very deliberate in their software purchasing decisions. The Company believes that customers remain selective in their capital spending and may continue to constrain budgets for an extended period of time, due to continued softness in their markets. These factors have affected and will continue to affect the amount and timing of transactions and revenues.

In addition to economic uncertainty as Portal pursues the transition of our business to a solution provider and expands the services component of its overall solutions, an increasing portion of revenues will be recognized over multiple periods, in contrast to the upfront recognition of revenue that historically has characterized our product sales. Economic uncertainty and intense market competition remain unchanged. In addition, certain tier one service delivery schedules continue to be planned and negotiated, which may have a significant impact on the timing of future revenues. As a result, Portal expects Q4 revenues to be in the range of 32 to $36 million. Fourth quarter gross margins are expected to improve to the range of 50 to 55 percent. The Company expects pro forma operating expenses for Q4 to be in the range of 24 to $25 million. Given the current outlook as expressed above, Portal expects to achieve pro forma operating results in the range of a loss of 13 to 18 cents per share based on 41.7 million shares.
I would now like to turn the call back to John for a question-and-answer session.

**John Little** - Portal Software - CEO
We will now open the call up for questions from listeners. Operator?

**QUESTIONS AND ANSWERS**

Operator

(OPERATOR INSTRUCTIONS). Arianna Wolf, Susquehanna.

**Arianna Wolf** - Susquehanna - Analyst
I had two questions. First on your guidance of 32 to 36 million in revenues. Can you give us some sense of your visibility to that figure? How much of that does depend on user acceptance testing or other deliverables, and how much do you feel very comfortable in saying that you have visible?

**Howard Bain** - Portal Software - CFO
I think it's a practical matter, especially given the results that we saw in Q3. Our confidence level in the bottom end of the range is one that is quite high. Once again, the visibility I think is subject to a lot of the variables that we have been talking about here. The visibility that I've talked about in the past, which I think continues to be very solid, is being able to go into a quarter seeing about 70 percent of the revenue. We saw this even in Q3 with the significant miss that we had. So I would say at this point I wouldn't particularly want to increase that percentage, but my confidence in the guidance that we have provided is quite solid.

**Arianna Wolf** - Susquehanna - Analyst
I guess what I am curious about is why you wouldn't have cut the guidance back to something closer to that 70 percent visibility level? And also, just trying to understand how much of that guidance reflects recognition of the 3 million increment in deferred revenue?

**Howard Bain** - Portal Software - CFO
Certainly, the recognition of the 3 million increment is included in it. Which would be one reason, for example, that the guidance on the lower end of the range would increase from what we saw in Q3.

**Arianna Wolf** - Susquehanna - Analyst
Second question was on user acceptance testing. Can you explain the 90 day delay? What is it that they are looking for that they are not getting? What makes you feel comfortable you'll get the acceptance in the 90 days time frame?

**Howard Bain** - Portal Software - CFO
We generally manage our statements of work for quarterly deliverables with our customers. So there is a detailed statement of work that says on a particular milestone date this is what we are going to deliver to you. And we look for the customer to basically confirm that they have in fact received those deliverables. I can't really speak to the specifics of these two projects, but given the fact that we do manage these things in relatively finite packets of deliverables, if you will, and that there has been a lot of attention paid to these two projects to ensure that we can satisfy the customer, I think that essentially is why we are saying the delay wouldn't be more than 60 to 90 days.

**Arianna Wolf** - Susquehanna - Analyst
I want to make sure I understand. Is there something depending on something a systems integrator does here, or are you in control of the project?

**Howard Bain** - Portal Software - CFO
In these particular cases, we are in control of the projects.
do you expect out of service? And perhaps more importantly, what might be viewed as kind of old business model versus new business model? What portion do you expect to get, especially on the license out of current quarter recognition type of deals, and which of the others which have more difficult types of recognition issues?

Howard Bain · Portal Software · CFO
I think first is we would look to see the mix being somewhat similar to what we have been seeing prior to Q3, with the 2/3 services and 1/3 licenses. So expect to see roughly around that mix. I would have to say that of the licenses that we expect to see, there is an increasing amount of those licenses that are tied to service deliverables. So I think very clearly, we are seeing an increasing complexity around license sales in that regard.

Michael Turits · Prudential Equity Group · Analyst
About how much, Howard, is tied to service deliverables?

Howard Bain · Portal Software · CFO
Once again, I go into a quarter and I am forecasting these things based upon what my understanding is of the deal that we are going to get. As I saw in Q3, by the time the transaction was finally negotiated there were links that we didn't realize were going to be there. So they become part of the forecasting process. I tried to reflect that in the forecast that we have provided.

Michael Turits · Prudential Equity Group · Analyst
If I just went to 34 million — the midpoint the range, 35 percent of that is about 12 million — about what portion of that is new business model versus old business model license revenues?

Howard Bain · Portal Software · CFO
I would say offhand probably about 50 percent. And then the rest of the services delivery, a significant portion of that is related to support, which is highly predictable. And service deliverable projects that we currently have underway, which there is some risk to, just as we saw with these two projects that were late this last quarter. But we have dozens of projects underway, so having two that slipped shouldn't be construed as anything really outside of the ordinary. SIs and companies engaged in services delivery routinely have cases where they have projects that miss milestones.

Michael Turits · Prudential Equity Group · Analyst
The expenses go up pretty significantly off of run rate. If you got to 24 to 25 million, that's a big bump in expenses. It also looks like if I roll the gross margin through, like your services — cost of services should go up a couple of million dollars also. These are all expense levels that are significantly higher than we had previously been forecasting (inaudible) we could have implied from the guidance for the current quarter. Why are they so much higher?

Howard Bain · Portal Software · CFO
I think there's a couple of factors that are contributing to that. One is on the R&D side of the business, I think we are finding that in India that we really want to make sure that we are buttoning down all of the issues that we need so that we don't have issues with deliverables going forward. So if you will, what we are reflecting is part of our action plan here to respond to the shortfall that we had in Q3 by increasing our investment in R&D and our investment in India and our investment in our services infrastructure and so on, around the world. We fundamentally see that this strategy is very dependent upon being able to grow services on a routine basis quarter to quarter, and meeting the requirements of our customers in terms of delivering those solutions. Right now, especially given the results of Q3, we feel it's a better choice to spend a little bit more in those areas to ensure that we don't stumble, if you will, on the revenue side.

Operator
Mike Latimore, Raymond James.

Mike Latimore · Raymond James · Analyst
With regard to the 8 million shortfall, is there any way to break it out between like the tier one target wireless customer and everybody else (inaudible) all of their customer categories?

Howard Bain · Portal Software · CFO
Yes, there is a way. I have to say, though, I have not done that — which I apologize. I thought I had anticipated every slice I could make of this thing. But no, I have not done that.
John Little - Portal Software - CEO

I think it is safe to say though that they tend to be the more complicated deals. A very straightforward transaction would tend to have fewer of the timing implications and correlations between services and license that we saw.

Mike Latimore - Raymond James - Analyst

John, maybe -- I am still not clear on what changed this quarter versus the last couple of quarters, because you have been working on some of these big deals for a while now. Any sort of feel for what changed this quarter versus the past few quarters?

John Little - Portal Software - CEO

When we look at the business, it's not clear that there is any substantial change between Q3 and Q2. The same sorts of contracts are there. I really hesitate to attribute it to, say, statistical fluctuations. But there doesn't seem to be any overwhelming pattern that drove (indiscernible) deals to kind of all have the same sorts of deferral issues on the revenue. Because there was no consistent pattern, they were done for 4 or 5 different ways. So I think it did -- maybe we were -- clearly, we were not as good at developing sophisticated forecasts. I think we have a much better understanding now of how to factor that into the forecast and how to really get a better level of visibility. But at this point, so far we have not identified a single underlying theme other than the timing issues and the services executions that we talked about.

Mike Latimore - Raymond James - Analyst

(inaudible) thing on the customer metrics page here, their percent of business from the wireless sector was roughly the same as last quarter, which would kind of suggest that the wireless segment was equally impacted as with other segments. Any comment on that, because it doesn't seem to match the commentary that wireless was the primary component of that 8 million?

John Little - Portal Software - CEO

We didn't say that wireless is a primary (indiscernible), I said the large tier ones, which we may have large deals other than wireless. We have not done that slice, but just to be specific we didn't say it was all -- not all tier one deals are wireless deals.

Mike Latimore - Raymond James - Analyst

With regard to the 70 percent visibility, Howard. Did you say that was into the lower end of the range?

Howard Bain - Portal Software - CFO

Yes.

Mike Latimore - Raymond James - Analyst

Could you build up that 70 percent, in terms of maintenance services, license from your kind of traditional base. And then some of the newer deals in the wireless sector? Something like that. Any way to build it up that way?

Howard Bain - Portal Software - CFO

Typically, we have not provided that level of details, and I don't think I would like to get into that now. But clearly, that is the way it's built up. We have support revenues that are -- had been very stable and are highly predictable. We have a number of projects at varying levels of service delivery complexity, where we can -- are able to have varying confidence levels on our ability to meet the quarterly milestones that are in those, and accordingly, the resultant services revenue that we will receive. We have some recurring revenue that comes from license revenue on historical contracts. We certainly have some that we think will carryover from Q3. So it's all those things basically, give us confidence in that 70 percent level. And as I have talked about before, what we are looking for is our services delivery over time for us to be able to build that percentage up to a much more significant percentage. But at this stage of the game, clearly, we have tried to take this forecast and make sure that it is a range that precludes us having the recurrence of the surprise in Q3.

Mike Latimore - Raymond James - Analyst

Just on these larger deals you are working on, do you feel like you have enough clarity into the costs that will be incurred over the next couple of years on these, or that still kind of being developed?
Howard Bain - Portal Software - CFO

No, I think we are pretty good on the cost side. The bigger issue for us has been when do we get projects launched? In some ways it's good news bad news. The fact that we have seen some delays in some of these has actually helped us gain more time to get the new hires that we have trained and to get our competencies up the curve. But by the same token, the way we plan these things, the way we bid these projects and so on, are done with a pretty solid handle on what our costs are. So it's not to say the world is perfectly predictable, but I do think we have a handle on those. As I have talked about for the last couple of quarters, when we go up a very very high ramp like we have been these last two quarters, is that there was risk to the downside on margins as a result. And I think we think we had a better handle on those than what we have shown to have had. But in point of fact, we do know what they are and are able to anticipate these things and, I think, are in a much better position going forward to manage them than we have been in the past.

John Little - Portal Software - CEO

It's not more conservative revenue recognition. I think it's important that I clarify here -- there is nothing here about accounting or policy changes or anything like that. It's just that one of the things that our strategy entails is delivering more complete solutions to our customers. Delivering those more complete solutions entails that there is a service component to that sale to that customer which makes the revenue recognition under existing rules more complex. If we don't craft those agreements or manage those agreements in ways that keep the service delivery very clearly separate from the license, then we can have different revenue recognition rules that we might use. And that's, I think, as we're seating. 50 percent of our business now is this more complex type of model. Over time, we expect our the bulk of our business is going to be solutions delivery. And we are going to face those challenges with most of the revenue we take in.

Mike Latimore - Raymond James - Analyst

Last question on the guidance. What are you thinking about in terms of other income, taxes and then, shares outstanding for Q4?

Howard Bain - Portal Software - CFO

The shares outstanding, I think, will be about 41.7 million. That's what I indicated. Other income expense and so on I would say would be essentially flat. Of course, you know if the dollar goes one way or the other strongly, that can have an impact.

Operator

Scott Sutherland, Wedbush Morgan.

Scott Sutherland - Wedbush Morgan - Analyst

The first question -- Harold, you just mentioned just a couple of questions that 50 percent of your revenue guidance is based on the new business model. Would you say that's tier one customers or is that more conservative revenue recognition where its multiple quarters?
to quarter. Now you did mention being more conservative in the guidance, but are you kind of assuming in the next quarter or two there are still some of these issues of revenue slippage you need to work through before you feel comfortable with the old guidance that you used to give?

Howard Bain - Portal Software - CFO
I think it's just prudent — given that we are accelerating some of the things that we are doing on managing our pipeline on services, really extending our sales effort around solutions and so on — that it's just prudent to be a little but more conservative around these things until we have some more experience under our belt. That's basically what's happening.

Scott Sutherland - Wedbush Morgan - Analyst
Last question — I know you don't give this number out — but can you characterize what's been occurring with the backlog (indiscernible) quarter to quarter, maybe the past few quarters?

Howard Bain - Portal Software - CFO
I can clearly say it's been growing.

Scott Sutherland - Wedbush Morgan - Analyst
Do you see better growth this quarter than previous quarters?

Howard Bain - Portal Software - CFO
That's an interesting question. Offhand — John, if you would want to answer that? But my sense is that it's fairly typical what we have been seeing the last year. We're continuing to see nice solid growth with our customer engagement.

John Little - Portal Software - CEO
I don't know if I could give a more precise answer whether that growth is accelerating or not, but I would say it does continue to grow, and these big deals do typically have kind of a large backlog that extends over time.

Operator
Paul Coster, J.P. Morgan.
Is the miss in any way related to the move to an India-based software development program?

Howard Bain - Portal Software - CFO
Not at all. If anything, the Indian move is intended to give us better capability to avoid these kinds of misses.

Last question. It's really just a -- I might have missed this earlier (indiscernible) a reminder perhaps. The $19.7 million in long-term accrued restructuring cost, can you just remind us what that is and how it gets worked off the balance sheet?

Howard Bain - Portal Software - CFO
It's largely excess facilities. It represents the amount of lease payments that we would expect to make until such time as we can either get the facilities subleased for our cost level, the lease expires, or we have a success in buying out or canceling the lease. We made some good progression on that this last quarter, so now we can look at that remaining balance that's on there, basically bleeding out at a rate of less than $2 million a quarter going forward.

A follow-up from Arianna.

I am all set. Please let someone else ask another question.

Atai Kidron (ph).

A couple of quick questions from me. With regards to the next quarter, Howard, when you look at the milestones that you need to achieve in order to reach your guidance for the quarter -- if I am not mistaken you mentioned that out of the 8 million, 40 percent of that is expected in the next quarter. Are these milestones lined up at the beginning of the quarter? And plus, with respect to the other milestones in the quarter, are there more back ended? How are they spread out along the quarter? And typically how long after a milestone is reached would you expect a customer to give you sort of acceptance that will enable you to recognize the revenue?

Howard Bain - Portal Software - CFO
I am going to answer those backwards. Generally when a milestone is reached, the customer provides acceptance fairly quickly; it's within a couple of weeks. So that typically -- as long as we have met it, it's typically not an issue, for example, with us being able to recognize the revenue or get cash payment in a timely manner. In terms of the 40 percent that we are looking to recognize in the fourth quarter, I would say that certainly more than half of it is already in hand. So my confidence level in that 40 percent is quite high. Did I answer all your questions or did I miss one in there?

(indiscernible) are your milestones, most of your milestones next quarter -- are they more back ended, or how are they spread out along the quarter would you say?

Howard Bain - Portal Software - CFO
No, I think they're for the most part just spread throughout the quarters.

Atai Kidron - - Analyst
Thanks for your questions, and this brings us to the end of our report on the Q3 results. Obviously, the financial results were a major surprise and a disappointment to us all, and I would like to leave you with these thoughts. First, we understand what happened in the quarter, we know how to fix the issues and we are already taking effective action. Second, we continue to make significant progress with our strategic transformation and our execution with customers around the world. And third, we have a business with challenging short-term dynamics but very
interesting long-term potential. We remain quite optimistic about the future and our position, and are redoubling our efforts to take full advantage of our opportunities. Thank you for your attendance. Bye-bye.

Operator
That concludes today's Portal Software conference call.
Exhibit Q
IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

IN RE PORTAL SOFTWARE, INC
SECURITIES LITIGATION

ORDER

Plaintiffs in this securities fraud class action face the unenviable task of complying with the stringent pleading requirements imposed on such actions. All too frequently, and once again here, plaintiffs attempt this endeavor by a complaint replete with evidentiary detail, but only a loose (and the court thinks too loose) connection between the wrongful conduct alleged and its effect on the class. The Supreme Court has recently reminded lower federal courts that the heart of a fraud on a securities market is the proximate causal link between the misstatement or omission alleged and the resulting impact on the security's price. Dura Pharms Inc v Broudo, 125 S Ct 1627 (2005). Despite the rather forgiving interpretation of Dura in this circuit, see In re Daou Systems, Inc Securities Litigation, 2005 WL 1431833 (9th Cir June 21, 2005), the operative pleading here fails to make this connection. Because plaintiffs will be allowed to amend, the court
emphasizes the need for plaintiff to allege facts that link defendants’ alleged wrongdoing to the class injury. A much shorter, but targeted, pleading may well be more effective in making this connection than the rather distended pleading now at bar. But there are other shortcomings in their pleadings that plaintiffs need to address and it is to these that the court devotes the bulk of this order.

I

Plaintiff John Romeo (Romeo) and plaintiff Pipefitters Local 522 & 633 Pension Fund Trust (Pipefitters) (collectively, plaintiffs), purporting to represent investors who purchased securities of Portal Software Inc (Portal) between May 20, 2003, and November 13, 2003, inclusive (the "class period"), bring this action under the Securities Exchange Act of 1934 (the "‘34 Act") and the Securities Act of 1933 (the "‘33 Act"). Plaintiffs allege that defendants Portal, John Little (Little), Howard A Bain III (Bain) and Arthur C Patterson (Patterson) (collectively defendants) violated the Generally Accepted Accounting Principals (GAAP) by artificially inflating the price of Portal’s stock and making false and misleading statements on which plaintiffs relied, thereby incurring substantial financial loss from purchasing Portal stock at fraudulently inflated prices. Defendants’ move to dismiss (Doc #115) plaintiffs’ third consolidated amended complaint (TCAC; Doc #111) for failure to meet the particularity requirement imposed by FRCP 9(b) and the Private Securities Litigation Reform Act (PSLRA)(amendments to the ‘33 and ‘34 Acts). Plaintiffs oppose the motion, asserting that the TCAC states sufficiently particularized
claims under § 10(b) and § 20(a) of the '34 Act, as well as claims under §§ 11, 12(a)(2) and 15 of the '33 Act.

The court heard argument on these motions on July 7, 2005. Based upon the parties' arguments and the applicable federal law, the court concludes that: (1) the allegations in plaintiffs' complaint are not pled with sufficient particularity under the PSLRA and FRCP 9(b); (2) the allegations are not sufficient to support a strong inference of scienter under the PSLRA; (3) defendants' forward-looking statements are protected by the PSLRA's safe harbor provision; (4) claims under the '33 Act sound in fraud and therefore fail with the '34 Act claims. Accordingly, the court GRANTS defendants' motion to dismiss in its entirety.

II

The factual and procedural history is derived from the TCAC and presumed true for purposes of this motion. Gompper v VISX, Inc, 298 F3d 893, 895 (9th Cir 2002). Portal provides billing and subscriber management solutions to its clients primarily through its "Infranet" software. Portal charges companies "license fees" for the Infranet product, as well as "service fees" for system implementation, consulting, maintenance and training. Prior to 2001, the majority of Portal's customer base consisted of "dot-com" start-up companies. Following the dot-com market crash of 2001, Portal lost many of its customers and incurred financial losses during fiscal 2002-2003 that wiped out more than 96% of Portal's equity. Portal subsequently began to market its Infranet product to more established and sophisticated business customers, including telecommunications providers.
These new clients required greater customization of the software than had the dot-com startups, which in turn affected the way in which Portal could recognize license fee revenues. Pursuant to GAAP, if a software provider rewrites portions of its product to conform to a client's unique needs, it may not fully recognize the revenue on the license of software until such substantial modification has been performed. Whereas Portal had historically been able to recognize revenue at the time it delivered its Infranet product to the dot-coms, the greater customization required by these new, more established clients required Portal to defer recognizing revenue from much of its contracts until customization was complete. Plaintiffs allege that during the class period, Portal began to manipulate its license fees so it could recognize more revenue "up-front." TCAC at ¶¶ 41-42.

To support their allegations that Portal improperly recognized revenue prematurely and in violation of GAAP, plaintiffs rely on information from four unnamed former Portal employees: (1) a controller; (2) a "Senior Business Analyst" (3) an accounts receivable and revenue assurance assistant; and (4) a "Senior Marketing Manager." TCAC at ¶¶ 41-54. The first three employees detail three different methods of accounting fraud allegedly undertaken by Portal management during the class period, while the Senior Marketing Manager alleges ongoing product problems and a decreasing market for key elements of Portal's software offering.

The information provided by the former controller involved Portal's method for recognizing licensing revenue. Historically, Portal preliminarily offered its customers a "developmental license," which consisted of a trial version of the
software for a few key employees. Portal would charge only a “nominal” amount for this first license. Then, if the client wished to obtain the full Infranet product, Portal would sell the client a “production license” and charge for the bulk of the contract. After fiscal 2004, plaintiffs allege that Portal simply charged a greater portion of the contract price under the developmental license, even though it was still only a trial version and significant modifications yet were to be performed under the production license. Plaintiffs also allege that Portal’s outside accountants, Ernst & Young, disapproved of this new split license arrangement and reversed Portal’s position, a determination which ultimately caused the shortfall in earnings and resulting stock price decline. TCAC at ¶ 43.

Next, the former Senior Business Analyst asserts that he was instructed by company officials, including Bain, to falsify revenue recognition studies to justify premature recognition of revenue. Under GAAP, when a software contract provides for both licensing and services, such as software modification and implementation, the revenue from each element can only be recognized as it is performed, so long as the “fair value” of each element is determinable. If the fair value of each element is not determinable, than recognition of the entire contract must be deferred until all elements have been delivered, or until such time as the fair value of the remaining elements are determinable. The Senior Business Analyst avers that when attempting to discern the fair value of elements of a software arrangement, he was directed by the management to “reverse engineer” the study to reach predetermined results. This employee, who ceased employment
several months before the end of the class period, alleges that he was instructed to falsify revenue recognition studies with regard to contracts performed in "Greece, Italy, Columbia [sic] and Spain," including a contract with "Columbia [sic] Mobile." TCAC at ¶ 48.

The third former employee on whom Plaintiffs rely is an accounts receivable and revenue assurance assistant employed during the class period. She alleges that "revenues related to [Portal’s] contracts with Onstar ... [were] materially overstated during the third quarter of fiscal 2004." TCAC at ¶ 49. Specifically, the former employee alleges that Portal would recognize revenue from the support, maintenance and upgrade elements of the software contract, even though the work had not yet been performed. This employee asserts that she obtained this knowledge because one of her duties of employment was to reclassify the prematurely recognized revenue for future quarters. She claims that she talked to her manager about her concerns with the way Portal was classifying revenue, and was subsequently dismissed from her position. TCAC at ¶ 49.

Finally, plaintiffs proffer the testimony of a Senior Marketing Manager to substantiate their allegations that Portal was misrepresenting the demand for its product and concealing significant technical problems with its applications. Specifically, the marketing employee stated that portions of Portal’s billing software were being rendered obsolete by Customer Relationship Management (CRM) applications sold by vendors like SAP and Siebel. TCAC at ¶¶ 51-52. Moreover, Portal’s Infranet product was having difficulty interfacing with these CRM applications,
resulting in unexpected costs and delays for Portal. TCAC at ¶¶ 53-54. Plaintiffs allege that Portal's management failed to disclose these technical difficulties and the declining demand for Portal's product during the class period, thus concealing the true state of Portal's financial health.

Plaintiffs' complaint alleges that the accounting fraud described above was undertaken by defendants to inflate Portal's reported revenue numbers, which were then used by defendants to create false and misleading statements regarding Portal's financial health and future business prospects. According to plaintiffs, these false and misleading statements artificially inflated Portal's stock price and allowed defendants to complete a $60 million secondary offering on September 12, 2003. Plaintiffs' claims for violations of the '33 Act are based on alleged false and misleading statements made in the registration statement and prospectus issued in connection with the secondary offering. TCAC at ¶¶ 142-165. Plaintiffs' claims for violations of the '34 Act are based on alleged false and misleading statements disseminated to the investing public via SEC filings and press releases. TCAC at ¶¶ 166-181.

After the close of the market on November 13, 2003, defendants announced that -- due to contract delays, revenue recognition deferrals and service execution issues -- Portal expected net losses of $0.36 to $0.40 per share for the third quarter fiscal 2004. These losses were in contrast to the net profits of $0.04 per share that Portal had previously projected for the quarter. Subsequent to the November 11, 2003, announcement, the price of Portal's common shares plummeted 42% to $8.77 in after
hours trading. TCAC at ¶ 75. Plaintiffs allege that this decline in Portal's stock price at the end of the class period was "a direct result of the nature and extent of [d]efendant's prior misrepresentations, omissions and fraudulent conduct concerning [Portal's] adverse business and financial conditions finally being revealed to investors and the market" and that plaintiffs "were damaged as a proximate result thereof." TCAC at ¶ 76.

