

August 2, 2010

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

Re.File No. 1820-100

Thank you for the opportunity to respond to the joint FASB/IASB (Boards) Exposure Draft on Revenue Recognition (Topic 605). Although I am a CPA / MBA in the twilight of my career, I live in the rough and tumble world of the construction industry. As a Regional Controller for a large, privately-held concrete construction subcontractor which also performs as a general contractor in certain circumstances, I don't get the luxury of breathing the rarified air found only in the theoretical purity of regulatory boards. The construction industry is real-world, results oriented. Our financial results are audited and are provided to our Owners, our bank, sureties and when necessary to pre-qualify for certain construction projects. I cringe when I read Discussion Papers and Exposure Drafts created ostensibly to "remove inconsistencies", "provide a more robust framework", "improve comparability" and "simplify preparation of financial statements".

In my reading of the Exposure Draft, the Boards came across are being rather dismissive of industry by industry nuances. Perhaps not enough consideration has been given to the validity of the "one-size-fits-all" approach. If one takes all the animals in the zoo and dresses them up in the same school uniform, they may all be animals, may all be in the same zoo and, so dressed, may all superficially bear a little more resemblance to one another, but they all remain uniquely different animals. We have to be careful to avoid mandating one size which fits none. We are not oblivious to the dangers of granting exceptions to individual industries. But from a practical point of view, we really don't care how every other industry manages their business. Construction is a universal activity with many similarities in many different countries, but I would maintain that the construction industry is uniquely different from most other industries. The management of construction companies, their financial preparers, the users or these financial statements and even the accountants that audit them are all specialists in their field. The same is true from the perspective of many other industries as well. From a practical point of view, none of us really need to know how the other industries manage their affairs.

The construction industry is an industry rooted in uncertainties and in estimates. Contracts are won and lost based on bids which are, in turn, based on underlying estimates. Contracts are sometimes let based on incomplete information and change orders are a fact of life – site conditions, material costs, weather, labor costs, project durations are all subject to changes as are project design and construction drawings. Construction projects are also subject to changes in job specifications, escalation clauses, back-charges, liquidated damages as well as performance milestone bonuses, early semiletion incentives, engineering and architectural revisions, delays, accelerations, additions and deletions, and material substitutions. Some change orders are priced timely, some change order issues are not settled until the project is closed out. Many contracts include "Notice to Proceed" provisions and provisions for "Time and Materials Work Authorizations". Many contracts also provide for "termination for convenience" clauses.

Contractors may wear multiple hats on the same project and may wear different hats and play different roles on different projects. The Boards have concluded there were no reasons to apply a different revenue recognition model to construction contracts. With all due respect, there are many of us who beg to differ. Similar construction projects may have entirely different contract terms and conditions. Some contracts are design/build. Contracts may be "lump sum" or "not-to-exceed". They may be "cost-plus", "unit-cost", or "guaranteed maximum price". Contracts may be "total package", "frame only", "labor only" or "pump/place/finish only". Contracts may be "hard-bid", or negotiated. They may be "public bid" or "closed bid". Some contracts have provisions for shared cost savings. Some may have provisions for "value engineering". Some contracts have price escalation clauses, some have provisions owner allowances. Some have provisions for owner provided materials. Some contracts involving federal funding are subject to federal acquisition regulations (FAR) and cost accounting standards (CAS). Some contracts mandate a "Schedule of Values", some don't.

Construction projects generally involve the use of first, second and even third tier subcontractors to actually perform the work; any of whom may fail. Most subcontracts contain "Pay-When-Paid" clauses, maybe even "Pay-If-Paid" clauses. Construction projects require the co-ordination of many different trade crafts. All construction contracts involve the installation of a project on land owned or leased by the Owner, but some projects may require some prefabrication off-site. Some contracts have retainage provisions which may vary over the duration of the project and some have retainage provisions that continue until the Owner receives a formal "Letter of Occupancy" from local building inspectors. Some contracts have warranty provisions that extend beyond the completion date.

Based on the above and the complexities of the actual means and methods utilized in the construction process, I believe my employer would argue that the contractual obligations and restrictions encountered in our area of specialty are different from, and more complex and dynamic than, economic transactions which are fairly simple and more straightforward. Given this greater level of complexity, we respectfully disagree that the stated goals of the Boards are best served by the cursory dismissal of the concerns expressed in the Construction Financial Management Association comment letter dated June 19, 2010. A few needed tweaks notwithstanding, SOP 81-1 works pretty darn well thank you very much.

Our estimation process and job cost tracking are fairly detailed already. To impose an even greater level of detail in order to determine how complete each individual aspect of our scope of the construction project has progressed may be more subjective, unduly burdensome and not practical. Some aspects are fundamentally linked and may not have value in and of themselves. Determining the number and type of performance obligations and deciding if different gross margins are required for different performance obligations can be very subjective. Allocation of project overhead might prove to be additionally burdensome.

