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Financial Accounting Standards Board

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Ladies and Gentlemen:

We thank you for the opportunity to comment on “Preliminary Views on Revenue Recognition in Contracts with Customers.” We have great concern about the application of the proposed model to the engineering and construction (“E&C”) industry. E&C contracts have risks, uncertainties, durations and unique characteristics that we believe are better recognized using a model other than that proposed in the Preliminary Views.

1) Enforceable obligations:

We believe that recording revenue based upon “enforceable obligations” could result in premature revenue recognition in the E&C industry in many instances.

Contract, change order and claim negotiations are lengthy processes and involve considerable uncertainty. Negotiations often occur across multiple reporting periods, are very uncertain and can take unexpected turns. Agreement can be reached with one level of a customer’s management and be overturned by a higher level. Claims with customers are often settled at amounts that are less than those initially proposed. Recording revenue for oral or not fully executed “agreements” leads to subjectivity and inconsistent practice. It would likely lead to reversals of revenue in the E&C industry, which hurts future stockholders and other financial statement users.

Additionally, the enforceability of oral contracts would be extremely difficult to document and support to our external auditors. The Boards will need to provide clear guidance in this area (will costly legal opinions be necessary to answer the legalistic distinctions?), or comparability between companies will not be achieved.

SOP 81-1 recognizes the significant uncertainties and risks involved in oral agreements in the E&C industry and allows contractors at their election to defer recognition until fully executed – either awarded in writing or payment received. This option allows entities to wait until the uncertainties are resolved before recognizing that revenue – revenue that otherwise will likely be significantly adjusted from initial estimates. We believe, given the nature of contract and change order negotiations in the E&C industry, that provisions allowing contractors to delay revenue recognition until contracts are fully executed and to disclose the accounting policy should be preserved.

2) Transfer of control:

Making the distinction between revenue while work is performed and revenue when work is completed, based on the bright line concept of transfer of control, will result in different revenue recognition patterns for otherwise economically identical E&C contracts. Under the proposed model, contracts that are bid, awarded, insured, managed, constructed, paid for by the customer, and that use the same cost control methods would have different revenue recognition based on legal transfer of control. We believe that this type of mixture will confuse both management and external users of our financial information. We have discussed this with our surety company, one of the largest sureties in the E&C industry, and they agree. They do not feel a completed contract method of revenue recognition provides them with the information they need to assess a contractor's results. They also feel that a mixture of revenue timing based on transfer of control would be confusing, and they would therefore require additional information using the SOP 81-1 model.

We believe that separating E&C contracts based on this distinction rather than on the basis of the economic similarities of contracts in the industry as a whole would be burdensome as it would require contract by contract assessment and judgment that would likely require legal opinion, and that, again, would be difficult and costly to support or audit.

We further believe that this distinction will likely be used to structure financial results. For example, a contractor could arrange with customers to word several contracts as transferring ownership at the end of the contract and others during the life of the contract in order to time recognition of revenue in the financial statements. The financial statement revenue recognition pattern would no longer be comparable to how revenue and contracts are actually managed. E&C contracts, by their nature, tend to be large dollar amounts, and to extend over multiple reporting periods. In the case of a contract in which the owner takes control at the end of the project, there would be a large amount of revenue recognized in only one reporting period. This would lead to very lumpy revenue and earnings results

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that seem to us to be very misleading as it does not report the consequences (revenue) of the effort expended during the actual periods of construction.

The model also proposes a rebuttable presumption that an asset used in satisfying another performance obligation in the contract is not transferred until the asset is used in satisfying that performance obligation. This proposal is very confusing in the E&C industry. Materials purchased for use in constructing a project are typically subject to customer specification as indicated in the contract, and have limited recoverability outside of use in the project for which they were purchased. The provision of goods and services within E&C contracts are frequently so intertwined that such a distinction often cannot be effectively made, nor is it an economically significant distinction. We believe that a contract by contract assessment of the treatment of these materials (and potentially tracking the costs until they are used) on this basis would be burdensome for any member of the E&C industry that operates in multiple jurisdictions (in fact, individual contracts can be constructed in multiple jurisdictions), and would result in otherwise similar transactions receiving different accounting. Also, as we noted earlier, we believe this assessment would require judgments and legal opinions that would be difficult and costly to support or audit. We believe the provisions of SOP 81-1 in this area should be preserved for the E&C industry.

We agree that legal ownership and title are important. However, we do not believe that this single difference outweighs other significant substantive economic similarities among E&C contracts, either in how projects are managed or in how customers pay for them.