III

As a preliminary matter, the court considers defendants' request for judicial notice (RJN, Doc #119) regarding certain documents attached to the declaration of Randolph Gaw in support of defendants' motion (Gaw Decl, Doc #116). Defendants contend that all the documents so attached are the proper subject of judicial notice pursuant to FRE 201.

Exhibits N through U to the Gaw declaration are Form 4s filed with the SEC regarding the stock sales of the individual defendants and other corporate officers and directors, while exhibits A through H are the SEC filings of defendant Portal. Defendants contend that the court is authorized to take judicial notice of documents filed with the SEC. The court agrees that judicial notice of such documents is proper. See, e.g., Bryant v Avado Brands, Inc, 187 F3d 1271, 1276 (11th Cir 1999); Allison v Brooktree Corp, 999 F Supp 1342, 1352 n3 (SD Cal 1998). This conclusion is bolstered by the fact that courts are specifically authorized, in connection with a motion to dismiss a securities fraud complaint, to consider documents and filings described in the complaint under the incorporation by reference doctrine. See, e.g,
Ronconi v Larkin, 253 F3d 423, 427 (9th Cir 2001); In re Silicon Graphics Securities Litigation, 183 F3d 970, 986 (9th Cir 1999).

Thus, the court takes notice of all the documents attached to the Gaw declaration that were filed with the SEC.

Exhibits I through M are Portal press releases, which defendants claim contain "safe harbor" warnings regarding any forward-looking statements in the press releases. Judicial notice of these exhibits is proper because the court is required to consider "any cautionary statement accompanying [a] forward-looking statement, which [is] not subject to material dispute, cited by the defendant." 15 USC § 78u-5(e). In addition, the court may take judicial notice of information that was publicly available to reasonable investors at the time the defendant made the allegedly false statements. See In re The First Union Corp Securities Litigation, 128 F Supp 871, 883 (WD NC 2001). This is true of press releases, even if they were not explicitly referenced in the complaint. See Wietschner v Monterey Pasta Co., 294 F Supp 2d 1102, 1108-09 (ND Cal 2003).

Exhibit V to the Gaw declaration is the "Statement of Position 97-2 Software Revenue Recognition." This is an accounting statement issued by the American Institute of Certified Public Accountants. RJN Doc #19 at 4. Courts may take judicial notice of documents that are alleged in the complaint and whose authenticity no party questions, even when not attached to the complaint. See Branch v Tunnell, 14 F3d 449, 454 (9th Cir 1994).

Finally, at oral argument on July 7, 2005, plaintiffs submitted to the court three additional documents and requested that the court take judicial notice of them in considering this
These documents include (1) a Portal press release dated June 30, 2005; (2) Portal's Form 8-K filed with the SEC on June 27, 2005; and (3) Portal's Form 10-Q for the quarter ending October 31, 2004, filed with the SEC on April 25, 2005. Id. The court takes notice of these documents, which are all public filings capable of judicial notice.

IV

Standard of Review

FRCP 12(b)(6) motions to dismiss essentially "test whether a cognizable claim has been pleaded in the complaint." Scheid v Fanny Farmer Candy Shops, Inc, 859 F2d 434, 436 (6th Cir 1988). FRCP 8(a), which states that plaintiff's pleadings must contain "a short and plain statement of the claim showing that the pleader is entitled to relief," provides the standard for judging whether such a cognizable claim exists. Lee v City of Los Angeles, 250 F3d 668, 679 (9th Cir 2001). This standard is a liberal one that does not require plaintiff to set forth all the factual details of his claim; rather, all that the standard requires is that plaintiff give defendant fair notice of the claim and the grounds for making that claim. Leatherman v Tarrant County Narcotics Intell & Coord Unit, 507 US 163, 168 (1993) (citing Conley v Gibson, 355 US 41, 47 (1957)). To this end, plaintiff's complaint should set forth "either direct or inferential allegations with respect to all the material elements of the claim". Wittstock v Van Sile, Inc, 330 F3d 899, 902 (6th Cir 2003).

Under Rule 12(b)(6), a complaint "should not be dismissed
for failure to state a claim unless it appears beyond doubt that plaintiff can prove no set of facts in support of [her] claim which would entitle [her] to relief." Hughes v Rowe, 449 US 5, 9 (1980) (citing Haines v Kerner, 404 US 519, 520 (1972)); see also Conley, 355 US at 45-46. All material allegations in the complaint must be taken as true and construed in the light most favorable to plaintiff. See Silicon Graphics, 183 F3d at 980 n10. But "the court [is not] required to accept as true allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." Sprewell v Golden State Warriors, 266 F3d 979, 988 (9th Cir 2001) (citing Clegg v Cult Awareness Network, 18 F3d 752, 754-55 (9th Cir 1994)).

Review of a FRCP 12(b)(6) motion to dismiss is generally limited to the contents of the complaint, and the court may not consider other documents outside the pleadings. Arpin v Santa Clara Valley Transportation Agency, 261 F3d 912, 925 (9th Cir 2001). The court may, however, consider documents attached to the complaint. Parks School of Business, Inc v Symington, 51 F3d 1480, 1484 (9th Cir 1995). If a plaintiff fails to attach to the complaint the documents on which the complaint is based, a defendant may attach such documents to its motion to dismiss for the purpose of showing that the documents do not support plaintiff's claim. In re Autodesk, Inc Securities Litigation, 132 F Supp 2d 833, 837 (ND Cal 2000) (citing Branch v Tunnel, 14 F3d 449, 454 (9th Cir 1994)). This permits the court to consider the full text of a document that the plaintiff's complaint only partially quotes. Autodesk, 132 F Supp 2d at 838 (citing In re Stac Electronics Securities Litigation, 89 F3d 1399, 1405 n4 (9th Cir
1996), cert denied, 520 US 1103 (1997)). Additionally, "[t]he court need not * * * accept as true allegations that contradict matters properly subject to judicial notice * * *." Sprewell, 266 F3d at 988 (citing Mullis v United States Bankr Ct, 828 F2d 1385, 1388 (9th Cir 1987)).

But these liberal pleading standards described above have been substantially tightened in the context of securities litigation, as will be discussed infra.

V

The TCAC alleges five causes of action. For the first and second causes of action, plaintiffs allege violations of sections 11 and 12(a)(2) of the '33 Act against all defendants. Plaintiffs' first and second causes of action are based on the registration statement Portal filed for its secondary public offering (SPO) in September 2003. Plaintiffs' third cause of action alleges control liability under section 15 of the '33 Act against Little, Bain and Patterson (the "individual defendants"). Plaintiffs' fourth cause of action alleges violations of section 10(b) of the '34 Act and Rule 10b-5 promulgated thereunder against all defendants. Lastly, plaintiffs allege control liability under section 20(a) of the '34 Act against the individual defendants.

The court will first address first plaintiffs' claims under the '34 Act before turning to the claims brought under the '33 Act.
A

Section 10(b) and 20(a) of the Exchange Act of 1934

Section 10(b) of the '34 Act and SEC Rule 10b-5, promulgated thereunder, make it unlawful for any person, in connection with the purchase or sale of any security, to (1) engage in fraud or (2) make an untrue statement regarding a material fact or (3) make a misleading statement by omitting a material fact. 15 U.S.C. § 78j(b); 17 CFR § 240.10b-5. Consequently, the elements of a Rule 10b-5 claim are: (1) a material misrepresentation or omission of fact, (2) scienter, (3) a connection with the purchase or sale of a security, (4) transaction and loss causation, and (5) economic loss. See Dura, 125 S Ct at 1633.

Claims brought under Section 10(b) and Rule 10b-5 must first meet the particularity requirements of FRCP 9(b). In re Stac, 89 F3d at 1404; see also In re GlenFed Inc Securities Litigation, 42 F3d 1541, 1545 (9th Cir 1994) (en banc). Rule 9(b) requires a plaintiff alleging fraud to "set forth what is false or misleading about [the] statement[] and why it is false." GlenFed, 42 F3d at 1548.

Second, a complaint must satisfy the more stringent requirements imposed on securities fraud pleadings by the PSLRA. Specifically, the PSLRA requires that a complaint: (1) "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading * * *" (15 USC § 78u-4(b)(1)); (2) with respect to any such allegations based upon information and belief, "state with particularity all facts on which that belief is formed" (15 USC § 78u-4(b)(1)); and (3) "with respect to each act or omission * * * state with particularity
facts giving rise to a strong inference that the defendant acted
with the required state of mind" (15 USC § 17u-4(b)(2)). The
required state of mind, or scienter, is met where the complaint
alleges that the defendants made the false or misleading statements
either intentionally or with deliberate recklessness." In re Daou
Systems, Inc Securities Litigation, 2005 WL 1431833 (9th Cir June
21, 2005) (citing Silicon Graphics, 183 F3d at 974) (emphasis
added). In securities cases, falsity and scienter "are generally
inferred from the same set of facts and the two requirements may be
combined into a unitary inquiry under the PSLRA." In re Vantive
Corp Securities Litigation, 283 F3d 1079, 1091 (9th Cir 2002)
(citations omitted).

Even if plaintiffs meet these heightened pleading
requirements, however, the PSLRA carves out a safe harbor from
liability if the alleged false or misleading statements were
forward-looking and accompanied by meaningful risk warnings. 15
USC § 78u-5(c); see also In re Splash Technology Holdings, Inc
Securities Litigation, 2000 US Dist LEXIS 15369, *16 (ND Cal)
(Splash I). An analogous doctrine (which predates the enactment of
the PSLRA) is the "bespeaks caution" doctrine, which allows a court
to rule as a matter of law that defendant's forward-looking
statements contained enough cautionary language or risk disclosure
to protect against liability. See, e.g., Provenz v Miller, 102 F3d
1478, 1493 (9th Cir 1996). If a defendant's statements are
immunized under either doctrine, dismissal of the complaint is
appropriate. See id; Splash I, 2000 US Dist LEXIS at *29.

Defendants challenge the sufficiency of plaintiffs' '34
Act claims on several grounds: (1) plaintiffs' complaint lacks the
specificity needed to plead accounting fraud; (2) plaintiffs fail
to plead facts raising a strong inference of scienter; and (3)
defendants' statements are protected by the PSLRA's safe harbor
provision. Before turning to the issue of safe harbor, the court
will address the defendants' first two contentions under the
"unitary inquiry" advocated in this circuit, as "falsity and
scienter are generally inferred from the same set of facts * * * ."
In re Vantive, 283 F3d at 1091.

Defendants contend that the TCAC should be dismissed
because plaintiffs have not adequately pled facts to support their
allegations of accounting fraud or to support a strong inference of
scienter. "If properly pled, overstating of revenues may state a
claim for securities fraud, as under GAAP, revenue must be earned
before it can be recognized." In re Daou, 2005 WL 141833 at *5
(citations omitted) (emphasis in original). Plaintiffs must plead
facts sufficient to support a conclusion that defendants "prepared
the fraudulent financial statements and that the alleged financial
fraud was material." See id (quoting In re Peerless Systems, Corp
Securities Litigation, 182 F Supp 2d 982, 991 (SD Cal 2002).

Although violations of GAAP standards may provide
evidence of scienter, see id, the complaint must allege GAAP
violations with sufficient particularity to support a strong
inference of scienter. See, e.g., In re McKesson HBOC, Inc
Securities Litigation, 126 F Supp 2d 1248, 1273 (ND Cal 2000)
("[w]hen significant GAAP violations are described with
particularity in the complaint, they may provide powerful indirect
evidence of scienter. After all, books do not cook themselves.”.

The inquiry focuses on the specificity of the allegations; “a
general allegation that the practices at issue resulted in a false
report of company earnings is not a sufficiently particular claim
of misrepresentation.” In re Daou, 2005 WL 1431833 at *5 (quoting

The Ninth Circuit recently instructed that complaints
stating sufficiently particular accounting irregularities should
include: “(1) such basic details as the approximate amount by which
revenues and earnings were overstated; (2) the products involved in
the contingent transaction; (3) the dates of any of the
transactions; or (4) the identities of any of the customers or
[company] employees involved in the transactions.” In re Daou,
2005 WL 1431833 at *6 (citations and internal quotation marks
omitted). Although the complaint need not provide each and every
detail described above, it should enable a court to determine
whether the alleged fraud “constituted widespread and significant
inflation of revenue.” Id.

Before reaching the substance of plaintiffs’ complaint,
the court notes that plaintiffs’ allegations are derived, in large
part, from information provided by confidential witnesses. The
Ninth Circuit requires a particular inquiry to determine if the use
of such confidential sources satisfies the PSLRA. See In re Daou,
2005 WL 1431833 at *4. The inquiry focuses on whether unnamed
sources of information in the complaint are described “with
sufficient particularity to support the probability that a person
in the position occupied by the source would possess the
information alleged.” Nursing Home Pension Fund, Local 114 v
Oracle Corp, 380 F3d 1226, 1233 (9th Cir 2001) (quoting Novak v Kasaks, 216 F3d 300, 314 (2d Cir 2000)). These personal sources need not be named so long as the information they provide is adequately corroborated by other facts. Silicon Graphics, 183 F3d at 985.

In In re Daou, the Ninth Circuit recently adopted the First Circuit’s "suggested criteria for assessing reliability of confidential witnesses." In re Daou, 2005 WL 1431833 at *4. These criteria include "the level of detail provided by the confidential sources, the corroborative nature of the other facts alleged (including from other sources), the coherence and plausibility of the allegations, the number of sources, the reliability of the sources, and similar indicia." In re Cabletron Sys Inc, 311 F3d 11, 29 (1st Cir 2002). Moreover, when a complaint relies on unnamed employees, courts generally look for specific descriptions of the employee's relevant duties and responsibilities to evaluate the reliability of their information. See, e.g., In re Daou, 2005 WL 1431833 at *4 (finding that confidential witnesses were described with a "large degree of particularity" where, in all cases, their job description and responsibilities were delineated, and in some cases, plaintiffs identified the executive to whom the employee reported); see also In re Northpoint Communications Group, Inc, 221 F Supp 2d 1090, 1097 (ND Cal 2002) (holding that a second amended complaint cured some specificity problems of original complaint where it set out, in addition to job titles and tenure of confidential witnesses, their responsibilities at the company).

The TCAC relies in large part upon information provided by three unnamed former Portal employees to substantiate
allegations that defendants were engaging in accounting fraud in order to overstate revenue. Plaintiffs identify these employees by either their titles or their positions in the company, but generally fail to describe with any particularity the duties of each employee, or how or why they came to be familiar with the information they provide. Despite plaintiffs' failure to specify each employee's duties, in some cases the employees' accounts themselves describe their relevant duties in the course of relating elements of the alleged accounting fraud. Consequently, the court cannot adopt wholesale the allegations provided by the unnamed employees in plaintiffs' complaint. Rather, in determining whether the TCAC adequately pleads violations of the securities laws, the court will rely only on factual allegations which evince reliability through detail, context and corroboration.

With these legal principles in mind, the court turns to plaintiffs' allegation that Portal engaged in accounting fraud by falsely inflating revenues to conceal Portal's precarious financial condition. Specifically, plaintiffs allege that defendants prematurely recognized revenue by (1) improperly categorizing licensing revenue, (2) overstating purported billing rates to recognize greater costs on delivered elements of a contract, (3) manipulating the fair value amount attributable to undelivered items and (4) recognizing revenue before project milestones were approved by customers.

Plaintiffs allege that defendants manipulated license agreements into two parts and improperly priced the first part of the license with the bulk of the contract fee so that they could recognize the revenue prematurely. TCAC ¶¶ 41-43. In support of
this allegation, plaintiffs rely entirely on information provided by a former controller. Id. Yet, the former controller's account does not contain inherent indicia of reliability. First, her employment with Portal ended almost a year before the class period even began. TCAC ¶ 41. Consequently, her entire account of Portal's fraudulent revenue recognition practices during the class period are based on second-hand reports from company "insiders." Id ¶ 43. Although she has personal knowledge to support her descriptions of Portal's revenue recognition practices prior to the class period, it is the allegations that Portal made fraudulent changes to these recognition practices during the class period that require "a reasonable conviction in the informant's basis of knowledge." In re NorthPoint, 221 F Supp 2d at 1097. Hence, plaintiffs must describe the job title, job description, duties, and dates of employment for the controller's sources before this information can be deemed reliable. Plaintiffs have made no attempt to provide such information about any of the controller's "insiders," and consequently, plaintiffs' allegations regarding improperly bifurcated contracts are not pled with sufficient particularity.

Plaintiffs' next allegations -- that defendants "cooked" revenue numbers to recognize revenue prematurely -- are somewhat better supported. The TCAC identifies a "Senior Business Analyst" who worked at Portal until July 2003, two months into the class period. Although the complaint again fails specifically to describe this employee's job duties, to whom he reported, or in which department he worked, his account ameliorates the shortfall. As part of his employment, the analyst asserts that he was required
to "reverse engineer" revenue recognition studies to reach a predetermined result. TCAC ¶ 45. Moreover, the analyst asserts that he was personally directed to create these false studies by defendant Bain, the CFO. Id ¶ 47. These fabrications involved falsely selecting high billing rates to inflate revenues for work already performed on contracts (Id ¶ 46) or falsely calculating a low value for undelivered elements so that greater revenue could be attributed to the elements already delivered (Id ¶ 47).

Although the Senior Business Analyst only identifies one customer by name for whom he created false revenue recognition studies (Columbia Mobile), he alleges that he was "required to perform analyses that matched management's predetermined results for work performed in *** Greece, Italy, Columbia and Spain in connection with at least six of Portal's major contracts" and that Portal booked $5 million in revenue as a result of these contracts. Id ¶ 48. Based on his personal involvement in fraudulent activity at the behest of Bain, the court concludes that these allegations potentially support a claim under the '34 Act. Moreover, the court finds that the specificity of the account indicates a level of reliability. Yet because the analyst's account provides no indication of how these alleged manipulations affected Portal's financial earnings statements, further corroboration is necessary to meet the heightened pleading requirements of the PSLRA.

Next, the TCAC alleges that defendants engaged in improper revenue recognition through testimony of an accounts receivable and revenue assurance assistant who allegedly worked at Portal during the class period. TCAC ¶ 49. Again, this employee's account self-identifies her duties and basis for knowledge,
mitigating the TCAC’s failure to do so. For example, the assistant specifies that “one of [her] duties was to reclassify revenue for future quarters.” Id ¶ 49. It was through this work, she alleges, that she came to learn that Portal was improperly recognizing revenue from software licensing contracts. Id. The assistant explains her basis for knowledge: “I have been working with revenue recognition for 12 years, and I understand the way revenue is supposed to be recognized.” Id. The assistant’s account also alleges a particular contract, with Onstar, for which Portal “materially overstated [revenues] during the third quarter of fiscal 2004.” TCAC ¶ 49.

In the Ninth Circuit, “although overstatement of revenues in violation of GAAP may support a plaintiff’s claim of fraud, the plaintiff must show with particularity how the adjustments affected the company’s financial statements and whether they were material in light of the company’s overall financial position.” In re Daou, 2005 WL 1431833 at *7. In In re Daou, the panel found that the plaintiff adequately described how “allegedly premature [revenue] recognition affected Daou’s financial bottom line” where the complaint pled “the approximate amount by which revenues and earnings were overstated, * * * the dates of some of the transactions and the identities of the customers and the company employees involved in the transactions.” Id at *8. For example, the plaintiffs in In re Daou alleged that only $5.9 million was eligible for recognition in the third quarter of 1997, 48% less than the $11.3 million that Daou publicly reported. Id.

In contrast, the TCAC is bereft of such comparisons. Only the Senior Business Analyst alleges a dollar amount -- $5
million -- for prematurely recognized revenue. Even this figure is unconnected to identified customers or dates, much less a specific quarterly report against which to assess its materiality. Although the accounts receivable assistant allegedly reclassified improperly booked revenues, she does not indicate how much revenue was reclassified or how this affected Portal's financial statements. The controller's statements, lacking in personal knowledge, also fail to specify how much revenue the allegedly improper licensing contracts allowed Portal to recognize prematurely, and how that affected Portal's bottom line.

The TCAC also alleges that defendants engaged in accounting fraud by recognizing "license and service fees under * * service arrangements prior to customer approval of specific project milestones in violation of the Company's publicly stated revenue recognition practices and policies" and in violation of GAAP. TCAC ¶ 50. To support this allegation, plaintiffs refer only to defendants' disclosure, subsequent to the class period, that it was excluding $700,000 of previously reported revenue for fiscal 2004 due to a customer's refusal to approve project milestones. TCAC ¶ 84. Defendants argue that this disclosure related to a contract performed after the class period, but plaintiffs provide information indicating the restatement related to fiscal 2004. TCAC ¶ 84. Even assuming this revenue was originally announced during the class period, the court finds that plaintiffs' single example of defendants' announcement of revenue prior to customer approval does not raise a strong inference of scienter.

Plaintiffs allege that defendants also violated the '34
Act by materially misrepresenting the declining demand for Portal's products and services and failing to disclose severe interface problems that delayed delivery and increased costs. TCAC ¶¶ 51-54. Support for this allegation, however, comes from only one unnamed employee, a Senior Marketing Manager, who worked for only two months of the class period. From this employee's title, the court might infer such a position would afford knowledge of the market for Portal's product. Thus, this account could conceivably provide evidence of the "shrinking market and role for billing software applications." Id ¶ 52. In addition, the employee identifies two vendors, SAP and Siebel, that offered products that "displaced the role previously provided" by aspects of Portal's billing software. Id ¶ 51. But the specificity ends there. The employee fails to identify any of "Portal's large telecommunications customers" for whom customer service applications were no longer required as part of Portal's billing software. Id. And, although the marketing manager alleges that Portal was spending too much time and money due to "excessive bugs and/or interface problems with other applications," these allegations fail to indicate any specific customers, contracts, or dates. Id ¶ 54.

The court finds that plaintiffs' allegations of accounting fraud and material misrepresentations are not pled with sufficient particularity and, consequently, do no raise a strong inference of scienter. Plaintiffs, however, present an alternative basis for demonstrating scienter; the complaint focuses on defendants' stock sales and Portal's SPO to show that defendants had the motive and opportunity to mislead investors deliberately. As discussed in the next section, however, these allegations fail
to plead a violation of section 10(b) adequately.

Sciente

To demonstrate motive, plaintiffs allege that defendants engaged in insider trading during the class period. The PSLRA neither prohibits nor endorses the pleading of insider trading as evidence of scienter, but requires that the evidence meet the 'strong inference' standard." Greebel, 194 F3d at 197. While "trading at suspicious times or in suspicious amounts" is probative of scienter, the trading must be "unusual, well beyond the normal patterns of trading by those defendants." Id. Under this standard, the court questions plaintiffs' reliance on the stock sales attributable to "company insiders" to demonstrate defendants' motive to conduct accounting fraud or issue misleading statements. First, defendant Little sold no personal stock. Defendant Bain sold 4,000 shares after exercising 7,500 stock options, which means he did not sell 3,500 shares.

Plaintiffs focus on "89,157 shares of Portal common stock" sold by "Portal insiders." TCAC at ¶ 65. Most of these "insiders," however, are not named defendants, nor do plaintiffs allege they were involved in the fraudulent activity. Moreover, plaintiffs' reliance on "suspicious" stock sales ultimately fails because the stock sales do not appear suspicious at all. For example, plaintiffs focus on the period from May 28, 2003, to July 2, 2003, which was "immediately after" the first earnings announcement of the class period -- but also after the announcement of an alliance with Microsoft. TCAC at ¶ 65. Although plaintiffs
allege that Portal common stock was artificially inflated during this period, they do not allege that the deal with Microsoft was improper. In fact, plaintiffs ignore the legitimate, positive effect the Microsoft deal might have had on Portal's stock or the role the Microsoft deal might have had in the executives' decision to sell. No attempt is made to delineate the "artificiality" of Portal's stock during this period, which is especially curious since it appears that Portal's stock actually dropped by several dollars after the first earnings announcement of the class period. TCAC at ¶ 140 (Charting NASDAQ Index). Moreover, plaintiffs fail to demonstrate that the timing of the stock sales was "suspicious" where the TCAC does not provide a comparison of these sales with the executives' "normal patterns of trading." Greebel, 194 F3d at 197.

