

**VIA email to: [director@fasb.org](mailto:director@fasb.org)**

June 19, 2009

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

Re: File Reference No. 1660-100  
Discussion Paper "*Preliminary Views on Revenue Recognition in Contracts with Customers*"

Dear Technical Director, Board Members and Staff,

URS Corporation (NYSE: URS) is a leading international provider of engineering, construction and technical services. We offer a broad range of program management, planning, design, engineering, construction and construction management, operations and maintenance, and decommissioning and closure services to public agencies and private sector clients around the world. We also are a major United States ("U.S.") federal government contractor in the areas of systems engineering and technical assistance, construction and operations and maintenance. We have more than 50,000 employees in a global network of offices and contract-specific job sites in more than 30 countries.

The joint initiative by the IASB and FASB to develop a decision-useful revenue recognition model is a noteworthy endeavor and we welcome the opportunity to provide our thoughts on this challenging undertaking by responding to the Discussion Paper, hereinafter referred to as the "DP."

While our response reflects only the perspectives and views of URS Corporation, we recently participated in an Engineering and Construction ("E&C") Industry Controllers' Roundtable, in which the subject DP was a topic for discussion. We understand that other companies in the E&C industry will also be providing responses to the DP. In addition, we would welcome the opportunity to meet with representatives of the IASB and/or the FASB to discuss the practical issues and questions that we have considered in formulating our response.

URS Corporation  
600 Montgomery Street  
San Francisco, CA 94111

### ***Question 1***

*Do you agree with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?*

#### **Response:**

In concept, we agree with the desire to simplify the revenue recognition model and develop a model that will facilitate greater consistency, comparability and clarity. However, while it may seem ideal to have a single and universal revenue recognition principle or standard, it may not be viable or practical because of the significant differences that exist between businesses and industries, and because similar transactions may require different treatment in different business environments. Said another way, we are concerned about whether a one-size-fits-all revenue recognition standard is practical in the real world, and in our view, practicality should trump theory, even if the factual differences between industries cause some inconsistencies in revenue recognition principles.

In addition, while the earnings process for some businesses lends themselves to simplicity, (retail point of sales transactions, for example), other businesses are based upon very complicated transactions that are not instantaneously executed, but rather occur over long periods of time and entail many individual steps to complete. For example, a major engineering and construction project, executed from initial planning through design engineering, construction, testing, start up, and in many cases, operations, can take years to complete and can comprise literally thousands of individual activities executed through a formalized work-breakdown-structure ("WBS"). Such transactions do not lend themselves to the same revenue recognition principles that would be employed by, for example, a retailer, a software developer, or a public utility.

We are, therefore, reluctant to support a revenue recognition model that does not give due regard to the unique, complex and specific characteristics of our industry, or in fact, other industries, and we observe that the premises behind the time-tested, improved and trusted contract accounting methodologies that we use today have served our industry and readers of our financial statements very well. In reviewing the DP, we do not find any specific criticisms or indictments of the method of recognizing revenues that have been followed by the E&C and similar industries over the past 25+ years.

The construction example provided in the DP, presents a contract that is static, simplified, and has a fixed price. This example is not representative of the wide variety of contracts in our industry, as it is neither the only type of contract in which we engage, nor does it necessarily represent the prevailing characteristics of contracts entered into by companies in the E&C industry. Unlike other industries, we are in the business of operating under complex contracts that require the preparation of continuous estimates to address constant variability.

Each contract that we enter into is unique; literally, no two are exactly alike. Our service duration ranges from a few weeks to several years. The sheer size, complexity and diversity of our projects

commonly require us to combine efforts with other entities through joint ventures and partnerships, and to enter into relationships with sub-contractors and various other individuals or organizations in order to meet project objectives and client specifications. Our work is dynamic, from the pre-contract activities throughout the life of the project. Our ever-changing markets and fluid economic conditions give rise to variable measurements of costs and revenues, which makes our industry conducive to change orders, claims and back charges.

We enter into several different types of contracts, each of which have different kinds of revenue recognition implications and challenges, ranging from firm fixed-price and time-and-materials contracts, to target-price and cost-reimbursable contracts. In fact, while sounding simple and straight-forward, cost-reimbursable contracts themselves come in several varieties, ranging from cost reimbursable contracts with fixed-fees to award-fees and performance-based or milestone incentive fees.

Because of the complexities and uncertainties in our projects, our industry has applied contract accounting practices and policies designed specifically to address the complex business arrangements and activities of our industry. In addition, the existing standards provide clear and specific principles for recognizing costs, allocating costs, recognizing project progress, measuring revenue and formulating disclosures, based on the relationships with various entities, and the risks that each bears. In relation to our industry, we believe the DP is primarily theoretical and so general that, if a final standard were to reflect its approach, the E&C industry would have to establish its own application guidelines or else the financial statements of the various E&C industry participants would cease to be remotely comparative.

