

Acquisition of Red Hat, Inc.—Valuation of Intangible Assets Acquired

As described in Note E to the consolidated financial statements, the Company completed its acquisition of Red Hat, Inc. for total consideration of \$35.1 billion during 2019, resulting in approximately \$13.5 billion in intangible assets and \$23.1 billion in goodwill being recorded. The intangible assets were comprised of client relationships of \$7.2 billion, completed technology of \$4.6 billion, and trademarks of \$1.7 billion. Management applied judgment in estimating the fair value of the intangible assets using a discounted cash flow model, which involved the use of significant estimates and assumptions with respect to revenue growth rates, the customer attrition rate, and discount rates.

The principal considerations for our determination that performing procedures relating to the valuation of intangible assets acquired in connection with the acquisition of Red Hat, Inc. is a critical audit matter are (i) there was a high degree of auditor judgment and subjectivity in applying procedures relating to the fair value measurement of intangible assets acquired due to the significant amount of judgment by management when developing the estimate; (ii) significant audit effort was required in evaluating the significant assumptions relating to the estimate, such as revenue growth rates, the customer attrition rate, and discount rates; and (iii) the audit effort involved the use of professionals with specialized skill and knowledge to assist in performing these procedures and evaluating the audit evidence obtained from these procedures.

Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included testing the effectiveness of controls relating to the valuation of intangible assets acquired and controls over the development of the assumptions, including the revenue growth rates, the customer attrition rate, and discount rates. These procedures also included, among others, reading the purchase agreements, and testing management's process for estimating the fair value of intangible assets, using professionals with specialized skill and knowledge to assist in doing so. Testing management's process included evaluating the appropriateness of the discounted cash flow models, testing the completeness and accuracy of data provided by management, and evaluating the reasonableness of significant assumptions, including revenue growth rates, the customer attrition rate, and discount rates. When assessing the assumptions related to revenue growth rates and the customer attrition rate, we evaluated whether the assumptions used were reasonable considering the past performance of the acquiree as well as industry data. The discount rates were evaluated by considering the cost of capital of comparable businesses and other industry factors. Professionals with specialized skill and knowledge were used to assist in evaluating the appropriateness of the Company's discounted cash flow models.

Income Taxes—Uncertain Tax Positions

As described in Notes A and G to the consolidated financial statements, the Company is subject to income taxes in the United States and numerous foreign jurisdictions. As disclosed by management, during the ordinary course of business there are many transactions and calculations for which the ultimate tax determination is uncertain. As a result, the Company recognizes tax liabilities based on estimates of whether additional taxes and interest will be due. As further described by management,

these tax liabilities are recognized when, despite management's belief that the tax return positions are supportable, management believes that certain positions may not be fully sustained upon review by tax authorities. Management bases its assessment of the accruals for tax liabilities on many factors, including past experience and interpretations of tax law. This assessment relies on estimates and assumptions, and may involve a series of complex judgments about future events. As of December 31, 2019, unrecognized tax benefits were \$7.1 billion.

The principal considerations for our determination that performing procedures relating to uncertain tax positions is a critical audit matter are there was significant judgment by management when estimating the tax liabilities for uncertain tax positions, including applying complex tax laws, and a high degree of estimation uncertainty based on potential for significant adjustments as a result of audits by tax authorities or other forms of tax settlement. This in turn led to a high degree of auditor judgment, effort, and subjectivity in performing procedures to evaluate the timely identification and measurement of uncertain tax positions. Also, the evaluation of audit evidence available to support the tax liabilities for uncertain tax positions is complex and required significant auditor judgment as the nature of the evidence is often inherently subjective, and the audit effort involved the use of professionals with specialized skill and knowledge to assist in evaluating the audit evidence obtained.

Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included testing the effectiveness of controls relating to the identification and recognition of the liability for uncertain tax positions, and controls addressing completeness of the uncertain tax positions, as well as controls over measurement of the liability. These procedures also included, among others, (i) testing the information used in the calculation of the liability for uncertain tax positions, including intercompany agreements, international, federal, and state filing positions, and the related final tax returns; (ii) testing the calculation of the liability for uncertain tax positions by jurisdiction, including management's assessment of the technical merits of tax positions and estimates of the amount of tax benefit expected to be sustained; (iii) testing the completeness of management's assessment of both the identification of uncertain tax positions and possible outcomes of each uncertain tax position; and (iv) evaluating the status and results of income tax audits pending in various tax jurisdictions. Professionals with specialized skill and knowledge were used to assist in the evaluation of the completeness and measurement of the Company's uncertain tax positions, including evaluating the reasonableness of management's assessment of whether tax positions are more-likely-than-not of being sustained and the amount of potential benefit to be realized.



PricewaterhouseCoopers LLP
New York, New York
February 25, 2020

We, or firms that we have ultimately acquired, have served as the Company's auditor since 1923. For the period from 1923 to 1958, the Company was audited by firms that a predecessor firm to PricewaterhouseCoopers LLP ultimately acquired.