By contrast, plaintiffs' contention that defendants were motivated to inflate artificially Portal's stock price in the short term in order to conduct a successful secondary public offering and obtain much-needed operating capital does allege facts of a palpable motive for fraud. In fact, Portal raised $60 million in September, just two months before Portal's stock plummeted by over 40%. Plaintiffs allege that Portal's finances were such that the $60 million was absolutely necessary to keep Portal a "going concern." Plaintiffs' Opposition at 21. Accordingly, this motive evidence is stronger than the generic "desire to raise capital" which can be attributed to every company. Metricom, 2004 US Dist LEXIS 7834 at *110. But in the Ninth Circuit, such motive pleading must be combined with allegations of other "red flags" to be probative. In re Vantive, 283 F3d at 1097. As discussed above,
plaintiffs' allegations of accounting fraud lack sufficient
particularity and cannot be combined with this alleged motive to
establish a strong inference of scienter.

3

Safe Harbor

In their motion to dismiss, defendants argue at great
length that plaintiffs' TCAC does not adequately plead claims based
on false projections or opinions. Defendants are correct that the
PSLRA carves out a safe harbor from liability for forward-looking
statements that are accompanied by meaningful cautionary language.
15 USC § 78u-5(c); see also In re Copper Mountain Securities
the analogous "bespeaks caution" doctrine, a court may also find as
a matter of law that "defendant's forward-looking statements
contained enough cautionary language or risk disclosure to protect
against liability." Id at 866. Mere boilerplate or generic
warnings, however, are insufficient; "[t]he cautionary warning
ought to be precise and relate directly to the forward-looking
statements at issue." Id at 882. Moreover, this court has
previously found that "vague and * * * run-of-the-mill corporate
optimism" is not actionable because no reasonable investor would
rely on "mere puffery." Id at 868-69.

A close reading of plaintiffs' TCAC reveals that the vast
majority of plaintiffs' allegations of "materially false and
misleading statements" focus on defendants' statements regarding
present or historical facts, such as Portal's past quarterly
earnings based on (1) allegedly inflated revenues (TCAC ¶¶ 58, 60,
64, 66, 67); (2) Portal's past and current revenue recognition
policies that plaintiffs allege misrepresented the way in which
Portal was recognizing revenue (TCAC ¶¶ 61-64, 68-70); (3)
omissions of past and current facts regarding declining sales and
product demand as well as difficulties marketing Portal's product
(TCAC ¶ 64e-f); and (4) omissions of the present fact that Portal
was experiencing severe technical problems with its core products,
which were eroding its revenue stream (TCAC ¶ 64g). But neither
the PSLRA's safe harbor provision nor the bespeaks caution doctrine
are applicable to statements of historical fact. See e.g., Livid
Holdings Ltd v Salomon Smith Barney, Inc, 403 F3d 1050, 1056-57
(9th Cir 2005).

In fact, the only forward-looking statements that
plaintiffs allege were false or misleading when made are the
revenue projections for fiscal 2004 and the subsequent quarter's
revenue projections that accompanied Portal's public announcement
of financial results for the quarter just concluded. See TCAC ¶ 58
(May 20, 2003, announcement of financial results for quarter ending
May 2, 2003); TCAC ¶ 66 (August 19, 2003, announcement of financial
results for quarter ending August 1, 2003). These announcements
were made in press releases and included defendants' statements
that Portal expected revenues to grow by "10-12%" over the prior
year and that Portal would "return to pro forma earnings" within
the current fiscal year. TCAC ¶ 58.

Both of these statements concerned "a projection of
revenues" and "future economic performance" and thus were clearly
forward-looking statements under the PSLRA. 15 USC § 78u-5(i);
Copper Mountain, 311 F Supp 2d at 880. The court now turns to
plaintiffs' argument that defendants' forward-looking statements are unprotected by the PSLRA's safe harbor provision or the bespeaks caution doctrine because (1) the statements were not accompanied by meaningful cautionary language and (2) defendants knew they were false when made.

The court finds that defendants' forward-looking statements were accompanied by cautionary language that was sufficiently specific and meaningful to warn investors of the risks that actually materialized. First, defendants' May 20 and August 19 press releases -- which contained the 10-12% profit projection and "return to pro forma earnings" statements -- each included "safe harbor" warnings that the statements were forward-looking and subject to uncertainties and risk. Gaw Decl; Exs I and J. Moreover, these press releases specified a number of factors which might effect the projections, including the migration to "larger, multi-year deals, which * * * may dampen near-term growth * * * and add[] to the volatility of license revenues." Id.

In addition to those warnings contained in the press releases, both press releases referred investors to the Form 10-K for additional warnings. Gaw Decl; Ex C. at 31 ("These and other factors are described in detail in our Annual Report on Form 10-K for the fiscal year ended January 31, 2003 * * *"). Thus, the information in the Form 10-K was incorporated into the "total mix of information in the document" available to reasonable investors, even though the Form 10-K did not actually accompany the press releases. Copper Mountain, 311 F Supp 2d at 876 (citing Fecht v The Price Co, 70 F3d 1078, 1082 (9th Cir 1995). The Form 10-K contained several pages of detailed and explicit warnings regarding
Portal’s dependance on a few large customers, the risks associated with long implementation periods, and the numerous variables which could adversely affect revenue recognition for any quarter. Also, the Form 10-K warned that Portal would begin offering “products and services for a ‘bundled’ price, such that a separate price would not be identified for the product and service components. Such a change may significantly delay the timing of our revenue recognition.” Gaw Decl; Ex C at 31 (emphasis added). Because these warnings hew to the actual deficiencies that caused Portal’s earnings shortfall -- “contract delays and revenue recognition deferrals” with existing large customers -- they provided sufficiently specific and material warnings to immunize defendants’ forward-looking statements. See Copper Mountain, 311 F Supp 2d at 882.

Plaintiffs also assert that, regardless of cautionary language, defendants are liable for their forward-looking statements because they knew them to be false and misleading when made. Plaintiffs are correct that a forward-looking statement cannot be immunized under the PSLRA if it was made with “actual knowledge * * * that the statement was false or misleading.” 15 USC 78u-5(c)(1)(B). In this case, however, plaintiffs’ argument is unavailing because plaintiffs have failed to demonstrate that the defendants knew that Portal would not achieve 10-12% growth or return to pro forma earnings within the year when the press releases were issued. As discussed above, the TCAC is deficient, in part, in that it fails to allege facts showing how the alleged accounting adjustments materially affected the company’s financial statements. See supra IV(A)(1)(i). These facts are necessary not
only to plead adequately accounting fraud or scienter on the part of defendants, but also to demonstrate that the defendants knew at the time the earnings projections were announced that Portal could not meet those projections. Accordingly, Defendants' cannot be liable for the forward-looking statements in the May 20 and August 19, 2005, press releases, and plaintiffs' claims premised on these statements must be dismissed.

4

20(a)

Control Liability

Section 20(a) provides for "controlling person liability." To establish such liability, plaintiffs must first demonstrate the existence of a violation under Section 10(b) -- the "primary violation." Copper Mountain, 311 F Supp 2d at 883 (citation omitted). "[I]n the absence of a viable claim under Section 10(b), any remaining Section 20(a) claims must be dismissed." Id (citations omitted).

Because the court has determined that plaintiffs have failed to state claims under Section 10(b), plaintiffs have "no basis upon which to premise a Section 20(b) claim" and the Section 20(b) claims must also be dismissed.

B

Section 11, 12(a)(2) and 15 of the Securities Act of 1933

Plaintiffs also bring claims against defendants for violations of the '33 Act arising out of Portal's secondary public offering in September 2003. In contrast to claims brought under
the '34 Act, section 11 of the '33 Act creates a private remedy for a purchaser of a security where "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statement therein not misleading." 15 USC § 77k(a). "The plaintiff in a § 11 claim must demonstrate (1) that the registration statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation was material, that is, it would have misled a reasonable investor about the nature of his or her investment." In re Stac, 89 F3d at 1403-04. "No scienter is required for liability under § 11; defendants will be liable for innocent or negligent material misstatements or omissions." Id (citations omitted). Before addressing the substance of the '33 Act claims, the court must first determine if they are time barred.

1

Relation Back

Defendants challenge the timeliness of plaintiffs' '33 Act claims. Section 13 of the '33 Act requires that claims under sections 11 and 12(a)(2) be brought "within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence." 15 USC § 77m. Plaintiffs' first complaint, filed on November 20, 2003, did not include '33 Act claims. These claims were not added until the second amended complaint (SAC), filed on March 30, 2005 (sixteen months later). Defendants argue that plaintiffs discovered the conduct giving rise to the '33 Act claims.
at least when the first complaint was filed. Consequently, defendants argue that the '33 Act claims are time-barred.

Plaintiffs seek to avoid this bar by asserting that the new claims in the SAC "relate back" to the initial complaint under FRCP 15(c)(2). Rule 15(c)(2) states that an amended complaint relates back to the initial one for statute of limitations purposes if the "claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth * * * in the original pleading." The crux of this inquiry is "whether the opposing party has been put on notice about the claim or defense raised by the amended pleading." SEC v Seaboard Corporation, 677 F2d 1301, 1314 (9th Cir 1982). This court previously observed that the class notice for the '34 Act claims would have put investors with '33 Act claims on notice. Doc #100. It follows that defendants were also put on notice of the potential for '33 Act claims arising from the same set of facts.

2

Sound in Fraud

Section 11 does not contain an element of fraud, yet a complaint may be subject to the particularity requirements of Rule 9(b) if it "sounds in fraud." Vess v Ciba-Geigy Corp USA, 317 F3d 1097, 1103 (9th Cir 2003). If the complaint alleges "a unified course of fraudulent conduct and rel[ies] entirely on that course of conduct as the basis of a claim * * * the claim is said to be 'grounded in fraud' or to 'sound in fraud,' and the pleading of that claim as a whole must satisfy the particularity requirement of Rule 9(b)." Id at 1103-1104.
In the TCAC, plaintiffs have made an artful attempt to avoid this requirement by carefully compartmentalizing the counts under the ’33 Act and ’34 Act. Whereas the ’34 Act claims allege that defendants knowingly or recklessly engaged in a fraudulent scheme to overstate revenues, for example, the ’33 Act claims merely allege that revenues were negligently overstated. Yet the Ninth Circuit has rejected this approach, finding that such “nominal efforts are unconvincing where the gravamen of the complaint is plainly fraud.” In re Stac, 89 F3d at 1405.

The court finds that plaintiffs’ Section 11 claim clearly “sounds in fraud.” Despite plaintiffs’ pains to avoid Rule 9(b), it is clear that the factual allegations upon which the entire complaint rests allege knowing, reckless and willful conduct. For example, plaintiffs allege that defendants “negligently overstated [revenue] due to the Defendants’ manipulation of the purported billing rates of Portal’s employees.” TCAC ¶ 145(d). Yet plaintiffs’ factual allegations supporting the manipulation of billing rates unequivocally describes the conduct as intentional and knowing. Id ¶¶ 47, 48. It strains credulity that plaintiffs should allege that the overstatement of revenues was merely “negligent” when it was a allegedly a direct result of defendants’ willful manipulation. Plaintiffs cannot avoid the theory they posit throughout the complaint: that defendants fraudulently schemed to inflate revenues. Accordingly, the court finds that the claims under the ’33 Act sound in fraud, and therefore fail with the ’34 Act claims to meet the heightened pleading requirements of the PSLRA and Rule 9(b).
V

Conclusion

For the reasons stated above, the court GRANTS defendants' motion to dismiss in its entirety. Doc #115. Plaintiffs' TCAC is DISMISSED, but plaintiffs may file an amended complaint remedying the pleading deficiencies identified in this order and complying with the following instructions.

An amended complaint should specify those misstatements plaintiffs allege were false or misleading, including with regard to each statement: (1) the date made; (2) the speaker; (3) the content; (4) the falsity; (5) the basis for plaintiffs' allegation of falsity; and (6) scienter. The amended complaint should also specify any omissions of fact that defendants were bound to disclose, including with respect to each omission: (1) the date the information became known to the public; (2) the facts omitted; (3) the date the duty to disclose arose; (4) the basis for claiming that omitted information was known to defendants; (5) the basis for claiming that defendants had a duty to disclose; and (6) scienter. Finally, in light of Dura, plaintiffs should endeavor to tether all allegations in the complaint to the price movement of Portal's stock during the class period. Any amended complaint must be filed within sixty (60) days of the date of this order.

IT IS SO ORDERED.

VAUGHN R WALKER
United States District Chief Judge
Exhibit R
ORDER GRANTING, WITH LEAVE TO AMEND, MOTIONS TO DISMISS FIRST AMENDED COMPLAINT; VACATING HEARING

This Document Relates to ALL ACTIONS (Docket Nos. 112, 113)

Before the Court is the motion to dismiss, filed February 17, 2004 by defendants Veritas Software Corporation ("Veritas"), Gary L. Bloom ("Bloom"), Mark Leslie ("Leslie") and Paul A. Sallaberry ("Sallaberry") (collectively "Veritas defendants"). Also before the Court is the separate motion to dismiss, filed February 17, 2004 by defendant Kenneth Lonchar ("Lonchar"). Having considered the papers filed in support of, and in opposition to, the motions, the Court finds the matters appropriate for decision without oral argument (see Civ. L.R. 7-1(b)) and hereby VACATES the May 21, 2004 hearing. For the reasons set forth below, defendants' motions to dismiss are GRANTED, and the complaint is DISMISSED, with leave to amend.

BACKGROUND

This is a purported securities fraud class action, brought on behalf of persons who bought Veritas stock between January 3, 2001 and January 16, 2003. The action is
brought against Veritas; its former Chief Executive Officer ("CEO") and Chairman of the
Board, Leslie; its current President and CEO, Bloom; its former Chief Financial Officer
("CFO") and Executive Vice President, Lonchar; and its Executive Vice President of
Worldwide Field Operations, Sallaberry. (See First Amended Class Action Complaint
("FAC"), filed January 16, 2004, ¶¶ 13-14.) Plaintiffs allege that defendants violated
§§ 10(b) and 20(a) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C.
§§ 78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, by
caus[ing Veritas to issue false and misleading statements about its financial performance for
the fourth quarter of its fiscal year 2000 ("4Q00") and fiscal year 2001. (See id. ¶¶ 4,
7, 10.)

Veritas is a supplier of “data availability software products[.]” (See id. ¶ 2.) Plaintiffs
allege that, in 4Q00, Veritas improperly recognized revenue and expenses with respect to a
September 2000 transaction with America Online, Inc. ("AOL"), in which AOL agreed to
purchase $50 million in software and services from Veritas, and Veritas agreed to purchase
$20 million in online advertising from AOL. (See id. ¶¶ 4, 56.) According to plaintiffs, the
AOL transaction was Veritas’ largest deal of the quarter. (See id. ¶ 71(n.).)

Plaintiffs allege that Veritas recognized $37 million in revenue from the transaction
during 4Q00, including $20 million that was recognized in violation of Generally Accepted
Accounting Principles ("GAAP"). (See id. ¶¶ 4, 54.) In particular, plaintiffs allege that
defendants had no reasonable basis for allocating $50 million to the sale of software and
services, based on the fair value of each component. (See id. ¶ 4.) Plaintiffs also allege
that Veritas had no economic reason to advertise on AOL, and thus had no basis for
valu[ing the advertising at $20 million. (See id. ¶ 6.)

Throughout fiscal year 2001, Veritas repeated the allegedly false 4Q00 and fiscal
year 2000 revenue and earnings results in press releases, conference calls and in public
filings with the Securities and Exchange Commission ("SEC"). (See id. ¶ 6.) Veritas also
allegedly falsely assured investors that its revenue recognition principles were in
compliance with GAAP. (See id. ¶¶ 6, 50.) Plaintiffs allege that as a result of Veritas’
allegedly improper accounting, Veritas beat Wall Street analysts’ revenue expectations by
$25 million, and beat their earnings per share ("EPS") estimates by $0.02 per share. (See
id. ¶ 44.) The price of Veritas stock allegedly was artificially inflated as a result of the
purportedly false 4Q00 financial results. (See id. ¶ 45.)

In August 2002, the United States Department of Justice ("DOJ") and/or the SEC
allegedly served a subpoena on Veritas, seeking documents relating to the AOL
transaction. (See id. ¶¶ 8, 98.) Additionally, Veritas’ auditors, KPMG LLP ("KPMG"),
allegedly began investigating the AOL transaction. (See id. ¶¶ 8, 98.)

According to plaintiffs, Veritas announced to investors, on October 3, 2002, that
Lonchar, its CFO, had misrepresented his educational background and had resigned. (See
id. ¶ 100.) In that announcement, plaintiffs allege, Bloom assured investors that Lonchar’s
misrepresentation had no effect on the accuracy of Veritas’ financial statements or on the
quality of its financial procedures and controls. (See id. ¶¶ 100-01.) According to the
complaint, Bloom further assured investors that it was unlikely that there would be any
additional scrutiny of Veritas’ accounting because it had just completed a review of its
procedures as part of the certification process to the SEC. (See id. ¶ 101.) Veritas
allegedly did not disclose the SEC’s investigation into the AOL transaction at that time, or
that KPMG had begun reviewing the transaction. (See id.)

On October 23, 2002, Veritas announced that it would restate its financial results for
the two years between September 30, 2000 and June 30, 2002, reducing revenues,
primarily from online advertising transactions, by $190 million. (See id. ¶ 103.) On
November 14, 2002, Veritas filed with the SEC its form 10-Q for the period ending
September 30, 2002. (See id. ¶ 104.) In that document, Veritas disclosed, for the first
time, that it had been served with a subpoena by the SEC for documents relating to the
AOL transaction. (See id.) Veritas also stated that it was reviewing its accounting
treatment of the transaction, focusing on $20 million in advertising services expense and
$20 million of the sales revenue. (See id.) On disclosure of this news, Veritas’ stock
dropped from $18.25 to $16.75 on November 15, 2002 on 24,622,200 shares traded, a
300% increase in volume from the previous day. (See id. ¶ 105.)

On January 17, 2003, Veritas, according to plaintiffs, announced that it would restate its 4Q00 and 2001 financial statements to eliminate approximately $20 million in revenue and approximately $7 million in net income previously reported for 4Q00. (See id. ¶¶ 108–09.) On January 28, 2003, Veritas allegedly explained, in a conference call, that the financial restatements were being restated “to reflect that $20 million of license and support fees paid by AOL [would] not be recognized as revenue and $20 million of advertising services paid to AOL would not be recorded as expense.” (See id. ¶ 110.) In the restatement, Veritas allegedly admitted that “the fair value of the goods and services purchased and sold in the AOL transactions could not be reasonably determined and [Veritas] ha[d] accordingly restated its financial results to reflect a reduction in revenues and expenses of $20.0 million.” (See id. ¶ 9.) Plaintiffs contend that Veritas, in doing so, acknowledged that there was no basis for Veritas’ purchase of $20 million in advertising services from AOL and that the AOL transaction was a “roundtrip transaction,” i.e., a transaction without economic substance that was designed to allow each party to fraudulently recognize revenue. (See id.)

On March 17, 2003, Veritas filed with the SEC its Form 10-K/A for the fiscal year ending December 31, 2001, officially announcing the restatement of revenue for the fourth quarter and fiscal years 2000 and 2001. (See id. ¶ 111.) Veritas also revealed that it would restate additional transactions. (See id.)

Plaintiffs allege that each of the lead plaintiffs and each of the class members purchased Veritas securities at inflated prices during the class period and was damaged thereby. (See id. ¶ 12.)

LEGAL STANDARD

A motion to dismiss under Rule 12(b)(6) cannot be granted unless “it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.” See Conley v. Gibson, 355 U.S. 41, 45–46 (1957). Dismissal can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged
under a cognizable legal theory. See Balistreri v. Pacifica Police Dept., 901 F.2d 696, 699 (9th Cir. 1990).

Generally, a district court, in ruling on a Rule 12(b)(6) motion, may not consider any material beyond the pleadings. See Hal Roach Studios, Inc. v. Richard Feiner And Co., Inc., 896 F.2d 1542, 1555 n. 19 (9th Cir. 1990). Material that is properly submitted as part of the complaint, however, may be considered. See id. Documents whose contents are alleged in the complaint, and whose authenticity no party questions, but which are not physically attached to the pleading, also may be considered. See Branch v. Tunnell, 14 F.3d 449, 454 (9th Cir. 1994). In addition, the Court may consider any document "the authenticity of which is not contested, and upon which the plaintiff's complaint necessarily relies," regardless of whether the document is referred to in the complaint. See Parrino v. FHP, Inc., 146 F.3d 699, 706 (9th Cir. 1998). Finally, the Court may consider matters that are subject to judicial notice. See Mack v. South Bay Beer Distributors, Inc., 798 F.2d 1279, 1282 (9th Cir. 1986).

In analyzing a motion to dismiss, the Court may disregard factual allegations if such allegations are contradicted by the facts established by reference to exhibits attached to the complaint. See Durning v. First Boston Corp., 815 F.2d 1265, 1267 (9th Cir. 1987). Conclusory allegations, unsupported by the facts alleged, need not be accepted as true.


DISCUSSION

A. Request for Judicial Notice

Defendants request that the Court, in ruling on the instant motions to dismiss, take judicial notice of four of Veritas' filings with the SEC, one each from 2000 and 2002, and two from 2001. Plaintiffs oppose the request, arguing that the Court may not consider any document that is not mentioned in, or attached to, the complaint. Plaintiffs further argue that to the extent the Court may consider such documents, it may consider them only for the purpose of reviewing the statements made therein, and may not accept any such statements as true.
Pursuant to Rule 201 of the Federal Rules of Evidence, the Court may take judicial notice of any fact that is "not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.

See Fed. R. Ev. 201. The Ninth Circuit has long recognized that the Court may take judicial notice of matters of public record in ruling on a motion to dismiss. See, e.g., Mack, 798 F.2d at 1282. The Court may consider such matters even when they are not included in or attached to the pleadings. See, e.g., Lee v. City of Los Angeles, 250 F.3d 668, 688-89 (9th Cir. 2001); MGIC Indemnity Corp. v. Weisman, 803 F.2d 500, 504 (9th Cir. 1986).

Other circuits have held that, in ruling on a motion to dismiss, it is appropriate for a court to "review and consider public disclosure documents required by law to be and which actually have been filed with the SEC." See Cortec Industries, Inc. v. Sum Holding L.P., 949 F.2d 42, 47 (2d Cir. 1991). The documents may be reviewed, however, "not to prove the truth of their contents but only to determine what the documents stated." See Kramer v. Time Warner, Inc., 937 F.2d 767, 774 (2d Cir. 1991); see also Lovelace v. Software Spectrum, Inc., 78 F.3d 1015, 1018 (5th Cir. 1996) (holding SEC documents "should be considered only for the purpose of determining what statements the documents contain, not to prove the truth of the documents' contents"); Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1278 (11th Cir. 1999) (holding that "a court, when considering a motion to dismiss in a securities fraud case, may take judicial notice (for the purpose of determining what statements the documents contain and not to prove the truth of the documents' contents) of relevant public documents required to be filed with the SEC, and actually filed"). Although the Ninth Circuit has not addressed the issue, it has similarly held that, in deciding a motion to dismiss, "when a court takes judicial notice of another court's opinion, it may do so 'not for the truth of the facts recited therein, but for the existence of the opinion, which is not subject to reasonable dispute over its authenticity.' " See Lee, 250 F.3d at 690 (quoting Southern Cross Overseas Agencies, Inc. v. Wah Kwong Shipping Group Ltd., 181 F.3d 410, 426-27 (3d Cir. 1999)).
Accordingly, the Court GRANTS defendants' request to take judicial notice of certain
of Veritas' filings with the SEC. The Court will take judicial notice of such documents only
to determine the statements that were made therein, however, and will not take judicial
notice of the truth of any factual assertions made therein.

B. Motions to Dismiss

The gravamen of plaintiffs' complaint is that defendants fraudulently recognized
$20 million in revenue in 4Q00 from the AOL transaction. (See FAC ¶4.) Plaintiffs allege
that, under GAAP, defendants were not permitted to recognize such revenue in that quarter
unless they had objective evidence of the fair market value of each component of the
transaction, which plaintiffs allege defendants lacked. (See id. ¶¶ 4, 6.)

The Court granted defendants' motions to dismiss the previous complaint on the
ground that plaintiffs had failed to adequately plead scienter. The Court explained:

The mere fact that Veritas has restated its accounting for the AOL
transactions does not give rise to a strong inference of fraudulent intent. . . .
[Plaintiffs have failed to plead facts sufficient to give rise to an inference that
anyone at Veritas knew, or was deliberately reckless in not knowing of the
accounting error with respect to the AOL transaction. . . . [P]laintiffs have not
alleged any facts to show how Veritas originally determined the value of the
components of the September 2000 AOL transaction at the time of the
transaction. The complaint also fails to allege who was involved in making
those decisions. Consequently, there are no facts from which the Court can
infer whether those valuations were so outside the bounds of reasonableness
as to constitute deliberate recklessness on the part of any defendant.

