

October 21, 2010

Technical Director-File Reference 1820-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

RE: Proposed Accounting Standards Update, *Revenue Recognition (Topic 605), Revenue from Contracts with Customers* (File Reference No. 1820-100)

Dear Technical Director:

We appreciate the opportunity to respond to the proposed Accounting Standards Update (ASU), *Revenue Recognition (Topic 605), Revenue from Contracts with Customers* (“the proposed Update” or “new Standard”).

This letter represents a group response from several of the largest Engineering & Construction (E&C) companies, which are primarily U.S. based entities, (“we”, “us”, “our Industry” or “the Industry”), all of whom provide long-term construction related services to project owners around the world. The services provided by the Industry are broad and can vary widely from one project to the next, and typically include some or all of the following: program management, planning, design, engineering, procurement (services and/or material procurement), fabrication, construction, construction management, installation, logistics, start-up/commissioning, operations and maintenance, and decommissioning/closure services. Our response reflects the collective perspective and view of the entities named below. Although each party has their own individual perspective, we are all unified in our view that there are aspects of the proposed Update that require revision, for the reasons expressed. Our group has participated in several industry roundtable meetings and conference calls, including a recent meeting held on August 19, 2010, where the proposed Update was the primary topic of discussion. Furthermore, we believe our views are generally shared by preparers who currently use Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 605-35 (formerly Statement of Position (SOP) 81-1) or International Accounting Standard (IAS) 11 as a revenue standard, including those companies in the Aerospace & Defense industry.

Currently, both U.S. GAAP and IFRS have unique standards for revenue recognition relating specifically to long-term contracts. The existing standards have served both financial statement users and preparers well for many decades, providing transparent information about the critical

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financial characteristics of long-term construction projects, including revenue and cost recognition, without significant diversity in practice within the Industry. In order to maintain this transparency and limit future divergence in practice, we encourage the FASB and International Accounting Standards Board (IASB) (collectively, “the Board”) to consider revisions to the proposed Update that will allow for the continued application of those principles and allow for the practical application of the proposed Update without unduly burdening the Industry.

While we recognize that one of the Board’s objectives in proposing the Update is to improve comparability of revenue recognition across all industries, we believe that the proposed Update will actually reduce comparability of revenue and profit recognition within our Industry and require burdensome activities without accomplishing the Board’s objectives. In particular, there are three primary features of the proposed Update that we believe require further consideration by the Board.

1. Although we agree that multiple performance obligations may exist in certain long-term contracts in our industry, we believe that many, if not most, of our contracts consist of a single performance obligation. Accordingly, the proposed Update should be modified to more clearly and affirmatively state that a single performance obligation could exist for certain long-term contracts. We believe that the proposed Update should allow for the determination of a single performance obligation when contract activities will be performed in an overlapping, concurrent or highly interrelated manner.
2. Although we agree with the use of indicators and principles within the continuous transfer of control model, we believe the guidance provided in the proposed Update for determining whether continuous transfer of control exists is unclear and difficult to apply to most long-term contracts, particularly contracts for services, and will lead to widespread diversity in practice. The basic principle underlying current accounting standards for long-term contracts is that the **earnings process** is continuous as the work progresses, whereas the principle proposed in the Update is that **transfer of control** is continuous. We believe continuous transfer of control represents the legal essence of most long-term contracts, particularly those in the E&C and the aerospace and defense industries. Application of either of these two principles should produce nearly identical results under long-term contracts. However, we believe the proposed Update should be modified to clarify the indicators of continuous transfer of control.
3. Various new requirements in the proposed Update, particularly those relating to the implication that multiple performance obligations would always be present in long-term EPC contracts, will cause retrospective application of the proposed Update to be particularly burdensome for any contractor, especially for those performing contracts with lives that regularly extend beyond five years. Other new requirements that would add to the complexity of retrospective application are highlighted in the paragraph below. We believe that retrospective application is impracticable for most companies in our Industry because many of the needed records and much of the needed information may no longer be

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available. Prospective application of the proposed Update should be allowed with an effective date that will reduce the burden of transition. However, we acknowledge that if the changes proposed by us in this response are accepted by the Board, the burden of retrospective application would be lessened.

In addition to the three primary concerns articulated above, we also have included comments on other topics in the proposed Update related to the accounting for **contract modifications, the use of a probability-weighted approach in determining transaction price, the application of time value of money to the transaction price, collectability, accounting for onerous performance obligations, and certain disclosure requirements**. We believe that each of these aspects of the proposed Update also should be modified to provide more accurate and useful information to financial statement users.

The following discussion provides our specific comments on the proposed Update.

Accounting for Separate Performance Obligations in Long-term Contracts

The Nature of Long-term Contracts

By their nature, long-term contracts, particularly those associated with specialized construction projects, differ from project to project in both their design and execution, such that the terms, conditions, and deliverables are matched to the specific needs of a particular project owner after an extensive bid and award process. In spite of the number of similar projects a contractor may perform over time (e.g., petroleum refineries, aquifers, wastewater treatment facilities, bridges, turnpikes, pharmaceutical facilities, etc.), there are a myriad of variables (quality and availability of feedstocks, local water tables, types and availabilities of raw materials, soil and site conditions, etc.) that render each project unique. In contrast, contracts in many other industries that truly include multiple elements are typically ones in which each individual deliverable is somewhat standard in nature, has a specific utility for the customer, and the customer could, if so desired, procure some of the deliverables, but not all of them, and still be satisfied with those delivered. For arrangements of this type and arrangements where similar performance obligations are in fact routinely sold separately, we agree that the goods and services to be delivered should reasonably be accounted for separately. However, for many long-term contracts in our Industry, the deliverable is the entire project, and the various activities comprising these projects are performed in an overlapping, concurrent or highly interrelated manner, such that, given the interdependencies, the activities do not have separate utility or risks and therefore, do not have a distinct function or margin. In their simplest form, the long-term contracts in our Industry often contain only one performance obligation: a single project designed and built to the project owner's specifications.

