



## THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

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August 26, 2003

Mr. Robert Herz  
Chairman  
Financial Accounting Standards Board  
401 Merritt 7, PO Box 5116  
Norwalk, CT 06856-5116

**Letter of Comment No: //**  
**File Reference: 1100-LEU**  
**Date Received: 08-26-03**

Dear Chairman Herz:

I am writing to express the serious concerns of the Associated General Contractors of America (AGC) regarding the severe impact that we believe Statement of Financial Accounting Standards No. 150 (FAS 150) will have upon the business operations of a vast number of non-public, non-SEC registered construction firms. We urge the Financial Accounting Standards Board to reconsider its decision to make FAS 150 applicable to non-public entities.

FAS 150 requires that issuers classify as liabilities any financial instrument issued in the form of shares that is "mandatorily redeemable." A financial instrument is "mandatorily redeemable" if it requires the issuer to redeem it by transferring its assets at a specified or determinable date upon an event that is certain to occur. Among such events are the death or termination of employment of an individual shareholder of the entity.

### ***Background***

Construction and construction related companies are predominantly non-public, non SEC-registered businesses. However, particularly in commercial construction, non-public contractors are currently able and should continue to be allowed to compete against publicly held contractors.

The requirement of FAS 150 to recognize a liability for a company's obligation to acquire shares under a buy/sell agreement poses an extreme problem for non-public construction and construction related companies.

A prerequisite for commercial contractors to obtain new business rests on their ability to obtain surety bonds on their contracts. Sureties require business continuity plans as part of their underwriting of credit on contractors. Thus, the nature of the business demands that shareholders and their corporations have binding agreements to provide for an orderly continuation of the business so that, in the case of a triggering event, their long-term contracts will be completed without additional financial risk to the surety.

The surety industry demands buy/sell agreements. Owners of non-public construction companies want buy/sell agreements that provide a meaningful market for their securities under events such as death, disability, retirement, etc. While public entities may have only a limited number of shares subject to a buy/sell agreement between the shareholder and the company, most non-public entities with buy/sell agreements subject all shares to the agreement.

It is wise and responsible for non-public contractors and construction related companies to have strong buy/sell agreements. Due to the adverse effect of FAS 150 on financial presentation and a company's ability to obtain future work, most contractors will be forced to eliminate or water down their agreements, so that no corporate obligation exists. Financial reporting standards are therefore driving businesses to conduct that is not prudent.

The valuation of all shares of a non-public entity will almost always produce a liability under FAS 150 that is equal to or greater than 100% of the equity of the business. This is in part due to the fact that many contractors hold real estate and equipment that has fair values that are greater than historical cost basis.

The extreme effect that FAS 150 will have on the balance sheet and income statement of non-public contractors and construction related firms will create an unfair competitive advantage for public entities. Sureties, contracting agencies and owners of projects will naturally look more favorably upon companies that report equity than those with no equity and no income on a year-to-year basis.

**AGC recommends that FASB exempt non-public companies from FAS 150. Prior to the issuance of FAS 150, buy/sell agreements generally did not require disclosure in financial statements of non-public entities. An alternative to recording the liability would be to require non-public entities to disclose the terms of buy/sell agreements including the events that would produce a liability. The guidance of FAS 150 would be applied by non-public entities only when a triggering event occurred.**

#### ***Going Concern***

Most non-public construction and construction related companies have buy/sell agreements. In order to apply correctly FAS 150, companies would be required to classify this equity as a liability. Without any equity, this will force CPAs who correctly apply the FAS to give a "going concern" opinion. This valuation will make it extremely difficult for construction and construction related companies to obtain surety or bonding. In essence, by following by the letter, FAS 150 could force non-public companies to go out of business.

#### ***Interest Classification***

FAS 150 proposes to record future changes in the valuation of the liability as a charge or credit to earnings classified as "interest." This can produce large charges and credits from year-to-year in non-public companies where 100% of the shares are subject to the agreement. The classification on the income statement as interest needs additional consideration. The current position does not lead to a better understanding of financial statements of non-public entities. **The FASB should**

**consider a special classification for the income statement just as it recommended a separate classification of the liability on the balance sheet.**

***Valuation costs***

Many non-public companies have buy/sell agreements that use formulas and appraisals to determine the value of redeemable shares rather than setting a specific value on a routine basis. The enterprise only incurs the cost of appraisals and other valuations in the rare event of a redemption.

FAS 150 requires the liability to be determined annually. This produces an undue hardship on non-public entities that will require them to incur valuation expenses annually to determine the liability required to be revalued on an annual basis under FAS 150. **AGC recommends that non-public companies be exempt from this proposal and continue to determine value at redemption.**

***Pre-qualification & Licensing***

Contractors must pre-qualify with project owners, Federal, state, and local governmental agencies in order to be allowed to bid on specific new projects. A significant element for pre-qualification is the equity and earnings of the company. Most of these jurisdictions also have financial requirements to obtain a contractor license. The class of the license is often statutorily based upon the financial condition of the contractor.

FAS 150 will cause many contractors to lose their pre-qualification and possibly their licensing status. **In light of these disastrous consequences, AGC recommends that non-public companies be exempt from FAS 150. Alternatively, postponement of the effective date might allow agencies to understand the issue and modify their regulations to accommodate FAS 150. Without this educational effort, the existence of a buy/sell agreement with mandatory redemption terms could preclude a contractor from a business opportunity and create undue hardship on the contractor.**

***Employee Stock Ownership Plan (ESOP)***

Many contractors and construction related companies create ESOP ownership structures primarily for continuity planning purposes. The redemption feature that is common with these plans, after the effect of FAS 150, will create an uneven playing field between companies with and without mandatory redemption provisions.

Especially with 100% ESOP companies, which defines many contracting and some construction related companies, all outstanding shares are subject to a "put" option, or mandatory redemption by the company. Since the independent stock valuation includes a premium over the book value of the shares, to report the entire ESOP repurchase liability as debt would result in either negative net worth or zero net worth with the premium amount classified as "goodwill."

Negative or zero net worth on a company's financial statements will have many devastating consequences. Among them, the company would be unable to procure bonding capacity, unable to secure bank financing, or would be in violation of banking covenants under a credit facility.

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The company would also be prohibited from bidding on work in various states, such as Texas and Oklahoma, as they require certain levels of net worth to show ability to perform contracts.

**AGC believes that private ESOP companies should not be punished by a FAS pronouncement, the intent of which was to prevent mismanagement and malfeasance in public companies. By choosing an ESOP ownership structure, companies have access to more capital, employee motivation helps foster greater profits, and meaningful retirement benefits are available for all employees from craft workers to executives. FASB should exempt non-public companies from FAS 150, so that an accounting rule does not drive ESOPs out of business.**

AGC believes that FAS 150 will have a disastrous affect on the construction industry if applied to non-public companies. We respectfully urge the Board to exempt non-public, non-SEC registered companies from this Statement.

Sincerely,

A handwritten signature in black ink that reads "David R. Lukens". The signature is written in a cursive style with a large initial "D".

David R. Lukens  
Chief Operating Office