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Financial Accounting Standards Board
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File Reference: No. 2011-230, Proposed Accounting Standards Update (Revised), Revenue Recognition (Topic 605), Revenue from Contracts with Customers

Dear Sir or Madam:

On behalf of the Associated General Contractors of America (AGC), I respectfully submit the following comments in response to the Revisions to the Exposure Draft, *Revenue from Contracts with Customers*. We appreciate the efforts of the Board and its staff in preparing the Revised Exposure Draft and for the opportunity to comment on the proposed standard. We acknowledge the improvements made in the revised exposure draft and thank the Board for taking the time to consider comments presented by AGC and other construction industry representatives.

AGC is the largest and oldest national construction trade association in the United States. AGC represents more than 33,000 firms, including 7,500 of America's leading general contractors, and over 12,500 specialty-contracting firms. Over 13,000 service providers and suppliers are associated with AGC through a nationwide network of chapters. AGC contractors are engaged in the construction of the nation's commercial buildings and industrial facilities, highway and public transportation infrastructure, water and wastewater systems, flood control and navigation structures, defense installations, multi-family housing, and more.

This proposed standard will have a profound impact on the construction industry. As such, AGC has been actively involved in this particular project since the issuance of the 2008 Discussion Paper on this topic. Throughout the period between then and now, we have remained actively engaged in the progression of this project and have sought to:

- understand the objectives which FASB (along with the IASB) has intended to achieve
- conduct outreach with our constituents
- inform FASB staff and Board members about some of the more unique aspects of the construction industry and how this particular standard would impact our industry
- educate our own membership and the industry as a whole
- offer pragmatic and reasoned solutions designed to meet the legitimate concerns of the industry while also maintaining respect for the challenges of synthesizing the concerns of multiple industries

In order to demonstrate our efforts to remain engaged, we have met multiple times with FASB staff and board members in both formal and informal settings, we have conducted webinars, conference education sessions, written comment letters and our members have published numerous articles on this topic, all with an effort towards being a positive force in the standard setting process.

Having been intimately involved in this entire process, we would first like to express our gratitude to FASB in responding to a number of the concerns we and other construction industry representatives have expressed. Specifically, we want to acknowledge the following improvements in the revised exposure draft:

- the ability to bundle promised goods or services which are highly interrelated and where the goods or services are significantly modified or customized to fulfill the contract when it comes to the identification of performance obligations (para. 29)
- clarity provided around the transfer of control of a good or service over time (paras. 35 & 36)
- the elimination of an implied preference for output methods over input methods in measuring progress towards satisfaction of a performance obligation (para. 40)
- the inclusion of a "most likely amount" method in estimating variable consideration (para. 55)
- relief from a number of disclosure requirements for non-public entities

We consider each of the above to be significant improvements for the construction industry when compared to the original exposure draft. As such, when weighing the comments from other respondents, we request that FASB consider the significance of these provisions to our industry.

However, we have some concerns with certain aspects of the revised exposure draft which we outline below, followed by our answers to questions posed in the revised exposure draft.

Contract Modifications

Construction contracts are frequently modified due to growth/reductions in work scope or to account for conditions that were unforeseen at the inception of the contract. In our industry, contract modifications are generally referred to as "change orders" and "claims." In our view, paragraphs 18 through 22 of the revised exposure draft adequately address the accounting for change orders that have been agreed-upon between contractors and their clients and change orders for which scope has been determined between the parties, but the transaction price has not. However, the revised exposure draft is not clear about the accounting for change orders that are unapproved as to both scope and price and about the accounting for claims.

Under current practice, change orders that are unapproved as to both scope and price are measured the same as claims. Generally, claims differ in nature from change orders in that, while a change order infers an amicable negotiation with a client or other party to the contract or subcontract, a claim infers a less than amicable situation, including denials of responsibility, denials of submitted change orders, and the potential of resolution through mediation, arbitration or litigation, rather than through negotiation.

It should also be noted that the concept of claims is one that is fairly unique to the construction industry because of the inter-dependence between the customer and the contractor. In order for the contractor to be able to fulfill their responsibilities under the contract, the customer must also fulfill their responsibilities. Examples of customer responsibilities may include supplying timely and accurate design documents, providing accurate information related to sub-surface site conditions, compliance with laws & regulations for pre-existing conditions encountered at the site, obtaining timely regulatory approvals with respect to matters like zoning and utility relocation, providing unobstructed access to the job site for the contractor and its subcontractors and ensuring timely progress payments among other potential responsibilities.