We prefer a model that results in similar revenue recognition for contracts that are economically similar within the E&C industry. E&C contracts are solicited, bid, awarded, bonded, insured, managed, performed, billed and paid the same way regardless of when control or legal ownership of the asset under construction transfers. Their physical and economic progress is evaluated the same way because both management and customers do not see the difference as material. Contracts must be managed continuously, and profitability should also be measured continuously. SOP 81-1 gives the E&C industry a straightforward and well-understood way to faithfully represent revenue in contracts that have these significant economic similarities.

3) Transaction price and multiple performance obligations:

We agree that transaction price is the appropriate initial measurement. This is the figure agreed upon by both parties to the contract. It is generally a readily and objectively determinable figure. Exit price and time discounted valuations, by comparison, add layers of estimates and calculations which lead to increased accounting, documentation and auditing burdens, and to inconsistency within and among companies as to appropriate factors. They would add no value to management or financial statement readers, as most use their own company or industry specific valuation factors and techniques which require transaction price as a starting point.

However, we do not agree that time of delivery is always the single determining factor in when performance obligations should be accounted for separately. We believe that for the E&C industry, revenue recognition should be on the basis of the contract as a whole rather than separate obligations within each contract as proposed under the continuous delivery model of the Discussion Paper. We believe that the similar economic characteristics of the obligations under long term E&C contracts, even though delivered over the life of the contract, should be significant factors in favor of aggregating the obligations and accounting for the contract as a whole. E&C contracts generally are priced as a whole and margin is determined on the whole. Contractors don't sell items separately and don't price contracts in that manner; therefore standalone prices are not generally observable in E&C. In E&C, the customer approaches the contractor with the scope of work. That scope is different for every project. In fact, even projects with similar scopes can be vastly different due to contract specifications for materials or the specific site conditions (for example, location, labor or weather) of the project. As a result, contractors do not separately track the selling price of separate performance obligations. The cost of the entire project is estimated, and margin is added to the project as a whole based on risk and market conditions specific to the contract at the time of bid.

We believe that allocation of transaction price to multiple performance obligations within an E&C contract is impractical and burdensome, will greatly increase the effort necessary to create financial information, and will harm comparability of financial results among E&C companies. We believe that splitting E&C contracts into different performance obligations would be arbitrary. It seems impossible that any two contractors would come to the same conclusion, affecting comparability. Contracts have hundreds to thousands of discrete pieces and parts. To what level of detail should contractors go in identifying separate performance obligations? Contract specifications and deliverables are very numerous, and no two parties will find the same set of obligations. One contractor might classify, for example, scaffolding and mobilization as deliverables; whereas another might classify them as indirect costs and spread them among other identified deliverables, leading to inconsistent revenue recognition between the two contracts. Inconsistency among contractors becomes particularly problematic when considering that joint ventures are common in the E&C industry. Consistency within a company's results is likely unachievable if it includes revenue based on a partner's differing methodology for determining performance obligations. We believe that is why SOP 81-1 applies at the contract level.

Furthermore, we are uncertain with regard to the level of evidence we would need to provide to our auditors to support the value assigned to the separate performance obligations. Again, every contract is different, nothing is priced separately, and margin is determined at the contract level at the time of bid based on risk and market conditions specific to the contract.

In addition to the above, we see a number of other factors that make accounting for separate performance obligations within a contract an inappropriate answer in the E&C industry:

- (1) Recognizing revenue based on separate performance obligations within a contract would require significant management effort and be something done only to meet the

requirements of the accounting model, as management does not and would not view the separate transaction prices as relevant. Management will still evaluate contract results using SOP 81-1. Contractors manage at the contract level, and view the results of the contract as relevant when assessing project success. E&C companies decide to bid on contracts, not subparts of contracts. Decision useful information is at the contract level – if it is a good contract or not, if the project is worth building or not. Further, bonuses are based on contract performance.

- (2) If management reporting is based on SOP 81-1, then this will affect segment reporting which is required to be in the form that management reviews. Consequently, there would be non-GAAP measures in the financial reports that require reconciliation to GAAP. This reconciliation would be complicated and not readily understandable by most readers.
- (3) MD&A for E&C is already extremely difficult to compose. The fact that contracts have finite durations means that an E&C contractor's revenue consists of many different projects at different stages of completion from year to year. Explaining year to year changes in that situation is very difficult, particularly if there are hundreds of contracts. If revenue were further split into separate performance obligations, that difficulty would be compounded many times over.
- (4) Even if management did migrate to the proposed model, tax laws in the United States likely will continue to require the use of an SOP 81-1 approach. Again, this means maintaining two parallel structures that require significant management effort.
- (5) We discussed the concept of separate performance obligations with our surety company. They indicated that they will continue to focus on contract level results and therefore will continue to require information using the SOP 81-1 model.