(See Order Granting Motions to Dismiss, filed December 10, 2003, at 8.) The Court also
noted that plaintiffs' confidential witnesses, "at least as shown by the pleadings, had little to
no experience with the accounting of the AOL transaction, or other information from which
a strong inference of scienter can be drawn." See id. at 9. The Court granted plaintiffs
leave to amend and, on January 16, 2004, plaintiffs filed their First Amended Complaint.¹

Defendants now move to dismiss the FAC, contending that plaintiffs' allegations still
fail to state a claim against them for securities fraud. As both motions to dismiss raise

¹ In connection with their opposition to the motion to dismiss, plaintiffs have
provided a helpful summary of the new allegations they have included in the FAC. (See
Plaintiff's Summary of the Amendments to the First Amended Complaint.)
similar issues, the Court will consider them together.

1. Section 10(b) and Rule 10b-5
   a. Legal Standard

   Section 10(b) of the Securities Exchange Act of 1934 provides that "[i]t shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe[.]") See 15 U.S.C. § 78j(b).

   Rule 10b-5 provides:

   It shall be unlawful for any person . . .

   (a) To employ any device, scheme, or artifice to defraud,

   (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

   (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

   17 C.F.R. § 240.10b-5. "The elements of a Rule 10b-5 claim are: (1) a misrepresentation or omission of a material fact; (2) reliance, (3) scienter, and (4) resulting damages." See Paracor Finance, Inc. v. General Electric Capital Corp., 96 F. 3d 1151, 1157 (9th Cir. 1996).

   Any class action complaint alleging securities fraud in violation of the Exchange Act is subject to the heightened pleading standards set forth in the Private Securities Litigation Reform Act of 1995 ("PSLRA"). See In re Silicon Graphics Inc. Sec. Litig., 183 F. 3d 970, 973-74 (9th Cir. 1999). Under the PSLRA, for all claims based on misrepresentations or omissions, plaintiffs must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." See 15 U.S.C. § 78u-4(b)(1). Plaintiffs "must provide all the facts forming the basis for [their] belief in great detail." See Silicon...
The PSLRA also requires that "the complaint shall, with respect to each such act or omission alleged to violate this chapter [the Securities Exchange Act of 1934], state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." See 15 U.S.C. § 78u-4(b)(2). The required state of mind is "deliberate recklessness, at a minimum." See Silicon Graphics, 183 F. 3d at 974. Plaintiffs "must plead, in great detail, facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct." See id. They "must state specific facts indicating no less than a degree of recklessness that strongly suggests actual intent." See id. at 979.

In determining whether scienter has been adequately alleged, the Court must examine the totality of plaintiffs' allegations. See No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp., 320 F.3d 920, 938 (9th Cir. 2003). The Court must consider "all reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs." See id. (quoting Gompper v. VISX, Inc., 298 F.3d 893, 897 (9th Cir. 2002)). "District courts should consider all the allegations in their entirety, together with any reasonable inferences that can be drawn therefrom, in concluding whether, on balance, the plaintiffs' complaint gives rise to the requisite inference of scienter." Gompper v. VISX, Inc., 298 F.3d at 897. To establish a strong inference of scienter, the allegations must show that an inference of fraud is "the most plausible of competing inferences." See id. (quoting Helwig v. Vencor, Inc., 251 F.3d 540, 553 (6th Cir. 2001) (en banc)).

In the instant case, the mere fact that Veritas restated its accounting for the AOL transactions does not give rise to a strong inference of fraudulent intent. See DSAM Global Value Fund v. Altris Software, Inc., 288 F.3d 385, 390 (9th Cir. 2002) (citation omitted) ("[T]he mere publication of inaccurate accounting figures, or a failure to follow GAAP, ....

\[2\] "Allegations are deemed to have been made on information and belief until the plaintiffs demonstrate that they have personal knowledge of the facts." In re The Vantive Corp. Sec. Litig., 283 F.3d 1079, 1085 n.3 (9th Cir. 2002).
without more, does not establish scienter.”) The Ninth Circuit has held that even allegations that an “auditor egregiously failed to see the obvious – that according to [GAAP], millions of dollars in revenue from software sales reflected in a financial statement should not have been recognized” – fail to establish a strong inference of scienter, but rather allege only “a compelling case of negligence – perhaps even gross negligence.” See id. at 387.

b. Adequacy of Scienter Allegations

Defendants again move to dismiss the First Amended Complaint for failure to adequately allege scienter. For the reasons set forth below, the Court agrees with defendants that plaintiffs still fail to allege facts sufficient to show that an inference of fraud, rather than negligence, is “the most plausible of competing inferences.” See Gompper, 298 F.3d at 897 (quoting Helwig, 251 .3d at 553).

Plaintiffs have amended their complaint to allege the contents of certain internal correspondence at Veritas during the fall of 2000. (See FAC ¶¶ 65-71.) Plaintiffs allege that on November 1, 2000, Rita Gladney (“Gladney”), Veritas’ revenue account manager, sent an email to Sallaberry in which she informed him that “[w]hen the services are bundled into a Site License (multiple element arrangement), a proportionate amount of the discount must be allocated to each element based on the fair market value of each element without regard to the discount.” (See id. ¶ 66, and Ex. 37.) Plaintiffs allege that Gladney informed Sallaberry that “[t]his is straight out of the SOP,” (see id.), and that on the same day, Gladney sent another email, which was copied to Sallaberry, in which she forwarded the “3rd Version of the AOL Breakdown,” and stated that the training allocation had been increased “to correctly reflect [Veritas’] highest priced Onsites.” (See id. ¶ 67, and Ex. 38.)

Far from raising an inference of scienter, however, these documents show that Veritas was attempting to comply with the Accounting Standards Executive Committee Statements of Position (“SOP”). (See id. ¶ 7 (defining “SOP”).) Moreover, Gladney’s statement that the training allocation was being adjusted “to correctly reflect our highest priced Onsites” indicates that Veritas was attempting to value the transaction with respect to actual fair
market values.

Additionally, plaintiffs now allege that the fact Veritas was still making changes to the pricing of the components of the AOL transaction more than a month after the transaction took place indicates an intent to manipulate the figures to maximize the amount of revenue that could be recognized in 4Q00. (See id. ¶¶ 69-71.) Plaintiffs point, in particular, to the charts attached to Gladney's November 1, 2000 email, which show significant increases in the percentages of the deal attributable to license fees and significant decreases in the amounts attributable to support fees. (See id.) Plaintiffs fail to allege, however, how these changes demonstrate an intent to defraud, rather than an attempt to comply with GAAP.

Although the theory of plaintiffs' case is that Veritas lacked objective evidence of fair market values for each element of the AOL transaction (see id. ¶ 4), plaintiffs point to no facts suggesting that the increased license fees and lowered support fees bear no relation to actual fair market values, let alone that anyone at Veritas was aware of it at the time.

Plaintiffs also have amended their complaint to include allegations with respect to four new confidential witnesses ("CW"): CWs 12, 13, 14, and 15. (See FAC ¶ 19(l)-(o).) CW12 is alleged to be a former Veritas senior revenue accountant who reported directly to Gladney. (See id. ¶ 19(l).) Although plaintiffs allege that CW12 had familiarity with certain aspects of Veritas' accounting procedures,³ (see id. ¶¶ 62-63), there is no allegation CW12 had any knowledge of any accounting decisions relating to the AOL transaction.

CW13 is alleged to have worked as a financial report accountant in Veritas' finance department from 4Q00 through the spring of 2003. (See id. ¶ 19(m).) Plaintiffs allege that, according to CW13, KPMG "discovered one of the earlier versions of the AOL transaction" and "ultimately determined" that the deal was not in compliance with SOP 97-2. (See id. ¶ 99.) It is undisputed that the initial accounting of the AOL transaction was erroneous. Plaintiffs' allegation that KPMG "ultimately determined" that the accounting was erroneous

³ Plaintiffs' allegation that CW12 witnessed and participated in improper accounting of maintenance revenue in unspecified transactions at unspecified times, (see FAC ¶ 62(f)), does not come close to alleging fraud with the specificity required under the PSLRA.
provides no basis for an inference that the erroneous accounting was made with scienter.

Plaintiffs do not allege that CW13 had any knowledge of the accounting decisions made with respect to the AOL transaction, let alone such knowledge from which one could infer that those decisions were made with intent to defraud or with deliberate recklessness.

CW14 is alleged to have been a Veritas account executive from November 2000 through the spring of 2001. (See id. ¶ 19(n).) According to plaintiffs, CW14 can attest that the senior management at Veritas, and particularly Sallaberry, had a "hands on approach to large deals." (See id. ¶ 71(m).) There is no allegation, however, that CW14 has any personal knowledge of any accounting decisions made by Veritas, much less any knowledge with respect to the particular AOL transaction at issue in this lawsuit.

CW15 is alleged to be a former Veritas director of marketing programs. (See id. ¶ 19(o).) According to plaintiffs, CW15 can attest that Mark Griffiths, Veritas' Vice President of Corporate Marketing, and Doug Roseborough, Veritas' Senior Vice President of Product Marketing, told CW15 that Veritas was advertising on AOL as a quid pro quo for software and services purchased by AOL. (See id. ¶ 71(c).) As the Court has previously noted, however, there is nothing intrinsically fraudulent about barter-type transactions. GAAP specifically provides for methods of accounting for them, as plaintiffs acknowledge in their complaint. (See id. ¶ 128.) Plaintiffs have not alleged that CW15 has any personal knowledge of accounting decisions with respect to the AOL transaction from which the Court could infer that those decisions, which were later determined to be erroneous, were made with intent to defraud, or deliberate recklessness, at the time they were made.

Finally, plaintiffs seek to allege scienter by alleging defendants engaged in obvious accounting improprieties. An inference of scienter may be raised when facts are alleged showing that the accounting decisions at issue were "such an extreme departure from reasonable accounting practice that [the defendant] knew or had to have known that its conclusions would mislead investors." See DSAM, 288 F.3d at 391 (internal quotation and citation omitted). Here, plaintiffs allege that Veritas falsely assured investors that its revenue recognition practices were in compliance with GAAP, and in particular, with SOP
97-2 and 98-9. (See id. ¶¶ 7, 24, 50.) Plaintiffs contend that Veritas' accounting for the AOL transaction was fraudulent because GAAP requires "that revenue from multiple element software transactions be based on vendor-specific objective evidence of fair value," and that "Veritas had to have vendor-specific objective evidence of fair value for each part of the transaction." (See id. ¶¶ 53, 61; see also id. ¶¶ 125-26 (alleging that "Veritas needed an objective basis to establish the fair value of each element of the AOL transaction").) Plaintiffs allege that Veritas lacked such evidence when it valued the components of the AOL transaction. (See id. ¶ 4.)

Defendants correctly point out that Veritas, in its Forms 10-K, informed investors that it applies SOP 97-2, as amended by SOP 98-4 and 98-9, and that it recognizes license revenue "using the residual method in accordance with SOP 98-9."4 (See Main Decl., Ex. A at 23, Ex. C at 25, Ex. D at 57.) As explained below, contrary to plaintiffs' allegations, accounting under the residual method does not require vendor-specific objective evidence of the value of each component of the transaction.

SOP 97-2 provides guidance on applying GAAP to software transactions. (See Main Decl., Ex. J at SOP 97-2.01.) According to SOP 97-2, if a software transaction "includes multiple elements, the fee should be allocated to the various elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated within the contract for each element."5 (See id. at SOP 97-2.10.) Generally, "[i]f sufficient vendor-specific objective evidence does not exist for the allocation of revenue to the various

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4 As noted above, the Court takes judicial notice only that these statements were made, and does not accept the truth of the statements.

5 Plaintiffs argue that the Court cannot consider defendants' arguments to the extent such are based on the application of accounting rules because, according to plaintiffs, any such argument is necessarily fact-based and thus improper to consider in ruling on a motion to dismiss. Plaintiffs, however, have alleged the specific accounting rules that Veritas allegedly violated. In ruling on a motion to dismiss, the Court may consider documents whose contents are alleged in the complaint, and whose authenticity no party questions, but which are not physically attached to the pleading. See Branch v. Tunnell, 14 F.3d at 454. Although the Court can imagine instances in which expert testimony might be necessary to interpret an accounting rule, the arguments addressed herein are based entirely on the plain language of the relevant rules.
elements of the arrangement, all revenue from the arrangement should be deferred until
the earlier of the point at which (a) such vendor-specific objective evidence does exist or (b)
all elements of the arrangement have been delivered." (See id. at SOP 97-2.12.)
SOP 98-9 amended the above-quoted section of SOP 97-2, however, for transactions
entered into in fiscal years beginning after March 15, 1999, to allow earlier recognition of
revenue, under certain circumstances, where vendor-specific objective evidence does not
exist for certain components of the transaction. (See id.) In particular, where “there is
vendor-specific objective evidence of the fair values of all undelivered elements in an
arrangement but vendor-specific objective evidence of fair value does not exist for one or
more of the delivered elements in the arrangement” and, in addition, “(a) all other
applicable revenue recognition criteria in [SOP 97-2] are met and (b) the fair value of all the
undelivered elements is less than the arrangement fee,” then the “residual method” of
accounting for the transaction may be used. (See id. at SOP 97-2.12 (emphasis in
original).) “Under the residual method, the arrangement fee is recognized as follows: (a)
the total fair value of the undelivered elements, as indicated by vendor-specific objective
evidence, is deferred and (b) the difference between the total arrangement fee and the
amount deferred for the undelivered elements is recognized as revenue related to the
delivered elements.” (See id.) SOP 98-9 was adopted to address the situation where
software and support services are always sold together so that there is no vendor-specific
objective evidence of the value of each of the separate components of the transaction.
(See id., Ex. K (SOP 98-9.14).)
Thus, as defendants correctly note, GAAP permits recognition of revenue under
certain circumstances, pursuant to the residual method set forth in SOP 98-9, even if
defendants lacked vendor-specific objective evidence of the value of some of the
components of the transaction. In addition, as defendants correctly point out, SOP 97-2
and 98-9 provide no guidance as how to account for a two-way contemporaneous
transaction in which one party agrees to purchase goods or services in exchange for the
selling party’s agreement to purchase goods or services from the first party. Plaintiffs
themselves allege that such a transaction is governed by Accounting Principles Board Opinion No. 29 ("APB No. 29"), "Accounting for Nonmonetary Transactions." (See FAC ¶ 128.) According to plaintiffs, "accounting for nonmonetary or barter transactions should be based on the fair values of the assets or services involved." (See id.) The plain language of APB No. 29 recognizes, however, that in some circumstances, fair values cannot be determined, and yet APB No. 29 provides for a method of accounting for such a transaction: "If neither the fair value of a nonmonetary asset transferred nor the fair value of a nonmonetary asset received in exchange is determinable within reasonable limits, the recorded amount of the nonmonetary asset transferred from the enterprise may be the only available measure of the transaction." (See Main Decl., Ex. H, APB No. 29 ¶ 26.) Consequently, plaintiffs' allegations that Veritas "had to have vendor-specific objective evidence of fair value for each part of the transaction," (see FAC ¶¶ 53, 61) and that Veritas "needed an objective basis to establish the fair value of each element of the AOL transaction," see id. ¶ 126, are not sufficient to plead an extreme departure from GAAP such that defendants must have been aware of the impropriety of their accounting decisions, see DSAM, 288 F.3d at 391, because the GAAP provisions that plaintiffs claim Veritas violated do not require evidence of fair value for each element of the transaction under all circumstances. In short, plaintiffs do not explain how Veritas' accounting of the AOL transaction falls outside the exceptions, as set forth in SOP 98-9 or APB No. 29, to the general rule requiring revenue recognition to be deferred in the absence of vendor-specific objective evidence of fair value for each component of the transaction.

Plaintiffs have not otherwise amended their previous allegations in any material way, and, for the reasons discussed above, plaintiffs have failed to set forth facts from which the Court may infer that it is more likely that Veritas committed accounting fraud than that it innocently or negligently committed an accounting error. In sum, plaintiffs' allegations, taken as a whole, do not establish a strong inference of scienter because the allegations do not demonstrate that an inference of fraud is "the most plausible of competing inferences." See Gompper, 298 F.3d at 897 (quoting Helwig, 251 F.3d at 553). Because plaintiffs have
failed to adequately allege scienter, the complaint must be dismissed.6

2. Section 20(a)

Plaintiffs also allege a cause of action against the individual defendants for violation of § 20(a) of the Exchange Act, which provides: "Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlling person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a). To be liable under § 20(a), defendants also must be liable under another section of the Exchange Act. See Heliotrope General, Inc. v. Ford Motor Co., 189 F.3d 971, 978 (9th Cir. 1999). As plaintiffs

6 In so ruling, the Court is aware of the district court's decision in In re AOL Time Warner, Inc. Sec. Litig., 2004 U.S. Dist. LEXIS 7917 (S.D.N.Y. May 5, 2004) and sees no conflict therewith. In AOL Time Warner, the district court denied a motion to dismiss a § 10(b) claim against an AOL vice-president based on allegations of his participation in the Veritas transaction. See id. at *89-90. The district court held that the plaintiffs therein had adequately alleged such defendant "consciously misbehaved" because if he "engineered a separate transaction to make it appear that AOL was receiving $20 million in advertising revenue, when in actuality it was giving itself its own money, then [he] has acted fraudulently." See id. at *89-90.

The Court notes, as an initial matter, that even if AOL officers acted with intent to defraud, it does not necessarily follow that Veritas officers also acted with intent to defraud. In addition, the fact that a complaint in one action may adequately plead fraud does not require a finding that a complaint in another action addressing some of the same events also is adequately pleaded. More importantly, the Ninth Circuit has recognized that the Second Circuit applies a lower standard for pleading securities fraud than is applied in the Ninth Circuit. See Silicon Graphics, 183 F. 3d at 974. The Second Circuit has declined to adopt the Ninth Circuit's more stringent pleading standards as set forth in Silicon Graphics. See Novak v. Kasaks, 216 F.3d 300, 310 (2d Cir. 2000). The AOL Time Warner decision itself notes that the Second Circuit does not require "great specificity" in allegations of securities fraud, see id. at *56, and that a court in the Second Circuit, in ruling on a motion to dismiss a securities fraud claim, must draw "all reasonable inferences from the complaint's allegations in favor of the plaintiff," see id. at *22.

By contrast, in the Ninth Circuit, plaintiffs in securities fraud actions are required to "plead, in great detail, facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct," see Silicon Graphics, 183 F. 3d at 974, and the court must consider "all reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs," see No. 84 Employer-Teamster Joint Council Pension Trust Fund, 320 F.3d at 938 (quoting Gompper, 298 F.3d at 897). Because the district court in AOL Time Warner did not determine that an inference of fraud is "the most plausible of competing inferences," see Gompper, 298 F.3d at 897 (quoting Helwig, 251 F.3d at 553), there is no inconsistency between this Court's decision and the decision in AOL Time Warner.
have not stated a claim under § 10(b), their claim for violation of § 20(a) also fails. See id.

CONCLUSION

For the reasons stated above:

1. Defendants’ request for judicial notice is GRANTED.

2. Defendants’ motions to dismiss are GRANTED, with leave to amend. Plaintiffs shall file an amended complaint within 21 days of the date of this order, or the complaint will be deemed dismissed with prejudice.

3. This order terminates Docket Nos. 112 and 113.

IT IS SO ORDERED.

/s/ Maxine M. Chesney

MAXINE M. CHESNEY
United States District Judge

Dated: May 19, 2004
Exhibit S
ACC Section 10,700

Statement of Position 97-2 Software Revenue Recognition

October 27, 1997

NOTE

Statements of Position (SOPs) on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles, identifies AICPA SOPs that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category b of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this SOP if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the SOP should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

An effective date provision of this SOP has been deferred by SOP 98-4, Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition. This SOP is effective March 31, 1998. If an enterprise had applied SOP 97-2 in an earlier period for financial statements or information already issued prior to the promulgation of this SOP, amounts reported in those financial statements or as part of that information may be restated to reflect the deferral of the effective date of the second sentence of paragraphs 10, 37, 41, and 57 of SOP 97-2 and the related examples noted in paragraph .03 of this SOP.

SOP 97-2 is amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. The provisions of this SOP that extend the deferral of the application of certain passages of SOP 97-2 are effective December 15, 1998. All other provisions of this SOP are effective for transactions entered into in fiscal years beginning after March 15, 1999. Earlier adoption is permitted as of the beginning of fiscal years or interior periods for which financial statements or information has not been issued. Retroactive application of the provisions of this SOP is prohibited.

Introduction

.01 Statement of Position (SOP) 91-1, Software Revenue Recognition, was issued in 1991 to provide guidance on applying generally accepted accounting principles to software transactions and to narrow the range of revenue recognition practices that were in use before its issuance. Since the issuance of SOP 91-1, practice issues have been identified that the AICPA's Accounting Standards Executive Committee (AcSEC) believes are not addressed adequately in SOP 91-1. In addition, AcSEC believes some of the guidance in SOP 91-1 should be reconsidered. This SOP supersedes SOP 91-1.

Scope

.02 This SOP provides guidance on when revenue should be recognized and in what amounts for licensing, selling, leasing, or otherwise marketing computer software. It should be applied to those activities by all entities that earn such revenue. It does not apply, however, to revenue earned on products or services containing software that is incidental to the products or services as a whole.

1 Terms defined in the glossary are set in boldface type the first time they appear in this SOP.

2 Indicators of whether software is incidental to a product as a whole include (but are not limited to) (a) whether the software is a significant focus of the marketing effort or is sold separately, (b) whether the vendor is providing postcontract customer support, and (c) whether the
vendor incurs significant costs that are within the scope of FASB Statement No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed. An example of the applicability of this SOP to revenue earned on products containing software is included in appendix A (paragraph .146).

03 In connection with the licensing of an existing product, a vendor might offer a small discount (for example, a coupon or other form of offer for five percent off) on additional licenses of the licensed product or other products that exist at the time of the offer but are not part of the arrangement. Such marketing and promotional activities are not unique to software and are not included in the scope of this SOP.

3 As discussed in paragraph .09, arrangements may include multiple elements. If the discount or other concessions in an arrangement are more than insignificant, a presumption is created that an additional element(s) (as defined in paragraph .09) is being offered in the arrangement.

Relationship to Other Pronouncements

04 If a lease of software includes property, plant, or equipment, the revenue attributable to the property, plant, or equipment should be accounted for in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 13, Accounting for Leases, and any revenue attributable to the software, including postcontract customer support (PCS), should be accounted for separately in conformity with the guidance set forth in this SOP. However, in conformity with paragraph .02, if the property, plant, or equipment contains software that is incidental to the property, plant, or equipment as a whole, the software should not be accounted for separately.

05 A number of the requirements of this SOP are similar to or overlap those in certain pronouncements of the Accounting Principles Board (APB) or the FASB, such as FASB Statement No. 48, Revenue Recognition When Right of Return Exists. This SOP does not alter the requirements of any APB Opinion or FASB pronouncement.

Conclusions

06 The following conclusions should be read in conjunction with the Basis for Conclusions section, beginning with paragraph .93 of this SOP, and the examples in appendix A, Examples of the Application of Certain Provisions of this SOP (paragraph .146).

Basic Principles

07 Software arrangements range from those that provide a license for a single software product to those that, in addition to the delivery of software or a software system, require significant production, modification, or customization of software. If an arrangement to deliver software or a software system, either alone or together with other products or services, requires significant production, modification, or customization of software, the entire arrangement should be accounted for in conformity with Accounting Research Bulletin (ARB) No. 45, Long-Term Construction-Type Contracts, using the relevant guidance herein, and in SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts [section 10.330].

4 If a software arrangement includes services that meet the criteria discussed in paragraph .65 of this SOP, those services should be accounted for separately.

08 If the arrangement does not require significant production, modification, or customization of software, revenue should be recognized when all of the following criteria are met:

- Persuasive evidence of an arrangement exists.
- Delivery has occurred.
- The vendor's fee is fixed or determinable.
- Collectibility is probable.

The term probable is used in this SOP with the same definition as used in FASB Statement No. 5, Accounting for Contingencies.

Software arrangements may provide licenses for multiple software deliverables (for example, software products, upgrades/enhancements, PCS, or services), which are termed multiple elements. A number of the elements may be described in the arrangement as being deliverable only on a when-and-if-available basis. When-and-if-available deliverables should be considered in determining whether an arrangement includes multiple elements. Accordingly, the requirements of this SOP with respect to arrangements that consist of multiple elements should be applied to all additional products and services specified in the arrangement, including those described as being deliverable only on a when-and-if-available basis.