An entire body of case law exists documenting that contractors are entitled to reasonable compensation from situations encountered during the project when these situations result in increased costs on the project and over which the contractor had little or no control.

Further, the contractor, unlike most other entities, has certain lien rights on the project, which, when enforced, helps to compel the customer to fulfill its obligations to the contractor. While facts and circumstances will dictate the enforceability of a lien filed in the case of a claim, this is still a right that is unique within the construction industry.

We believe that this background is valuable context for understanding why revenue associated with claims were granted a special status under ASC 605-35-25-30 & 31 and not simply subject to the gain contingency requirements of FAS 5.

We believe that it remains very important for the construction industry to continue to be able to avail itself to the claims accounting opportunities which exist under ASC 605-35-25. It should be noted that the established threshold for recognition of revenue is extremely high, though somewhat short of FAS 5, and is limited to costs incurred, which the industry has accepted as being appropriate given the very nature of claims.

Further, in our observation of industry practices, we believe most claims that are recorded as revenues under ASC 605-35-25-31 ultimately get recovered. This is due to the very high hurdles which exist in qualifying to recognize claim income, which includes demonstrating that a legal basis for the claim exists, which, in practice, is quite often supported by a third-party legal opinion.

As the revised exposure draft is currently written, we acknowledge that some preparers are interpreting the language of paragraph 14b as a "claim killer" with no opportunity to recognize claims as long as amounts are being actively disputed between the customer and the contractor. Others are interpreting the revised exposure draft to mean that the broader contract, supplanted by existing case law, grants a contractor a right to recognize claim revenue subject only to paragraphs 49 & 81, which also opens the door to margin recognition for the amount of claim income expected to be received above and beyond actual costs incurred and likely accelerating the recognition of claim revenue.

We believe that there are hazards with either interpretation and that neither one may lead to good accounting. If, on the one hand, claim accounting is eliminated entirely, this deprives the

industry of important financial statement recognition which is appropriate in certain unique and select situations. On the other hand, permitting the recognition of margin associated with a claim would have the impact of communicating a level of certainty to users of the financial statements about the resolution of the claim that rarely exists.

For this reason, we ask FASB to provide clear guidance in the standard on its intended treatment of claim revenue to eliminate the differing interpretations of the proposed exposure draft that exist today. Further, we strongly encourage FASB to visit the threshold guidance for recognizing claim revenue as contained in ASC 605-35-25-31 and consider adopting similar thresholds within the new revenue recognition standard along with the disclosure requirements of ASC 605-35-50-6, 7 & 8.

Notwithstanding the recommendations above, there are a significant number of contractors who only deal occasionally with claims and, because of the infrequent nature in which they participate in this process as well as the very high thresholds for recognition which have been established, take advantage of a practical expedient as described in ASC 605-35-50-7 whereby claims are recorded only when amounts have been received or awarded. We believe that for those contractors, the practical expedient provides tremendous relief from the administrative burden associated with initially evaluating the claim in order to even determine whether recognition would be permissible. Just as the rules allowing for the recognition of claims are very important to certain segments of the contracting community, the practical expedient is equally important to those contractors who only occasionally deal with claims. Therefore, we request that the practical expedient be availed in the final standard.

Additionally, we wish to call FASB's attention to what we believe may be an unintended consequence contained in the new standard. Should those readers of the revised exposure draft be correct in their interpretation that claim amounts in dispute are not, out of hand, eliminated by paragraph 14b, but instead are constrained by paragraph 81, then there is an odd interplay between certain other paragraphs of the revised exposure draft that will produce a result that we do not believe was contemplated by the drafter(s). Specifically, claim amounts would be counted in the total transaction price as determined under paragraphs 50-52.

Suppose that a contract, because of the conditions encountered giving rise to the claim, is now a loss contract, or onerous performance obligation absent the inclusion of the expected claim revenue. Under existing literature, unrecognized losses for an onerous performance obligation would be accrued while the claim revenue would only be recognized once all of the criteria have been met for recognizing the claim. This result is not uncommon in the construction industry.