We do believe that different types of deliverables should be separated using transaction price. By that, we mean that contracts calling for the design, engineering and construction of a project, as well as warranty, operation and maintenance provisions should be separated using EITF 00-21. The transaction price should be allocated to the design, engineering and construction as one deliverable, and to the warranty, operation and maintenance of the project separate deliverables.

In addition, we believe there should be a provision allowing the aggregation of a group of E&C contracts as provided by SOP 81-1. This is appropriate because when contracts are bid together and not separately negotiated, they tend to rely on the same estimates, assumptions, and resources (management, craft and equipment are shared and the contracts function as one project), becoming effectively bid items under one contract with similar economic characteristics. To separate such contracts into multiple obligations for revenue recognition adds accounting effort that is unnecessary to completion of the project and ignores the economic substance of the entire set of agreements with the customer.

4) Measurement and remeasurements:

We agree that an E&C contract as a whole should be remeasured immediately at a loss when expected costs exceed expected future revenue, as is already provided by SOP 81-1. However, the E&C industry is too volatile to remeasure only when onerous. E&C contracts, by their nature, are large, cross multiple reporting periods, and are unique. As such, it is the norm, rather than the exception, that job end forecasts change materially over time. We believe remeasurements should occur at every financial statement date, and that remeasurements in the E&C industry should use current estimates of contract results to adjust for both increases and decreases in profitability as is done currently under SOP 81-1.

The pattern suggested in the Preliminary Views could yield misleading results in the E&C industry. Projects can make less than expected without losing money overall. Under the proposed model, such projects would not be adjusted. Instead, the original margin is used to allocate the remaining revenue and is never changed during the course of a profitable contract. We agree that increased costs do not generate additional obligations. However, using only the original margin ignores the fact that it was also an estimate, that it was based on the contract as a whole and not individual obligations, that it may have been made years ago, and that better, more current information is available.

The Discussion Paper indicates that percentage of completion would still be acceptable for E&C contracts, but the illustration at 5.65 does not represent how most E&C contractors currently, and will likely continue to, practice this measurement. If the contractor is aware at December 31, 20X1 and before financials have been issued that expected costs will exceed original estimates, the contractor wouldn't recognize a gain of CU 10,000 for the previous year leaving only CU 2,000 of gain for the next year. This would be an overly optimistic picture of the contract as of December 31, 20X1 based on an outdated estimate of total margin. We believe that it would be misleading to show this much gain up front, as there could never be enough disclosure to explain it without adding future or forward looking statements to the financials, and transparency would suffer. Instead, most contractors would recognize a gain of CU 5,455 for the previous year and CU 6,545 the next, based on new information that would allocate margin differently had that information been available at inception.

Example 5.65 using cost-to-cost:

CU's	20X1	20X2	Total
Revenue	45,455	54,545	100,000
Expenses	(40,000)	(48,000)	(88,000)
Margin	<u>5,455</u>	<u>6,545</u>	<u>12,000</u>

For the E&C industry, we believe this result under SOP 81-1 is much more useful and representative of the companies' financial results. It also gives a clearer view into the future based on current results.

In Example 5 of Appendix A, another example is provided. Under the proposed model, the contractor would present a gain of CU 0 for the quarter ended June 30, CU 50,000 for the quarter ended September 30, and CU 10,000 for the quarter ended December 31. The SOP 81-1 results follow:

Appendix A Example 5 (A32) using cost-to-cost:

CU's	Jun 30	Sep 30	Dec 31	Total
Revenue	352,941	294,118	352,941	1,000,000
Expenses	<u>(300,000)</u>	<u>(250,000)</u>	<u>(300,000)</u>	<u>(850,000)</u>
Margin	<u>52,941</u>	<u>44,118</u>	<u>52,941</u>	<u>150,000</u>

We feel the SOP 81-1 results are much more useful. Under the proposed model, no gain would be shown in the quarter ended June for a profitable contract. Undoubtedly, financial statement users like lenders and bonding companies would require supplemental measures when presented with such results. If that supplemental, non-GAAP, information is needed to inform management and financial statement readers, then the proposed model is not helpful.