If an arrangement includes multiple elements, the fee should be allocated to the various elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated within the contract for each element. Vendor-specific objective evidence of fair value is limited to 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 probable that the price, once established, will not change before the separate introduction of the element into the marketplace

The amount allocated to undelivered elements is not subject to later adjustment. However, if it becomes probable that the amount allocated to an undelivered element will result in a loss on that element of the arrangement, the loss should be recognized pursuant to FASB Statement No. 5, Accounting for Contingencies. When a vendor's pricing is based on multiple factors such as the number of products and the number of users, the amount allocated to the same element when sold separately must consider all the factors of the vendor's pricing structure.

If a discount is offered in a multiple-element arrangement, a proportionate amount of that discount should be applied to each element included in the arrangement based on each element's fair value without regard to the discount. However, as discussed in paragraph .37, no portion of the discount should be allocated to any upgrade rights. Moreover, to the extent that a discount exists, the residual method described in paragraph .12 attributes that discount entirely to the delivered elements.

If sufficient vendor-specific objective evidence does not exist for the allocation of revenue to the various elements of the arrangement, all revenue from the arrangement should be deferred until the earlier of the point at which (a) such sufficient vendor-specific objective evidence does exist or (b) all elements of the arrangement have been delivered. The following exceptions to this guidance are provided:

- If the only undelivered element is PCS, the entire fee should be recognized ratably (see paragraphs .56 through .62).
- If the only undelivered element is services that do not involve significant production, modification, or customization of software (for example, training or installation), the entire fee should be recognized over the period during which the services are expected to be performed (see paragraphs .63 through .71).
- If the arrangement is in substance a subscription, the entire fee should be recognized ratably (see paragraphs .48 and .49).
- If the fee is based on the number of copies, the arrangement should be accounted for in conformity with paragraphs .43 through .47.
- There may be instances in which there is vendor-specific objective evidence of the fair values of all undelivered elements in an arrangement but vendor-specific objective evidence of fair value does not exist for one or more of the delivered elements in the arrangement. In such instances, the fee should be recognized using the residual method, provided that (a) all other applicable revenue recognition criteria in this SOP are met and (b) the fair value of all of the undelivered elements is less than the arrangement fee. Under the residual method, the arrangement fee is recognized as follows: (a) the total fair value of the undelivered elements, as indicated by vendor-specific objective evidence, is deferred and (b) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.


[As amended, effective for transactions entered into in fiscal years beginning after March 15, 1999, by Statement of Position 98-9.]

6 This does not apply to changes in the estimated percentage of customers not expected to exercise an upgrade right. See paragraph .37.

If a discount is offered in a multiple-element arrangement, a proportionate amount of that discount should be applied to each element included in the arrangement based on each element's fair value without regard to the discount. However, as discussed in paragraph .37, no portion of the discount should be allocated to any upgrade rights. Moreover, to the extent that a discount exists, the residual method described in paragraph .12 attributes that discount entirely to the delivered elements.

If a discount is offered in a multiple-element arrangement, a proportionate amount of that discount should be applied to each element included in the arrangement based on each element's fair value without regard to the discount. However, as discussed in paragraph .37, no portion of the discount should be allocated to any upgrade rights. Moreover, to the extent that a discount exists, the residual method described in paragraph .12 attributes that discount entirely to the delivered elements.

If sufficient vendor-specific objective evidence does not exist for the allocation of revenue to the various elements of the arrangement, all revenue from the arrangement should be deferred until the earlier of the point at which (a) such sufficient vendor-specific objective evidence does exist or (b) all elements of the arrangement have been delivered. The following exceptions to this guidance are provided:

- If the only undelivered element is PCS, the entire fee should be recognized ratably (see paragraphs .56 through .62).
- If the only undelivered element is services that do not involve significant production, modification, or customization of software (for example, training or installation), the entire fee should be recognized over the period during which the services are expected to be performed (see paragraphs .63 through .71).
- If the arrangement is in substance a subscription, the entire fee should be recognized ratably (see paragraphs .48 and .49).
- If the fee is based on the number of copies, the arrangement should be accounted for in conformity with paragraphs .43 through .47.
- There may be instances in which there is vendor-specific objective evidence of the fair values of all undelivered elements in an arrangement but vendor-specific objective evidence of fair value does not exist for one or more of the delivered elements in the arrangement. In such instances, the fee should be recognized using the residual method, provided that (a) all other applicable revenue recognition criteria in this SOP are met and (b) the fair value of all of the undelivered elements is less than the arrangement fee. Under the residual method, the arrangement fee is recognized as follows: (a) the total fair value of the undelivered elements, as indicated by vendor-specific objective evidence, is deferred and (b) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.

[As amended, effective for transactions entered into in fiscal years beginning after March 15, 1999, by Statement of Position 98-9.]

If sufficient vendor-specific objective evidence does not exist for the allocation of revenue to the various elements of the arrangement, all revenue from the arrangement should be deferred until the earlier of the point at which (a) such sufficient vendor-specific objective evidence does exist or (b) all elements of the arrangement have been delivered. The following exceptions to this guidance are provided:

- If the only undelivered element is PCS, the entire fee should be recognized ratably (see paragraphs .56 through .62).
- If the only undelivered element is services that do not involve significant production, modification, or customization of software (for example, training or installation), the entire fee should be recognized over the period during which the services are expected to be performed (see paragraphs .63 through .71).
- If the arrangement is in substance a subscription, the entire fee should be recognized ratably (see paragraphs .48 and .49).
- If the fee is based on the number of copies, the arrangement should be accounted for in conformity with paragraphs .43 through .47.
- There may be instances in which there is vendor-specific objective evidence of the fair values of all undelivered elements in an arrangement but vendor-specific objective evidence of fair value does not exist for one or more of the delivered elements in the arrangement. In such instances, the fee should be recognized using the residual method, provided that (a) all other applicable revenue recognition criteria in this SOP are met and (b) the fair value of all of the undelivered elements is less than the arrangement fee. Under the residual method, the arrangement fee is recognized as follows: (a) the total fair value of the undelivered elements, as indicated by vendor-specific objective evidence, is deferred and (b) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.

[As amended, effective for transactions entered into in fiscal years beginning after March 15, 1999, by Statement of Position 98-9.]
.13 The portion of the fee allocated to an element should be recognized as revenue when the criteria in paragraph .08 of this SOP are met with respect to the element. In applying those criteria, the delivery of an element is considered not to have occurred if there are undelivered elements that are essential to the functionality of the delivered element, because the customer would not have the full use of the delivered element.

.14 No portion of the fee (including amounts otherwise allocated to delivered elements) meets the criterion of collectibility if the portion of the fee allocable to delivered elements is subject to forfeiture, refund, or other concession if any of the undelivered elements are not delivered. In order for the revenue related to an arrangement to be considered not subject to forfeiture, refund, or other concession, management must intend not to provide refunds or concessions that are not required under the provisions of the arrangement. All available evidence should be considered to determine whether the evidence persuasively indicates that the revenue is not subject to forfeiture, refund, or other concession. Although no single item of evidence may be persuasive, the following additional items should be considered:

- Acknowledgment in the arrangement of products not currently available or not to be delivered currently
- Separate prices stipulated in the arrangement for each deliverable element
- Default and damage provisions as defined in the arrangement
- Enforceable payment obligations and due dates for the delivered elements that are not dependent on the delivery of the future deliverable elements, coupled with the intent of the vendor to enforce rights of payment
- Installation and use of the delivered software
- Support services, such as telephone support, related to the delivered software being provided currently by the vendor

Regardless of the preceding, the vendor's historical pattern of making refunds or other concessions that were not required under the original provisions (contractual or other) of other arrangements should be considered more persuasive than terms included in the arrangement that indicate that no concessions are required.

Evidence of an Arrangement

.15 Practice varies with respect to the use of written contracts. Although a number of sectors of the industry rely upon signed contracts to document arrangements, other sectors of the industry that license software (notably the packaged software sector) do not.

.16 If the vendor operates in a manner that does not rely on signed contracts to document the elements and obligations of an arrangement, the vendor should have other forms of evidence to document the transaction (for example, a purchase order from a third party or on-line authorization). If the vendor has a customary business practice of utilizing written contracts, evidence of the arrangement is provided only by a contract signed by both parties.

.17 Even if all other requirements set forth in this SOP for the recognition of revenue are met (including delivery), revenue should not be recognized on any element of the arrangement unless persuasive evidence of an arrangement exists.

Delivery

.18 The second criterion in paragraph .08 for revenue recognition is delivery. The principle of not recognizing revenue before delivery applies whether the customer is a user or a reseller. Except for arrangements in which the fee is a function of the number of copies, delivery is considered to have occurred upon the transfer of the product master or, if the product master is not to be delivered, upon the transfer of the first copy. For software that is delivered electronically, the delivery criterion of paragraph .08 is considered to have been met when the customer either (a) takes possession of the software via a download (that is, when the customer takes possession of the electronic data on its hardware), or (b) has been provided with access codes that allow the customer to take immediate possession of the software on its hardware pursuant to an agreement or purchase order for the software. In such cases, revenue should be recognized if the other criteria of paragraph .08 have been satisfied.

.19 Paragraphs .20 through .25 provide guidance on determining whether delivery is considered to have occurred in certain kinds of software transactions.

Customer Acceptance

After delivery, if uncertainty exists about customer acceptance of the software, license revenue should not be recognized until acceptance occurs.

**Determining Delivery—Multiple Copies of Software Products Versus Multiple Licenses**

Arrangements to use multiple copies of a software product under site licenses with users and to market multiple copies of a software product under similar arrangements with resellers should be distinguished from arrangements to use or market multiple single licenses of the same software.

- In the former kind of arrangement, duplication is incidental to the arrangement and the delivery criterion is met upon the delivery of the first copy or product master. The vendor may be obligated to furnish up to a specified number of copies of the software, but only if the copies are requested by the user. The licensing fee is payable even if no additional copies are requested by the user or reseller. If the other criteria in this SOP for revenue recognition are met, revenue should be recognized upon delivery of the first copy or product master. The estimated costs of duplication should be accrued at that time.
- In the latter kind of arrangement, the licensing fee is a function of the number of copies delivered to, made by, or deployed by the user or reseller. Delivery occurs and revenue should be recognized as the copies are made by the user or sold by the reseller if the other criteria in this SOP for revenue recognition are met.

**Delivery Other Than to the Customer**

Delivery should not be considered complete unless the destination to which the software is shipped is the customer's place of business or another site specified by the customer. In addition, if a customer specifies an intermediate site but a substantial portion of the fee is not payable until the delivery by the vendor to another site specified by the customer, revenue should not be recognized until the delivery is made to that other site.

**Delivery Agents**

Vendors may engage agents, often referred to as fulfillment houses, to either duplicate and deliver or only deliver software products to customers. Revenue from transactions involving delivery agents should be recognized when the software is delivered to the customer. Transferring the fulfillment obligation to an agent of the vendor does not relieve the vendor of the responsibility for delivery. This is the case even if the vendor has no direct involvement in the actual delivery of the software product to the customer.

**Authorization Codes**

In a number of software arrangements, vendors use authorization codes, commonly referred to as keys, to permit customer access to software that otherwise would be restricted. Keys are used in a variety of ways and may serve different purposes. For example, permanent keys may be used to control access to the software, or additional permanent keys may be necessary for the duplication of the software. Temporary keys may be used for the same purposes and also may be used to enhance the vendor's ability to collect payment or to control the use of software for demonstration purposes.

In software arrangements involving the use of keys, delivery of a key is not necessarily required to satisfy the vendor's delivery responsibility. The software vendor should recognize revenue on delivery of the software if all other requirements for revenue recognition under this SOP and all of the following conditions are met.

- The customer has licensed the software and the vendor has delivered a version of the software that is fully functional except for the permanent key or the additional keys (if additional keys are used to control the reproduction of the software).
- The customer's obligation to pay for the software and the terms of payment, including the timing of payment, are not contingent on delivery of the permanent key or additional keys (if additional keys are used to control the reproduction of the software).
- The vendor will enforce and does not have a history of failing to enforce its right to collect payment under the terms of the original arrangement.

In addition, if a temporary key is used to enhance the vendor's ability to collect payment, the delivery of additional keys, whether temporary or permanent, is not required to satisfy the vendor's delivery responsibility if (a) the above conditions are...
met and (b) the use of a temporary key in such circumstances is a customary practice of the vendor. Selective issuance of temporary keys might indicate that collectibility is not probable or that the software is being used only for demonstration purposes.

Fixed or Determinable Fees and Collectibility

.26 The other prerequisites in paragraph .08 for revenue recognition are that (a) the vendor's fee is fixed or determinable and (b) collectibility is probable. A software licensing fee is not fixed or determinable if the amount is based on the number of units distributed or copied, or the expected number of users of the product. Revenue recognition for variable-pricing arrangements is discussed in paragraphs .43 through .47 of this SOP. Additionally, if an arrangement includes (a) rights of return or (b) rights to refunds without return of the software, FASB Statement No. 48 requires that conditions that must be met in order for the vendor to recognize revenue include that the amount of future returns or refunds can be reasonably estimated.

Factors That Affect the Determination of Whether a Fee is Fixed or Determinable and Collectible

.27 A number of arrangements that call for fixed or determinable payments, including minimum royalties or license fees from resellers, specify a payment period that is short in relation to the period during which the customer is expected to use or market the related products. Other arrangements have payment terms that extend over a substantial portion of the period during which the customer is expected to use or market the related products. Because a product's continuing value may be reduced due to the subsequent introduction of enhanced products by the vendor or its competitors, the possibility that the vendor will provide a refund or concession to a creditworthy customer to liquidate outstanding amounts due under the original terms of the arrangement increases as payment terms become longer.

.28 For the reason cited in paragraph .27 any extended payment terms in a software licensing arrangement may indicate that the fee is not fixed or determinable. Further, if payment of a significant portion of the software licensing fee is not due until after expiration of the license or more than twelve months after delivery, the licensing fee should be presumed not to be fixed or determinable. However, this presumption may be overcome by evidence that the vendor has a standard business practice of using long-term or installment contracts and a history of successfully collecting under these original payment terms without making concessions. In such a situation, a vendor should consider such fees fixed or determinable and should recognize revenue upon delivery of the software, provided all other conditions for revenue recognition in this SOP have been satisfied.

.29 If it cannot be concluded that a fee is fixed or determinable at the outset of an arrangement, revenue should be recognized as payments from customers become due (assuming all other conditions for revenue recognition in this SOP have been satisfied).

.30 For reseller arrangements, the following factors also should be considered in evaluating whether the fixed or determinable fee and collectibility criteria for revenue recognition are met.

- Business practices, the reseller's operating history, competitive pressures, informal communications, or other factors indicate that payment is substantially contingent on the reseller's success in distributing individual units of the product.
- Resellers are new, undercapitalized, or in financial difficulty and may not demonstrate an ability to honor a commitment to make fixed or determinable payments until they collect cash from their customers.
- Uncertainties about the potential number of copies to be sold by the reseller may indicate that the amount of future returns cannot be reasonably estimated on delivery; examples of such factors include the newness of the product or marketing channel, competitive products, or dependence on the market potential of another product offered (or anticipated to be offered) by the reseller.
- Distribution arrangements with resellers require the vendor to rebate or credit a portion of the original fee if the vendor subsequently reduces its price for a product and the reseller still has rights with respect to that product (sometimes referred to as price protection). If a vendor is unable to reasonably estimate future price changes in light of competitive conditions, or if significant uncertainties exist about the vendor's ability to maintain its price, the arrangement fee is not fixed or determinable. In such circumstances, revenue from the arrangement should be deferred until the vendor is able to reasonably estimate the effects of future price changes and the other conditions of this SOP have been satisfied.

7 Contractual arrangements under which the reseller is obligated to pay only as and if sales are made to users should be accounted for as consignments.

.31 Customer Cancellation Privileges. Fees from licenses cancelable by customers are neither fixed nor determinable until the cancellation privileges lapse. Fees from licenses with cancellation privileges expiring ratably over the license period are considered to become determinable ratably over the license period as the cancellation privileges lapse. In applying the provisions of this paragraph, obligations related to warranties for defective software, including warranties that are routine, short-term, and relatively minor, should be accounted for in conformity with FASB Statement No. 5. Additionally, short-term rights of return, such as thirty-day money-back guarantees, should not be considered cancellation privileges; the related returns should be accounted for in conformity with FASB Statement No. 48.

.32 Fiscal Funding Clauses. Fiscal funding clauses sometimes are found in software license arrangements in which the licensees are governmental units. Such clauses generally provide that the license is cancelable if the legislature or funding authority does not appropriate the funds necessary for the governmental unit to fulfill its obligations under the licensing arrangement.

.33 Consistent with FASB Technical Bulletin No. 79-10, Fiscal Funding Clauses in Lease Agreements, a software licensing arrangement with a governmental unit containing a fiscal funding clause should be evaluated to determine whether the uncertainty of a possible license arrangement cancellation is a remote contingency. If the likelihood is assessed as remote, the software licensing arrangement should be considered noncancelable. Such an assessment should include the factors discussed in paragraphs .27 and .28 of this SOP. If the likelihood is assessed as other than remote, the license should be considered cancelable, thus precluding revenue recognition. A fiscal funding clause with a customer other than a governmental unit that is required to include such a clause creates a contingency that precludes revenue recognition until the requirements of the clause and all other provisions of this SOP have been satisfied.

8 The evaluation of whether the level of uncertainty of possible cancellation is remote should be consistent with FASB Statement No. 5, which defines remote as relating to conditions in which "the chance of the future event or events occurring is slight."

Multiple-Element Arrangements

.34 As discussed in paragraph .09, multiple-element arrangements to which contract accounting does not apply may include customer rights to any combination of additional software deliverables, services, or PCS. If contract accounting does not apply, individual elements in such arrangements should be accounted for in accordance with paragraphs .08 through .14. Paragraphs .35 through .73 provide guidance on the application of those paragraphs to multiple-element arrangements.

Additional Software Deliverables and Rights to Exchange or Return Software

.35 As part of a multiple-element arrangement, a vendor may agree to deliver software currently and to deliver additional software in the future. The additional deliverables may include upgrades/enhancements or additional software products. Additionally, a vendor may provide the customer with the right to exchange or return software, including the right to transfer software from one hardware platform or operating system to one or more other platforms or operating systems (a platform-transfer right).

.36 Upgrades/enhancements. As part of a multiple-element arrangement, a vendor may agree to deliver software currently and provide the customer with an upgrade right for a specified upgrade/enhancement. The upgrade right may be evidenced by a specific agreement, commitment, or the vendor's established practice. (Rights to receive unspecified upgrades/enhancements on a when-and-if-available basis are PCS, as it has been redefined in this SOP.) The upgrade right should be accounted for as a separate element in accordance with paragraphs .08 through .14. Guidance on the application of those paragraphs to multiple-element software arrangements that include upgrade rights is given in paragraphs .37 and .38.

.37 If a multiple-element arrangement includes an upgrade right, the fee should be allocated between the elements based on vendor-specific objective evidence of fair value. The fee allocated to the upgrade right is the price for the upgrade/enhancement that would be charged to existing users of the software product being updated. If the upgrade right is included in a multiple-element arrangement on which a discount has been offered (see paragraph .11), no portion of the discount should be allocated to the upgrade right. If sufficient vendor-specific evidence exists to reasonably estimate the

percentage of customers that are not expected to exercise the upgrade right, the fee allocated to the upgrade right should be reduced to reflect that percentage. This estimated percentage should be reviewed periodically. The effect of any change in that percentage should be accounted for as a change in accounting estimate.

.38 The amount of the fee allocated to the upgrade right should be recognized as revenue when the conditions in paragraphs .08 through .14 are met. If sufficient vendor-specific objective evidence does not exist for the allocation of the fee to the upgrade right, revenue from the arrangement should be deferred until the earlier of the point at which (a) such sufficient vendor-specific objective evidence does exist or (b) all elements of the arrangement have been delivered.

.39 Additional Software Products. As part of a multiple-element arrangement, a vendor may agree to deliver software currently and deliver specified additional software products in the future. The rights to these additional products may be included either in the terms of a PCS arrangement or in a separate agreement. Even if the rights to the additional software products are included in a PCS arrangement, the revenue allocable to the additional software products should be accounted for separately from the PCS arrangement as an element of a multiple-element arrangement.

.40 Multiple-element arrangements that include rights to undeclared additional software products that are not subscriptions (see paragraphs .48 and .49) should be accounted for in accordance with paragraphs .08 through .14 of this SOP. Guidance on the application of those paragraphs to such arrangements is provided in paragraphs .41 through .47 below.

.41 The fee from the arrangement should be allocated among the products based on vendor-specific objective evidence of fair value. The allocation should be based on the relative sales prices (determined pursuant to paragraphs .10 and .11 of this SOP) of the products. If vendor-specific objective evidence of fair value does not exist, paragraph .12 of this SOP requires that all revenue from the arrangement be deferred until the earlier of the point at which (a) such sufficient vendor-specific objective evidence does exist or (b) all elements of the arrangement have been delivered. The fee allocated to the additional software products should not be reduced by the percentage of any customers that are not expected to exercise the right to receive additional software products.

.42 If the arrangement is based on a price per product (not a price per copy), the portion of the fee allocated to a product should be recognized as revenue when the product is delivered, assuming all other provisions of paragraphs .08 through .14 of this SOP are met.

.43 Some fixed fee license or reseller arrangements provide customers with the right to reproduce or obtain copies at a specified price per copy (rather than per product) of two or more software products up to the total amount of the fixed fee. A number of the products covered by the arrangement may not be deliverable or specified at the inception of the arrangement. Although the price per copy is fixed at the inception of the arrangement, an allocation of the arrangement fee to the individual products generally cannot be made, because the total revenue allocable to each software product is unknown and depends on the choices to be made by the customer and, sometimes, future development activity while the arrangement is in effect. Nevertheless, as discussed in paragraph .46 of this SOP, in certain situations, revenue can be allocated to the products that are undeclared or not specified at the inception of the arrangement.

.44 In arrangements in which no allocation can be made, until the first copy or product master of each product covered by the arrangement has been delivered to the customer assuming the provisions of paragraphs .08 through .14 of this SOP are met, revenue should be recognized as copies of delivered products either (a) are reproduced by the customer or (b) are furnished to the customer if the vendor is duplicating the software. Once the vendor has delivered the product master or the first copy of all products covered by the arrangement, any licensing fees not previously recognized should be recognized. (At that point, only duplication of the software is required to satisfy the vendor's delivery requirement. As discussed in paragraph .21 of this SOP, duplication of the software is incidental to the arrangement, and delivery is deemed to have occurred upon delivery of the product master or first copy.) When the arrangement terminates, the vendor should recognize any licensing fees not previously recognized.

.45 The revenue from the kind of arrangements discussed in paragraph .44 should not be recognized fully until at least one of the following conditions is met.

- Delivery is complete for all products covered by the arrangement.
- The aggregate revenue attributable to all copies of the software products delivered is equal to the fixed fee, provided that the vendor is not obligated to deliver additional software products under the arrangement.

.46 Nevertheless, certain arrangements that include products that are not deliverable at the inception impose a maximum number of copies of the undeclared product(s) to which the customer is entitled. In such arrangements, a portion of the
arrangement fee should be allocated to the undeliverable product(s). This allocation should be made assuming that the customer will elect to receive the maximum number of copies of the undeliverable product(s).

.47 The revenue allocated to the delivered products should be recognized when the product master or first copy is delivered. If, during the term of the arrangement, the customer reproduces or receives enough copies of these delivered products so that revenue allocable to the delivered products exceeds the revenue previously recognized, such additional revenue should be recognized as the copies are reproduced or delivered. The revenue allocated to the undeliverable product(s) should be reduced by a corresponding amount.

.48 As part of a multiple-element arrangement with a user, a vendor may agree to deliver software currently and to deliver unspecified additional software products in the future (including unspecified platform transfer rights that do not qualify for exchange accounting as described in paragraphs .50 through .55). For example, the vendor may agree to deliver all new products to be introduced in a family of products over the next two years. These arrangements are similar to arrangements that include PCS in that future deliverables are unspecified. Nevertheless, they are distinguished from arrangements that include PCS because the future deliverables are products, not unspecified upgrades/enhancements.

.49 The software elements of the kinds of arrangements discussed in paragraph .48 should be accounted for as subscriptions. No allocation of revenue should be made among any of the software products, and all software product-related revenue from the arrangement should be recognized ratably over the term of the arrangement beginning with delivery of the first product. If the term of the arrangement is not stated, the revenue should be recognized ratably over the estimated economic life of the products covered by the arrangement, beginning with delivery of the first product. An intent on the part of the vendor not to develop new products during the term of the arrangement does not relieve the vendor of the requirement to recognize revenue ratably over the term of the arrangement, beginning with the delivery of the first product.

