Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: FASB Exposure Draft Revenue Recognition (Topic 605), Revenue from Contracts with Customers, Issued November 14, 2011 and January 12, 2012
File Reference No. 2011-230

Dear Sir/Madam:

Mentor Graphics appreciates the opportunity to comment on FASB Exposure Draft Revenue Recognition (Topic 605), Revenue from Contracts with Customers, Issued November 14, 2011 and January 12, 2012.

**Mentor Graphics Business**

Mentor Graphics Corporation is a technology leader in electronic design automation (EDA). Our products are used in the design and development of a diverse set of electronic products, including automotive electronics, video game consoles, digital cameras, cellular telephones, medical devices, smart phones, and e-book readers. We provide software and hardware design solutions that enable our customers to develop better electronic products faster and more cost effectively. The electronic components and systems that our customers create with our products include printed circuit boards, integrated circuits, field programmable gate arrays, embedded software solutions, wire harness systems, and computers.

We derive software revenues from the sale of licenses of software products. We primarily license our products using term licenses (where revenue is recognized upfront upon delivery of a fixed list of software products) and perpetual licenses (where revenue is recognized upon delivery of the software). The term licenses often include additional rights that are granted at the outset of the arrangement and do not require any further performance obligations on our part, including the ability to use the licenses in different geographic locations, the ability to reconfigure the products in use from a list of available products and the ability to use varying quantities of our products. These arrangements also provide customers rights to purchase additional products that are currently available and future products when and if available for a specified, substantive
increase in fees. In addition, on a limited basis, we have provided customers rights to unspecified future products during the term of the arrangements. In these cases, we have recognized revenue ratably over the term of the license as we have not established vendor specific objective evidence of fair value for these unspecified future deliverables.

**We agree with the proposed guidance**

The FASB and the IASB have invited organizations to comment on whether the proposed guidance in the exposure draft is clear and can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity’s contracts with customers. We agree that the guidance is clear and can be applied in a way that most effectively captures the substance of our customer contracts. We also believe that the enhanced guidance would allow us to effectively communicate the nature of our contracts to investors.

The FASB’s basic principles of revenue recognition which results in revenue being recognized when the customer takes control of software products reflect the substance of our licensing transactions with our customers. Currently, the elements of our license arrangements may vary minimally but result in significant differences in the timing of revenue recognition. The proposed guidance reduces the extreme variability of revenue timing that we have experienced between these arrangements. To illustrate this variability consider the following historic transactions into which we have entered:

- **Example 1:** As previously mentioned, our most common transaction is a three year fixed term license arrangement that includes rights to reconfigure the delivered products in use from a fixed list of available delivered products, the ability to use varying quantities and the ability to use the products at multiple customer sites across multiple geographic locations. These arrangements include post contract support (PCS) that provides the customer with unspecified enhancements and bug fixes as well as technical support assistance for which we have vendor specific objective evidence of fair value (VSOE). On occasion these arrangements also include professional services that are not essential to the functionality of the software for which we have VSOE. Since the only undelivered elements at the outset of the arrangement are PCS and possibly professional services for which we have VSOE, software revenue is recognized upon delivery at the outset of the term under current accounting rules.

  Our understanding of the proposed guidance is that a distinct and separate fair value would be assigned to the software product and related license rights delivered upfront and to the PCS to be delivered evenly over the contract term. Each value would then be recognized upon delivery to the customer either upfront or ratably as appropriate. This treatment would be similar to the outcome prescribed under current accounting rules.

- **Example 2:** As previously mentioned, on a limited basis, we have provided rights to unspecified future products on a when and if available basis during the term of the
arrangement. Other than this additional license right, these arrangements include the same license right choices as those available in Example 1 above. Our experience with this type of arrangement is that the amount of software and value of the software from both the customer’s and our perspective is largely delivered at the outset of the arrangement.

Future products are introduced on a limited basis from a relative perspective during the contract term. This fact is measurable by a historic study of new product introductions made available in previous transactions compared to total products available at the outset of the arrangements. In addition, most customer projects require development tools to remain constant throughout the design cycle and switching or adding design tools in the middle of a design project is uncommon and unproductive. As such we believe a value, which we estimate is nominal, can be reasonably assigned to this element of the arrangement based on our historical experience in similar transactions. Since these arrangements include rights to unspecified products in the future for which we do not have VSOE, we recognize revenue ratable under current accounting rules, even though a substantial majority of software and rights to use the software is delivered upfront.

Our understanding of the proposed guidance is that a distinct and separate fair value would be assigned to the portion of licenses delivered upfront and to the portion to the licenses to be delivered on a when and if available basis and that each value would be recognized upon delivery to the customer. This bifurcation would require revenue to be recognized upfront when the initial product set is delivered and ratable for the remaining when and if available product deliverables.

We believe the proposed guidance better reflects the economics of our transactions and more consistently assesses delivery, transfer of use and revenue timing between Example 1 and Example 2. The prescribed revenue timing under current accounting rules places an extreme value on a proportionally and measurably small element of subscription transactions in our view. Under the new literature, we will achieve substantive consistency in that sales of software will be recognized when the customer has the use of the product.

We have noted other comment letters which state that revenue recognition on software licensing transactions is “aggressive” and will “reduce the comparability across entities”. We believe that the current accounting literature already reduces the comparability across entities. The proposed guidance in the exposure draft, along with the proposed enhanced disclosure requirements will allow investors to better compare our results with those of our competitors and to better understand our business. The timing of revenue recognition and economic substance of software transactions as proposed will more directly correlate with the transfer of control. We therefore, encourage the FASB and the IASB to finalize the revenue proposal as exposed.
Sincerely,

Richard P. Trebing

Corporate Controller and Chief Accounting Officer

George N. Kolln, CPA (inactive)

Director of Accounting