However, paragraph 86 refers to "the transaction price allocated to that performance obligation" in determining whether a performance obligation is onerous. The clear implication for what is meant by the transaction price referred to in this paragraph is the transaction price determined in accordance with paragraphs 50-52. By counting the estimated claim income in the total transaction price, the entity would, in effect, be able to defer losses that would otherwise have been recognized under existing standards. It seems counterintuitive that an entity would be precluded from revenue recognition due to the constraints in paragraph 81, but would be able to avoid loss recognition under paragraph 86 because those same constraints do not apply.

Exclusion of inputs that do not reflect the transfer or control (para 45 along with para 93b)

As written, paragraphs 45 and 93b could be interpreted to mean that the first dollar of labor spent on re-work would need to be charged to expense as incurred and excluded from the calculation of revenue. On its face, this language is not operational within the nature of the construction industry. Every construction project is unique and every project is going to have varying elements of waste, re-work or other inefficiencies. Further, reasonable efforts are made to provide allowances for anticipated inefficiencies in the negotiation of the transaction price, but, by the very nature of the estimating process, it would be impractical, if not impossible, to attempt to identify which inefficiencies were reflected in the price of the contract and which ones were not. Moreover, the incurrence of inefficiencies is tempered through the self-correcting nature of re-measuring revenue on a percentage of completion method since increased costs, if any, are included in the numerator and denominator of a cost-to-cost calculation. Finally, should inefficiencies be so substantial as to produce a loss on the contract, the onerous performance obligation language serves as a backstop to require a full accrual of the remaining unrecognized loss at the point in which that loss is identified.

Consequently, we believe that the broad guidance provided in paragraphs 38-40 combined with the constraint provided in paragraph 47 are sufficient parameters to ensure that companies do not over-report revenues from activities that do not result in advancement of the contract. As a consequence of having these parameters and the impracticality imposed by paragraph 45, we respectfully request that this paragraph (45) be stricken from the final standard along with related paragraph 93(b).

Uninstalled Materials & Specialized Equipment

From our review of the language contained in the revised exposure draft compared to what we anticipated seeing in the draft based upon our following of deliberations, we have concerns that the language in the revised exposure draft related to uninstalled materials and specialized equipment does not clearly convey the intent of the deliberations held on this topic.

Specifically, paragraph 46, as interpreted by Example 8, seems to be mixing the distinct concepts of uninstalled materials and specialized equipment together in a way that could lead to an erroneous application of the standard.

We can appreciate that the Boards may have intended to exclude margin from the measure of revenue for uninstalled materials that were delivered to the jobsite significantly before receiving the installation or integration services related to those materials. In fact, paragraph BC 122 seems to lend credence to this intent. However, by including the interpretation of paragraph 46b, we are concerned that issuers and auditors may read this language as meaning "specialized equipment" and the way Example 8 is illustrated, it practically underscores this interpretation.

Further, we believe that Example 8 is simply a bad example because it assumes that the specialized equipment is never completely installed until the completion of the contract, which is a virtual impossibility. Similar to our concerns with respect to paragraph 46, we are concerned

that issuers and auditors will interpret Example 8 to mean that specialized equipment would never attract a profit margin – regardless of whether it is installed or not.

For this reason, we specifically recommend the following changes to paragraph 46:

"When applying the input method to a separate performance obligation that includes goods the customer obtains control of significantly before receiving installation or integration services related to those goods, the best depiction of the entity's performance may be for the entity to recognize revenue for the transferred goods in an amount equal to the cost of those goods until such time as the installation or integration services are performed, unless the entity was involved in the design, manufacture or fabrication of those goods, in which case a deferral of margin would not be expected. This provision needs to only be applied to those performance obligations where the overall costs of all goods expected to be transferred to the customer is significant relative to the total overall expected costs of completely satisfying that performance obligation.

Should the Board not adopt our proposed language, we believe the limitation in paragraph 46 that the conditions of paragraphs 46(a) and (b) must be present "at contract inception" may allow entities to avoid the proposed zero profit recognition for procurement decisions after the contract inception or alternatively, management may represent that they do not make those determinations until after the contract is commenced. Therefore, we recommend that the qualifier of the contract inception be removed from the final standard.

Further, we recommend that Example 8 be re-worked to show a more straightforward application of the intent of paragraph 46 by showing the deferral of margin at the point in time the materials were uninstalled and the inclusion of margin on those goods once the materials are installed.