As a final general observation, we offer the following: in our industry, as in some others, revenue recognition is not a process that can be fully automated, nor is it simply an exercise for accountants to undertake. Because our projects are based upon complex contractual relationships and highly complex technical activities, the recognition of revenue requires the participation of professionals in the legal, engineering, project management, project controls and construction operation departments of the company. Thus, employees from those organizations must all be educated regarding revenue recognition principles because they are required to make many of the critical estimates and decisions regarding the status and progress of projects, which drive the measurement and recognition of revenue under any revenue recognition model.

Changing the revenue recognition model from the current one to any significantly different approach will require an enormous investment by the E&C industry to “re-tool,” particularly to re-educate the non-financial professionals that participate in measuring revenue, not to mention the potential modifications to financial information system tools currently in use by the industry. As such, we are concerned about the practical consideration of costs versus benefits in the Boards’ deliberations on this topic. If a fatal flaw had been determined to exist in the current revenue recognition principles used by the E&C industry, we would undoubtedly be more enthusiastic about making such a fundamental change.

The following addresses significant issues that we have identified related to the DP.

- Long-term Contract

We are concerned about the Boards' view regarding long-term contracts. Our industry predominantly uses the percentage-of-completion ("POC") method to account for long-term contracts. A basic tenet in accounting for long-term contracts under the POC method is that in performing a construction project for a tangible asset that is being built to the client's specifications and on the customer's site, the contractor is primarily providing a service and will generally not hold any title or ownership of the asset, tangible or intangible, that is completed at the end of the project. Hence, we recognize revenue as we provide services to our client. This is stated in SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," ¶ 22, as shown below:

*"The legal right of the buyer to require specific performance of the contract means that the contractor has, in effect, agreed to sell his rights to work-in-progress as the work progresses. This view is consistent with the contractor's legal rights; he typically has no ownership claim to the work-in-progress but has lien rights. Furthermore, the contractor has the right to require the buyer, under most financing arrangements, to make progress payments to support his ownership investment and to approve the facilities constructed (or goods produced or services performed) to date if they meet the contract requirements. The buyer's right to take over the work-in-progress at his option (usually with a penalty) provides additional evidence to support that view. Accordingly, the business activity taking place supports the concepts that in an economic sense performance is, in effect, a continuous sale (transfer of ownership rights) that occurs as the work progresses."*

The guidance found in SAB 104 is also similar to SOP 81-1, ¶ 22, where both the buyer and seller obtain enforceable rights that indicate the continuous transfer of ownership rights. As this is fundamental to our industry's revenue recognition principles and is a foundation concept, we recommend that the principle be incorporated in the proposed model.

- Transfer of control

We believe the DP's model focuses on the contract-based approach to revenue recognition (section 2.11 and summarized in 2.40) and allows contractual language to determine revenue recognition. We observe that the DP appears to be more concerned with the legal form rather than the true economic substance of the agreement between the two parties.

We believe that the economic substance of long-term contracts is more important than their form and observe that the current POC method facilitates the presentation of the substance of economic transactions entered into under long-term contracts. In contrast, we are concerned that, as outlined by the DP, focusing revenue recognition on contractual language may give rise to an opportunity for entities to craft contract terms and conditions to manipulate the timing of revenue recognition based on arbitrarily identifying performance obligations and the timing of their satisfaction. Influencing the contract language to drive revenue recognition may reduce the comparability of financial statements and facilitate the presentation of economically similar transactions in a dissimilar manner. In addition, if manipulated, the resulting financial statements may not reflect the true economic substance of the contract or mis-distribute revenue across reporting periods.

- Identification of performance obligations

The DP does not clearly indicate the level of granularity for an entity to segment performance obligations. Section 3.45 indicates “an entity accounts for performance obligations separately if the promised assets are transferred to the customer at different times.” The DP’s focus on the timing of the asset transfer for triggering revenue recognition assumes that the level of detail required to segment performance obligations (the transfer of promised assets) is clear. However, the level at which an entity should separate obligations is not always clear. For example, assume that we enter into a long-term construction contract for seven years where we operate under the specific direction of our client. During the construction period, thousands of individual task items will be occurring, many simultaneously and pertaining to very different aspects of the project, which makes it very difficult to group these activities into separate performance obligations. Under the current guidance of SOP 81-1 where control is transferred continuously, our costs are considered, in essence, the performance obligations. With each service hour expended, brick installed or nail driven, we recognize revenue in conjunction with the costs incurred. However, based on the DP, we are not clear as to how we can identify the performance obligation and the level of detail of an asset transfer for which to measure each obligation.

We recommend that the Boards consider project progress measurements of continuous transference such as the underlying costs, accumulated labor hours, accumulated labor dollars, engineering estimates and various other methods as they are the most identifiable and assignable elements to each contract.