.50 Rights to Exchange or Return Software. As part of an arrangement, a software vendor may provide the customer with the right to return software or to exchange software for products with no more than minimal differences in price, functionality, or features. The accounting for returns is significantly different from the accounting for exchanges. Although it is sometimes difficult to determine whether a transaction is a return or exchange of software, the fact that the software is not returned physically does not preclude accounting for the transaction as either an exchange or a return. If the software is not returned physically and the customer contractually is entitled to continue to use the previously delivered software, the arrangement should be accounted for in the manner prescribed in the section herein entitled "Additional Software Products" (see paragraphs .39 through .49). If the software is not returned physically and the customer contractually is not entitled to continue to use the previously delivered software, the transaction should be accounted for either as a return or as an exchange, as discussed in the following paragraphs.

.51 If the rights discussed in the previous paragraph are offered to users (but not resellers), the exchanges are analogous to "exchanges by ultimate customers of one item for another of the same kind, quality, and price ... [that] are not considered returns" described in footnote 3 of FASB Statement No. 48. Conversely, exchanges by users of software products for dissimilar software products or for similar software products with more than minimal differences in price, functionality, or features are considered returns, and revenue related to arrangements that provide users with the rights to make such exchanges should be accounted for in conformity with FASB Statement No. 48. If the other product(s) is not available at the time the initial product is delivered, there should be persuasive evidence that demonstrates there will be no more than minimal differences in price, features, or functionality among the products in order for the right to qualify as a right to exchange. Additionally, if the vendor expects to incur a significant amount of development costs related to the other product, the other product should be considered to have more than a minimal difference in functionality.

.52 As part of a multiple-element arrangement, a vendor may grant a user a platform-transfer right. Depending on the circumstances, the exercise of a platform-transfer right may represent an exchange, a return, or additional software products for accounting purposes. If the customer contractually is entitled to continue to use the software that was delivered originally (in addition to the software that is to be delivered for the new platform), the platform transfer right should be accounted for in the manner prescribed in the section herein entitled "Additional Software Products" (see paragraphs .39 through .49).

.53 If, as part of a multiple-element arrangement, a vendor offers a user (not a reseller) a platform-transfer right, and the provisions of paragraphs .08 through .14 of this SOP are met, the revenue from the software license should be recognized upon the initial delivery of the software, and the exercise of the platform-transfer right should be treated as an exchange, if the platform-transfer right —

- Is for the same product (see paragraph .54)
- Does not increase the number of copies or concurrent users of the software product available under the license arrangement.

.54 Products are considered to be the same product if there are no more than minimal differences among them in price, features, and functions, and if they are marketed as the same product, even though there may be differences arising from environmental variables such as operating systems, databases, user interfaces, and platform scales. Indicators of "marketed as the same product" include (a) the same product name (although version numbers may differ) and (b) a focus on the same features and functions.

.55 As part of their standard sales terms or as a matter of practice, vendors may grant resellers the rights to exchange unsold software for other software (including software that runs on a different hardware platform or operating system). Because the reseller is not the ultimate customer (see paragraph .51), such exchanges, including those referred to as stock balancing arrangements, should be accounted for as returns. Arrangements that grant rights to make such exchanges should be accounted for in conformity with FASB Statement No. 48, even if the vendors require the resellers to purchase additional software to exercise the exchange rights.

Postcontract Customer Support

.56 Software arrangements may include the right to PCS. PCS includes the right to receive PCS services or unspecified upgrades/enhancements, or both, offered to users or resellers. A vendor may develop historical patterns of regularly providing all customers or certain kinds of customers with the services or unspecified upgrades/enhancements normally associated with PCS, or may anticipate doing so, even though there is no written contractual obligation or the stipulated PCS term commences at some date after delivery. In those situations, an implied PCS arrangement exists that commences upon product delivery. For purposes of applying the guidance in this SOP, PCS includes a vendor's expected performance based on such patterns, even if performance is entirely at the vendor's discretion and not pursuant to a formal agreement.

.57 If a multiple-element software arrangement includes explicit or implicit rights to PCS, the total fees from the arrangement should be allocated among the elements based on vendor-specific objective evidence of fair value, in conformity with paragraph .10. The fair value of the PCS should be determined by reference to the price the customer will be required to pay when it is sold separately (that is, the renewal rate). The portion of the fee allocated to PCS should be recognized as revenue ratably over the term of the PCS arrangement, because the PCS services are assumed to be provided ratably. However, revenue should be recognized over the period of the PCS arrangement in proportion to the amounts expected to be charged for the PCS services rendered during the period if—

- Sufficient vendor-specific historical evidence exists demonstrating that costs to provide PCS are incurred on other than a straight-line basis. In making this determination, the vendor should take into consideration allocated portions of cost accounted for as research and development (R&D) costs and the amortization of costs related to the upgrade-enhancement capitalized in conformity with FASB Statement No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed. Such costs should be considered as part of the costs to provide PCS.
- The vendor believes that it is probable that the costs incurred in performing under the current arrangement will follow a similar pattern.

Because the timing, frequency, and significance of unspecified upgrades/enhancements can vary considerably, the point at which unspecified upgrades/enhancements are expected to be delivered should not be used to support income recognition on other than a straight-line basis.

.58 If sufficient vendor-specific objective evidence does not exist to allocate the fee to the separate elements and the only undelivered element is PCS, the entire arrangement fee should be recognized ratably over (a) the contractual PCS period (for those arrangements with explicit rights to PCS) or (b) the period during which PCS is expected to be provided (for those arrangements with implicit rights to PCS).

.59 PCS revenue may be recognized together with the initial licensing fee on delivery of the software if all of the following conditions are met.

a. The PCS fee is included with the initial licensing fee.

b. The PCS included with the initial license is for one year or less.

c. The estimated cost of providing PCS during the arrangement is insignificant.

d. Unspecified upgrades/enhancements offered during PCS arrangements historically have been and are expected to

continue to be minimal and infrequent.

If PCS revenue is recognized upon the delivery of the software, the vendor must accrue all estimated costs of providing the services, including upgrades/enhancements. Upgrades/enhancements are not developed solely for distribution to PCS customers; revenues are expected to be earned from providing the enhancements to other customers as well. Therefore, costs should be allocated between PCS arrangements and other licenses.

.60 A determination that unspecified upgrades/enhancements offered during the PCS arrangement are expected to be minimal and infrequent should be evidenced by the patterns of minimal and infrequent unspecified upgrades/enhancements offered in previous PCS arrangements. A conclusion that unspecified upgrades/enhancements are expected to be minimal and infrequent should not be reached simply because unspecified upgrades/enhancements have been or are expected to be offered less frequently than on an annual basis. Regardless of the vendor's history of offering unspecified upgrades/enhancements to initial licensees, PCS should be accounted for separately from the initial licensing fee if the vendor expects to offer upgrades/enhancements that are greater than minimal or more than infrequent to the users or resellers of the licensed software during the PCS arrangement.

.61 Postdelivery Telephone Support at No Additional Charge. Postdelivery telephone support provided to users by the vendor at no additional charge should be accounted for as PCS, in conformity with this SOP, regardless of whether the support is provided explicitly under the licensing arrangement. Although such telephone support may be offered or available for periods exceeding one year, if the vendor has established a history of providing substantially all the telephone support within one year of the licensing or sale of the software, the PCS may be considered to have a term of one year or less in applying paragraph .59, item (b) of this SOP. Accordingly, revenue allocable to telephone support may be recognized together with the initial licensing fee on delivery of the software if all the conditions in paragraph .59 of this SOP are met. This provision applies only to telephone support provided at no additional charge. If revenue allocable to telephone support is recognized together with the licensing fee on delivery, the vendor should accrue the estimated cost of providing that support.

.62 PCS Granted by Resellers. An arrangement in which a vendor grants a reseller the right to provide unspecified upgrades/enhancements to the reseller's customers is an implied PCS arrangement between the vendor and the reseller, even if the vendor does not provide direct telephone support to the reseller's customers. If sufficient vendor-specific objective evidence does not exist to allocate the fee to the software and the PCS, revenue from both the licensing arrangement and the PCS should be recognized ratably over the period during which PCS is expected to be provided.

Services

.63 Certain arrangements include both software and service elements (other than PCS-related services). The services may include training, installation, or consulting. Consulting services often include implementation support, software design or development, or the customization or modification of the licensed software.

.64 If an arrangement includes such services, a determination must be made as to whether the service element can be accounted for separately as the services are performed. Paragraph .65 discusses the criteria that must be considered in making such a determination. If the nature of the services is such that the service element does not qualify for separate accounting as a service, contract accounting must be applied to both the software and service elements included in the arrangement. Paragraphs .74 through .91 of this SOP address the application of contract accounting to software arrangements.

.65 In order to account separately for the service element of an arrangement that includes both software and services, sufficient vendor-specific objective evidence of fair value must exist to permit allocation of the revenue to the various elements of the arrangement (as discussed in paragraphs .10 and .12). Additionally, the services (a) must not be essential to the functionality of any other element of the transaction and (b) must be described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services.

.66 If an arrangement includes services that meet the criteria of paragraph .65 for separate accounting, revenue should be allocated among the service and software elements of the contract. This allocation should be based on vendor-specific objective evidence of fair values. (Fair values are not necessarily the same as any separate prices stated for the separate elements of the arrangement.) Revenue allocated to the service element should be recognized as the services are performed or, if no pattern of performance is discernible, on a straight-line basis over the period during which the services are performed.

.67 If vendor-specific objective evidence of the fair value does not exist to allocate a portion of the fee to the service components of the arrangement, the services must be accounted for as a single unit of account if the criteria in paragraph .10 of this SOP apply.

element, and the only undelivered element is services that do not involve significant production, modification, or customization of the software (for example, training or installation), the entire arrangement fee should be recognized as the services are performed. If no pattern of performance is discernible, the entire arrangement fee should be recognized on a straight-line basis over the period during which the services are performed.

.68 An important factor to consider in determining whether the services are essential to the functionality of any other element is whether the software included in the arrangement is considered core or off-the-shelf software. Core software is software that a vendor uses in creating other software. It is not sold as is because customers cannot use it unless it is customized to meet system objectives or customer specifications. Off-the-shelf software is software that is marketed as a stock item that can be used by customers with little or no customization.

.69 Software should be considered off-the-shelf software if it can be added to an arrangement with insignificant changes in the underlying code and it could be used by the customer for the customer's purposes upon installation. Actual use by the customer and performance of other elements of the arrangement is not required to demonstrate that the customer could use the software off-the-shelf. If significant modifications or additions to the off-the-shelf software are necessary to meet the customer's purpose (for example, changing or making additions to the software, or because it would not be usable in its off-the-shelf form in the customer's environment), the software should be considered core software for purposes of that arrangement. If the software that is included in the arrangement is not considered to be off-the-shelf software, or if significant modifications or additions to the off-the-shelf software are necessary to meet the customer's functionality, no element of the arrangement would qualify for accounting as a service, and contract accounting should be applied to both the software and service elements of the arrangement.

.70 Factors indicating that the service element is essential to the functionality of the other elements of the arrangement, and consequently should not be accounted for separately, include the following.

- The software is not off-the-shelf software.
- The services include significant alterations to the features and functionality of the off-the-shelf software.
- Building complex interfaces is necessary for the vendor's software to be functional in the customer's environment.
- The timing of payments for the software is coincident with performance of the services.
- Milestones or customer-specific acceptance criteria affect the realizability of the software-license fee.

.71 Judgment is required in determining whether the obligation to provide services in addition to the delivery of software should be accounted for separately as a service element. Services that qualify for accounting as a service element of a software arrangement always are stated separately and have one or more of the following characteristics.

- The services are available from other vendors.
- The services do not carry a significant degree of risk or unique acceptance criteria.
- The software vendor is an experienced provider of the services.
- The vendor is providing primarily implementation services, such as implementation planning, loading of software, training of customer personnel, data conversion, building simple interfaces, running test data, and assisting in the development and documentation of procedures.
- Customer personnel are dedicated to participate in the services being performed.

.72 Funded Software-Development Arrangements. Software-development arrangements that are fully or partially funded by a party other than the vendor that is developing the software typically provide the funding party with some or all of the following benefits:

- Royalties payable to the funding party based solely on future sales of the product by the software vendor (that is, reverse royalties)
- Discounts on future purchases by the funding party of products produced under the arrangement
- A nonexclusive sublicense to the funding party, at no additional charge, for the use of any product developed (a prepaid or paid-up nonexclusive sublicense)

.73 A funded software-development arrangement within the scope of FASB Statement No. 68, Research and Development Arrangements, should be accounted for in conformity with that Statement. If the technological feasibility of the computer software product pursuant to the provisions of FASB Statement No. 86 has been established before the arrangement has been entered into, FASB Statement No. 68 does not apply because the arrangement is not a research and development arrangement. Accounting for costs related to funded software-development arrangements is beyond the scope of this SOP. However, if capitalization of the software-development costs commences pursuant to FASB Statement No. 86, any income
from the funding party under a funded software-development arrangement should be credited first to the amount of the
development costs capitalized. If the income from the funding party exceeds the amount of development costs capitalized, the
excess should be deferred and credited against future amounts that subsequently qualify for capitalization. Any deferred
amount remaining after the project is completed (that is, when the software is available for general release to customers and
capitalization has ceased) should be credited to income.

**Contract Accounting**

.74 If an arrangement to deliver software or a software system, either alone or together with other products or services,
requires significant production, modification, or customization of software, the service element does not meet the criteria for
separate accounting set forth in paragraph .65. The entire arrangement should be accounted for in conformity with ARB No.
45, using the relevant guidance in SOP 81-1 [section 10,330]. Nevertheless, transactions that normally are accounted for as
product sales should not be accounted for as long-term contracts merely to avoid the delivery requirements normally
associated with product sales for revenue recognition.

.75 In applying contract accounting, the vendor must use either the percentage-of-completion method or the completed-
contract method. The determination of the appropriate method should be made according to the recommendations in
paragraphs 21 through 33 of SOP 81-1 [section 10,330.21 through .33].

.76 **Segmentation.** Software contracts may have discrete elements that meet the criteria for segmenting in paragraphs 39
through 42 of SOP 81-1 [section 10,330.39 through .42]. If a contract is segmented, each segment is treated as a separate
profit center. Progress-to-completion for each segment should be measured in conformity with paragraphs .78 through .80 of
this SOP.

.77 Some vendors of arrangements that include software combined with services or hardware or both do not identify
the elements separately and do not sell them separately because of agreements with their suppliers. Other vendors who are not
restricted by such agreements nevertheless bid or negotiate software and other products and services together. Arrangements
that do not meet the segmentation criteria in paragraph 40 of SOP 81-1 [section 10,330.40] are prohibited from being
segmented, unless the vendor has a history of providing the software and other products and services to customers under
separate arrangements and the arrangement meets the criteria in paragraph 41 of SOP 81-1 [section 10,330.41].

.78 **Measuring Progress-to-Completion Under the Percentage-of-Completion Method.** Paragraph 46 of SOP 81-1 [section
10,330.46] describes the approaches to measuring progress on contracts (or segments thereof) under the percentage-of-
completion method. Those approaches are grouped into input and output measures, as follows.

Input measures are made in terms of efforts devoted to a contract. They include the methods based on costs
and on efforts expended. Output measures are made in terms of results achieved. They include methods based
on units produced, units delivered, contract milestones, and value added. For contracts under which separate
units of output are produced, progress can be measured on the basis of units of work completed.

For software contracts, an example of an input measure is labor hours; an example of an output measure is arrangement
milestones, such as the completion of specific program modules.

.79 If, as discussed in paragraph .76 of this SOP, a software contract includes a discrete element that meets the
segmentation criteria of SOP 81-1 [section 10,330], the method chosen to measure progress-to-completion on the element
should be the method that best approximates progress-to-completion. Progress-to-completion on separate elements of the
same software arrangement may be measured by different methods. The software vendor should choose measurement
methods consistently, however, so that it uses similar methods to measure progress-to-completion on similar elements.

.80 Output measures, such as value-added or arrangement milestones, may be used to measure progress-to-completion on
software arrangements, but many companies use input measures because they are established more easily. As noted in
paragraph 47 of SOP 81-1 [section 10,330.47], "The use of either type of measure requires the exercise of judgment and
the careful tailoring of the measure to the circumstances." Further, paragraph 51 of SOP 81-1 [section 10,330.51] states that

The acceptability of the results of input or output measures deemed to be appropriate to the circumstances
should be periodically reviewed and confirmed by alternative measures that involve observation and inspection.
For example, the results provided by the measure used to determine the extent of progress may be compared to

the results of calculations based on physical observations by engineers, architects, or similarly qualified personnel. That type of review provides assurance somewhat similar to that provided for perpetual inventory records by periodic physical inventory counts.

.81 Input Measures. Input measures of progress-to-completion on arrangements are made in terms of efforts devoted to the arrangement and, for software arrangements, include methods based on costs, such as cost-to-cost measures, and on efforts expended, such as labor hours or labor dollars. Progress-to-completion is measured indirectly, based on an established or assumed relationship between units of input and productivity. A major advantage of input measures is that inputs expended are easily verifiable. A major disadvantage is that their relationship to progress-to-completion may not hold if inefficiencies exist or if the occurrence of the input at a particular point does not indicate progress-to-completion.

.82 Costs incurred should be included in measuring progress-to-completion only to the extent that they relate to contract performance. Items not specifically produced for the arrangement, such as hardware purchased from third parties or off-the-shelf software, should not be included in the measurement of progress-to-completion.

.83 Labor hours often are chosen as the basis for measuring progress-to-completion, because they closely approximate the output of labor-intensive processes and often are established more easily than output measures. Core software requires labor-intensive customization. Therefore, labor hours provide a good measure of progress-to-completion on elements of software arrangements that involve the customization of core software.

.84 If the measurement of progress-to-completion is based primarily on costs, the contribution to that progress of hardware and software that were produced specifically for the arrangement may be measurable and recognizable before delivery to the user's site. For example, efforts to install, configure, and customize the software may occur at the vendor's site. The costs of such activities are measurable and recognizable at the time the activities are performed.

.85 Output Measures. Progress on arrangements that call for the production of identifiable units of output can be measured in terms of the value added or milestones reached. Although progress-to-completion based on output measures is measured directly from results achieved, thus providing a better approximation of progress than is provided by input measures, output measures may be somewhat unreliable because of the difficulties associated with establishing them.

.86 In order for the value added to be verifiable, the vendor must identify elements or subcomponents of those elements. If output measures are neither known nor reasonably estimable, they should not be used to measure progress-to-completion.

.87 If value added by off-the-shelf software is to be included in the measurement of progress-to-completion, such software cannot require more than minor modifications and must be usable by the customer for the customer's purpose in the customer's environment. If more than minor modifications or additions to the off-the-shelf software are necessary to meet the functionality required under the arrangement terms, either by changing or making additions to the software, or because the software would not be usable by the customer in its off-the-shelf form for the customer's purpose in the customer's environment, it should be accounted for as core software.

.88 Value added by the customization of core software should be included in the measurement of progress-to-completion of the customization and installation at the user's site. However, if the installation and customization processes are divided into separate output modules, the value of core software associated with the customization of a module should be included in the measurement of progress-to-completion when that module is completed.

.89 Contract milestones may be based on contractual project plans. Contractual provisions generally require the performance of specific tasks with the approval or acceptance by the customer; project plans generally schedule inspections in which the project's status is reviewed and approved by management. The completion of tasks that trigger such inspections are natural milestones because they are subject to relatively independent review as an intrinsic part of the project management process.

.90 Considerations other than progress-to-completion affect the amounts that become billable at particular times under many arrangements. Accordingly, although the achievement of contract milestones may cause arrangement revenues to become billable under the arrangement, the amounts billable should be used to measure progress-to-completion only if such amounts indeed indicate such progress.

.91 The milestones that are selected to measure progress-to-completion should be part of the management review process. The percentage-of-completion designated for each milestone should be determined considering the experience of the vendor on similar projects.

Effective Date and Transition

.92 This SOP is effective for transactions entered into in fiscal years beginning after December 15, 1997. Earlier application is encouraged as of the beginning of fiscal years or interim periods for which financial statements or information have not been issued. Retroactive application of the provisions of this SOP is prohibited. [Note: An effective date provision of this SOP has been deferred by SOP 98-4. See section 10,740.]

The provisions of this Statement need not be applied to immaterial items.

Basis for Conclusions

Background

.93 SOP 91-1 was issued in December 1991. AcSEC understands that certain provisions of that Statement are being applied inconsistently in practice and that various practice issues have arisen that were not addressed in SOP 91-1. As a result, AcSEC added a project to its agenda in March 1993 to interpret those provisions and provide additional guidance. The key issues identified at the outset of the project related to accounting for arrangements that provided for multiple deliverables (including PCS). The project began as an amendment to SOP 91-1. However, as deliberations progressed, AcSEC determined that it would be more appropriate to supersede SOP 91-1 to (a) amend the provisions in question and (b) incorporate AcSEC’s conclusions on practice issues that had not been addressed in SOP 91-1.

Basic Principles

.94 Transfers of rights to software by licenses rather than by outright sales protect vendors from the unauthorized duplication of their products. Nevertheless, the rights transferred under software licenses are substantially the same as those expected to be transferred in sales of other kinds of products. AcSEC believes the legal distinction between a license and a sale should not cause revenue recognition on software products to differ from revenue recognition on the sale of other kinds of products.

.95 Arrangements to deliver software or a software system, either alone or together with other products, may include services. AcSEC believes that if those services entail significant production, modification, or customization of the software, such software before those alterations (even if already delivered) is not the product that has been purchased by the customer. Instead, the product purchased by the customer is the software that will result from the alterations. Accordingly, AcSEC concluded that arrangements that include services that entail significant production, modification, or customization of software are construction-type or production-type contracts, and should be accounted for in conformity with ARB No. 45 and SOP 81-1 [10,330]. AcSEC concluded that if the services do not entail significant production, modification, or customization of software, the service element should be accounted for as a separate element.

.96 AcSEC believes that revenue generally should not be recognized until the element has been delivered. The recognition of revenue from product sales on delivery is consistent with paragraphs 83(b) and 84 of FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises. Paragraph 83(b) provides the following guidance for recognition of revenues.

Revenues are not recognized until earned. An entity’s revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. [Footnote omitted][Emphasis added]

Paragraph 84 states that in recognizing revenues and gains

[t]he two conditions [for revenue recognition] (being realized or realizable and being earned) are usually met by the time the product or merchandise is delivered ... to customers, and revenues ... are commonly recognized at time of sale (usually meaning delivery). [Emphasis added]

.97 SOP 91-1 did not address arrangements that included software that was deliverable only when-and-if-available. Implementation questions arose as to whether when-and-if-available terms created contingencies that could be disregarded in...
determining whether an arrangement consists of multiple elements. AcSEC believes that because the when-and-if-available deliverables are bargained for in arrangements, they are of value to the customer. Accordingly, AcSEC concluded that when-and-if-available deliverables should be considered in determining whether an arrangement consists of multiple elements. 

Thus, the requirements of this SOP with respect to arrangements that consist of multiple elements should be applied to all additional products and services specified in the arrangement, including those described as being deliverable only when-and-if-available.

.98 In SOP 91-1, the accounting for vendor obligations remaining after delivery of the software was dependent upon whether the obligation was significant or insignificant. However, these determinations were not being made in a consistent manner, leading to a diversity in practice. AcSEC believes that all obligations should be accounted for and that revenue from an arrangement should be allocated to each element of the arrangement, based on vendor-specific objective evidence of the fair values of the elements. Further, AcSEC concluded that revenue related to a particular element should not be recognized until the revenue-recognition conditions in paragraphs .08 through .14 of this SOP are met, because the earnings process related to that particular element is not considered complete until that time.

.99 In paragraph .10 of this SOP, AcSEC concluded that the revenue from an arrangement should be allocated to the separate elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated in the contract for each element. AcSEC believes that separate prices stated in a contract may not represent fair value and, accordingly, might result in an unreasonable allocation of revenue. AcSEC believes that basing the allocation on fair values is consistent with the accounting for commingled revenue. An example is the following discussion in paragraph 12 of FASB Statement No. 45, Accounting for Franchise Fee Revenue.

The franchise agreement ordinarily establishes a single initial franchise fee as consideration for the franchise rights and the initial services to be performed by the franchisor. Sometimes, however, the fee also may cover tangible property, such as signs, equipment, inventory, and land and building. In those circumstances, the portion of the fee applicable to the tangible assets shall be based on the fair value of the assets.

.100 AcSEC considered allowing the use of surrogate prices such as competitor prices for similar products or industry averages to determine fair value. However, AcSEC believes that inherent differences exist between elements offered by different vendors. These inherent differences led AcSEC to conclude that only vendor-specific evidence of fair value can be considered sufficiently objective to allow the allocation of the revenue to the various elements of the arrangement.