Onerous Performance Obligation Exemption

Paragraph 86 provides an exemption from the application of the onerous performance obligation guidance if, at contract inception, the entity expects to satisfy the contract over a period of one year or less. We believe that this exemption is unwarranted and unnecessary. It provides an exclusion which is not present in the existing standards and moreover, seems to be arbitrary and subject to potential manipulation for contracts that are close to one year in length. By using the exemption, an entity could have a small loss on a contract expected at inception to be satisfied over more than one year which would be required to be recognized, while at the same time, have a much more significant loss on a contract expected at inception to be satisfied over less than one year, which it would not reflect in its financial statements. Instead of providing the one year exemption, we believe that materiality should be the sole arbiter in determining which losses should be accrued.

Further, we believe that a second onerous test be performed at the contract level before requiring accrual of any remaining loss under the onerous performance obligation. If the performance obligations and financing elements under a contract are combined and indicate a non-onerous contract, then there should be no accrual of the onerous performance obligation. If the combined

elements indicates an onerous contract, then the accrual of unearned loss should be limited to the overall loss on the contract.

Relationship between Collectibility and Transaction Price (Paras. 68-69, 49-56)

We strongly prefer the treatment of collectibility afforded in paragraph 43 of the original exposure draft, which we believe better reflects the economic realities encountered in the construction industry, where it can often be difficult to delineate credit risk issues, as defined in the revised exposure draft, from mutual compromises made on individual projects for the sake of the overall customer relationship.

Notwithstanding, we recognize that many other industries hold a differing view from ours. As such, we are seeking clarification in the final standard that we believe will result in reasonable reporting for all industries.

Specifically, absent a clearer definition of the term "expects to be entitled," issuers could reach the conclusion that it should report any revenue to which it is legally entitled under the contract at gross, with the only option for bridging the gap between gross revenue and the amount ultimately collected as being a credit loss.

Consider the situation of the contractor that performs work outside of the scope of work required by the contract and where the contract contains terms sufficient to establish the variable consideration that the contractor is entitled to receive. However, because the contractor is desirous of maintaining a positive relationship with the customer, he only bills the customer for 50% of the extra work, which is promptly paid. Absent both a formal change order followed by a deductive change order for the 50% not billed (i.e. formal contract modifications which amend the basic contract), a sincere reading of paragraphs 49 through 56 could lead the contractor to believe that he is compelled to report the full amount of the revenue to which he is legally entitled and then report a credit loss for the 50% of the revenue on which he did not pursue collection from the customer.

However, such an interpretation dilutes the ability of the users to differentiate true credit losses in the financial statements from simple pricing concessions and negotiations. Such a presentation also ignores the reality of sound and fundamental business practices.

Alternatively, paragraph 50 provides that an entity shall consider the terms of the contract and its customary business practices to determine the transaction price. From this language, it appears that the boards did not intend for "expects to be entitled" to be interpreted to be the full amount to which an entity is legally entitled, but instead, it was intended to allow for prudent business judgment exercised by the entity in setting the consideration at an amount that is below the full amount to which the entity might be legally entitled.

The measurement based on "the amount an entity expects to be entitled" is a change from current measurement based on the amount the entity "expects to realize from the contract" ASC 605-35-25-16.

We strongly believe that concessions granted by the entity should never enter into the evaluation of credit losses and, accordingly, to address this position and to clarify ambiguity contained in the proposed standard, we recommend the following modifications:

- The first sentence of paragraph 50 should be amended to read: "An entity shall consider the terms of the contract and its customary business practices, which would include any pricing adjustments granted to the customer, to determine the transaction price."
- The first sentence of paragraph 68 should be amended to read: "Collectibility refers to a customer's credit risk—that is the risk that an entity will be unable to collect from the customer the amount of consideration which it has billed or would have billed to the customer absent the customer's ability to pay.

It is also worth noting that there are potential adverse tax ramifications to co-mingling the concepts of pricing concessions and credit losses. US tax code does not allow a deduction for provisions for bad debts until all collection processes are exhausted. Additionally, US taxation requires contingent (variable) consideration to be included in taxable income if it is included in income for financial reporting purposes under GAAP. Otherwise, taxable income is determined based upon the amount the entity reasonably expects to be received (rather than entitled).

We are supportive of the Boards' proposal to present bad debts/credit losses as contra-revenue instead of as an item of operating expense. We believe that the resulting net revenue amount will more easily allow users of the financial statements to reconcile net revenue to gross cash receipts from operations in the statement of cash flows under the direct method after considering the change in accounts receivable balances between periods.

