Technical Director  
Financial Accounting Standards Board  
401 Merritt 7, PO Box 5116  
Norwalk, Connecticut 06856-5116  
U.S.A.  
(Submitted via e-mail (director@fasb.org)

March 12, 2012

Re:  File Reference: No. 2011-230, Exposure Draft: Revenue from Contracts with Customers

Dear Sir/Madam,

Thank you for the opportunity to provide comments on your Joint Exposure Draft on Revenue from Contracts with Customers.

We develop software, hardware and intellectual property which are used by semiconductor and electronic system customers to develop and design integrated circuits and electronic devices. We license our software, and two categories of intellectual property, or IP, commonly referred to as verification IP, or VIP, and Design IP. In addition, we sell and lease hardware technology. We provide maintenance for our product offerings and provide engineering services related to methodology, education, and hosted design solutions which help customers manage and accelerate their electronics product development processes. We are headquartered in San Jose, California, with sales offices, design centers, and research facilities around the world to serve the global electronics industry. We employ approximately 4,700 individuals worldwide.

We are supportive of your efforts to move toward one principles-based, universal standard and congratulate you on your efforts to date. We are committed to strong corporate governance and recognize the need to simplify accounting guidance related to Revenue from Contracts with Customers. This letter represents Cadence’s view.

On February 6, 2012, we met with Mr. R. Harold Schroeder, FASB Board Member, and Mr. Philip Hood, FASB Project Manager, among others, to discuss this exposure draft. We appreciate the time and effort by the FASB to discuss the impacts of this exposure draft on individual companies and entire industries. We especially appreciate Mr. Schroeder’s and Mr. Hood’s willingness to understand the uniqueness of our industry and our contracts with our customers. This letter summarizes our concerns with the exposure draft and the significant impact that it will have on us and our industry.
Executive Summary

Our main concern with the current exposure draft is that it would require us to recognize software product revenue related to our time-based license arrangements at a point in time, instead of ratably over a period of time, which would have an adverse impact to both our business and our shareholders. The impacts of this change include the following:

- The revenue recognition would not reflect the true economic value of our time-based arrangements with our customers;

- Recognizing revenue at a point in time will hinder our ability to maximize the value of our contracts because our customers may wait until the last day of the reporting period because they will be expecting a larger discount to close the deal on that date; and

- The combination of a larger discount and an increased duration would reduce the annual value of our contracts while at the same time increasing the revenue recognized in the period that the contract is signed/fulfilled.

Recognizing revenue at a point in time would not reflect the economic substance of our time-based license arrangements.

Our Business

Our customers use our software products across multiple projects to design and verify advanced semiconductors, consumer electronics, networking and telecommunications equipment, and computer systems. Depending on the complexity of the design, these projects can take months or years to complete. Also, the types of product a customer chooses to use at any point in time will often depend upon which stage the customer is at in their design cycle for each project.

At Cadence, we have traditionally structured our software licensing arrangements in a fashion that is quite similar to how Netflix provides entertainment.

Generally, we provide our customers with access to a portfolio of software products that they will need and use during the design cycle for each project, with the knowledge that our customers will require different products at different times during the term of the arrangement. To ensure that our customers can rely on using the most up to date version of our software products when they need to use them, Cadence invests between 30% to 40% of our annual revenue in research and development, constantly updating and upgrading existing products, while creating new products. In addition, we have spent more than $300 million, net of cash acquired, on acquiring additional technology through business combinations during the last two years.
As a result, our time-based licenses are subscriptions and our customers use our subscription arrangements to access and use our portfolio of software products over a specific time period (i.e. the term of the arrangement) and consistent with that view, our customers generally pay us over the time period of those arrangements for a right to use our software.

Our time-based license agreements generally include a combination of the following:

- Rights to use various software products over a period of time;
- Rights to exchange software products, which rights are exercisable multiple times during the arrangement;
- Rights to use our software at various locations through a Wide Area Network (WAN);
- Maintenance (i.e. Post Contract Customer Support, or PCS);
- When-and-if-available software products; and
- Services to assist our customers to maximize their use of our software.

The primary component of our business consists of licensing arrangements that allow our customers to use our software over a period of time, generally two to four years. Under the current software revenue recognition accounting literature, more than 90% of our revenue is recognized ratably over time, which reflects the economic substance of those arrangements.

*Example*

Under the exposure draft, as currently proposed, revenue for our time-based licenses would be recognized at a point in time, which we believe would accelerate revenue recognition in advance of when that revenue is earned.

In an effort to illustrate how recognizing revenue at a point in time would distort our revenue results, we have included an example below.

Under the currently proposed exposure draft, we believe that very similar transactions would provide very different revenue results in our financial statements.

Assume that we sold:

- The exact same products;
- To two identical creditworthy customers;
- For the exact same annual price; and
- With identical contract terms.

