



October 19, 2010

Technical Director
Financial Accounting Standards Board
407 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

File Reference No. 1820-100

Re: Exposure Draft: Revenue Recognition (Topic 605) *Revenue from Contracts with Customers*

GALLINA LLP is pleased to provide our comments to the Financial Accounting Standards Board on the proposed accounting standard update.

GALLINA LLP is a certified public accounting firm that serves as independent auditors and accountants to over 600 construction contractors in California, Nevada and Washington. The majority of our clients are small to mid-sized, closely held entities that would be greatly impacted by the changes that this exposure draft suggests. We are extremely interested in the Board's project on revenue recognition and it is our desire to ensure that high-quality accounting and financial reporting for the construction industry is maintained.

For almost 30 years the construction industry has used the guidance provided by ASC 605-35 (formerly known as SOP 81-1). The revenue recognition model in SOP 81-1 is clearly understood by the contractor reporting entity and users of the financial statements including Surety Bond providers, banks, public agencies, and others. It meets the definition of a generally accepted accounting standard and has allowed the users of financial statements to consistently evaluate the financial capacity of a contractor over a period of time as well as compare their financial capacity to other contractors.

The current guidance in the Exposure Draft for recognizing revenue at the "performance obligation" level represents a significant change and presents a significant challenge to preparers, users and auditors. The inherent subjectivity of the prescribed process for identifying and allocating revenue to performance obligations will lead to less consistency and transparency in the financial reporting process in the construction industry. The inherent subjectivity also opens the door to financial statement manipulation. While the concept of performance obligation in the revenue recognition process may make sense for other industries, it doesn't meet economic reality for the construction industry.

Technical Director
Financial Accounting Standards Board
October 19, 2010
Page 2

When the Accounting Senior Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) and the AICPA's Construction Contractors Guide Committee wrote the *Audit & Accounting Guide – Construction Contractors* and Statement of Position 81-1, the criteria for segmenting a contract was very strict. They recognized the potential for profit manipulation and acceleration inherent in segmenting a contract and as a result set out the standard as currently portrayed in ASC 605-35-25-10 to limit the use of segment reporting. This proposed new standard seeks to encourage segmenting of contracts and will result major disagreements between contractors and their auditors over the allocation of the contract amounts to processes and the allocation of estimated profit to the related processes.

An owner of a project contracts with a construction contractor to provide a finished project, not a series of performance obligations. A contract should not be subdivided into multiple profit centers because the risks within the contract are inseparable and all elements of the project must function together. Trying to subdivide the contract into various separate performance obligations ignores the overriding risk the contractor bears in making sure that all of the pieces of the project fit together as the owner has specified in the contract.

Construction companies manage their business at the contract level. Surety bonding is provided on a contract-by-contract basis. It is inappropriate to try to determine revenues on any basis other than at the contract level.

Current software used by the construction industry accounts for projects on a contract-by-contract basis. A change to the performance obligation model would require a costly rewrite of software. Additionally, having multiple performance obligations for each project could result in misclassification of costs between the various performance obligations and result in less accurate financial reporting. In addition, the costs in terms of manpower and resources to set up multiple performance obligations for each contract for financial reporting purposes and the potentially recombine them for management purposes is huge. This combined with the additional work that auditors and independent accountants will charge for the annual financial statements is a substantial additional cost without a corresponding benefit to the contractor or the users of their financial statements.

The contract price used for measuring revenue recognition should exclude the effects of bonuses or penalties until the impact of such bonuses or penalties can be measured with reasonable certainty. The example of probability weighted consideration shown in Example 19 of the Implementation Guidance makes no sense to a contractor. If a contractor is entitled to an early completion or cost savings bonus, the events that will entitle the contractor to the bonus should occur before the additional revenue is recognized. The use of probability weighting will only ensure that the incorrect amount of contract revenue will be recognized until the events entitling the contractor to the bonus has either occurred or not occurred.

We would suggest that more examples of construction contractors be provided in the Implementation Guidance. The only construction contract example, Example 11, needs further clarification. We can understand how the design services and performance guarantee might be separate performance obligations, but don't understand why the site preparation and site finishing would be separate performance obligations. While these activities might have distinct risks from the other construction activities, they are clearly not separable. The owner will not accept just the site preparation or site finishing, but rather the entire project contemplated by the contract.

Technical Director
Financial Accounting Standards Board
October 19, 2010
Page 3

Private construction companies will need additional time to comply with any new revenue recognition standard should the board go forward with the proposed standard. We would request that private construction companies be given at least two additional years to comply with the proposed standard once it becomes effective for public companies.

We would be glad to discuss our comments further should you have any questions or require additional information.

Very truly yours,

A handwritten signature in black ink, appearing to read "Donald L. Pfluger", written over a light gray rectangular background.

Donald L. Pfluger
GALLINA LLP