<u>Determining and Constraining the Transaction Price and Challenges with Newly Introduced</u> <u>Terminology (paras. 49, 81-83)</u>

We are concerned that the introduction of the term and the failure to define the term "reasonably assured" in paragraph 49 and repeated again in paragraph 81 could lead to confusion, manipulation or bad accounting.

We recognize that an attempt is made to set a standard for inclusion of variable consideration, which is the amount of consideration the entity is reasonably assured to be entitled and which includes the experiential unique measure of "entity experience with similar types of performance obligations and the experience is predictive of the amount of consideration the entity will be entitled in exchange for satisfying the performance obligation."

Yet, we believe these criteria are still unnecessarily subjective and this subjectivity will lead to confusion and/or manipulation.

To better explain the potential for confusion, please consider the existing types of variable consideration which may be encountered in the construction industry, along with the existing guidance which sets various thresholds for recognition which are designed to consider the unique aspects of the various types of variable consideration.

Common variable consideration drivers in the construction industry for long-term contracts include pre-contract costs, unapproved change orders as to price, unapproved change orders as to scope and price, liquidated damages, early completion incentives, cost savings incentives, and claims.

- ASC 605-35-25-25 through 31 creates multiple standards and alternatives for revenue recognition for certain select types of variable consideration which are described as follows: Unpriced change orders –
 - o Standard for recognition if recovery of costs are "**probable**"
 - Probable means if the future events necessary for recovery are likely to occur.
 - Factors (indicators)
 - Customer's approval of the scope of the change order
 - Separate documentation for change order costs that are identifiable and reasonable
 - Entity's favorable experience in negotiating change orders, especially as it relates to the specific type of contract and change order being evaluated
 - Accounting
 - Change order costs that are **not probable** of recovery through change in contract price should be treated as a cost of contract performance in the period incurred
 - Change order cost recovery is **probable**
 - Costs should be deferred (excluded from the cost of contract performance) until the parties have agreed to pricing
 - Alternatively Cost should be treated as costs of contract performance in the period incurred and contract revenue recognized to the extent of costs incurred.
 - Change order cost recovery plus profit is **probable** and the amount can be "**reliably estimated**"
 - Adjust the original contract price when the costs are incurred
 - Adjust the original contract price for additional gross profit only when realization is "assured beyond a reasonable doubt"
 - Indicators
 - Historical experience provides assurance
 - Entity has received a bona fide offer
 - Change orders in dispute or unapproved as to both scope and price should be evaluated as "Claims"
- Claim recognition
 - Only if additional revenue is **probable** and the amount can be **reliably** estimated

- o Requirements (ALL)
 - Legal basis for claim
 - Additional costs arise from unforeseen circumstances and are not performance deficiencies
 - Costs are identifiable and reasonable
 - Evidence is objective and verifiable
- o Revenue recognition allowed if conditions met
 - Revenue recognized to the extent of costs incurred
 - No gross profit enhancement
 - Alternatively, revenue recognized only when amounts have been received or awarded

As can be seen from the framework noted above, it is extremely difficult to put all variable consideration into a single category and then attempt to constrain it with the new and difficult to understand term of "reasonably assured".

In fact, in trying to understand the hierarchy of confidence along the uncertainty continuum, we have developed the following ordering (lowest to highest) which we believe is correct, but in reality, cannot be sure of this interpretation:

- Reliably estimated (SOP 81-1)
- Expects to be entitled (ED)
- Probable (SOP 81-1)
- Reasonably assured (ED)
- Assured beyond a reasonable doubt (SOP 81-1)

Due to the confusion that we anticipate in the preparer, auditor and user communities, we recommend the following:

- Consider segmenting variable consideration into categories that better reflect the specific attributes and risks associated with each type of variable consideration and then provide guidance for recognition based upon the attributes of the categories not unlike the approach reflected in ASC 605-35-25.
- Avoid the introduction of new and potentially subjective terminology when there is existing terminology which can adequately address the thresholds that must be met prior to recognition
- If new terminology must be introduced, define it within the context of existing terminology to help reduce the confusion that will ensue when the new terms are being interpreted by the preparer, auditor and user communities.

Finally, we believe that the two-step screen on revenue recognition that exists between paragraphs 49 and 81 are unnecessarily complex and could easily be simplified, which may help eliminate some of the difficult-to-understand new terminology that is being introduced.