As currently drafted, the proposed Update (including Example 11) implies that most long-term contracts will result in the identification of multiple performance obligations. Although we agree that multiple performance obligations may exist in certain long-term contracts for engineering (design), procurement, and construction (collectively, "EPC") services, we believe, for the reasons

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discussed herein, that many, if not most, long-term EPC contracts consist of a single performance obligation. Furthermore, we do not believe that users of our financial statements view our revenues as being attributable or relating to as many “separate and distinct” performance obligations as implied by the proposed Update. This point was made clear to us during the Engineering & Construction Executive Forum held in New York on October 14, 2010. At that forum, representatives from our surety, banker and investor communities were in general agreement with our points of view and none expressed concerns that our current revenue recognition policies produced inadequate information or significant diversity in practice.

Consequently, unless modified, we believe the proposed Update would result in burdensome activities that will produce subjective and dissimilar allocations of the transaction price across companies in like industries and thus, more variability in application, with less meaningful information conveyed to the users of our financial statements.

We believe that a single standard for revenue recognition can achieve comparability within the Industry and with other industries only if the final standard acknowledges the facts described above and allows preparers to apply judgment in evaluating whether the individual characteristics of each long-term contract meet separation criteria used to identify if and when there are multiple performance obligations in long-term contracts. We do not mean to imply that the final standard be written in a manner that allows preparers to use “free choice” in determining whether multiple obligations exist. Instead, we believe it should be written using a principled-based set of guidelines that will require preparers to carefully evaluate whether the activities, phases and deliverables of each contract are distinct.

Potential Issues in the Identification of Performance Obligations in Long-term Contracts

The proposed Update indicates in paragraph 22 that, “in some cases” the promised goods or services, or any combination thereof, may not be determined to be distinct, resulting in an entity accounting “for all the goods and services promised in the contract as a single performance obligation.” We believe that for many, if not most, of our long-term contracts in which we perform various tasks over multiple phases that are **overlapping, concurrent or highly interrelated**, such goods or services, or tasks performed, are generally not distinct. Such tasks are merely interdependent steps in the overall process of delivering the entire project to the project owner. We carefully chose the words “overlapping, concurrent or interrelated” to describe possible criteria to be applied because each of these words has a different definition, yet each meaning is relevant to the typical activities performed on long-term contracts.

In our Industry, project tasks are regularly performed as a bundled set of services or activities with a single objective: the delivery of the project to the project owner in accordance with their specifications. Accordingly, in many of such situations, we do not price the tasks individually, nor do we and our project owners separately negotiate the individual tasks when we establish the value of the contract. However, in all such situations, the tasks required under the contract are performed

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and managed in an overlapping, concurrent or interrelated manner. Consequently, we do not believe that the separate tasks within the bundled set of services or activities should always, or by a default treatment, be determined to be “distinct” and accounted for separately just because, on occasion, we might be asked and agree to perform only one task that could be viewed by some as “similar.” Accordingly, the pricing of the individual tasks, depending on the facts and circumstances including the intentions of the parties, the significance and relevance of available market price information, and the type of negotiation we enter into with our project owners, will vary widely from one project to the next. Consequently, there is not a standard margin realized from one project to the next.

As a result, we believe that Example 11 in the Implementation Guidance and Illustrations should be modified to remove the implication created by the proposed Update that a contract to provide EPC services will always consist of multiple performance obligations. The number of performance obligations in an EPC contract should be determined based on the terms of the contract and all relevant facts and circumstances. The identification of performance obligations will require the use of business judgment applied to each unique set of facts.

We acknowledge that companies that perform EPC contracts might also, from time to time, provide engineering (design) services on a stand-alone basis to project owners. We want to stress to the Board that most in our Industry do not routinely seek or perform standalone phases of a project and that when we do so, in many cases, it is with the expectation that if the project owner decides to proceed with a larger, more extensive project, we are in a preferred position, due to the knowledge obtained from having performed some earlier phases of the project, to be awarded the later (procurement and construction) elements of the project. Additionally, when we do perform standalone services, the pricing models typically used are substantially different than those used to price out full service EPC contracts. Under paragraph 23, each phase of a full service project, if deemed similar to a service sold separately, would likely be considered distinct and, therefore, would be accounted for as a separate performance obligation in accordance with the proposed Update. However, that conclusion does not give proper recognition to the contracts, the complexity of the underlying project, or the interrelatedness inherent in many long-term contracts, including many EPC contracts, in which each of the apparent “performance obligations” are interdependent, overlapping, or concurrent activities with limited or no standalone utility to the project owner. This differs from those instances in which we may provide such services individually, at the request of the project owner because the project owner perceives a standalone utility to exist. **We believe the body of the Update and Example 11 should be clarified to state that contracts requiring the performance of multiple tasks should be carefully evaluated to determine whether such tasks constitute separate performance obligations and that this evaluation should consider all relevant facts and circumstances including whether the tasks are overlapping, concurrent or highly interrelated. In situations where the tasks are considered to be overlapping, concurrent or highly interrelated, such tasks may be deemed to be non-distinct, and therefore, in such circumstances, would be accounted for as a single performance obligation as discussed in paragraph 22 of the proposed Update.**

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Application of “Distinct Risks and Resources” to Long-term Contracts

Many EPC contracts are priced, bid, negotiated, signed, executed, and monitored based on a price that was negotiated on a total contract basis (i.e., the engineering/design services are not regularly negotiated separately from the procurement/construction services) using a highly integrated project execution plan. Although there are generally different teams of people involved in the different services provided during the project (for example, engineering and design services often require a different skill set than do procurement, fabrication and construction services), there are also overall project management personnel who are responsible for the oversight and management of the entire project and ensure that the timing of the various interrelated activities is on schedule, performed according to specifications, properly sequenced, and that the different resources have been properly assigned to help ensure the successful outcome of the project.

Risks can and often do affect multiple phases of a project. For example, although it may initially appear that there are separate and distinct resources and risks related to the different tasks performed on a construction project, the activities performed by the engineering and design team have a direct and iterative effect on the amount and timing of procurement activities and on the outcome of the construction phase of the project. Engineering can be executed with no issues/cost overruns or delays in schedule, but if the engineering or design results are flawed or improper, there could be a significant impact on, for example, whether the correct type and quantities of materials are procured, and on the amount of labor and other costs incurred during construction.