- Re-measurements of contract

We agree that performance obligations should be deemed onerous if cost exceeds the transaction price of the obligation. However, we believe that subsequent changes to the initial transaction price resulting from change orders, claims, schedule incentives, safety incentives, target cost over and/or under-runs, award fees and other performance-based incentive payments should allow for re-measurements of the original transaction price.

We concur with the Financial Accounting Standard Board’s (FASB) decision on June 10, 2009, allowing for re-measurements on a cumulative “catch-up” basis if the changes are interdependent to the original contract. However, as the DP is dynamic and still in developmental stage, we strongly recommend that both Boards conclude with this guideline as we believe the cumulative “catch-up” methodology results in a more accurate reflection of the underlying economic substance of the contract as it fully captures the total costs and revenue related to the contract. Without resolution of a method for addressing changes in contract value over the life of a long-term contract, any revenue recognition model is inherently insufficient for our industry.

- Combining and Segmenting of contracts

We often account for a group of projects that we negotiate as a package to achieve an overall profit margin, as a single project since these projects were, in effect, from a single

contract and are parts of a single project. Accounting for the contracts individually may not be feasible or appropriate as the projects may be performed simultaneously, as part of a single effort, and segregation would not provide information that is comparatively more useful to readers. Conversely, we also enter into contracts that provide for different contract terms for portions of a single contract. For example, we may enter into a contract to design, construct and then operate a facility for a client. The design and construction phases of the contract may be based upon firm-fixed price or a target price arrangement and the operations phase may be based upon a time and materials or a cost-reimbursable arrangement. In such situations, we believe it is appropriate to segment the contract to better reflect the substance of the contract.

The tentative decision by the FASB on June 10, 2009 to account for two or more contracts as a single contract if the prices of those contracts are interdependent and to account for a single contract as multiple contracts if each contract segment is priced independently, is manifested in the examples provided above. We recommend that the Boards adopt this as the final standard as it provides decision-useful information and addresses the substance of underlying facts. We further recommend that the guidelines related to combining or segmenting of contracts currently contained in SOP 81-1, ¶ 39 - ¶42 be adopted.

- Gross vs. Net, or “Agency vs. At-Risk”

At the June 10, 2009 FASB meeting, the FASB decided to use guidelines similar to those contained in current US GAAP and IAS in determining gross versus net presentation of revenues when other parties are involved in providing goods and services to an entity’s client. However, this decision has not yet been approved by the IASB. Hence, we recommend that the Boards incorporate the concepts in EITF 99-19 and IAS 18, ¶8 into the proposed model as application of these concepts would result in the most appropriate accounting for the vendor-client relationships and reflect the substance of a contract, rather than just its form.

- Contingent consideration

In our industry, we define contingent consideration as performance-based incentives, award fees, safety incentives, schedule incentives, target cost over or under-runs, liquidated damages and other incentives. Under certain of our Engineering, Procurement, and Construction-type projects, these contract variables have significant influence on a project’s financial performance. As noted in Appendix C of the DP, contingent consideration was not addressed, but is to be discussed in future meetings. At the IASB meeting held in March 2009, the staff discussed the issue of contingent consideration and published various recommendations. URS agrees with the recommendation that contingent consideration be estimated at contract inception and allocated to all performance obligations. We agree with the recommendation that the measurement of these contingencies should be updated to reflect changes in the transaction price and that those changes in profit or loss should be recognized only to the extent that they relate to satisfied performance obligations.

There are many situations in which the contingent consideration is repetitive or relates to performance criteria that the company has executed many times before. In such situations, we believe that it is appropriate to recognize that portion of the contingent consideration that is indicative of historical performance against similar criteria. Of course, current performance must be monitored to assure that it actually corresponds with prior experience; if it does not, revenue must be appropriately adjusted. An expected outcome approach is consistent with current guidance and would be beneficial to the industry because the estimation process is already commonly understood.

- Pre-contract costs

SOP 81-1, ¶ 75, allows for deferral of pre-contract costs based on certain criteria, including when probable recoverability exists related to costs that are directly associated with a specific anticipated contract. The DP allows deferral of costs only if they qualify for capitalization in accordance with other standards. Although the majority of pre-contract costs are generally expensed as incurred, we believe that certain costs described in SOP 81-1 ¶75 should continue to be deferred. We recommend that pre-contract costs be included as part of the total contract costs since the required services in the stated contract would not have been made possible without the conceptualization and planning performed during the pre-contract activities. In many cases, a significant portion of the pre-contract costs are incurred by the performance of professional engineering activities that will ultimately benefit the proposed project, such as conceptualization, preliminary design and technical specification, and cost estimation. Hence, because such costs are integral and necessary to the ultimate completion of the project and may be material to the financial statements, they should be deferred. Separating the pre-contract costs would not be a fair representation of the true cost and income of a contract, and in measuring when a net position of a contract becomes onerous.