Time Value of Money

We has several construction industry specific issues regarding the concept of time value of money that we believe could lead to less reliable financial statements for users.

It is not clear how the financing component is expected to be measured in a performance obligation when the goods or services are transferred to the customer on a continuous basis. In a typical construction contract, there are daily transfers of goods and services and, therefore, daily accumulations of the transaction price arise. Additionally, goods and services do not transfer at a consistent level from day to day. The timing of these transfers is not subject to precise estimation at the inception of a contract.

Under fixed price contracts as well as several other common contract forms, a contractor may bill at a moment in time an amount that is more or less than the revenue recognized to date (commonly referred to as "underbillings" or "overbillings"). It is not clear whether the financing component is an assessment of the period that the billed receivable is outstanding or the period that the revenue recognized remains uncollected or paid in advance. Alternatively, should the assessment of a financing component be made on the net contract asset or liability pertaining to a given performance obligation?

Another means of measuring a financing component could be for the entity to prepare a cash flow analysis of each performance obligation to identify moments where a financing is present and determine if it is significant. This cash flow analysis process would be an expensive cost to impose on issuers and auditors through this standard, as contractors typically do not prepare cash projections on all contracts.

It is common for contracts to have retention provisions whereby up to 10% of the amount billable to date is retained by the customer. The purpose behind retention arrangements is not a financing objective. Retention is withheld to mitigate risk that the contractor will not comply with some aspect of the contract. In recent years, several states have passed laws to either eliminate or reduce retention on public projects. Pricing for contracts after these law changes have not reflected any change in the price of the projects. Many contracts, particularly with state agencies, allow for the contractor to substitute collateral in lieu of customer retention. The agreements do not reduce the contract price when collateral substitution is provided. This is a strong indication that the customer does not perceive retention as a financing. WE does not believe it is good accounting to assert that every bargained transaction that alters the timing of payment between the parties is necessarily a financing and that a time value of money should be measured. Retention is one of those situations where payment is withheld for a commercial reason other than a financing.

Alternatively, we request that the Boards consider the ability to net retainage in the following circumstance when determining if a financing is present. In the case of most general contractors and many specialty contractors, the customer retains a portion of the contractor's billings (retainage receivable) and the contractor retains a similar portion of its billings from subcontractors (retainage payable). The right of offset is supported by both contracts and law. Under contracts, it is normal that the subcontract agreement will provide that the subcontractor

retention be paid within a few days following the contractor's receipt from its customer. Additionally, both Federal and state laws regarding prompt payment create civil and occasionally criminal penalties for a contractor receiving payment and not making prompt payment to its suppliers and subcontractors.

It is not clear in the exposure draft if the assessment of the existence of a financing component is done only once at the time the parties enter into a contract or if it is intended to be a continuing assessment. We recommend that this be clarified and, under a cost/benefit concept, be limited to determination at the time the contract is entered into.

IG66 demonstrates a situation where there is a financing component from a customer payment prior to the transfer of goods or services. Under the measurement and reporting demonstrated in Example 9, the entity recognizes revenue that it never receives and an expense it never pays. We fail to understand how the receipt of an advance payment results in the entity recognizing interest expense. We do not agree that this is good accounting. Specific to the construction industry are trust fund statutes in every state that significantly limit the use of funds received from a customer to either holding the funds on an interim basis for investment or for paying only costs associated with the performance of the contract. These laws have both civil and criminal penalty provisions. Therefore, the contractor may be precluded by law from using the advance payment for funding any operations other than those directly associated with the contract with the customer. Under those conditions, it is bad accounting to recognize a hypothetical expense for interest and a hypothetical offsetting amount of revenue.

Example 9 fails to consider the likelihood that the entity actually invests the \$150,000 advance funds and earns income on the investment during the "financing" period. The entity ends up with a double measurement of the earnings, one actual and the other hypothetical. Again, this is not good accounting.

FASB should also not lose sight of the fact that the accounting proposed in Example 9 has the affect of erroneously increasing reported EBITDA, which is one of the most important financial measures for most companies.

We recommend that the time value of money only be recognized in the event there is a significant financing provided (as opposed to incurred) by the entity. Example 9 should be modified to reflect entity financing as opposed to advanced collection. Alternatively, the implementation guidance should present an example of both an advanced collection financing and an entity financing.