Furthermore, on EPC projects, the engineering services are rarely completed before procurement, fabrication, construction or construction management begins. The performance of engineering services normally occurs throughout typical EPC projects, overlapping other significant project phases, as designs are updated to reflect new information and the progress of other aspects of the project proceeds, and therefore runs concurrently with procurement, construction, and all other aspects of the project. Similar interdependencies exist between other phases of an EPC project. For example, the timing and accuracy of procurement activities have a direct impact on the success or failure of the construction phase. As another example, subcontracts may seem on the surface to have distinct utility and margins, but in reality subcontracts are an extension of the prime contractor’s overall responsibilities and therefore subcontractor performance is managed in an overlapping, concurrent or interrelated manner similar to every other phase of the project. These interdependencies may result in tasks performed having non-distinct margins or margins that are not easily determinable for the different tasks. In these instances, the EPC project would best be characterized as having a single performance obligation.

Potential Issues in the Allocation of Transaction Price to Multiple Performance Obligations

As stated previously, there are no standard market prices charged by participants in our Industry for services we provide. Therefore, the profit margin generated on services sold on a standalone basis may be significantly different than the profit margin that would be allocated to the same services

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provided within a long-term, multi-faceted project. Pricing for standalone services varies widely, depending on the project characteristics, the contractual arrangement, the location and scope of work to be performed, the project owner, the bidding form (e.g. competitively bid or negotiated), expectations for additional work, cyclical market demand, and various other conditions. As a result of these factors, two similar projects in two different locations could yield significantly different prices, because each project is unique and for each contract the pricing is determined independently.

The accounting for separate performance obligations that are misidentified and which do not actually exist in many long-term contracts would result in subjective and perhaps, arbitrary allocations of transaction prices and prices for contract modifications as a result of the artificial segmenting of overlapping, concurrent or highly interrelated contract phases that were not separately negotiated and priced. The reason we believe such allocations would be at least subjective, if not arbitrary, is because the proposed Update requires preparers to allocate the overall price based on the relative values of standalone performance obligation pricing. As discussed earlier, standalone pricing varies widely and should not be used as a reliable standard for allocation purposes.

Even if a satisfactory population of projects with similar characteristics were available to represent a historical pricing “standard,” historical pricing will generally not be indicative of current pricing or “as executed” results. Therefore, in order to allocate a transaction price to the individual tasks within a contract, averages would need to be determined for and applied to each performance obligation. In our view the use of such averages would introduce an arbitrary element into the revenue recognition process.

Subjective allocations of transaction prices, based on artificial segmenting of contract phases will not produce more meaningful information for the users of our financial statements because the users of our financial statements are interested in the overall project-level financial results of a particular project or business unit and the expected profit margins contained in backlog, rather than how many different services a single contract includes or which ones had higher or lower profit margins. The interrelationship between the various stages of a project is one of the primary reasons why construction projects are tracked and monitored for profitability and reporting to management, sureties and other constituents on an overall basis rather than by individual tasks performed within a project.

Changes in the Timing of Revenue Recognition

If the proposed Update is adopted as currently drafted, we believe the timing of revenue recognized would change compared to current practice. If profit margins for standalone engineering services were determined to be higher than those for procurement and construction services and such services were accounted for as separate performance obligations, an entity would recognize more revenue at a higher profit margin during the beginning stages of the project, since engineering is the primary activity performed during the initial stages of a project. We believe recognition of higher

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profits during the initial phase of a project may fail to consider how the risks related to engineering activities impact the success or failure of later phases of the project and the economic performance of the project as a whole. We believe that the current wording and example provided in the proposed Update (Example 11) would lead to a practice of nearly always segmenting phases of EPC contracts into multiple performance obligations and would result in the potentially misleading accounting effects described above, thereby failing to accomplish the primary purpose of the proposed Update.

Additional Burden to Financial Statement Preparers

In addition to the inappropriate acceleration of profit and revenue recognition described above, we also highlight to the Board that **separate accounting for multiple phases of long-term contracts will significantly increase the number of separate projects that an entity will be required to track, apply controls to, and separately determine the amount of revenue to recognize during a reporting period.** If a contractor does not already separately account for tasks at the outset of a contract, it will be difficult if not impossible to do so retroactively because information required to account for separate tasks is not always tracked on a disaggregated basis. Consequently, **the proposed Update would require changes to accounting systems, potential expansion of the number of accounting and project staff, and a required breakdown of tasks, costs, and estimates to a level that is below the level being collected currently and reviewed by project and senior management.** In fact, as we have begun to inform our various management personnel, including operations management, about the potential changes to our financial reporting resulting from the proposed Update, they have expressed their intention to continue using project level information for tracking the financial progress and performance of our projects for internal management reporting purposes. They do not believe that breaking projects down into the number of performance obligations implied by the proposed Update reflects either the economic substance of the contractual arrangements we have with our project owners or the way we measure our own performance. We believe that our project owners and other significant constituents, including investors, sureties, and creditors, will continue to want financial information prepared on a consistent basis applying principles substantially similar to current guidance, rather than the financial data that will result from the application of the proposed Update. This view was confirmed during the E&C Executive Forum on October 14, 2010. The initial and on-going effort to implement these changes would be costly and burdensome, without producing meaningful information to the internal or external users of our financial statements. Although it is not possible to provide a precise estimate of all one-time and continuing costs to implement the proposed Update, we view the major and most costly elements of any such conversion to be those costs relating to:

- The retrospective application of the proposed Update;

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- System conversion costs and costs relating to the future and continuing training of operations personnel to identify and track multiple performance obligations that do not represent the economic substance of the contractual arrangements;
- System conversion costs and costs relating to the future and continuing training of operations personnel relating to the development and tracking of complex indicators of the transfer of control of performance obligations; and
- Changes necessary to develop and implement a probability-weighted approach to determining the transaction price, as well as the application of the time value of money and the risk of collection.

Suggested Aggregation of Performance Obligations

We understand the Board's desire for entities to recognize revenue and profit for distinct functions that present different risks, utilize different resources, and provide distinct profit margins as they are earned in a contract. As discussed above, we strongly believe the proposed Update should be modified to allow an entity to aggregate contract activities based on a careful evaluation of the contract. The evaluation should consider all relevant facts and circumstances including whether the contract activities are overlapping, concurrent or highly interrelated. **We believe contract activities may not be distinct if the outcome and execution of one activity could directly affect the outcome of another activity. In those situations, we believe that often only one performance obligation exists. We also believe there is a rebuttable presumption that projects that are performed in an overlapping, concurrent or highly interrelated manner will not have separate and distinct performance obligations, given the intentions of the parties and the expectation of the project owner, the interrelationship of the various risks inherent in long-term contracts, and the manner in which both the project owner and contractor manage their risks.**

Continuous Transfer of Control

Paragraphs 25 – 31 of the proposed Update discuss the criteria used to assess satisfaction of performance obligations and thus, the recognition of revenue. Those paragraphs specifically address the transfer of promised goods and services to a customer. In our industry, the customer is typically referred to as “the project owner”. This is because, in the majority of cases, the work is performed at a location owned or controlled by the customer. Where we fabricate deliverables at our own location, the project owner usually directly oversees the design and construction activities. Consequently, we support the concept that control of our work-in-process deliverables is continuously transferred.