Some individual steps may be designated "onerous" but others might be considered to be "ahead of the game". Dissimilar treatment would present a misleading picture of the overall results of the project. Under your present proposals how would one account for an overrun in costs on a segment of the scope of work (presumably an "onerous" performance obligation) because one has incurred \$1 million of cost on a pending change order on which one is obligated to start work because they have received a formal Notice to Proceed from the General Contractor? Accounting for change orders under your proposals would be further complicated by having to re-allocate pricing to performance obligations and by different treatment depending on whether the change order is interdependent with an existing contract or not.

If revenue is to be recognized only when the contractor satisfies a performance obligation by transferring a promised good or service to a customer and that transfer is only deemed complete when the customer obtains control over that good or service, it appears your revenue recognition proposals, despite your protestations to the contrary, could very well also have the effect of delaying that recognition. If not to the extent of the "completed contract method", the delay would at the least push revenue recognition to later stages of the construction process. Not only would this change paint a very different picture of the progress on a project, any deviation from the IRS sanctioned percentage of completion method of revenue recognition will create additional complications in reconciling the two methods.

We have no idea at this point if the changes you are proposing can be handled by our existing software. Even if our current accounting system can accommodate any required extra detail, it remains questionable if this additional detail would provide any more useful and/or more useful information. After all, we have been in business for 40 years and management has already determined the level of detail they feel is necessary to effectively manage our business. What are we practitioners/preparers supposed to do when management, the bankers and sureties all proclaim that, your proposals of what you think is worthwhile notwithstanding, they also still want all the information they currently believe they need to run their business?

It is also too soon to tell if there would be a push by the industry to try and re-structure the format of future construction contracts to try to segregate separate phases. There might also be a tendency to expand the use of a Schedule of Values in future contracts in order to clarify the value attributable to each aspect of the contractual scope of work.

Furthermore, there is also the possibility that all of this proposed additional analysis and disclosure may further impede the financial reporting process. This especially true if a formal probability-weighted analysis of expected direct and indirect costs is to be mandated.

So much for your stated objectives for the publishing of this Exposure Draft! At the very least you have raised many more questions than you have answered. Those of us who are tasked with trying to implement these lofty ideals would like to see many more examples of how you envision all of this working in actual practice on an industry by industry basis. Bankers, sureties, board members, senior managers, project managers and auditors are all going to need to be reducated and we, the practitioners, are going to need much more assistance with this transformation.

Responses to specific Exposure Draft Questions:

- Ouestion # 1 Do you agree with the price interdependence principle to help an entity determine whether to combine or segment contracts?

  Response # 1- No. It might be possible to segment additions to or deletions from the scope of work, but the revisions to the contract may be negotiated later than the initial contract and may not be actually issued until the job is essentially complete. In the construction industry, contract modifications are a fact of life. Some Change Orders are to cover schedule delays, some are to correct design flaws or plan errors, some change orders are to cover design changes and revisions, some are modifications of previously incomplete plans and some are to cover additions to and/or deletions from the scope of work.
- 2) Question # 2 Do you agree with the principle proposed for determining when a good or service is distinct?

Response # 2 - No. It is not uncommon for our Company to sell a package of deliverables for items that are distinct. For example, on any single project we might be providing a labor only contract, we might provide "pump, place, finish", we might offer frame only or we might bid to provide a "total package". Therefore, one may argue each of these services is distinct. But this begs the question if all of these services really are distinct on a total package contract.

3) Question # 3 – Do you agree the proposed guidance is sufficient for determining when control of a promised good or service has been transferred to a customer?
Response # 3 - No. When does control transfer? It is not clear when the customer has the ability to control the use of a building under construction. A building under construction has no benefit or positive cash-flow. Although there are usually contract provisions for progress payments along the way to the constructors, these payments may be subject to percentage of completion calculations, an agreed upon Schedule of Values, end of the month projections, based upon actually installed materials, negotiations with the General Contractor, the Construction Manager or even the U.S. Army Corp of Engineers. Even then, payment to the subcontractor may be conditioned upon when and if the General Contractor is paid.

Does the customer take possession of an excavated foundation? Does the customer take possession when grade beams are formed or when poured? When the slab-on-grade is poured? When columns are formed, when they are poured, when they are stripped or perhaps when they are patched? At what stage of the construction of a deck does the customer take control? Does the customer take control when the building is topped out or when the final punch list is complete? What about the site-work? Legal title may not transfer until the building is complete and occupied? There may be no physical possession of a building under construction. Perhaps, transfer of control does not occur until the customer obtains a Certificate of Occupancy from the local building inspector? There may be no obligation to release monies retained until the final punch list has been completed, until the building has been completed and occupied or, until the warranty period has expired.