We also recommends that FASB allow the entire financing estimate, and not just the discount rate itself, to be determined at contract inception with a need to only revisit that estimate if the actual timing of transfers of promised goods and services relative to the timing of receipt of customer payments significantly differs from original estimates.

Finally, it is unclear to us whether FASB intended the onerous performance obligation test to be applied before or after the application of paragraph 58, and we believe that FASB needs to clarify this intent.

Contract Costs

The general flow of concepts for classification and recognition of contract costs in paragraphs 91 - 97 is confusing because of the order in which each concept is presented in the revised exposure draft. Generally, the majority of costs incurred for fulfillment of a contact will be recognized as incurred. For better clarity, we suggest that this overall section begin with what is now paragraph 93 and the subsections be listed in the order of what is presently (c), (d), and (a). Consistent with our prior comments regarding costs of wasted materials, etc. (paragraph 45), we recommend that subsection (b) be eliminated. The section should then present paragraph 92, followed by 91, followed by 94-97, followed by 98-99.

It is not clear from paragraph 91 if the intent is for performance obligation costs to have an interim step in accounting to be accumulated as an asset and then amortized under paragraph 96, or if paragraph 91 is intended for only selected transactions. We believe that in the case of the construction industry, there will be limited situations (other than possibly the home building sector) that an asset will result from fulfillment costs.

Paragraph 91 lists three criteria that must all be met for an asset to be recorded (as opposed to expensed as incurred in paragraph 93). One of these criteria is "the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future." There are common costs that construction entities incur early in the performance or fulfillment of a contract such as surety bond fees, mobilization, etc. These costs must be incurred in full in order to perform the first elements in the process of transferring goods or services to the customer. Typically, contracts allow for the payment of these costs in initial pay applications. While it may be true that the cost of these items enhance resources that will be used in satisfying future performance, the entity could not have satisfied a single performance without incurring the full cost. In the event of a contract termination, mobilization is a compensable item.

Therefore, we believe that the criteria under paragraph 91 should exclude costs that are required to be incurred as a condition precedent and directly related to satisfaction of the initial transfer of goods or services to the customer.

Percentage of Completion Computation

We are also concerned about how the revised exposure draft will impact the percentage of completion method of accounting for construction contracts. We believe that without better guidance and examples, the unintended consequence may occur whereby preparers compute revenue using improper methodology.

Percentage of completion is a margin driven concept. The revised exposure draft and examples should refrain from suggesting that the revenue recognized throughout the duration of a performance obligation is determined by the product of the input or output measurement of progress times the transaction price.

The predominant computation of revenue under the percentage of completion method is often referred to as the gross profit method and also Method B (ASC 605-35-25-84). Using the

language of the revised exposure draft, revenue equals the cost of goods and services for which the customer has obtained control plus the amount of margin earned to date. The margin earned to date is equal to the percent complete (measured by a reasonable input or output measure) times the estimated margin on a contract-wide basis (assuming a single performance obligation).

This computation is emphasized in the contract asset description on balance sheets when a contract is under billed which is normally labeled "Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts".

The other method of computing percentage of completion revenue is described as Method A (ACS 605-35-25-83). This method computes revenue in an amount equal to the percent complete times the estimated transaction price. It also computes cost of revenue in an amount equal to the percent complete times the total estimated costs at completion of the performance obligation.

The two methods described report identical revenue, costs, and margin if the percent complete is measured using a total cost-to-cost method. However, if any other input or output measure is used, the choice of computation will report different revenue and costs, but the same margin.

We are concerned that since the Amendments to the FASB Accounting Standards Codification would remove the existing guidance for the computation, inappropriate computations may arise that are both improper and result in inconsistencies in practice. We recommend that the standard either include better guidance on the percentage of completion computation or include an example emphasizing the recognition of the proper amount of margin earned to date.

Our observation is that there is no example in the Implementation Guidance and Illustrations that demonstrates a revenue computation whereby revenue is the sum of the costs for which the customer has control plus the margin recognized to date. We recommend that, at a minimum, such an example be presented. We will be happy to provide assistance in developing a meaningful example.