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Within the Continuous Transfer guidance we note the following:

- Paragraphs 32 and 33 in the proposed Update address suitable revenue recognition methods to be applied when the control of performance obligations is continuously transferred to a customer. However, these two paragraphs do not provide guidance for use in evaluating how or when control over goods and services are continuously transferred.
- Within paragraphs 25 – 31 only paragraph 30(d) mentions a scenario in which customer control is obtained as the asset is created. We note that paragraphs IG63 through IG65 and BC63 through BC65 contain additional comments about making a determination of whether control is transferred continuously; however, the discussion focuses only on whether the customer has the ability to direct the use of, and receive the benefit from, the work in progress. In addition, paragraph 30(a) discusses the unconditional obligation of a customer to pay as an indicator of control, which we feel is applicable to determining whether continuous transfer of control is occurring as it is consistent with the indicators that are discussed in paragraph 23 of ASC Topic 605-35.
- Example 16 discusses a scenario in which a services contract results in continuous transfer of control.
- Finally, we noted that the Board’s joint webcast entitled, “Exposure Draft, Revenue from Contracts with Customers, Potential Effects on Construction Accounting,” held on September 13, 2010, contained the following bullet points on slide #8, “Customer must have control of the work-in-process for continuous transfer recognition” and “Impact: some POC contracts will go to completed contract if control is not transferred continuously.”

Although we support the indicators and principles-based guidance on transfer of control, our view is that the guidance in the proposed Update should be modified to more clearly communicate the indicators of continuous transfer of control.

We continue to believe that the accounting reality of performing long-term contracts is that revenue and profits are earned continuously as the work progresses and control is transferred. The continuous earnings process is a more realistic accounting concept of the contractual agreement between contractors and project owners than is the transfer of control at interim points during the performance of a contract or at the completion of the contract. In addition, we believe that the following, which is derived from paragraph 23 of ASC Topic 605-35, is an accurate depiction of the legal concept of continuous transfer of control:

“Under most contracts for construction of facilities, production of goods, or provision of related services to a buyer’s specifications, both the buyer and the seller (contractor) obtain enforceable rights. *The legal right of the buyer to require specific performance of the contract* means that the contractor has, in effect, agreed to sell his rights to work-in-progress as the work progresses. This view is consistent with the

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

Based upon the above, we recommend that the following be included in the proposed Update as indicators of continuous transfer of control:

- 1. The project owner has the right to require specific performance from the entity under the contract.**
- 2. Under the contractual arrangement, the entity has no ownership claim to the work completed to date, but may have lien rights or other similar protective rights.**
- 3. The project owner supports his ownership investment by agreeing to a payment structure that relates to the progress of the work.**
- 4. The project owner or the project owner's agent(s) participate in the periodic evaluation of the work completed to date.**
- 5. The project owner has a right to take over the work completed to date at their option, even though such a right may include a penalty to be paid by the project owner to the benefit of the entity.**

We recommend that the Update be modified to clarify that these indicators should be considered in determining if transfer of control exists.

We note further that the authors of ASC Topic 605-35 also viewed the percentage of completion method (meaning continuous transfer of control) as superior to the completed-contract method, as indicated in paragraph 23 of ASC Topic 605-35:

"The percentage-of-completion method recognizes the legal and economic results of contract performance on a timely basis. Financial statements based on the percentage-of-completion method present the economic substance of a company's transactions and events more clearly and more timely than financial statements based on the completed-contract method..."

We agree with the assertion in ASC Topic 605-35 that the percentage-of-completion, or continuous transfer of control method, is more appropriate than the completed contract method of revenue

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recognition. As such, we believe our suggested changes are important in that they will clarify that companies in our Industry should continue to be able to utilize continuous transfer of control.

Retrospective Application

Paragraph 85 of the proposed Update indicates that the new Standard would be applied retrospectively upon adoption. Retrospective application would require an entity to restate the results of their financial statements for the past one to five years, depending on whether the entity is a listed entity. Since many contracts in our Industry have a long duration (often 5 years and in some cases up to 15 years), the entity may be required to look back 10 or more years in order to determine the appropriate adjustments to make retrospectively. If a five-year contract ended five years prior to the effective date, an entity would need to examine information created and maintained at the contract inception in order to determine the price, number of contracts, number of performance obligations, whether continuous transfer of control occurred and the appropriate method to use to determine progress, and how to account for contract modifications. In addition, an entity would have to review historical records as of each reporting period, which may not always be either readily available to an entity or captured and archived in an entity's accounting system, in order to determine the amount of revenue and profit that should have been recognized during each period. Because each contract is generally unique in its terms, conditions, and set of estimates made at each reporting period, the exercise to retrospectively determine the accounting under the proposed Update would be extremely onerous for even one historical period.

Given that estimates are a critical element in accounting for long-term contracts, retrospective application would require preparers to make assumptions about management's intent in prior periods that cannot be independently substantiated. **As such, we expect that it would be considered impracticable for most entities in our Industry to adopt the proposed Update through retrospective restatement as we will likely encounter several of the conditions articulated in paragraph 9 of ASC Topic 250-10-45.**

A further complication arises with respect to retrospective application for periods in which a business combination occurred. The history of acquired contracts is not typically reviewed by the acquirer at the level of detail needed to comply with retrospective application. Instead, due diligence is performed considering the current state of the projects and the potential risks. Therefore, the information required to identify and retrospectively account for additional performance obligations may not be available.