- Transition method

Appendix C of the DP notes that transition and effective date for the proposed standard was not addressed, but will be considered in future staff meetings. We recommend to the Boards that a prospective transition approach be used, as it would otherwise create difficulties in transitioning large volumes of pre-existing, complex long-term contracts. A prospective application after the effective date would allow the industry to absorb the proposed model's significant changes without having to transition the existing contracts. This type of transition will also assist in mitigating the costs of implementation and the re-training of internal and external personnel throughout the industry.

As noted above, in our view, the inconsistency in existing standards that arises from having different revenue recognition principles may be necessary, in order to address the factual and substantial complexities and differences between industries. We do not believe that it would be appropriate to impose rules and guidelines to fit all industries and businesses, as the dynamics of different industries are not alike, and in many cases, the differences are profound. The risks, exposures, and internal controls necessary for consistency and transparency for one industry may not be appropriate for another. In addition, intended enhancements to one industry's accounting and reporting principles may only detract from another's. We believe that any attempt to bridge

inconsistencies and reduce the volume of guidance for revenue recognition should not eliminate the strengths of current promulgations.

In relation to our industry, we believe that current standards in SOP 81-1, SAB 101 and SAB 104 provide decision-useful information to the users of financial statements for engineering and construction industry, but which are not evident in the proposed model. These standards have evolved through many years to create comparability, present the substance of the industry's underlying economic basis, strengthen processes and redress shortcomings. Further, unless the proposed standard is proven to have a more superior reporting and analytical perspective, then we recommend that current standards be maintained, but we welcome improvements.

### ***Question 2***

*Are there any types of contracts for which the Boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?*

#### **Response:**

As noted in our response to Question 1 above, we are concerned about the appropriateness of the proposed revenue recognition principle on long-term contracts for the reasons described above. Depending on the interpretation of "transfer of control," the treatment could vary significantly. If revenue is deferred until the asset is physically delivered to the client, then we do not believe that this model would provide decision-useful information to users of financial reports. In fact, it would infer revenue recognition similar to the completed-contract method, which we believe is useful only in very limited situations. We understand that such a result was not intended by the DP; however, without clarification of the definition of "transfer of control," the proposed approach could be interpreted as requiring revenue recognition similar to the completed-contract method.

Such an approach would not provide an accurate financial depiction of the timing surrounding the economic substance of the transaction and the performance of the entity in the periods prior to the delivery of the asset. It would be difficult for the users of these reports to clearly understand the activities performed by the entity if revenue was not recognized until completion. The financial statements would lose relevance, comparability and transparency, which are needed by investors and analysts to evaluate the business and for management to manage its activities. More robust disclosures would be required in order to bring a semblance of order, which begs the question of whether the disassociation should have been made in the first place.

### ***Question 3***

*Do you agree with the Boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.*

#### **Response:**

We agree with the Boards' definition of a contract as an enforceable obligation between two or more parties. It is consistent with both the FASB and IASB's previous definitions of a contract,



with the exception of the reference to law. Paragraph 4.19, page 25 of the DP, notes that legal differences between jurisdictions can create substantive economic differences between two similar-type contracts, which could lead to:

- Inconsistency in the associated revenue recognition practices,
- Incomparability of the financial results for the same type of contracts and deliverables, and
- Less useful financial information for the stakeholders.

Hence, we believe that the Boards' definition of a contract should be revised and clarified to read: "A contract is an agreement between two or more parties that creates obligations that are enforceable under applicable laws that govern the parties."

#### **Question 4**

*Do you think the Boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.*

#### **Response:**

The proposed definition of a performance obligation states that it is "a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer. Hence, the satisfaction of a performance obligation depends on when the promised asset is transferred to the customer." We believe that this definition will not allow for consistent identification of deliverables stipulated in contracts as varied and complex as those commonly used in the E&C industry. The definition does not specify to what level of granularity performance obligations should be identified. As it is open-ended, it would inevitably result in inconsistent interpretations of "performance obligations." It is not clear whether the model intends to capture all promises to the customer in the contract, or whether the model only intends to capture a promise to transfer an "asset," particularly in those situations where a contract requires the performance and delivery of many thousands of services and components.