Disaggregation of revenue

Nonpublic entities will be required to disclose disaggregated revenue based upon the timing of transfer (paragraph 116). Construction entities may have some operations with point in time transactions, such as a quarry where aggregates may be sold at a point in time. The same entity may also have small performance obligations that are completed in a day, week, or few months. Some entities might choose to disaggregate by selecting a dollar amount of a transaction as a reasonable proxy of the short duration. It is not clear from the guidance how this disclosure will lead to comparable information being provided by issuers. Given the added cost of collecting, disclosing, and auditing this information, we question its value to users. Accordingly, we recommend that either paragraph 116 be included in paragraph 130 or, alternatively, the disclosure be specifically limited to public companies. We do not believe this information is important to users of private company financial statements and, where it is important, they can request that information in a specific manner that will be meaningful to that specific user.

Effective Date and Transition

We believe that significant training, system enhancements, and planning will be necessary to implement the proposed standard. Assuming the final standard is published by the end of 2012, we support an implementation date of no sooner than 2015 for public entities and 2016 for nonpublic entities.

We perceive that the cost of retrospective reporting will be significant and request the Boards to impose as few requirements of issuers as necessary to meet the needs of the users. Further, please recognize that nonpublic entities' users typically have the ability to request transition information outside of GAAP financial reporting.

We reiterate our comment made in the Implementation Discussion Paper that from a cost benefit perspective, nonpublic entities should be allowed to apply the new revenue recognition standard on a prospective basis for new performance obligations. Only performance obligations that are in progress at the effective date with an expected remaining duration of more than 2 years should be required to be restated.

We also would request that the Boards reconsider the guidance on early adoption (paragraph 131). We believe that new reporting entities that start-up after the standard is published should have the flexibility of adopting the revenue recognition standard immediately and avoid the near-term transition costs.

Answers to Questions for Respondents

Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognizes revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

We fully support the proposed guidance in paragraphs 35 and 36 for performance obligations satisfied over time and believe that the Board has done an admirable job of creating a framework which contemplates the various types of revenue transactions that would qualify for revenue recognition over time.

Question 2: Paragraphs 68 and 69 state that an entity would apply Topic 310 (or IFRS 9, if applicable) to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

Please refer to comments within the body of our letter above regarding collectibility.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not

exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

As more fully discussed above, we support the intent behind constraining revenue, but we are concerned by the subjectivity that is permitted within the proposed standard, particularly when coupled with the introduction of new and difficult-to-understand terminology. Further, we believe that not all variable consideration should be treated the same.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognize a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

As noted in our comments above, we disagree with the scope of the onerous test applying to only contracts which are expected at inception to be satisfied over greater than one year. Instead, we believe that the scope of paragraph 86 should apply to all contracts, with materiality being the sole arbiter in determining whether an anticipated loss should be accrued.

Further, we believe that a second onerous test be performed at the contract level before requiring accrual of any remaining loss under the onerous performance obligation. If the performance obligations and financing elements under a contract are combined and indicate a non-onerous contract, then there should be no accrual of the onerous performance obligation. If the combined elements indicate an onerous contract, then the accrual of unearned loss should be limited to the overall loss on the contract.

Question 5: The Boards propose to amend Topic 270 and IAS 34 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial statements. The disclosures that would be required (if material) are:

- 1. The disaggregation of revenue (paragraphs 114–116)
- 2. A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- 3. An analysis of the entity's remaining performance obligations (paragraphs 119–121)

- 4. Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- 5. A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial statements? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial statements.

We have chosen not to comment on this question

Question 6: For the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities (for example, property, plant, and equipment within the scope of Topic 360, IAS 16, or IAS 40), the Boards propose amending other standards to require that an entity apply (a) the proposed guidance on control to determine when to derecognize the asset and (b) the proposed measurement guidance to determine the amount of gain or loss to recognize upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement guidance to account for the transfer of nonfinancial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

We believe that any proposed action on this topic should be subjected to a separate due process and, as such, we believe it is clearly outside the scope of this proposed standard. Accordingly, we are not prepared at this time to comment.

In conclusion, AGC appreciates the opportunity to again comment on this very important exposure draft. We appreciate the modifications that were made to the original exposure draft and we are committed to working with the FASB/IASB in arriving at workable solutions that result in improved financial reporting and transparency. We will continue to offer our assistance in working to improve the standard setting process initiated by this exposure draft including field testing various concepts considered in the exposure draft or its revisions.

Thank you for your consideration of our views.

Sincerely,

Stephen E. Sandherr Chief Executive Officer

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