The onerous nature of this exercise is further compounded by the fact that a construction contractor can have several thousand active contracts at any point in time. At the August 19th meeting referred to in the introduction, attendees were polled about the number of active contracts in their portfolios under current accounting standards and their responses ranged from less than one hundred to over 24,000 individual contracts. As such, the information to be gathered, analyzed and accounted for is exponentially compounded. For example, over a 10 year period, a company with 20,000 active

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contracts may be required to review at several different points in time perhaps as many as 100,000 or more contracts in order to comply with retrospective application currently required in the proposed Update. Subsequent to an entity determining the adjustments to be made to the accounting records as a result of the proposed Update, the entity's auditors would also be required to perform audit test work over the restated balances, which would essentially require re-auditing the revenue, expenses, and contract accounting balances as of each period end, resulting in significant additional expense to entities and their shareholders.

While we understand the Board's desire in proposing retrospective application in order to improve comparability across all current and historical periods and to ensure that revenue trends are comparable over a period of time, the cost of compliance with retrospective application and the potential inaccuracy and lack of meaningfulness of the information will greatly exceed any potential benefit to investors. **The Industry's only practical implementation option is to adopt the proposed Update prospectively, by applying the proposed accounting to any new contracts entered into or commenced after the effective date.**

Regardless of the transition method, we believe that the Board should ensure that they provide sufficient time between the issuance of a final ASU and the effective date of the ASU to allow entities to perform the potentially complex tasks required upon adoption and make the necessary modifications to their enterprise resource systems to record and report transactions appropriately subsequent to the adoption of the proposed Update. **We suggest that the earliest date that the Industry would be ready to adopt prospectively would be no earlier than 2014 assuming a final standard is issued during 2011.** Allowing or requiring adoption by prospective application will also reduce the amount of time required between the issuance of a final ASU and the effective date thereof.

Contract Modifications

Contracts are modified frequently in the construction industry because of changes in scope or unforeseen conditions or circumstances. While the negotiation of change orders takes place throughout the execution and completion of long-term projects, change orders rarely relate to the entire project and usually result from a specific event or change that is associated with one or more specific phases of a construction project. Accordingly, the value of contract modifications, if and when they occur, should be allocated to the phase of the contract that gave rise to the modification. **Furthermore, if the final standard requires the identification of multiple performance obligations, the value of contract modifications associated with the same performance obligation should be combined and allocated solely to that performance obligation.**

The provisions of paragraphs 17 through 19 of the proposed Update require contract modifications, such as change orders, to be evaluated to determine if the "prices of the modification and the existing contract are interdependent (as described in paragraph 13)" in order to determine the proper accounting for the contract modification. For the most part, an entity will likely determine that the

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prices in the modification are interdependent because construction activities are normally performed concurrently or consecutively, which is one indicator noted in paragraph 13 of the proposed Update for combination of contracts. Additionally, when EPC contracts are bid, and prices determined, they are normally done so with one single commercial objective – construction of the ultimate deliverable, which is another indicator noted in paragraph 13 of the proposed Update.

If an entity concluded that the prices of a change order and existing contract are interdependent, as noted in paragraph 53 of the proposed Update, the entity would then be required to allocate any change in the transaction price to “all performance obligations on the same basis as at contract inception.” Allocation of incremental revenue arising from a change order relating to a specific activity on a project to all performance obligations, including those completed and not yet begun, even though they had nothing to do with the change order in question would, in our view, mislead financial statement users. This conflicts with one of the original principles of the proposed Update, which is that a performance obligation exists if it can be sold separately and that the pricing of such performance obligation should be based on its stand-alone selling price. In addition, this type of allocation would be arduous, given the large number of change orders that can be typical for long-term projects. Please refer to Exhibit II for further illustration of the potential accounting implications of using this model.

While we believe that many long-term contracts do not contain multiple performance obligations, as discussed in detail in the preceding paragraphs, following the guidance in paragraph 53 for contracts where multiple performance obligations do exist could result in a significant amount of revenue and profit recognition resulting simply from obtaining a change order without having made any significant progress on the activities related to the change order. The concepts and potential effects on revenue recognition are illustrated in Exhibit II.

In order to eliminate this unintended effect and to ensure that revenue recognition appropriately matches the economics of the arrangements entered into, we suggest that the Board include language that would allow an entity to allocate the price of contract modifications only to the activities affected if such activities are identifiable. We further recommend that, if a contract modification relates to more than one activity on a contract for which multiple performance obligations have been identified, the price should be allocated to the performance obligation(s) to which it relates, rather than to all performance obligations under the contract, based on the results of the negotiation of the change order(s). This approach would acknowledge that the final enhancement to overall revenue is, in many cases, a negotiated amount based simply on what the project owner is willing to pay for a variety of change orders, regardless of the individual circumstances behind each change order. **However, we also highlight to the Board that the aggregation of activities into a single performance obligation for certain long-term contracts, as previously discussed, would eliminate or minimize the impact of this potential issue in the proposed Update.**

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Under the proposed Update, and in contrast to the accounting for combining contract modifications with existing contracts, if an entity concluded that the prices of the change orders and the existing contract are independent, an entity would account for each change order as a separate contract. Similar to the issue noted above under the title “Identification of Performance Obligations,” with hundreds or thousands of change orders arising under many projects in our Industry, it would be an onerous task to track the separate costs related to each change order (which is not currently performed by most companies in our Industry), revise the analysis of project progress, calculate a separate cumulative revenue adjustment and determine the profit and revenue recognition for each change order on a recurring basis at the end of each reporting period.

Determining the Transaction Price

Use of Probability-Weighted Approach

Performance-based incentives, bonuses, unpriced change orders, liquidated damages, and other pricing features that create variable transaction prices are common features in many of our contracts. Relative to these features, paragraph 35 of the proposed Update proposes that an entity estimate the transaction price based on the probability-weighted amount of consideration that the entity expects to receive from the customer.

Current Industry practice under existing U.S. GAAP and IFRS is to utilize the entity’s best estimate of amounts that are probable of recovery, with such estimate based on all of the information available to the entity as of the end of each reporting period. This practice results in revenue recognition at each reporting date that is based on the best estimate of amounts deemed realizable.