Consider the following examples:

#### Example 1

A Phase1 Environmental Assessment contract for multiple sites will be performed simultaneously on all sites and the required steps to perform the assessment are as follows:

- Interviewing site representatives at each site
- Walk-through each site
- Inquire about and review any governmental documents associated with the potential for site contamination
- Write a report for each site

Based on the DP guidance, it is not clear if a separate performance obligation exists for:

- Each one of the above mentioned steps for each site
- Each one of the above mentioned steps for all sites
- All steps for each site, or
- All steps for all sites

Example 2:

A fixed price contract may require an entity to deliver mission support services to the U.S. Government, which may include continual transfers of assets to the client (labor hours incurred related to providing customer site security); or it may involve transfers of assets only on an as-requested basis, (to move a box of materials from one location to another). Assets may be transferred to the client in the first 6 months of the year, and then not again until requested during the next fiscal year, depending on the client direction. We believe the identification of performance obligations could be viewed in several ways as shown below. In order for the concept of a performance obligation to be practical and workable, we believe that more definitive guidance is necessary regarding what constitutes a performance obligation.

As we read the DP, we believe that a performance obligation could be interpreted a variety of ways, such as:

- The continual performance of ongoing services (We believe this should be applied to the delivery of mission support services portion of the contract.);
- The completion of each discrete task, i.e., moving a box from one location to another (We believe this should be applied to the portion of the contract that involves the movement of materials for the client);
- The overall completion of all tasks promised in the contract; or
- The completion of each function or activity, i.e., security, plant and maintenance, administrative.

Example 3:

We perform a variety of Engineer-Procure-and-Construct (EPC) contracts where all three components will be performed over several years. These components are typically grouped by our customers into one request-for-proposal. We then develop an overall proposal for all three components as a whole, at the request of the client. To further illustrate that these components are grouped together, the majority of our contracts do not meet the criteria outlined in SOP 81-1 to segment the different EPC components. There are not separate bona fide proposals submitted for each component and the customer generally does not have the ability, or right, to accept or reject anything but the overall proposal. In example 5 of the DP's Appendix A, it states that conceptually, each service hour, brick, and nail is a promised asset that is transferred to the customer but for practicality, the performance obligation may be separated by the first and second floor being renovated. However, in many long-term construction contracts, there are thousands of individual performance obligations that are required to be performed, many of which may be occurring simultaneously.

Example 5 in Appendix A provides an example of how revenue and costs would be recognized under the proposed model. We have proposed the following schedule to outline our understanding of Example 5 and how it would be different from SOP 81-1.

Rev Calc for Floor 1			
<b>Using new Revenue Recognition Method</b>		<b>Using current SOP 81-1 Revenue Recognition Method</b>	
Recognized in Example at June		To recognize using % complete at June	
Revenue	300,000 (600k @ 50%)	EAC @ June	600,000 Rev
Costs	300,000 Actual costs incurred	Costs	550,000 Updated cost est.
Profit	-	Profit	27,273
			300,000 Actual costs incurred
Recognized in Example in Sept		To recognize using % complete at Sept (100% complete)	
Revenue	300,000 (600k @ 50%)	Revenue	272,727
Costs	250,000 Actual costs incurred	Costs	250,000
Profit	50,000	Profit	22,727
			54.545% % complete

In our interpretation of the above, we believe that revenue and profit are more accurately stated as of June using an input/output methodology. It appears that recording profits in relation to the progress of the project, or in relation to the assets being transferred, is more appropriate than recording all the profits upon completion. In addition, Example 5 provides the assumption that as of June, the Contractor assesses that floor 1 was 50% complete. It is unclear how this determination was made. We believe the approach outlined in Example 5 would allow for errors, inconsistent estimates and subjective determinations, and suggest using an input/output approach to recognize revenue.

Our definition of performance obligations would generally be the costs, or any other appropriate measure of progress, that are incurred during the construction project. Under an EPC project, assets are generally continuously transferred to our clients. As we incur costs, or improve the asset(s) under construction, we are meeting performance obligations and transferring control to the client. From that perspective, revenue should be recognized based on the percent of costs incurred to date or the percent of the transferred asset to date. At the same time, we acknowledge that there are a variety of ways to measure project progress and that using “costs” is not appropriate in all circumstances. However, we believe that “continuous transference” can be measured through engineering estimates, accumulated labor hours, accumulated labor dollars and various other ways.

**Question 5**

*Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?*

**Response:**

It seems reasonable that an entity should separate performance obligations in a contract based on when the assets are transferred to a customer. However, we would like further clarification as to the definition of the transfer of an asset or assets, based on the transfer of control, since transfer of the asset(s) or control is not often clear in the contract. In such cases, we can only determine

control based on indicators as follows, which we believe should be incorporated in the proposed guidance:

- The project is being built to customer defined specifications
- Designs are approved by the client and can be changed by the client throughout the life of the project.
- The project is being built on the client's site
- The client has rights to terminate the contractor under certain conditions and take over the work-in-progress
- Contractor only has lien rights to the asset built and client assumes the benefit of the work-in-process or, in other words, a partially completed asset. This could be comprised of engineering drawings or a physical asset under construction.
- Client is required and makes progress payments that are non-refundable.