Appendix B provides a final example. It is a warranty example, but it could easily be a contracting example. The proposed model indicates a gain of CU 954 for 20X1, a loss of CU 641 for 20X2, and a gain of CU 2,987 for 20X3. The cost to cost results under SOP 81-1 are below:

Appendix B Example using cost-to-cost:

CU's	20X1	20X2	20X3	Total
Revenue	2,655	1,897	5,448	10,000
Expenses	<u>(1,500)</u>	<u>(1,550)</u>	<u>(3,650)</u>	<u>(6,700)</u>
Margin	<u>1,155</u>	<u>347</u>	<u>1,798</u>	<u>3,300</u>

We believe that users of E&C financial information will find the results under the proposed model to be confusing, and they will require supplemental non-GAAP information to better understand the results. Presenting a loss in 20X2 and then a large gain in 20X3 could cause poor decisions. Investors could sell their stock not realizing the gain to be earned in 20X3. Banks and bonding companies would also need additional information to prevent inappropriate decisions. The SOP 81-1 method, however, provides a clearer view, at the contract level, of to-date results and also the current belief of future results. It does that because it uses the most current information available and not revenue allocations that were 1) determined years ago and 2) were themselves estimates. Point 2 is important to note. Fixing a revenue amount for a portion of an E&C contract implies that allocation was much more accurate and precise than it actually was. As noted earlier, separate prices are not determined in the E&C industry. Any estimate of a transaction price for a separate obligation would be based on cost, and therefore would only be as accurate as that cost estimate. If the cost estimate was wrong, then the value of the revenue was wrong, but the proposed model does not allow for that revenue remeasurement. SOP 81-1

recognizes the nature of the estimate in E&C, and that is why it allows for revenue remeasurements at the contract level.

5) Other items:

We cannot comment on matters not addressed by the Preliminary Views which are critical in our industry. Before replacing SOP 81-1 and EITF 00-21 with the proposed model, these items must be addressed:

- Where do contract gains and losses go? Do the Boards see this as a separate line item in the financial statements? If so, is it a gross margin item or an operating item below gross margin? Is it a reduction of revenue or an addition to cost? As the net contract gain or loss in the example nets to zero by the end of the project, we don't see this as providing enough useful information to merit separate presentation.
- Do the Boards anticipate different effective adoption dates for public versus private entities?
- How would transition issues be addressed for long term contracts already in progress?
- Time and materials contracts, cost plus contracts, and cost reimbursable contracts generally recognize revenue in amounts equal to billable amounts for work completed. Since the Preliminary Views does not comment on measurement of rights in these instances, we can't comment. However, we believe continuing with the current practice would be faithful representation.
- Contract penalties and bonuses are significant in our industry. Please provide guidance.
- The proposed model indicates that no day one revenue should be recognized for precontract costs. Given that, we believe clearer guidance regarding the types of costs to be considered precontract costs should be given. For example, in the E&C industry, engineering and design costs may be incurred while preparing an estimate for a bid. These services assist in the development of the bid, but also produce deliverables that will be provided to the customer if the project is won. How would these costs affect revenue in the new model?
- When control does not transfer to the customer until the end of the contract or, with materials, until they are incorporated into the project, how are the costs handled? Are they expensed as incurred, or are they inventoried, and then expensed when the revenue is recognized?
- How will time value of money affect the model? Would forecast losses on projects be discounted?

Conclusion

As we have indicated above, E&C contracts have many unique characteristics that are better recognized using a model other than that proposed in the Preliminary Views. We believe that the E&C industry should continue to use the principles contained in SOP 81-1 and EITF 00-21. Although forming a separate standard, this model is consistent with the majority of the principles contained in the Preliminary Views, and in our understanding is also consistent with IAS-11:

- It is contract based;
- Revenue from economically similar contracts is recognized consistently;
- Revenue is comparable because there is no splitting of contracts into very subjective separate obligations;

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- Revenue is recognized based on changes in net position in a contract;
- Revenue is recognized when the contract assets increase or contract liabilities decrease;
- Changes in performance obligations are recognized as the assets are delivered, but on an aggregate basis;
- Revenue is generally recognized when the owner controls the asset but control is not a bright line, keeping otherwise economically similar contracts in a familiar revenue recognition process;
- Transaction price of the contract is used for initial and subsequent measurement;
- Remeasurement is performed when the contract is onerous, as well as at every financial statement date using the most recent available data.

We believe the current guidance is faithfully representational of results in the E&C industry, and is a model that is well understood and accepted by financial statement users. Therefore we believe it should continue forward.

Thank you for consideration of our views. If you should wish to discuss them further, please don't hesitate to contact us.

Very truly yours,

Peter Kiewit Sons', Inc.

/s/ Michael J. Piechoski
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/s/ Michael Whetstine
Michael Whetstine
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