We do not believe that a probability-weighted model results in a better estimate or better decision useful information. Estimates of transaction prices, which are inherently subjective in nature, should be based on an entity’s careful, good-faith evaluation of all available information and not based on a prescriptive method of probability-weighted outcomes. We believe that requiring the use of a probability-weighted approach to determine transaction prices associated with long-term contracts will not provide more accurate accounting and reporting or provide any additional benefits to an entity’s shareholders and users of the financial statements. On the contrary, we believe that it will increase the time and expense required for an entity to prepare its financial statements resulting in costs that clearly outweigh the benefits of the probability-weighted approach. We believe that the proposed Update should be modified to permit the use of the **best estimate of probable recovery or loss**, if one can be determined, based on the information and data available to the entity. A probability-weighted approach should only be used if an entity cannot form a single best estimate.

Consideration of the Time Value of Money

As currently drafted, we believe that paragraphs 44 and 45 do not adequately explain how to determine when a contract includes a “material financing component”. While we note paragraph 45

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explains that the effect is material to contracts when payment from the customer is due either significantly before or significantly after the transfer of goods or services to the customer, this does not take into account situations where continuous transfer of control occurs, nor does it adequately define the terms used within the proposed Update.

Because long-term contracts are performed over an extended period of time, payments are generally received from the project owner at times and in amounts that generally match the timing and cost of work as the project is being completed by the contractor. Throughout the life of the long-term contract, the contractor can be in a position of billing and collecting payment in excess of the amount of work completed to date (advance billing position) or in a position of completing work on the project in excess of the amount of billing and payments collected (unbilled position). Further, during the life of the contract, the billing position will generally move back and forth between an unbilled and advance billing position.

When trying to apply the concept of time value of money to long-term contracts, the ability to predict the timing of cash flows that are tied to performance metrics/milestones, how to account for future changes in the cash flows as the project advances, and complications in establishing the appropriate rates to use all make the concept difficult to apply.

The terms and conditions of most long-term contracts are written to provide cash flows throughout the duration of the project and are intended to follow the general pattern of work that is expected to be performed. In some cases, achievement of specified milestones triggers billings to customers; in others, progress billings occur periodically (monthly, for example, as costs are incurred by the entity). While an entity may have an initial projection of the timing of meeting milestones and/or project progress metrics required for billing, the actual timing of such achievements, and timing of actual payment, will often change throughout the performance of the contract. Further, the actual cash flow position throughout the life of a project will often bear little resemblance to what was initially projected. As a result of the subjectivity required in estimating future cash flows during the life of long-term projects and the consistent changes in the amounts and timing of cash flows that occur as a long-term project progresses, the attempted application of the time value of money in the determination of the transaction price for long-term contracts will introduce several arbitrary variables into the determination of the transaction price utilized by an entity in recognizing revenue and profit, which will add no value to financial statement preparers or users and may result in the reporting of inherently inaccurate financial information.

In addition to the other judgments and estimates required for each individual contract, the transaction price would have to be updated at each reporting period to reflect any changes in the expected timing of cash flows.

It will also be difficult to determine the appropriate rate to use in determining the discounted transaction price for a long-term contract when the contract position changes back and forth from an advance billing position to an unbilled position at different times during the life of the contract.

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Using either the contractor's incremental borrowing rate or the customer's incremental borrowing rate (which may not be known or available), including credit risk, would not seem appropriate as it would not reflect the true financing element that might be present throughout the contract given that the asset/liability position will change over time.

While we understand the Board's objective behind the inclusion of a time value of money component in determining the transaction price, the concept ignores the timing of cash outflows that are made during the performance of contracts. This is especially true in long-term contracts where subcontractors are often used and/or specialized products are purchased requiring separate construction, all of which are subject to differing payment terms including similar milestone and objective triggers for payment. Currently, neither U.S. GAAP nor IFRS separately captures the time value of money effects of any potential financing components within payments made for services and materials during the performance of long-term contracts. Because revenue will be discounted while costs will not be, the usefulness of the metric presented in the income statement will be reduced.

In addition to the issues noted above, we also believe that the guidance provided in paragraphs 44 and 45 is unclear on how the time value of money consideration should be applied in practice as it could be interpreted, as currently written, as potentially applying at the onset of the contract, and updated each reporting period, to all the expected future cash inflows for the contract or only applying to the balance sheet position as of the end of each reporting period.

Based on the above factors, we suggest that the Board consider providing an exception for contracts that have continuous transfer and where the payment terms allow for payment throughout the contract that are intended to match the delivery of service over a period of time. Alternatively, the Board should consider inclusion of language that will provide guidance in determining whether a material financing component is included in a continuous transfer of control situation and what constitutes payment being due "significantly" before or after the transfer of goods or services. The Board could consider, in these revisions, defining "significant" as being greater than one year, consistent with the FASB Proposed ASU, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, or by defining material financing component as financing arrangements that are considered to be outside the entity's normal business practice or typical operating cycle.

Collectability

While we acknowledge that the Board's guidance in Paragraph 43 of the proposed Update, related to including collectability in the determination of the transaction price, is conceptually simple, we believe that the execution would be quite complex when applied to long-term contracts. Our financial systems do not currently have the capability to comply with this requirement and compliance would require costly changes to our systems, controls, and processes. Additionally, we

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believe the result of incorporating collectability into the transaction price is counterintuitive to the underlying economics of contracts and will not result in more meaningful financial information for the readers of our financial statements.

Discounting contract values for perceived credit risk (determined at the inception of the contract) will require each and every invoice to be discounted. Assuming the client pays the contract value as invoiced, the difference between the amount received and the amount invoiced will generate income to the contractor which is not revenue. Participants in our Industry have thousands of projects with potentially dozens of outstanding invoices on each of these projects at any given time. **We believe the better approach to this issue is to continue to allow receivables to be recorded based on contract values, with any subsequent adjustments that are based on credit risk and collectability issues recorded as separate and distinct events. Users of our financial statements who attended the E&C Executive Forum on October 14, 2010 agreed with this position and stated that the proposed change would result in confusion.**

Accounting for Onerous Performance Obligations

Similar to the requirements under current accounting literature, the proposed Update would require the recording of a liability and expense when a long-term contract is expected to be unprofitable (i.e., the estimated cost of the project exceeds the estimated revenues for the project). While we agree with this concept in principle, we disagree with the guidance in paragraphs 54 through 56 of the proposed Update that require both a probability-weighted approach and the assessment and recording of liabilities at an individual performance obligation level for a contract that is profitable overall.