The following are examples to further illustrate our concerns regarding separating performance obligations in a contract:

Example 1:

Consider a contract to provide engineering services to a client in which the contract contains the provision that the title of final engineering drawings will be transferred to the client, but only after full payment for the service. We would like further guidance as to when control is transferred if the client makes partial payments periodically for the service, the drawings are unique to the client's specifications and payment is non-refundable. It is not clear from the DP if revenue should be recognized in any of the following ways:

- Progressively as the contract performance takes place,
- Proportionally to the client's periodic payments, or
- Only when the client makes final payment.

We believe revenue should be recognized progressively as the contract performance takes place in the above example since we are providing engineering services and the client has a right to the uncompleted engineering drawings if payments for services performed to date are remitted. Recognizing revenue in proportion to the client's periodic payments is not appropriate since payment terms may differ from performance or progress of performance significantly. Recognizing revenue only upon client's final payment is also not appropriate because this does not reflect the economic substance of the contract.

Example 2:

In a construction-type contract in which the promise is to Design-Engineer-Procure-Construct an asset that meets a client's specifications, we are unsure as to the Boards' view of what is being transferred. Is this a transfer of a good (product), a continuous transfer of service, or both? SOP 81-1, ¶ 22 and IFRIC 15, "Agreements for Construction Real Estate," ¶ 11, supports the view that if the buyer is able to specify major structural elements or take over the work-in-progress, then the contractor transfers control of the asset(s) continuously. We believe that the satisfaction of performance obligation and transfer of control is continuously transferred as work progresses, and

revenue should be recognized in a way that reflects that continuous transfer. If this is the case, we believe that, in order to facilitate greater financial transparency and decision useful information with respect to evaluating the timing of changes in net contract position and the related impact to revenue, an entity should treat services provided as satisfaction of performance obligations. This will result in continuous recognition of revenue as services are performed and would depict the economic substance of the transaction and more closely align revenue recognition with the timing of the fulfillment of performance obligations. This method facilitates greater financial transparency and decision useful information with respect to evaluating the timing of changes in net contract position and the related impact to revenue.

In a Design-Engineer-Procure-and Construct contract, and similarly in a single contract for various projects, we generally do not separately specify all the deliverables under the contract as it has not met the segmentation criteria of SOP 81-1, ¶ 39 - ¶42. In some situations like this, we believe that accounting for the individual performance obligation is not practicable, because we account for this from the perspective that value is transferred to the client as costs are incurred, or by another appropriate method of measuring progress, regardless of which individual part of the assumed deliverables falls into any particular accounting period. If, for the sake of argument, we were required to segregate the activities into various performance obligations with differing profit margins, we would be required to operate the project as if there were various contracts and perform the same tracking, evaluating, and managing of multiple contracts instead of one. We do not believe that this is a cost effective and practical model, as it would not provide any additional decision useful information than if those obligations were accounted for together. This would only add complexity, increase risk of errors and cost of business. In addition, since the projects are negotiated as a single contract, it would be inherently difficult to allocate the initial transaction price to the different projects.

### ***Question 6***

*Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?*

#### **Response:**

An entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation, if there is a reasonable possibility that a return or non-acceptance will be made by the client or if history indicates that some level of rejection occurs. We believe that a performance obligation is related to fulfilling the entity's promise to transfer a good, or to return the consideration paid by the customer if the contract obligations are not satisfied. That being said, engineering and construction projects are seldom "returned" by a client. If a performance issue exists or a client specification is not satisfied, the engineer/constructor will normally be obliged by the contract to remediate the problem; taking back the asset is generally not possible.

Performance guarantees are generally invoked when the vendor is negligent in providing the service or when there are errors in design or specifications. These claims are unpredictable and it would be impracticable to estimate the monetary exposure of such performance guarantees until we believe it is reasonably possible that we may have to incur expenses under our performance

guarantees. Hence, we do not believe performance guarantees should be included as performance obligations and be allocated a portion of the initial transaction price in a contract. We recommend that the Boards provide guidance that performance guarantees be accounted for similar to the current guidance under FIN 45.

**Question 7**

*Do you think that sales incentives (for example, discounts on future sales, customer loyalty points, and “free” goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?*

**Response:**

No Comment.

**Question 8**

*Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.*

**Response:**

Please also refer to our response to Question 5 above.

As previously described, we believe that the definition of control requires further clarification in order to adequately comment on the criteria for establishing the point at which an asset is transferred, thereby triggering revenue recognition. The approach in the DP in relation to the transfer of the asset from the seller to the client appears to be too simplistic, at least to the business realities of the E&C industry. Further guidance in defining control and how it relates to those performance obligations, which are goods, compared to those, which are services are necessary for our industry to apply the concept to real situations. In addition, we do not think that the difference between receipt of the asset and control of the asset has been appropriately defined, as noted in example 1 of our response for Question 5. The definition of control seems focused on physical possession and this is not easily understood in a context where services are performed with a good provided at the end of the project.