Also assume that we provided these two identical customers with the exact same software and associated access codes at regular monthly intervals throughout the duration of their contract.
The only difference between these two transactions is that Customer A likes to renew their contract every three years, whereas, Customer B prefers to renew their contract annually. Please see Table 1.1 below for an illustration of the basic details of each software subscription, Table 1.2 for the revenue recognition under the current accounting literature and Table 1.3 for the revenue recognition under the current exposure draft:

**Table 1.1 - Summary of details**

<table>
<thead>
<tr>
<th>Customer</th>
<th>Duration (years)</th>
<th>Total Fee</th>
<th>Annual Value</th>
<th>Quarterly Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer A</td>
<td>3</td>
<td>$3,000,000</td>
<td>$1,000,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Customer B</td>
<td>1</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$250,000</td>
</tr>
</tbody>
</table>

**Table 1.2 - Revenue timing, existing guidance**

<table>
<thead>
<tr>
<th>Customer</th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer A</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td></td>
</tr>
<tr>
<td>Customer B</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td></td>
</tr>
</tbody>
</table>

**Table 1.3 - Revenue timing, current exposure draft**

<table>
<thead>
<tr>
<th>Customer</th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer A</td>
<td>$2,250,000</td>
<td>$2,250,000</td>
<td>$2,250,000</td>
<td>$2,250,000</td>
<td>$2,250,000</td>
<td>$2,250,000</td>
</tr>
<tr>
<td>Product</td>
<td>$250,000</td>
<td>$250,000</td>
<td>$250,000</td>
<td>$250,000</td>
<td>$250,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Maintenance*</td>
<td>$750,000</td>
<td>$750,000</td>
<td>$750,000</td>
<td>$750,000</td>
<td>$750,000</td>
<td>$750,000</td>
</tr>
<tr>
<td>Total, Customer A</td>
<td>$2,500,000</td>
<td>$2,500,000</td>
<td>$2,500,000</td>
<td>$2,500,000</td>
<td>$2,500,000</td>
<td>$2,500,000</td>
</tr>
<tr>
<td>Customer B - Total</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Product</td>
<td>$750,000</td>
<td>$750,000</td>
<td>$750,000</td>
<td>$750,000</td>
<td>$750,000</td>
<td>$750,000</td>
</tr>
<tr>
<td>Maintenance*</td>
<td>$250,000</td>
<td>$250,000</td>
<td>$250,000</td>
<td>$250,000</td>
<td>$250,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Total, Customer B</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

* Note $250,000/year allocated to maintenance for illustrative purposes

As you can see from the above table, the difference in revenue timing under the proposed revenue recognition guidance in the current exposure draft is significantly impacted by the duration of the contract, rather than the economic substance of the transaction. If we were to apply the exposure draft, as it is currently drafted, we believe that the resulting revenue outcome places undue emphasis on the duration of the contract, and the resulting revenue is misleading to any shareholder.

We understand that we could potentially change the way we sell, or restructure our standard contracts to provide all of our customers with a quarterly cancellation right to ensure that our revenue accounting would continue to reflect the substance of each transaction. However, we do not wish to create additional cancellation risk for the sole purpose of having our accounting reflect the economic substance of our transactions. In addition, we do not wish to increase the
administrative burden for ourselves or our customers as this may place us at an unfair disadvantage in negotiations with our customers.

In addition, we believe that the application of the proposed guidance would require considerable judgment to determine how much revenue should be assigned to the first delivery of software products and how much should be assigned to all other elements of our time based license arrangements. In fact, we would go so far as to say that we would find it extraordinarily difficult to apply the existing guidance to our time based license arrangements. This is because there is no consistency with regard to how our customers value the different individual variables that we include in our standard time based license arrangements. Given the significant divergence in how each of our customers’ value various components, or elements, of our time based license offering, there is no rational way to establish a standard allocation of the fee between the variable elements included in those arrangements. We believe that what our customers really value consistently, is the right to use, and have access to our services for the duration of our time based licenses. We would like to see the Joint Board adopt the practical expedient currently available under IAS18, Appendix 1, Paragraph 20 into its next Exposure Draft to allow us to continue to apply ratable revenue accounting to our time based license arrangements.

**Impact on Investors**

In our industry, ratable revenue recognition is also very important from an investor perspective. As our customers pay us over the term of the arrangement, ratable revenue recognition generally aligns cash payments with the associated recognition of revenue. If revenue were required to be recognized upon the effective date of the arrangement, large, long-term receivables will appear on our balance sheet, some of which may not be realizable due to changes within our customers’ business during the term of the arrangements. In addition, companies may use longer contract terms and may give larger discounts to customers that could be used to increase revenue in the short-term, but could cause significant harm to long-term shareholder returns. Both of these results would be harmful to our value as a company and the value of our shareholder’s investment in us.

