March 12, 2012

Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Ladies and Gentlemen:

Padgett, Stratemann & Co., L.L.P. is an accounting firm in South Texas which specializes in providing quality service to over 100 construction industry entities. We appreciate the opportunity to voice our opinion and comment on the Revision of Exposure Draft, Revenue Recognition (Topic 605).

We believe that this proposed accounting standard, if adopted as final, will require significant changes in internal accounting practices to properly apply the new recognition and measurement standards for revenue, costs, and gross profit on projects.

Construction firms have many complex contracts to continuously evaluate for cost estimates, schedules, and customer service. The proposed changes to the accounting recognition will not help companies achieve their objectives. In addition, we foresee that the proposed changes to existing practices will not help sophisticated users of construction industry financial statements, such as bankers and sureties, who make credit decisions based on this information.

**Onerous Performance Obligations**

Paragraph 86 requires an entity to recognize losses and liabilities related to onerous performance obligations that would be satisfied over a period of time greater than one year. Construction contracts often vary in length and could straddle two fiscal years. Therefore, we believe a material loss on any contract, short-term or long should be required to be accrued if the total contract will result in a loss.

We believe that more clarification and industry guidance will be needed in this area.

**Contract Costs**

The proposed standard allows revenues to be recognized based on measurement of required outputs (such as miles of highway completed), or inputs (such as costs to date as a percentage of total estimated cost). Most of our clients will continue to use the cost-to-cost method, but will be required to exclude the following costs from the percentage completion calculation under the new standard of input measurement:
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- Procurement costs – will need to be expensed as incurred.
- Mobilization costs – can be capitalized as prepaid expenses if costs are recoverable under an active contract, and then amortized ratably as contract revenue is earned.
- Costs of inefficiency or waste – should be expensed as incurred as these would not satisfy performance obligations.

We feel that this method of accounting will be very confusing for a majority of our clients and will produce inconsistent information among contractors. It will also be very difficult for auditors of the financial statements to determine if a cost was part of an original budget, a change in estimate, or unproductive costs.

**Unapproved Change Orders and Claims**

The current standards provide specific rules for recognizing revenue and profits when change orders are unapproved, unpriced, or for claims. Under certain circumstances, unapproved change orders can be accounted for at zero profit (when the likelihood of approval is probable) until such time it is approved or realization is likely. The new wording in the proposed standard is inconsistent and could result in different interpretations and inconsistencies in reporting. We believe contractors should be able to continue to recognize revenue when received rather than having to make predictive judgments about probabilities and recording an estimated revenue amount.

Respectfully,

Padgett, Stratemann & Co.

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