The example discussed in Section 4.31 indicates to us that although the economic substance of the performance obligation had been fulfilled, if physical possession of the asset had not been transferred to the client per negotiated terms (assume, for example, the client does not have adequate space for the good at the time it is completed), control would continue to reside with the entity. Because control resides with the entity, revenue recognition would be deferred until the customer took physical possession of the good. Essentially, the DP’s focus on physical control triggering revenue recognition (without terms specifying otherwise or operation of law), unreasonably places the burden of accounting for revenue on the structure and wording of a contract, rather than its substance. This scenario would not benefit the user of the financial

statements and would lead to reduced comparability amongst entities and an inaccurate financial representation of a firm's performance as a result of inherent differences in contract terms and conditions amongst firms and the differences in business activities among industries.

Consider also an example of a three-year long-term contract for a procure-construct-and-install project, with materials comprising 50% of the transaction price. The contract states that upon billing and payment by the client for the material, regardless of where the material is located, that the material transfers to the client's control. The material is procured at the initial stage of the contract. However, the construction and installation is a three-year process and no labor or any effort has yet been expended. Based on the DP, 50% of the revenue would be recognized without regard to a meaningful measurement of the extent of progress towards efforts to complete the project, which to us seems inappropriate. We believe that in these kinds of situations, revenue should be recognized as meaningful progress is made to the accomplishment of the project. Use of a progress measure that removes the distortion of the acquisition of such significant materials at the beginning, or at any single point along the progress of the project, such as a completion percentage based on labor hours, labor dollars or estimated engineering cumulative percent complete.

#### ***Question 9***

*The Boards propose that an entity should recognize revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.*

#### **Response:**

As mentioned in our response to Question 4 above, we do not believe "performance obligation" has been adequately defined and is detailed enough to rely upon for purposes of measuring revenue on long-term contracts. Specific contract changes and modifications, including change orders, options, claims, and other contingent consideration defined above are not addressed in the DP that need to be addressed in order to assure consistent revenue recognition across the E&C industry.

An example of a contract with contingent consideration that has not been addressed in the DP is a "Cost plus award fee (CPAF)" or "Cost plus incentive fee (CPIF)" contract. As noted in Section 5.5, the DP "assumes that consideration is fixed and paid in cash." Under CPAF and CPIF contracts, the award fee or incentive fee is predicated on cost and/or scheduled performance metrics that are not fixed, but rather, whereby an entity may earn monetary consideration for meeting certain milestones throughout the life of a contract, or for the fulfillment of an event or events, at the end of a contract. If all agreed-upon criteria have been met by the time the incentive period has occurred, the entity may earn 100% of the incentive fee. If only a portion of the cost and scheduled performance criteria has been achieved, some lesser percentage of the contingent consideration pool would be earned, thereby introducing a variable consideration element to the contract.

As previously noted, current standards permit a revenue accrual in relation to work performed toward completion of contingent consideration criteria. The incremental accrual is reflected in the periods in advance of the contingent consideration being paid, and is supported by the historical pattern of earning contingent consideration on similar engagements and the incremental work performed to achieve the contingent consideration criteria. The consideration is not fixed until such a time as the criteria has been achieved and approved by the customer; however, if at any time it becomes evident that some portion of the contingent consideration will not be earned, a cumulative correction adjustment would be made to the accrual. Since the DP is silent on matters of contingent consideration, we recommend further guidance on how one would measure contingent consideration, the degree to which performance obligations would be separated between the original scope of the contract and the award or performance fee obligations, and what events may trigger re-measurement other than an onerous net contract position.

Further, the satisfaction of a performance obligation is based on the notion of control, but as noted in Question 8 above, this concept has not been sufficiently defined in the DP. Therefore, as currently drafted, we anticipate difficulties in obtaining decision-useful information from the proposal when considering contracts currently used in the E&C industry. The DP states that the proposed model should reflect the transfer of goods and services and not the activities undertaken to produce those goods and services. When considering long-term engineering and construction contracts, the distinction between the end product and the activities undertaken to deliver the end product needs to be explored further in order to understand what constitutes a performance obligation, and when a performance obligation is satisfied.

**Question 10**

*In the Boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.*

- (a) *Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?*

**Response:**

We agree that performance obligations should be measured initially at the transaction price since the transaction price is what the entity and the client agreed upon in the contract to deliver the performance obligation(s). However, we also believe that the transaction price must subsequently be modified for change orders, options exercised, scheduled price escalations based on variable criteria, claims, and other contingent consideration.