The ratable model allows investors to predict our results for multiple periods in the future. If we were required to recognize revenue at a point in time, we may be not be able to maximize the value of our contracts because our customers may wait until the last day of the reporting period because they will be expecting a larger discount to close the deal on that date. This, combined with an increased duration, could reduce the annual value of a contract while at the same time increasing the revenue recognized in the period that the contract is signed/fulfilled, once again decreasing shareholder value and at the same time not reflecting the true economic value of the arrangement.
Recommendations

Because the economic substance of our arrangements supports ratable revenue recognition, we recommend the following adjustments to the current exposure draft to enhance the overall model, which would also clarify that ratable revenue is appropriate for our arrangements:

- Add as a practical expedient, the following from paragraph 20 in Appendix 1 of IAS 18: Revenue: "As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time." For situations such as ours, particularly where payments are made equally over the term of the arrangement and there is no rational way to measure the value of the future performance obligations, this would enable the recognition of revenue to match the economics of the arrangement. We believe a similar principle is present under US GAAP, under paragraph 12 of Statement of Position 97-2: Software Revenue Recognition: "If the arrangement is in substance a subscription, the entire fee should be recognized ratably." We believe that our customers consider our time-based license arrangement to be a subscription in substance, constituting one continuous performance obligation.

- Because of the possibility for technological obsolescence and the extended payment terms in the agreements, add a paragraph after paragraph 85 stating "Notwithstanding the requirements in paragraphs 81-83, if an entity licenses intellectual property to a customer over a period of time and the customer promises to pay over a period greater than one year, the cumulative amount of revenue recognized as of the reporting date is limited to the amount of the transaction price that is 'due and payable'."

- Example 18 in paragraph 1G74 of the exposure draft allows revenue to be recognized for one performance obligation in an arrangement when payment is not due until a second performance obligation is completed. We suggest that the contingent revenue concept should be added to the exposure draft so that revenue cannot be recognized for one performance obligation if payment is contingent upon delivery of other performance obligations in the arrangement.

Retrospective application of this guidance would be very expensive and complex and we question whether the benefit is justified by the cost.

As noted in our letter dated October 21, 2010, we agree that retrospective application may preserve trend information for many, and if some companies can implement the proposed guidance retrospectively, we believe they should be allowed to do so. If the required revenue recognition for a business model does not reflect the economic substance of the arrangements, companies will most likely change their business model so that the revenue recognition is consistent with the economic substance of the arrangements. Therefore, the retrospective adoption will make the financial statements less comparable. Therefore we do not believe that
retrospective application should be mandatory, particularly where the outcome may not be beneficial for investors.

We would find retrospective application of some of the proposed guidance to be a daunting task, likely requiring many man-years of effort and significant expense to implement. It would require us to look at contracts as early as 2007 to determine the revenue impact on fiscal 2011 (due to the five-year financial data required in the Form 10-K). This contract by contract review is required because certain data that will affect our revenue recognition under the current exposure draft, but did not affect our revenue recognition under the current accounting standards, was not stored in our systems. The complexity and potential for error is enormous and we do not believe that the benefits of this particular aspect of the proposal to the investor would outweigh the implementation costs and risks to the company.

Also, we strongly suspect that many shareholders would prefer a temporary lapse in trend information about revenue rather than suffer the massive cost associated with trying to implement retrospective application of the proposed guidance.

We recommend that the Board include a transition alternative similar to that allowed in Update No. 2009-13 Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements and Update No. 2009-14 Software (Topic 985): Certain Revenue Arrangements That Include Software Elements. It would be far more practical and shareholder friendly to apply the proposed guidance on a prospective basis, with suitable disclosures wherever possible.

**Requiring a large set of disclosures decreases the value of the disclosures and may potentially make competitive information available.**

We believe that the required disclosures will provide a plethora of information to investors, customers and competitors. In fact, we believe that there are so many required disclosures that investors may find that they are not using the most useful information in an attempt to decipher and use all the most valuable of the information. In addition, the amount of disaggregation that is required may allow customers to determine customer specific data. This is a large risk for us because of the small number of companies that compete in our industry.

We recommend that the Board retain the principles-based concept and replace many of the “an entity shall” disclosure requirements with “an entity should consider” disclosures, particularly in the disaggregation of information disclosures. In addition, we recommend that the Board add a paragraph that allows the elimination of some disclosures if they are not material to the company. For example, with a ratable revenue model, we would expect to have few contract assets, therefore this table would not provide valuable data to our shareholders, but would require much time and effort to complete.

We recommend that disclosures should only be included in the interim periods if there is a significant change to the most recent annual disclosures. Including all required disclosures in
interim periods would significantly impact the timing to get all financial data to investors on a quarterly basis.

Requiring entities to show amounts of promised consideration assessed to be uncollectible because of a customer’s credit risk adjacent to the revenue line item is misleading.

We do not agree that revenue should be recognized on a gross basis only to have a second line item on the face of the financial statements that reduces income for amounts deemed uncollectible in the period that revenue was recognized. If collectability is not probable, we believe that revenue should not be recognized until collectability is assured. As an alternative and if significant to each entity, we recommend that entities disclose in the footnotes significant judgments and estimates that were used to conclude that collectability was not probable for some arrangements.

We would be pleased to respond to any questions or comments you may have regarding this matter.

Yours sincerely,

G. Sean Sobers, CPA (inactive)
Corporate Controller

cc: R. Harold Schroeder, FASB Board Member
Philip Hood, FASB Project Manager