.101 AcSEC believes that the best evidence of the fair value of an element is the price charged if that element is sold separately. Still, an arrangement may include elements that are not yet being sold separately. As discussed in the previous paragraph, because of inherent differences between the elements offered by different vendors, AcSEC concluded that companies should not use surrogate prices, such as competitor prices for similar products or industry averages, as evidence of the fair value for an element. AcSEC believes, however, that if a price for the element has been established by management having the relevant authority, such a price represents evidence of the fair value for that element. To meet the criterion of objectivity, it must be probable that the established price will not change before the introduction of the element to the marketplace. Thus, the internally established prices should be factual and not estimates. For this reason, AcSEC concluded that the allocations may not be adjusted subsequently.

.102 AcSEC is aware that the pricing structure of certain arrangements is not limited to the prices charged for the separate elements. Pricing may be based on many different factors or combinations thereof. For example, certain arrangements are priced based on a combination of (a) the prices of products to be licensed and (b) the number of users that will be granted access to the licensed products. In some of these arrangements, the vendor requires a minimum number of users.

.103 The products contained in such arrangements are not available to the customer at the prices charged in the arrangement unless the customer pays for the minimum number of users. Therefore, the prices contained in the arrangement do not represent the prices charged for the product when sold separately. AcSEC believes that it would be inappropriate to determine the fair values of the products (as discussed in paragraph .10) without giving consideration to the impact of the user-based portion of the fee. For this reason, AcSEC concluded in paragraph .10 that when a vendor's pricing is based on multiple factors such as the number of products and the number of users, the price charged for the same element when sold separately must consider all factors of the vendor's pricing structure.

.104 Often, multiple element arrangements are sold at a discount rather than at the sum of the list prices for each element. If the amounts deferred for undelivered elements were based on list prices, the amount of revenue recognized for delivered elements would be understated. Accordingly, AcSEC concluded that relative sales prices should be used in determining the amount of revenue to be allocated to the elements of an arrangement.
AcSEC believes that if an undelivered element is essential to the functionality of a delivered element, the customer does not have full use of the delivered element. Consequently, AcSEC concluded that delivery is considered not to have occurred in such situations.

AcSEC believes that the earnings process with respect to delivered products is not complete if fees allocated to those products are subject to forfeiture, refund, or other concession if the vendor does not fulfill its delivery responsibilities. AcSEC believes that the potential concessions indicate the customer would not have licensed the delivered products without also licensing the undelivered products. Accordingly, AcSEC concluded that in order to recognize revenue, persuasive evidence should exist that fees allocated to delivered products are not subject to forfeiture, refund, or other concession. In determining the persuasiveness of the evidence, AcSEC believes that a vendor's history of making concessions that were not required by the provisions of an arrangement is more persuasive than terms included in the arrangement that indicate that no concessions are required.

**Delivery**

In paragraph .18 of this SOP, AcSEC concluded that for software that is delivered electronically, the delivery criterion of paragraph .08 is deemed to have been met when the customer either (a) takes possession of the software via a download or (b) has been provided with access codes that allow the customer to take immediate possession of the software on its hardware pursuant to an agreement or purchase order for the software. AcSEC believes that the delivery criterion is met by use of access codes only when software is being delivered electronically.

AcSEC believes that if the fee is not based on the number of copies to be delivered to or made or deployed by the customer, duplication of the software may be incidental to the arrangement. Paragraph .21 of this SOP describes circumstances (arrangements in which duplication is required only if additional copies are requested by the customer; arrangements in which the licensing fee is payable even if no additional copies are requested) that would lead to a conclusion that duplication is incidental to the arrangement. In other arrangements, vendors insist on duplicating the software to maintain quality control or to protect software transmitted by telecommunications. Others agree to duplicate the software as a matter of convenience to the customer.

In arrangements in which duplication is considered incidental, AcSEC believes the vendor has fulfilled its delivery obligation as soon as the first copy or product master of the software has been delivered. Therefore, AcSEC concluded that in such instances, the vendor should not be precluded from recognizing revenue if the customer has not requested additional copies (particularly since the fee is payable regardless of whether such additional copies are requested by the customer). However, the estimated costs of duplicating the software should be accrued when the revenue is recognized.

**Fixed or Determinable Fees and Collectibility**

In paragraphs .27 through .30, in the discussion of factors that affect the determination of whether a fee is fixed or determinable, AcSEC sought to clarify—but not change—similar provisions in SOP 91-1. In practice, some had interpreted those provisions to mean the following.

- Extended payment considerations could be overcome if customers were creditworthy.
- A fee could never be considered fixed or determinable if payment terms extended for more than twelve months after delivery.

Others had interpreted these provisions to mean the following.

- If payment terms extended beyond customary terms but were twelve months or less, they were fixed or determinable.
- If payment terms exceeded twelve months, a vendor could recognize amounts due in the first twelve months as revenue at the time of the license. Additional revenue would be recognized based on the passage of time such that, at any point, any amounts due within one year would have been recognized as revenue (the rolling twelve months approach).

Paragraphs .112 through .114 of this SOP—

- Explain that the concern with extended payment terms is technological obsolescence and similar factors, not customer creditworthiness.
Describe circumstances in which the presumption that a fee is not fixed or determinable because of extended payment terms may be overcome.

- Confirm that any extended payment terms, even if for less than twelve months, must be assessed for their effects on the fixed or determinable aspects of the fee.
- Clarify that the rolling twelve months approach should not be used.

.112 AcSEC believes that, given the susceptibility of software to significant external factors (in particular, technological obsolescence), the likelihood of vendor refunds or concessions is greater in an arrangement with extended payment terms than in an arrangement without extended payment terms. This is true regardless of the creditworthiness of the customer. Because of this greater likelihood of refunds or concessions, AcSEC believes that any extended payment terms outside of a vendor’s normal business practices may indicate that the fee is not fixed or determinable.

.113 In paragraph .28 of this SOP, AcSEC concluded that if payment of a significant portion of a licensing fee is not due until after the expiration of the license or more than twelve months after delivery, the fee should be presumed not to be fixed or determinable. This conclusion is based on AcSEC’s belief that payment terms of such extended duration indicate that vendor refunds or concessions are more likely than not. AcSEC acknowledges that the one-year provision is arbitrary. However, AcSEC concluded that such a limitation is needed to provide greater comparability within the industry.

.114 In considering the “rolling twelve months” approach found in practice, AcSEC considered the guidance in Chapter 1A of ARB No. 43, Restatement and Revision of Accounting Research Bulletins, paragraph 1, which states that “Profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured.” Accordingly, if a fee is considered fixed or determinable, it should be recognized as revenue when the sale is effected. If not, AcSEC believes that it should be recognized as revenue as payments from customers become due.

.115 In paragraph .08 of this SOP, AcSEC concluded that collectibility must be probable before revenue may be recognized. This conclusion is based on paragraph B4g of FASB Concepts Statement No. 5, which reads

If collectibility of assets received for product, services, or other assets is doubtful, revenues and gains may be recognized on the basis of cash received.

.116 AcSEC notes that requiring collectibility enhances the verifiability of the other revenue recognition criteria of paragraph .08, as discussed below.

- Persuasive evidence of an arrangement—AcSEC included this criterion in order to prevent revenue recognition on delivery of elements which, in fact, had not been ordered by a customer. AcSEC believes it is unlikely that a customer would pay for an element that had not been ordered. Therefore, AcSEC believes that requiring collectibility of a receivable related to the sale or license acts to verify that an arrangement does exist.
- Delivery—AcSEC believes that until delivery of an element has occurred (including delivery of all other items essential to the functionality of the element in question), the customer has not received full use of the element ordered. A customer that has not received full use of the element ordered is likely to withhold payment or require a refund. Therefore, AcSEC believes that requiring collectibility of a receivable related to the sale or license acts to verify that the element has been delivered.
- Fixed or determinable fee—Much of AcSEC’s concern related to fixed or determinable fees relates to arrangements with extended payment terms. In the software industry, requiring collectibility of a receivable prior to revenue recognition is important because of the frequency with which upgrades, enhancements, or new versions are released. As discussed elsewhere in this SOP, in certain instances it may be difficult to determine which version of an element induced a customer to enter into an arrangement. By requiring collectibility, AcSEC sought to prevent revenue recognition on sales or licenses of an element in situations in which circumstances may prompt the vendor to make subsequent adjustments to the price of a customer’s purchase or license of a subsequent version of that element.

The likelihood that subsequent versions will be released is greater over the long term than over the short term. Therefore, concerns related to concessions increase in arrangements with extended payment terms. AcSEC notes that prohibiting revenue recognition in circumstances in which the price adjustments discussed above could occur serves to ensure that the portion of the fee allocated to each element is fixed or determinable. That is, if the price on a subsequent element cannot be adjusted for concessions, and the amount allocated to the initial element must be collected in full, neither amount is subject to adjustment. Therefore, AcSEC believes that requiring collectibility of a receivable related to the sale or license acts to verify that the fees are fixed or determinable.
Multiple-Element Arrangements

Additional Software Deliverables and Right to Exchange or Return Software

1.17 Upgrades/enhancements. In paragraph .37 of this SOP, AcSEC concluded that the portion of the arrangement fee allocated to an upgrade right should be based on the price for the upgrade/enhancement that would be charged to existing users of the software product being updated. AcSEC believes that in arrangements that include upgrade rights, it may be difficult to determine which version of the software induced the customer to enter into the arrangement. For example, a customer licensing an existing version of the software may have done so to facilitate obtaining the updated version upon its introduction. To eliminate the possibility of allocating too much revenue to the delivered software (and thereby accelerating recognition), AcSEC concluded that the upgrade price (without the allocation of any discount on the arrangement) should be used to determine the amount to be deferred. The residual amount, if any, is considered to be the fair value of the original product.

1.18 AcSEC believes that upgrades/enhancements do not necessarily contain improvements that all customers would desire. A customer may not exercise an upgrade right for various reasons, including any of the following.

a. The benefits to be gained from the related upgrade/enhancement may not be important to that customer.

b. The customer may not wish to learn new commands for what may be perceived by that customer as marginal improvements.

c. The upgrade/enhancement would require more hardware functionality than the customer currently has.

Consequently, AcSEC concluded that amounts allocated to upgrade rights should be reduced to reflect the percentage of customers not expected to exercise the upgrade right, based on vendor-specific evidence.

1.19 Additional Software Products. As stated in paragraph .118, AcSEC believes that not all customers entitled to an upgrade/enhancement will exercise their upgrade rights. AcSEC believes, however, that it is probable that all customers will choose to receive additional software products. Consequently, AcSEC concluded that the fee allocated to additional software products should not be reduced by the percentage of any customers not expected to exercise the right to receive the additional products.

1.20 Paragraphs .48 and .49 of this SOP discuss accounting for software arrangements in which vendors agree to deliver unspecified additional software products in the future. AcSEC concluded that such arrangements should be accounted for as subscriptions, and that the fee from the arrangement should be recognized ratably as revenue over the term of the arrangement. AcSEC notes that, because the vendor is obligated to deliver these items only if they become available during the term of the arrangement, in some situations, the delivery of additional products will not be required. AcSEC believes that because these items are unspecified, vendor-specific objective evidence of fair value of each unspecified additional product cannot exist. However, AcSEC believes that requiring the deferral of all revenue until the end of the arrangement is too onerous because of the following.

a. All other revenue-recognition conditions in paragraphs .08 through .14 of this SOP have been met.

b. The additional software products in fact may never be delivered.

However, AcSEC also was concerned that if revenue recognition were permitted to begin at the inception of the arrangement, revenue may be recognized too early, particularly in arrangements in which the first product was not delivered for some time after inception. Accordingly, AcSEC concluded that the revenue from the arrangement should be recognized ratably over the term of the arrangement beginning with the delivery of the first product.

1.21 Rights to Exchange or Return Software. AcSEC believes that the rights to exchange or return software (including platform transfer rights) are subject to the provisions of FASB Statement No. 48, even if the software is not returned physically. Accordingly, AcSEC concluded that the accounting for exchanges of software for products with no more than minimal differences in price, functionality, and features by users qualify for exchange accounting because, as discussed in footnote 3 to FASB Statement No. 48, (a) users are "ultimate customers" and (b) exchanges of software with no more than minimal differences in price, functionality, and features represent "exchanges... of one item for another of the same kind.

quality, and price.” AcSEC concluded that because resellers are not "ultimate customers," such exchanges by resellers should be considered returns.

.122 AcSEC reached similar conclusions related to certain platform-transfer rights. Additionally, AcSEC concluded that in situations in which customers are entitled to continue using the software that was originally delivered (in addition to the software that is to be delivered for the new platform), the customer has received additional software products, and the platform-transfer right should be accounted for as such. Other platform-transfer rights do not allow customers to continue to use the software on the original platform. Those platform-transfer rights should be accounted for as exchange rights or rights of return.

.123 It is possible that exchange rights may be granted for software that has not been developed for other platforms at the time revenue from the arrangement is recorded. AcSEC did not address the issue of whether such future development costs related to deliverable software, for which no further revenue will be received, should be capitalized pursuant to FASB Statement No. 86 because it was believed that such costs would not be significant. Accordingly, AcSEC concluded that in the event of significant development costs, the vendor would not be likely to be able to demonstrate persuasively that the future software would have similar pricing, features, and functionality, and would be marketed as the same product (that is, qualify as an exchange for accounting purposes). In that event, the vendor has granted a return right that must be accounted for pursuant to FASB Statement No. 48.

**Postcontract Customer Support**

.124 An obligation to perform PCS is incurred at the inception of a PCS arrangement and is discharged by delivering unspecified upgrades/enhancements, performing services, or both over the period of the PCS arrangement. The obligation also may be discharged by the passage of time. AcSEC concluded that because estimating the timing of expenditures under a PCS arrangement usually is not practicable, revenue from PCS generally should be recognized on a straight-line basis over the period of the PCS arrangement. However, AcSEC also concluded that if there is sufficient vendor-specific historical evidence that costs to provide the support are incurred on other than a straight-line basis, the vendor should recognize revenue in proportion to the amounts expected to be charged to the PCS services rendered during the period.

.125 SOP 91-1 required that revenue from both the PCS and the initial licensing fee be recognized ratably over the period of the PCS arrangement if no basis existed to derive separate prices for the PCS and the initial licensing fee. Diversity in practice arose as to what constituted a sufficient basis in arrangements involving vendors that did not have a basis to derive a separate price for the PCS. In this SOP, AcSEC has concluded that arrangement fees must be allocated to elements of the arrangement based on vendor-specific objective evidence of fair value. Because AcSEC determined that the evidence should be limited to that which is specific to the vendor, AcSEC believes that vendors that do not sell PCS separately have no basis on which to allocate fair values. AcSEC concluded that the total arrangement fee should be recognized in accordance with the provisions on recognition of PCS revenues. AcSEC also believes that, because a substantial portion of the arrangement fee typically is represented by the delivered software (rather than the performance of support), requiring the deferral of all revenues until the PCS obligation is fully satisfied would be too onerous. Accordingly, AcSEC concluded that, as discussed in the previous paragraph, the total arrangement fee generally should be recognized ratably over the period of the PCS arrangement.

**Services**

.126 Certain software arrangements include both a software element and an obligation to perform non-PCS services. SOP 91-1 provided guidance on the conditions that must be met in order to account for the obligation to provide services separately from the software component. AcSEC is aware that this guidance has been interpreted in varying ways, leading to a diversity in practice. During its deliberations on this SOP, AcSEC reached conclusions intended to clarify this issue, but did not redeliberate the other conclusions related to services that were included in SOP 91-1.

.127 AcSEC believes the service element should be accounted for separately if the following occur.

a. All other revenue allocation provisions of this SOP are met.

b. The services are not essential to the functionality of any other element in the arrangement.

c. The service and product elements are stated separately such that the total price of the arrangement would vary as a result of inclusion or exclusion of the services.
Accordingly, AcSEC concluded that a service element need not be priced separately in an agreement in order to account for the services separately. AcSEC believes that this conclusion represents the original intent of SOP 91-1, and wishes to clarify the language at this time.

.128 Paragraphs .129 through .132 of this SOP are carried forward from SOP 91-1 with certain editorial changes.

.129 Service Elements. Footnote 1 to paragraph 11 of SOP 81-1 [section 10,330.11, footnote 1] excludes service transactions from the scope of the SOP, as follows.

This statement is not intended to apply to "service transactions" as defined in the FASB's October 23, 1978 Invitation to Comment, Accounting for Certain Service Transactions. However, it applies to separate contracts to provide services essential to the construction or production of tangible property, such as design ... [and] engineering ... .

.130 The previously mentioned Invitation to Comment, which was based on an AICPA-proposed SOP, was issued in 1978. The FASB later included service transactions as part of its project to develop general concepts for revenue recognition and measurement. The resulting FASB Concepts Statement No. 5, however, does not address service transactions in detail. Nevertheless, some of the concepts on service transactions developed in the Invitation to Comment are useful in accounting for certain software transactions.

.131 A service transaction is defined in paragraphs 7 and 8 of the Invitation to Comment as follows.

A transaction between a seller and a purchaser in which, for a mutually agreed price, the seller performs ... an act or acts ... that do not alone produce a tangible commodity or product as the principal intended result ... A service transaction may involve a tangible product that is sold or consumed as an incidental part of the transaction or is clearly identifiable as secondary or subordinate to the rendering of the service.

The term service transaction is used in the same sense in this SOP but, as used in this SOP, does not apply to PCS. Items classified as tangible products in software service transactions generally should be limited to off-the-shelf software or hardware.

.132 This SOP, like the Invitation to Comment, recommends the separation of such arrangements with discrete elements into their product and service elements. Paragraph 8(b) of the Invitation to Comment states the following.

If the seller of a product offers a related service to purchasers of the product but separately states the service and product elements in such a manner that the total transaction price would vary as a result of the inclusion or exclusion of the service, the transaction consists of two components: a product transaction that should be accounted for separately as such and a service transaction ...

Contract Accounting

.133 SOP 91-1 included guidance on the application of contract accounting to software transactions. Questions arose as to whether output measures could be used to measure progress-to-completion if the amounts recorded would differ from those that would have been reported had input measures been used. During its deliberations of this SOP, AcSEC reached conclusions intended to clarify this issue, but did not redeliberate the other conclusions related to services that were included in SOP 91-1.

.134 AcSEC believes that the method chosen to measure progress-to-completion on an individual element of a contract should be the method that best approximates progress-to-completion on that element. Accordingly, AcSEC concluded that output measures may be used to measure progress-to-completion, provided that the use of output measures results in "the method that best approximates progress-to-completion."

.135 Paragraphs .136 through .142 of this SOP are carried forward from SOP 91-1 with certain editorial changes.

.136 ARB No. 45 established the basic principles for measuring performance on contracts for the construction of facilities or the production of goods or the provision of related services with specifications provided by the customer. Those principles are supplemented by the guidance in SOP 81-1 [section 10,330].

Distinguishing Transactions Accounted for Using Contract Accounting From Product Sales

137 SOP 81-1 (section 10,330) suggests that transactions that normally are accounted for as product sales should not be accounted for using contract accounting merely to avoid the delivery requirements for revenue recognition normally associated with product sales. Paragraph 14 of SOP 81-1 (section 10,330.14) states the following:

Contracts not covered ... include ... [s]ales by a manufacturer of goods produced in a standard manufacturing operation, even if produced to buyers' specifications, and sold in the ordinary course of business through the manufacturer's regular marketing channels if such sales are normally recognized as revenue in accordance with the realization principle for sales of products and if their costs are accounted for in accordance with generally accepted principles of inventory costing.

Application of ARB No. 45 and SOP 81-1

138 SOP 81-1 (section 10,330) provides guidance on the application of ARB No. 45 that applies to a broad range of contractual arrangements. Paragraph 1 of SOP 81-1 (section 10,330.01) describes contracts that are similar in nature to software arrangements, and paragraph 13 (section 10,330.13) includes the following kinds of contracts within the scope of that SOP:

- Contracts to design, develop, manufacture, or modify complex ... electronic equipment to a buyer's specification or to provide services related to the performance of such contracts
- Contracts for services performed by ... engineers ... or engineering design firms

139 ARB No. 45 presumes that percentage-of-completion accounting should be used when the contractor is capable of making reasonable estimates. Paragraph 15 of ARB No. 45 states the following:

In general when estimates of costs to complete and extent of progress toward completion of long-term contracts are reasonably dependable, the percentage-of-completion method is preferable. When lack of dependable estimates or inherent hazards cause forecasts to be doubtful, the completed-contract method is preferable.

Evidence to consider in assessing the presumption that the percentage-of-completion method of accounting should be used includes the technological risks and the reliability of cost estimates, as described in paragraphs 25, 26, 27, 32, and 33 of SOP 81-1 (section 10,330.25, .26, .27, .32, and .33).

140 Paragraph 24 of SOP 81-1 (section 10,330.24) specifies a further presumption that a contractor is capable of making reasonable estimates and states the following:

[T]he presumption is that [entities] ... have the ability to make estimates that are sufficiently dependable to justify the use of the percentage-of-completion method of accounting. Persuasive evidence to the contrary is necessary to overcome that presumption. [Footnote omitted]

141 Although cost-to-cost measures may be verified easily, they tend to attribute excessive profit to the hardware elements of arrangements with combined software and hardware elements for contracts under which segmentation is not permitted. Although the hardware elements of such arrangements have high cost bases, they generally yield relatively low profit margins to vendors. Furthermore, if excessive revenue is attributed to the hardware element, revenue recognition on the arrangement becomes overly dependent on when that element is included in the measurement of progress-to-completion.

142 For off-the-shelf software elements, the application of the cost-to-cost method produces the opposite effect. The book basis of the software tends to be low, because most of the costs associated with software development frequently are charged to expense when incurred in conformity with FASB Statement No. 86. Although the profit margins associated with software are generally higher than those for other elements of the arrangement, the application of cost-to-cost measures with a single profit margin for the entire arrangement would attribute little or no profit to the off-the-shelf software. Similarly, the application of the cost-to-cost method to arrangements that include core software, which also has a relatively low cost basis, would attribute a disproportionately small amount of profit to the software.
Effective Date and Transition

.143 AcSEC concluded that the provisions of this SOP should be applied prospectively and that retroactive application should be prohibited. AcSEC recognizes the benefits of comparable financial statements but is concerned that the application of the provisions of this SOP to contracts existing in prior periods would require a significant amount of judgment. The application of that judgment likely would be impacted by the hindsight a company would have, resulting in judgments based on information that did not exist at the time of the initial judgment but that would be called for if the SOP were to be applied retroactively.

.144 Additionally, AcSEC concluded that some entities would be required to incur large expenditures in determining restated amounts or the cumulative effect of adoption. AcSEC concluded that the cost of calculating such amounts likely would exceed the related benefit of that information. This SOP does not preclude an entity from disclosing in the notes to the financial statements the effect of initially applying this SOP if an entity believes it is practicable to do so.

Items Not Retained From SOP 91-1

.145 AcSEC believes that the guidance included in SOP 91-1 related to discounting receivables and the collectibility of receivables (discussed in paragraphs 56 and 78, respectively, of SOP 91-1) is not specific to the software industry and thus does not need to be retained in this SOP.

Appendix a

Examples of the Application of Certain Provisions of This Statement of Position

.146

Scope—Example 1

Facts

An automobile manufacturer installs software into an automobile model. This software is used solely in connection with operating the automobile and is not sold or marketed separately. Once installed, the software is not updated for new versions that the manufacturer subsequently develops. The automobile manufacturer’s costs for the development of the software that are within the scope of FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* and the production costs of such software are insignificant relative to the other development and production costs of the automobile.

Applicability

The Statement of Position (SOP) is not applicable to such software because the software is deemed incidental to the product as a whole.

Discussion

Although the software may be critical to the operations of the automobile, the software itself is not the focus of the marketing effort, nor is it what the customer perceives he or she is obtaining. The development and production costs of the software as a component of the cost of the automobile is incidental.

Scope—Example 2

Facts
An entity develops interactive training courses for sale or licensing to customers. These courses are delivered on a compact disc, which is loaded onto a customer's computer. The courses are developed such that, based on the responses received to a particular question, different questions are generated and content of the course material that is displayed is determined in a manner that directs the user's learning experience in a more focused way. The course developer's costs for the development of the software content are within the scope of FASB Statement No. 86 and are significant. The interactive nature of the courses is mentioned prominently in the marketing efforts.

**Applicability**

The SOP is applicable because the software is not incidental to the product.