- 4) Question # 4 Do you agree that an entity should recognize revenue on the basis of an estimated transaction price?
  Page 200 # 5 Veg. The construction industry lives and dies on estimated transaction prices. Most an estimated transaction prices.
  - Response # 5 Yes. The construction industry lives and dies on estimated transaction prices. Most of the time, that's all we have to work with anyway.
- Ouestion # 5 Do you agree that the customer's credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue?
  - Response # 5 No. The allowance for doubtful accounts is a statistical calculation based on past history and current economic conditions. As such, by definition it can't be applied to specific projects. Additionally, contract pricing shouldn't be based on a subjective determination of collectability. Are you suggesting the amount of revenue recognized should fluctuate up or down as the customer's credit risk worsens or improves?
- 6) Question # 6 Do you agree that an entity should adjust the amount of promised consideration to reflect the time value of money?
  - Response # 6 No. It is one thing to argue that sales revenue should be reported separately from an expressed financing component of that specific transaction, but what happens when the project is delayed, which could happen for any number of reasons weather, changes, material shortages, labor issues, even an accident on the project.
- Question # 7 Do you agree that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand alone selling price of the good or service underlying each of those performance obligations?
  Response # 7 Only assuming one can determine this stand alone selling price. Just because
  - there may be a subcontractor who specializes in some arcane aspect of the project doesn't necessarily mean there is a specific separate performance obligation attached to a particular task. The construction industry is familiar with preparing what is known as a Schedule of Values as a means of allocating the transaction price, but one needs to understand that there may be a greater degree of subjectivity to this Schedule of Values and actually requiring allocation of contract pricing to variously performance obligations. There are certain elements such as Administrative/Project Overhead, Mobilization and perhaps even Materials and Equipment which are attributable to all components of the project and difficult to allocate.
- 8) Question #8 Do you agree that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient?

Response #8 - Yes, we concur with paragraph #57.

- 9) Question # 9 Do you agree with the costs specified that relate directly to a contract for purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation?
  - Response #9 Yes, we concur with paragraph #58.
- 10) Question # 10 Do you agree that the proposed disclosure requirements will meet the objective of helping users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers?

  Response # 10 Has the user community stated their preference? This information may or may not prove helpful to some industries, but what if other user communities insist that providers continue to provide historical disclosures? We also don't know at this point if the proposed disclosure information is readily available without systems/programming changes.
- Question # 11 Do you agree that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year?
  Response # 11 Has the user community stated their preference? This information may prove helpful, but at this point we don't know if this information would become "in addition to" as opposed to "instead of" disclosure or if it is readily available without systems/programming changes.
- 12) Question # 12 Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors?

  Response # 12 Again, shouldn't this be determined by the user community? This information may prove helpful, but at this point we don't know if this information would become "in addition to" as opposed to "instead of" disclosure or if it is readily available without systems/programming changes.
- 13) Question # 13 Do you agree that an entity should apply the proposed guidance retroactively? Response # 13 - No. Retroactive application might provide the best ideal information, but it will require so much additional time and cost, the effective date would have to be pushed back in order to accommodate this implementation.
- 14) Question # 14 Do you think that the implementation guidance provided is sufficient to make the proposals operational? Response # 14 - No. The very fact that the Boards seriously believes the Exposure Draft might provide sufficient guidance indicates that they have little understanding and appreciation of the complexities they are planning on imposing.
- 15) Question # 15- Do you agree with the proposed distinction between the types of product warranties?
  Response # 15 N/A
- 16) Question # 16- Do you agree that the pattern of revenue recognition should depend on whether a license to use intellectual property is exclusive?
  Response # 16 N/A
- 17) Question # 17- Do you agree that an entity should apply the recognition and measurement principles of the proposed revenue model in accounting for the gain or loss on the sale of some non-financial assets?
  Response # 17 N/A
- 18) Question # 18 Should any of the proposed guidance be different for nonpublic entities?

  Response # 18 N/A. There is already a separate task force to debate the pros and cons of establishing divergent accounting and reporting rules for non-public (private companies and not-for-profit organizations). I find it inappropriate to propose that we decide this issue on a case by case basis.

In summary, although I believe the changes proposed by the Boards are well intentioned, the paucity of information specific to the impact these recommendations might have on the various industries raises concern that the practical impact of these proposals have not been thought all the way through. Rather than achieve the lofty goals espoused by the Boards I am concerned that not only will management not receive more useful and understandable information, but the users of the financial reports from the construction industry may find themselves with more subjectivity, less relevance, less reliability and more cost. Many people may have to be re-educated and confusion will reign supreme until the folks who have to live with the consequences of your decisions get familiarized with the new and improved way of looking at results. I encourage the Boards to reconsider some of their basic assumptions and, at the very least, to be prepared to furnish substantially more detailed implementation guidance to specific industries.

Thank you again for taking the time to allow us the opportunity to express our concerns.

Sincerely yours,

Alian Korsakov

Southern Region Controller

Baker Concrete Construction, Inc.