In order to determine if a performance obligation is onerous under the proposed Update, an entity would be required to calculate the present value of the probability-weighted costs that relate directly to satisfying the performance obligation and determine if that calculated amount exceeds the transaction price allocated to that performance obligation. This proposed methodology represents both a significant change in accounting standards and an arduous task for an entity to perform for each of their individual projects. Neither accounting for costs incurred by an entity nor the estimate of cost used in determining progress under the continuous transfer of goods and services currently requires the use of a probability-weighted determination of estimated costs. As such, the requirement within the proposed Update to do so would require a secondary set of cost estimates to be generated for each performance obligation.

Similar to the views expressed above in relation to the use of the probability-weighted approach in determining the transaction price, estimates are inherently subjective in nature and should be based on an entity's careful, good-faith evaluation of all available information and not based on a prescriptive method of probability-weighted outcomes. Determining an entity's best estimate of the expected cost of a long-term project requires extensive time and effort and can often include the use of internal and external experts, highly complex cost forecasting models, manual evaluation and

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analysis of project progress and schedules, analysis of the current risks and opportunities on the project, comparisons to historical data for similar projects, and many other estimation techniques. The result of these procedures is an estimate that is based on an appropriate methodology and a plethora of relevant data about the project, which is sufficient to determine the expected amount of costs to be incurred in excess of the transaction price.

We also note that while the proposed Update requires that the costs to fulfill a performance obligation be discounted in determining if a performance obligation is onerous, the proposed Update does not provide a definition of the rate to use in this required analysis. As currently drafted, the proposed Update would be open to interpretation by each entity as to the appropriate rate to use and the rates used could vary from one entity to the next resulting in significant diversity in practice and financial information that is not comparable. **We suggest that the Board modify the proposed Update to include a definition of the rate to be used in performing this analysis.**

Further, we also question the Board's rationale for using expected costs that have been discounted in the determination of onerous performance obligations. As transaction prices are only discounted to the extent that they contain a material financing component, it is possible that in many situations the analysis would result in a comparison of discounted costs to an undiscounted transaction price. **We believe that the comparison of an undiscounted value to a discounted value is not appropriate and will produce results that are not meaningful to users of the financial statements and will not appropriately account for all performance obligations that are onerous.**

In addition to our concerns regarding the determination of when a performance obligation is onerous, we also would ask the Board to consider the usefulness of the proposed accounting for onerous performance obligations as described in paragraphs 54 through 56 of the proposed Update. **Recognizing a liability and expense for certain performance obligations within an overall profitable project does not accurately reflect the true economics of the project and will confuse readers of the financial statements.** Exhibit I provides an example of the accounting effects of recognizing separately an expense and liability for an onerous performance obligation on an overall profitable project, demonstrating that the information does not provide any additional insight into the project and potentially skews the financial results and provides misleading information to users of the financial statements. In further support of the view expressed above that only one performance obligation exists for many long-term contracts, accounting for long-term contracts as one single performance obligation under the proposed Update would appropriately result in the recording of a liability and expense only when a long-term contract is expected to be onerous, or unprofitable, in total, which we believe is appropriate and accurately reflects the economics of many long-term projects.

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Disclosure Requirements

Remaining Performance Obligations

Backlog is a forward-looking performance metric that many analysts and investors utilize in their analysis of E&C contractors. Consistent with current AICPA or SEC guidance, entities within our Industry disclose the method and assumptions used to measure backlog. As a result, we currently enjoy transparent communications with the users of our financial statements that highlight trends in backlog, and the reasons for major changes in the value of backlog from period to period. Because users of our financial statements are primarily interested in the trend of backlog values and the reasons for major changes, backlog has historically been disclosed outside of the entity's financial statements, such as in the Management's Discussion and Analysis (MD&A) section of the periodic reports on Forms 10-K and 10-Q. Therefore, we believe the disclosure requirements described in paragraph 78 of the proposed Update will not improve information about backlog.

The disclosure requirements described in paragraph 78 of the proposed Update will define backlog as the amount of transaction price allocated to the performance obligations remaining to be recognized at the end of the reporting period. While backlog using this methodology can be calculated based on the population of uncompleted contracts in place as of the end of the reporting period, significant judgment will be required to forecast the appropriate allocation of progress and resulting revenue to be recognized across all future periods in which those performance obligations are expected to be satisfied. The use of such judgments will introduce a level of uncertainty into audited financial statements that does not currently exist. While the information to factually determine the periods for which the goods/services will be transferred may be readily obtained for some contracts (such as retail or manufacturing contracts) most long-term contracts will not provide this factual information, and will thus require reliance on the entity's subjective judgments and projections. Separately, auditors will be required to audit the information as it is intended to be included in the footnotes, which could prove to be a significant and costly challenge given the inherent variability of the nature of backlog within the E&C industry and the forward-looking nature of the estimates. This would be particularly true in those cases where a contract has been awarded but has not begun as of the date of the financial statements. In this situation, the proposed Update will require determination of the various revenue recognition aspects, such as decisions about performance obligations, the transaction price (e.g., using the probability-weighted approach and considering the time value of money), continuous transfer of control, methods of determining progress, etc., before the contract activities are even initiated.

Since forward looking information is not normally included in financial statements, we caution the Board to consider whether this is intended or even appropriate in defining the disclosure requirements of the proposed Update.

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Accordingly, while we agree that the disclosure may be useful to investors, we believe that given the subjectivity involved and the forward-looking nature of the information, the disclosure is better made outside of the financial statements. Privately held companies should be allowed to present the information in the footnotes, but to label such information as “unaudited.”

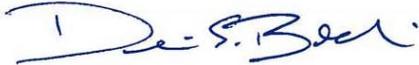
Reconciliation of Contract Balances

We do not believe that the disclosure requirements in paragraph 75 of the proposed Update, which requires the disclosure of a reconciliation of contract assets and liabilities from the opening to the closing aggregate balance, will provide information that is more useful than the information that is already provided in other parts of the financial statements. It is unclear to us how to apply this proposed disclosure requirement to long-term contracts. In particular it is unclear if the rollforward should include the net change in the balances between periods, which we believe would not be meaningful to a financial statement user, or if the rollforward should include the gross change in the balances between periods, which would be potentially redundant given that similar information is often provided in other portions of the financial statements, such as the statement of cash flows when prepared under the direct method. As such, we suggest that the Board review the guidance currently provided to provide examples and clarify the application of the rollforward requirements to long-term contracts and to consider if the information that will be presented to users of the financial statements will provide value beyond that already included in financial statements.