**Discussion**

Although some might say that the product is educational services, the marketing of the product focuses on the software-reliant interactive features. In addition, the course developer incurs significant costs that are within the scope of FASB Statement No. 86. The interactive nature of the courses is mentioned prominently in the marketing efforts.

**Additional Software Products—Price per Copy—Example 1**

**Facts**

A vendor enters into an arrangement under which a customer has the right to make copies of Product A at $100 a copy, copies of Product B at $200 a copy, or copies of Product C at $50 a copy until such time as the customer has made copies aggregating $100,000 based on the per copy prices. The customer is obligated to pay the $100,000 whether or not the customer makes all the copies to which it is entitled under the arrangement. In all other respects, the $100,000 is considered to meet the criteria of a fixed fee, as described in this Statement of Position.

Master copies of products A and B are available currently and have been delivered. Product C is not available yet; therefore, no master copy has been delivered. The contract is clear that no portion of the fee allocable to copies made of products A and B is refundable if Product C is not delivered, nor is there any further obligation to deliver product C if copies of products A and B aggregating $100,000 have been made. The per copy prices included in the arrangement for Products A and B are the per copy prices included in the company's price list, and the company has already approved the per copy price list for Product C to be $50 per copy. Product C is not essential to the functionality of Products A or B.

The maximum number of copies of Product C that can be made is 500.

**Revenue Recognition**

The vendor should allocate $25,000 of the arrangement fee to Product C. The remaining $75,000 of revenue should be recognized when the master copy of Product C is delivered to the customer. The $25,000 allocated to Product C would be recognized when the master copy of Product C is delivered to the customer. If the customer duplicates enough copies of Products A and B so that the revenue allocable to those products exceeds $75,000, the additional revenue should be recognized as the additional copies are made.

**Discussion**

As discussed in paragraph .43 of this SOP, in an arrangement in which a number of products are not deliverable or specified at the inception of the arrangement, an allocation of the arrangement fee generally cannot be made, because the total revenue allocable to each software product is unknown and depends on choices to be made by the customer and, sometimes, future development activity. As discussed in paragraph .46 of this SOP however, if such an arrangement specifies a maximum number of copies of the undeliverable or unspecified product, a portion of the arrangement fee should be allocated to the undeliverable product(s). This allocation should be made assuming the customer elects to receive the maximum number of copies of the undeliverable product(s).
Because the arrangement states a maximum number of copies of Product C that can be made, a basis for allocating the fair value to each product of the arrangement exists. The amount allocated to the undelivered product is the maximum amount that can be allocable to that product, based on the maximum number of copies of Product C that can be made (500) and the fee per copy ($50). Accordingly, $25,000 should be allocated to Product C and deferred until delivery of the product master. Because all other conditions for revenue recognition in this SOP have been met, revenue related to Products A and B may be recognized upon delivery of the masters of those products as discussed in paragraph .44 of this SOP.

**Additional Software Products—Price per Copy—Example 2**

**Facts**

Assume the same facts as in the preceding example, except the arrangement does not state a maximum number of copies of Product C that can be made.

**Revenue Recognition**

Revenue should be recognized as copies of Products A ($100 of revenue per copy) and B ($200 of revenue per copy) are made, until the master of Product C is delivered to the customer. Any remaining revenue should be recognized upon delivery of the master of Product C.

**Discussion**

As discussed in paragraph .43 of this SOP, although the fee per copy is fixed at the inception of the arrangement and the cost of duplication is incidental, the total fee allocated to the undelivered software (Product C) is unknown and will depend on the choices made by the customers as to how many copies of each product will be utilized.

**Authorization Codes—Example 1**

**Facts**

A vendor includes ten optional functions on a compact disc (CD-ROM) on which its software product is licensed. Access to those optional functions is not available without a permanent key. Users can order the optional functions and receive permanent keys to enable the full use of those functions.

**Revenue Recognition**

Revenue for each individual optional function should be recognized by the vendor when the user purchases it by placing an order, evidence of such order exists, and the key is delivered to the user.

**Discussion**

Although the user has received a fully functional version (except for the keys) of the optional functions on the CD-ROM, the user has not agreed to license them. Because no evidence of an arrangement exists (as discussed in paragraphs .15 through .17 of this SOP), revenue for the optional functions may not be recognized when the CD-ROM is delivered.

**Authorization Codes—Example 2**

**Facts**

A software vendor’s products run on two different levels of central processing units (CPU) of the same manufacturer—Model X and Model Y (both of which are on the same platform). The vendor enters into a license arrangement with a user whereby the user licenses the vendor’s products to run on Model X but allows the user to move to Model Y at no additional charge. The vendor delivers the product in the form of a disc pack along with a CPU authorization code. At the time the user chooses to...
move to Model Y, the user does not receive a new disc pack; rather the vendor gives the user a new CPU authorization code.

**Revenue Recognition**

Revenue should be recognized on the delivery of the disc pack.

**Discussion**

Delivery of the authorization code to move to another CPU is not considered to be an additional software deliverable.

**Multiple Element Arrangements, Products—Example 1**

**Facts**

A vendor licenses a user one license covering a single copy of products A, B, C, and D for a nonrefundable fixed fee of $80, with no stated price per product. Products A, B, and C are deliverable. Product D is not deliverable and is not essential to the functionality of products A, B, or C. Persuasive evidence exists that indicates that the revenue related to products A, B, or C is not subject to refund, forfeiture, other concessions if product D is not delivered. The vendor has a history of sales prices for products A, B, and C of $25 each. The vendor’s pricing committee has established a price for product D of $25. It is probable that the price established by the pricing committee for product D will not change before introduction. Therefore, the vendor is able to derive its specific price for the undelivered software.

**Revenue Recognition**

Revenue allocated to each product based on the existing prices for products A, B, and C and the probable price for product D should be recognized when each individual product is delivered. The revenue allocated to each of the products would be $20.

**Discussion**

Revenue allocated to each product should be recognized upon the delivery of that product if the criteria in paragraphs .08 through .14 of this SOP have been met.

The allocation of revenue to each product is based on the relative fair value of each product. As discussed in paragraph .12 of this SOP, sufficient vendor-specific objective evidence must exist to determine allocation. In this example, sufficient vendor-specific objective evidence exists to determine that the fair value of each product on a stand-alone basis is $25. Therefore, in accordance with paragraph .41 of this SOP, the discount should be allocated evenly to each product, and revenue of $20 per product should be recognized when each product is delivered.

**Multiple Element Arrangements—Products—Example 2**

**Facts**

The transaction is the same as that outlined in the prior example. The contract is silent about penalties for the nondelivery of product D, but the proposal and other communications indicate that it is a required capability of the offering and that the user does not want any of the vendor’s products unless product D is delivered.

**Revenue Recognition**

All revenue must be deferred until delivery of product D.

**Discussion**

Because revenue allocable to the delivered software is subject to forfeiture, refund, or other concession if product D is not
delivered, all revenue under the agreement should be deferred until product D is delivered, in accordance with paragraph .13 of this SOP.

**Multiple Element Arrangements—Products—Example 3**

**Facts**

A vendor licenses version 1.0 of a software product to 100 customers for $300 per copy with a right to receive version 2.0 at no additional cost when it becomes available. The pricing committee has not yet decided whether version 2.0 will be offered to users of version 1.0 for $100 or for $200.

**Revenue Recognition**

All revenue should be deferred until the pricing committee makes its decision and it is probable that the price established will be the price charged upon introduction.

**Discussion**

Because the pricing committee has not yet decided whether version 2.0 will be offered at $100 or at $200, sufficient vendor-specific objective evidence does not yet exist supporting the price of the undelivered software. As discussed in paragraph .12 of this SOP, if sufficient vendor-specific objective evidence does not exist to determine the allocation of revenue, all revenue should be deferred until sufficient vendor-specific objective evidence exists.

**Multiple Element Arrangements—Products—Example 4**

**Facts**

In the preceding example, assume that the pricing committee determines that version 2.0 will be offered to users of version 1.0 as a specified upgrade/enhancement at a price of $100. It is probable that such price will not change prior to introduction. Persuasive evidence exists indicating that the amount allocated to version 1.0 will not be subject to forfeiture, refund, or other concession. Also, the vendor's experience indicates that 40 percent of customers do not exercise upgrade rights.

**Revenue Recognition**

The vendor should defer $6,000 (upgrade price of $100 multiplied by 100 copies, reduced by 40 percent to account for the customers expected not to exercise the upgrade right) until delivery of the upgrade/enhancement, and recognize the remaining $24,000 on delivery of version 1.0.

**Discussion**

The portion of the arrangement fee allocated to the upgrade right is equal to the price for the upgrade/enhancement determined pursuant to paragraph .37 of this SOP. This amount should be deferred and recognized on the delivery of version 2.0. The amount deferred for the specific upgrade/enhancement should be reduced to reflect the percentage of customers that, based on experience, are not expected to exercise the upgrade right (see paragraph .37 of this SOP). Accordingly, the $10,000 revenue allocated to the upgrade right should be reduced by $4,000 (40 percent of the allocated revenue).

If the vendor did not have information based on experience that indicates the percentage of customers that do not exercise the upgrade right, the vendor should defer the entire $10,000 of revenue allocated to the upgrade right, under the assumption that, in the absence of vendor-specific objective evidence to the contrary, 100 percent of customers will exercise the upgrade right.

**Multiple Element Arrangements—Products and Services—Example 1**

Facts

A vendor has entered into an arrangement to provide a customer with its off-the-shelf software product and related implementation services. The software and service elements of the contract are stated separately and the company has a history of selling these services separately such that the revenue allocation criteria of paragraphs .08 through .14 of this SOP can be satisfied. The software license fees are due under the company’s normal trade terms, which are net 30 days. The services are expected to be provided over the next 90 days and are of the type performed routinely by the vendor. The features and functionality of the software are not altered to more than a minor degree as a result of these services.

Revenue Recognition

The vendor should recognize the license revenue allocated to the software element upon its delivery and the revenue allocated to the service element as such services are performed.

Discussion

When license arrangements have multiple elements, revenue should be allocated to each of the elements and recognized when the related element is delivered and the following occur.

1. The undelivered elements are not essential to the functionality of the delivered elements.

2. The revenue allocated to the delivered elements is not subject to forfeiture, refund, or other concession if the undelivered elements are not delivered.

3. Sufficient company-specific objective evidence exists to allocate separate prices to each of the elements.

The service element in this arrangement is not deemed to be essential to the functionality of the software element because the features and functionality of the software are not altered to more than a minor degree as a result of the services.

Multiple Element Arrangements—Products and Services—Example 2

Facts

Assume the same transaction as described above except that the vendor agrees to make more than minor modifications to the functionality of the product to meet needs as defined by the user. Payment terms are 10 percent upon installation of the software, with the remainder according to a time line, and the final 25 percent withheld until acceptance. The desired modifications are not unusual; the vendor has made similar modifications to the product many times and is certain that the planned modifications will meet the user’s needs.

Revenue Recognition

This arrangement should be accounted for pursuant to the guidance on contract accounting (using either the percentage-of-completion or completed-contract method, depending on the facts and circumstances) included in paragraphs .74 through .91 of this SOP.

Discussion

The new conditions would preclude service transaction accounting because the functionality of the software product is being altered in more than a minor way, the payment of the fees is coincident with the services being performed, and the software is subject to the user’s unique acceptance criteria.

Multiple Element Arrangements—Products and Services—Example 3
Facts

Assume the same transaction as described in "Multiple-Element Arrangements—Products and Services—Example 1," except that the vendor never sells implementation services separately. The implementation services do not involve significant customization of the software.

Revenue Recognition

The vendor should recognize all revenue from the arrangement over the 90 day period during which the services are expected to be performed, commencing with delivery of the software product.

Discussion

The criteria for vendor-specific objective evidence of the fair value require that the element be sold separately or be planned to be sold separately. Because implementation services are neither sold separately nor planned to be sold separately, and upon delivery of the software product such services are the only undelivered elements, paragraph .67 of this SOP requires that all revenue be recognized over the period during which the implementation services are expected to be provided.

Multiple Element Arrangements—Products and Services—Example 4

Facts

A vendor sells software product A for $950. The license arrangement for product A always includes one year of "free" PCS. The annual renewal price of PCS is $150.

Revenue Recognition

Assuming that, apart from the lack of vendor-specific objective evidence of the fair value of the delivered software element, all applicable revenue recognition criteria in this SOP are met, revenue in the amount of $150 should be deferred and recognized in income over the one-year PCS service period. Revenue of $800 should be allocated to the software element and recognized upon delivery of the software.

Discussion

Vendor-specific objective evidence of the fair value of the software does not exist because the software is never sold separately. Consequently, sufficient vendor-specific objective evidence of fair value does not exist for the allocation of revenue to the various elements based on their relative fair values. Paragraph .12 of this SOP states, however, that the residual method should be used when there is vendor-specific objective evidence of the fair values of all undelivered elements; all other applicable revenue recognition criteria in this SOP are met; and the fair value of all of the undelivered elements is less than the total arrangement fee.

If there had been vendor-specific objective evidence of the fair value of the delivered software but not of the undelivered PCS, the entire arrangement fee would be deferred and recognized ratably over the contractual PCS period in accordance with paragraphs .12 and .58 of this SOP.

Multiple Element Arrangements—Products and Discounted PCS—Example 1

Facts

A software vendor has entered into an arrangement under which it has licensed software that has a list price of $1 million to a customer for $600,000 (which is the price being charged for the software when sold separately under other arrangements). The arrangement also includes annual PCS, priced for the first year at 15 percent of the discounted license fee, or $90,000 (rather than 15 percent of the list price of the licensed software). After the first year, the customer will have the right to renew annual maintenance on the licensed software at 15 percent of the list price of the software (or $150,000).
There are no other undelivered elements. All revenue recognition conditions of this SOP have been satisfied. The vendor does not have sufficient vendor-specific historical evidence that costs of providing PCS are incurred on other than a straight-line basis.

Revenue Recognition

In Year 1, the total arrangement fee is $690,000. Of this amount, $552,000 should be allocated to the software element and recognized upon delivery of the software element. The remaining $138,000 should be allocated to the PCS element and recognized ratably over the period during which the PCS services are expected to be performed. The allocation of the $690,000 arrangement fee is determined as shown in the following table.

Fair value when sold separately:

Allocation:

Discussion

In allocating the arrangement fee to the PCS element, the vendor should look first to the price the customer will pay for the PCS when it is sold separately as a renewal under the arrangement. In this example, that price is $150,000. This price is considered the vendor-specific objective evidence of the fair value for the PCS element, as discussed in paragraph .10.

If the customer were entitled to the PCS in subsequent years at the same price at which it had been included in the initial year of the arrangement (that is, $90,000), and the vendor's pricing practices were such that renewals of PCS were based on the discounted value of license fees, no additional fees would have been allocated from the software element to the PCS element. Therefore, the vendor would have allocated $600,000 to the software element and $90,000 to the PCS element.

[As amended, effective for transactions entered into in fiscal years beginning after March 15, 1999, by Statement of Position 98-9.]

Appendix b

Response to Comments Received

B.1. An exposure draft of a proposed Statement of Position (SOP), Software Revenue Recognition, was issued for public comment on June 14, 1996.

B.2. The majority of the comments received related to the basic principles of the exposure draft, particularly the provisions requiring the allocation of the arrangement fee to individual elements in a multiple-element arrangement based on vendor-specific objective evidence of the fair value. Several commentators requested clarification of the wording in the exposure draft related to extended payment terms and the effect of such terms on the determination of whether a fee is fixed and determinable or collectible. Some commentators requested guidance on the application of the provisions of the SOP to marketing arrangements in which coupons or other price incentives are offered. Other commentators requested the reconsideration of the transition provisions of the exposure draft, which required a cumulative-effect adjustment.

B.3. These comments and the Accounting Standards Executive Committee's (AcSEC's) response to them are discussed below.

Multiple-Element Arrangements

B.4. Several commentators responded that the limitations on what constitutes vendor-specific objective evidence of the fair value...
value were too onerous. These commentators stated that many instances exist in which elements are not priced separately, and that because of these limitations, revenue related to delivered elements would be deferred even though the customer received the element. Additionally, several commentators expressed concern that the requirement to allocate revenue to all elements, particularly those deliverable "when and if available" was not meaningful. (Obligations to deliver "when and if available" elements were considered by the commentators to be either insignificant vendor obligations or not vendor obligations at all.)

B.5. AcSEC considered these comments but continues to support the provisions of the exposure draft. AcSEC noted that these comments had been considered in the process leading to the exposure draft. Although AcSEC agrees that the provisions of the SOP may be troublesome to some companies, AcSEC notes that commentators did not suggest alternatives that AcSEC considered adequate to meet the criteria of objective evidence of fair value.

B.6. AcSEC continues to believe that the allocation of the arrangement fee to all elements, including those deliverable on a when-and-if-available basis, is meaningful. AcSEC believes that these elements are bargained for by the customer and should be accounted for. Furthermore, AcSEC believes that the concept of significant versus insignificant obligations should not be used to determine whether revenue should be allocated to an element. This concept had been included in SOP 91-1 and had resulted in varying interpretations in practice. AcSEC further notes that these comments had been considered previously by AcSEC during the process leading to the exposure draft.

B.7. Several commentators stated that the limitations on vendor-specific objective evidence of fair value should be expanded to permit the use of prices in published price lists. AcSEC believes that the price for an element as included in a price list does not necessarily represent the fair value of that element.

Extended Payment Terms

B.8. The exposure draft stated that a software licensing fee should not be considered fixed or determinable if the payment of a significant portion of the licensing fee is not due until after the expiration of the license or more than twelve months after delivery. Exceptions were permitted for vendors that have a business practice of using installment contracts and an extended history of entering into contracts with terms in excess of twelve months and successfully enforcing payment terms without making concessions. Several commentators requested clarification of these provisions.

B.9. AcSEC considered these comments and agreed that clarification was needed. Relevant clarifications were made to paragraphs .27 through .29 of the SOP. The revised provisions now state that any extended payment terms in a software licensing arrangement may indicate that the fee is not fixed or determinable, particularly if the use of extended payment terms is not the vendor's customary practice. Further, if the payment of a significant portion of the software licensing fee is not due until after the expiration of the license or more than twelve months after delivery, the licensing fee should be presumed not to be fixed or determinable. However, this presumption may be overcome by evidence that the vendor has a standard business practice of using long-term or installment contracts and a history of successfully collecting under the original payment terms without making concessions. Such a vendor should consider such fees fixed or determinable and should recognize revenue upon the delivery of the software, provided all other conditions for revenue recognition in this SOP have been satisfied.

B.10. Several commentators requested guidance on the application of the SOP to arrangements in which discounts are offered on subsequent licenses of software. The exposure draft did not have provisions addressing such arrangements.

B.11. AcSEC has added wording to the scope section (paragraph .03) of the SOP to address these questions. The new wording states that arrangements in which a vendor offers a small discount on additional licenses of the licensed product or other products that exist at the time of the offer represent marketing and promotional activities that are not unique to software and, therefore, are not included in the scope of this SOP. However, judgment will be required to assess whether price-off and other concessions are so significant that, in substance, additional elements are being offered in the arrangement.

Transition

B.12. The exposure draft required a cumulative-effect adjustment for the adoption of the SOP. Several commentators noted that considerable effort would be required on the part of many vendors to measure the cumulative effect. Additionally, it was noted that in many instances, the application of the provisions of this SOP to contracts existing in prior periods would require a significant amount of judgment. AcSEC was concerned that the application of that judgment likely would be impacted by the
hindsight a company would have, resulting in judgments based on information that did not exist at the time of the initial judgment but that would be called for if the SOP were to be applied retroactively.

B.13. AcSEC considered these issues and determined that the transition requirements of the SOP should be amended to require prospective application.

Appendix C

Revenue Recognition on Software Arrangements

.148 The following flowchart illustrates a decision process for recognizing revenue on software arrangements. The flowchart is intended to illustrate the basic principle of revenue recognition and does not address the difference in accounting depending upon the type of element (services, upgrade rights, additional software products, or postcontract customer support) included in the arrangement. The flowchart summarizes certain guidance in this SOP and is not intended as a substitute for the SOP.

Glossary

.149 Authorization Codes (keys). A vehicle used by vendors to permit customers access to, use of, or duplication of software that would otherwise be restricted.

Core software. An inventory of software that vendors use in creating other software. Core software is not delivered as is because customers cannot use it unless it is customized to meet system objectives or customer specifications.

Customer. A user or reseller.

Delivery. A transfer of software accompanied by documentation to the customer. The transfer may be by the following:

a. A physical transfer of tape, disk, integrated circuit, or other medium

b. Electronic transmission

c. Making available to the customer software that will not be physically transferred, such as through the facilities of a computer service bureau

d. Authorization for duplication of existing copies in the customer's possession

If a licensing agreement provides a customer with the right to multiple copies of a software product in exchange for a fixed fee, delivery means transfer of the product master, or the first copy if the product master is not to be transferred.

Fixed fee. A fee required to be paid at a set amount that is not subject to refund or adjustment. A fixed fee includes amounts designated as minimum royalties.

Licensing. Granting the right to use but not to own software through leases or licenses.

Milestone. A task associated with long-term contracts that, when completed, provides management with a reliable indicator of progress-to-completion on those contracts.

Off-the-shelf software. Software marketed as a stock item that customers can use with little or no customization.

Platform. The hardware architecture of a particular model or family of computers, the system software, such as the operating system, or both.

Platform-transfer right. A right granted by a vendor to transfer software from one hardware platform or operating system to one or more other hardware platforms or operating systems.

Postcontract customer support (PCS). The right to receive services (other than those separately accounted for as described in paragraphs .65 and .66 of this Statement of Position) or unspecified product upgrades/enhancements, or both, offered to users or resellers, after the software license period begins, or after another time as provided for by the PCS arrangement. Unspecified upgrades/enhancements are PCS only if they are offered on a when-and-if-available basis. PCS does not include the following:

- Installation or other services directly related to the initial license of the software
- Upgrade rights as defined in this Statement of Position
- Rights to additional software products

PCS may be included in the license fee or offered separately. PCS is generally referred to in the software industry as maintenance, a term that is defined, as follows, in paragraph 52 of FASB Statement No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed:

Activities undertaken after the product is available for general release to customers to correct errors or keep the product updated with current information. Those activities include routine changes and additions.

However, the term maintenance is not used in this Statement of Position for the following reasons.

1. It has taken on a broader meaning in the industry than the one described in FASB Statement No. 86.
2. It may be confused with hardware maintenance as it is used elsewhere in accounting literature.
3. Its meaning varies from company to company.

The right to receive services and unspecified upgrades/enhancements provided under PCS is generally described by the PCS arrangement. Typical arrangements include services, such as telephone support and correction of errors (bug fixing or debugging), and unspecified product upgrades/enhancements developed by the vendor during the period in which the PCS is provided. PCS arrangements include patterns of providing services or unspecified upgrades/enhancements to users or resellers, although the arrangements may not be evidenced by a written contract signed by the vendor and the customer.

Reseller. Entity licensed by a software vendor to market the vendor’s software to users or other resellers. Licensing agreements with resellers typically include arrangements to sublicense, reproduce, or distribute software. Resellers may be distributors of software, hardware, or turnkey systems, or they may be other entities that include software with the products or services they sell.

Site license. A license that permits a customer to use either specified or unlimited numbers of copies of a software product either throughout a company or at a specified location.

Upgrade/Enhancement. An improvement to an existing product that is intended to extend the life or improve significantly the marketability of the original product through added functionality, enhanced performance, or both. The terms upgrade and enhancement are used interchangeably to describe improvements to software products; however, in different segments of the software industry, those terms may connote different levels of packaging or improvements. This definition does not include platform-transfer rights.

Upgrade right. The right to receive one or more specific upgrades/enhancements that are to be sold separately. The upgrade right may be evidenced by a specific agreement, commitment, or the vendor’s established practice.

User. Party that ultimately uses the software in an application.

When-and-if-available. An arrangement whereby a vendor agrees to deliver software only when or if it becomes deliverable.

while the arrangement is in effect. When-and-if-available is an industry term that is commonly used to describe a broad range of contractual commitments. The use of the term when-and-if-available within an arrangement should not lead to a presumption that an obligation does not exist.

The Accounting Standards Executive Committee and the Software Revenue Recognition Working Group gratefully acknowledge the contributions of the former Software Revenue Recognition Task Force members Joseph Lhotka, Naomi Erickson, James Gillespie, Francis O'Brien, and Paul Wilde in the development of this Statement of Position.

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Exhibit T
### Portal Software Inc (PRSF)

**Historical Prices**

**SET DATE RANGE**

- **Start Date:** Jan 1 2003
- **End Date:** Dec 31 2003

**PRICES**

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29-Sep-03 1:5 Stock Split

* Close price adjusted for dividends and splits.