- (b) *Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?*



**Response:**

We concur that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation. Since the entity no longer expects to earn the original margin on the sale of the service, remeasurement is required to reflect this. However, further clarification is needed regarding whether the re-measurement-base would include the effects of change orders, claims, incentive bonuses, and other changes to performance obligations of a contract for reasons other than entity's transfer of goods and services to the customer under the initial contract and transaction price. We believe that limiting the re-measurement of performance obligations to only onerous contracts is too narrow of a focus. Logically, one would assume performance obligations would be re-measured for changes in project scope. This process is not clearly delineated in the DP.

As provided in our response to Question 1, above, we believe that the Boards should consider a re-measurement methodology similar to current guidance that would result in a cumulative "catch-up" for changes throughout the life of the contract. This "catch-up" methodology results in a more accurate reflection of the underlying economic substance of the contract than the proposed onerous methodology proposed in the DP.

- (c) *Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.*

**Response:**

Please see our response to Question 10(b) above.

- (d) *Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.*

**Response:**

Please see also our response to Question 10(b) above.

In relation to measurement of performance obligations upon initial recognition, we do not think that another measurement approach is required. However, as noted in Question 1, "Identification of performance obligation," we believe that the underlying costs, or another reasonable methodology to measure project progress, is considered the performance obligation on contracts that have continuous transfers of assets. Further, the issue of subsequent measurement needs to be further defined, such as in relation to change orders, performance incentives and other contingent consideration.

**Question 11**

*The Boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (for example, selling costs) are included in the initial measurement of the performance obligations. The Boards propose that an entity should recognize those costs as expenses unless they qualify for recognition as an asset in accordance with other standards.*

- (a) *Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?*

**Response:**

Please see our response to Question 1 under "Pre-contract costs," above.

We agree that any amounts an entity is able to directly charge and invoice a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations. If, however, the selling costs are not directly related to and readily identifiable with an awarded contract or are not able to be billed under the terms of the contract, then these costs should be treated as period costs and not included in the allocation of performance obligations of a specific contract.

- (b) *In what cases would recognizing contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.*

**Response:**

Please see also our response to Question 11.a and our response to Question 1 under "Pre-contract costs" above.

**Question 12**

*Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's standalone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?*

**Response:**

If the standalone selling price is reasonably estimable for a good or service, and if allocation to various performance obligation components to determine appropriate profit margin would be decision useful information, then it is logical to allocate the related portion of the transaction price to the overall performance obligations to be fulfilled. However, as previously discussed, in the E&C industry, a project with various phases and components is typically processed as a single project or contract because the segregation is based on effort expended, cost incurred or progress to date over the estimated total effort or cost to complete, which can be measured using a variety

of techniques. This method provides more decision useful information than segregation by phases or components, where the divisions may not be clearly identifiable in practice.

In a multi-national E&C company, standalone selling prices would be difficult to estimate because of the complexity of long-term contracts and the various markets served. As outlined in paragraph 5.48, the *expected cost plus a margin* approach appears to be the most reasonable allocation method.

### **Question 13**

*Do you agree that if an entity does not sell a good or service separately, it should estimate the standalone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?*

#### **Response:**

Please see also our response to Question 12 above.


If components of a good or service are not sold separately, and if it would not provide decision useful information to be allocated separately, then estimating selling prices for each component should not be required. We also disagree with estimating selling prices to components if these standalone selling prices are not readily estimable and allocable because of various factors including the unique nature of the work or the level of granularity to attach to a given performance obligation. Requiring allocation could be an exercise in subjectivity and might permit gaming of the performance obligations.

As previously discussed, we believe it is costs incurred or other observable performance measurements of continuous transference, and not the assumed phases or components that best allocate the elements of our projects. Such objective measures are the lowest common denominators that bridge the gaps between the uniqueness of each contract, their operational size and complexity, and the uncertainty of each project. It has served as an efficient method of comparison and unity within our industry. We, therefore, believe that deconstructing contracts in our industry to phases and components of performance obligations will provide little or no value and in fact, may detract from providing decision-useful information.

As the Boards are still developing the proposed revenue recognition model, and as the proposed model is still at a relatively basic nature, our responses are based on our assumption of what the Boards' intent for establishing certain model criteria or the interpretation of key terms or concepts on which the Boards' proposed model is based. Of course, our ability to respond to the DP questions is materially dependent on whether our interpretation of the Boards' intent is accurate. Therefore, our responses might be different if our assumptions are inconsistent with the Boards' position. We request that the Boards be receptive to further comments upon the issuance of further guidance or an Exposure Draft in the event that these provide additional clarity on topics the DP did not adequately detail. We reiterate our offer to meet with representatives from either or both Boards to discuss our perspectives in further detail.

Again, we appreciate the opportunity to comment on this Discussion Paper and offer our comments and suggestions sincerely and in good faith.

With every good wish,

A handwritten signature in black ink that reads "Reed N. Brimhall". The signature is written in a cursive style.

Reed N. Brimhall  
Vice President, Controller,  
and Chief Accounting Officer