We would be happy to further discuss the specifics of these issues in more detail at the request of the Board. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Dennis S. Baldwin, Chief Accounting Officer – KBR, Inc., at (713) 753-3635.

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Very truly yours,



Dennis S. Baldwin
Vice President and Chief Accounting Officer - KBR, Inc.

Submitted on behalf of the E&C Industry and the Industry leading firms below:

H. Thomas Hicks, *Vice President and Chief Financial Officer – URS Corporation*

Reed N. Brimhall, *Vice President, Controller, and Chief Accounting Officer – URS Corporation*

John W. Prosser, Jr., *Executive Vice President and Chief Financial Officer – Jacobs Engineering Group Inc.*

Ronald A. Ballschmiede, *Executive Vice President and Chief Financial Officer – CB&I*

Westley Stockton, *Vice President, Controller, and Chief Accounting Officer – CB&I*

D. Michael Steuert, *Senior Vice President and Chief Financial Officer– Fluor Corporation*

Gary G. Smalley, *Vice President and Controller – Fluor Corporation*

Peter A. Dawson, *Senior Vice President and Chief Financial Officer – Bechtel Group, Inc.*

Anette Sparks, *Principal Vice President and Controller – Bechtel Group, Inc.*

Michael Whetstine, *Vice President and Controller - Peter Kiewit Sons', Inc.*

Mike Kershaw, *Senior Vice President and Chief Accounting Officer – The Shaw Group Inc.*

Lisa Z. Wood, *Vice President and Controller – Foster Wheeler AG*

Laurel J. Krzeminski, *Vice President and Chief Financial Officer – Granite Construction Inc.*

Bill Patt, *Vice President, Controller, and Chief Accounting Officer – Mortenson Construction*

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JoAnn Shea, *Chief Accounting Officer – CH2M HILL Companies, Ltd.*

Gary J. Brauchle, *Corporate Controller – McDermott International, Inc.*

Steven M. Meilicke, *Vice President and Controller – Tutor Perini Corporation*

James H. Allen, Jr., *Chief Financial Officer – Sterling Construction Company, Inc.*

Derrick A. Jensen, *Vice President and Chief Accounting Officer – Quanta Services, Inc.*

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EXHIBIT I

Illustrative Example – Accounting for Onerous Performance Obligations

Background

Company A enters into a contract to perform engineering (design), procurement, and construction services for a lump sum price of \$400,000, which commences upon signing of the contract on January 1, 20X1. Company A and its competitors deliver one of the services separately to project owners, referred to in this example as Obligation 1. Company A determines, based on the fact that different resources are used in the delivery of Obligation 1 on the project and because Obligation 1 is sold separately, that Obligation 1 represents a separate performance obligation and that the remaining activities of the project constitute a single performance obligation, referred to in this example as Obligation 2.

After execution of the contract, the Company allocates the transaction price (based on standalone selling price) and estimates costs as follows:

	Obligation 1	Obligation 2	Total
Allocated Transaction Price	100,000	300,000	400,000
Estimated Cost	(120,000)	(270,000)	(390,000)
Estimated Profit	(20,000)	30,000	10,000
Estimated Profit %	-20.0%	10.0%	2.5%

Company A determines that control is transferred continuously under both performance obligations and that the cost of inputs is the most relevant measure of progress of transfer of the goods and services under the contract.

First Reporting Period

The Company performs services under the contract through the first reporting period, March 31, 20X1, which primarily relates to the delivery of Obligation 1, and expends \$72,000 of costs related to Obligation 1 and \$54,000 related to Obligation 2. As of March 31, 20X1, the following would be recorded:

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	Obligation 1	Obligation 2	Total
Costs incurred	72,000	54,000	126,000
Total est cost	120,000	270,000	390,000
% complete	60.0%	20.0%	32.3%
Revenue to be recognized	60,000	60,000	120,000
Costs incurred	(72,000)	(54,000)	(126,000)
Onerous liability recorded	(8,000)	-	(8,000)
Profit/(Loss)	(20,000)	6,000	(14,000)
Profit/(Loss) %	-33.3%	10.0%	-11.7%

This is in contrast to the use of one performance obligation, which would produce the following result based on a cost-to-cost method of determining percent complete for the project in total:

	Obligation 1	Obligation 2	Total
Costs incurred	72,000	54,000	126,000
Total est cost	120,000	270,000	390,000
% complete	60.0%	20.0%	32.3%
Revenue to be recognized			129,231
Costs incurred			(126,000)
Profit on contract			3,231
Profit %			2.5%

Finding: As illustrated above, the accounting for an onerous performance obligation within a profitable project will produce results that suggest that the Company has incurred a significantly lower margin on a project that is projected to ultimately produce profit for the entity. We do not believe that the results produced under the proposed Update present any additional meaningful information to financial statement users.

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EXHIBIT II

Illustrative Example – Contract Modifications

Background

Company A enters into a contract to perform engineering (design), procurement, and construction services for a lump sum price of \$500,000, which commences upon signing of the contract on January 1, 20X1. Company A and its competitors deliver one of the services separately to project owners, referred to in this example as Obligation 1. Company A determines, based on the fact that different resources are used in the delivery of Obligation 1 on the project and because Obligation 1 is sold separately, that Obligation 1 represents a separate performance obligation and that the remaining activities of the project constitute a single performance obligation, referred to in this example as Obligation 2.

After execution of the contract, the Company allocates the transaction price (based on standalone selling price) and estimates costs as follows:

	Obligation 1	Obligation 2	Total
Allocated Transaction Price	200,000	300,000	500,000
Estimated Cost	(150,000)	(280,000)	(430,000)
Estimated Profit	50,000	20,000	70,000
Estimated Profit %	25.0%	6.7%	14.0%

Company A determines that control is transferred continuously under both performance obligations and that the cost of inputs is the most relevant measure of progress of transfer of the goods and services under the contract.

First Reporting Period

The Company performs services under the contract through the first reporting period, March 31, 20X1, which primarily relates to the delivery of Obligation 1, and expends \$90,000 of costs related to Obligation 1 and \$56,000 related to Obligation 2. As of March 31, 20X1, the following would be recorded:

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	Obligation 1	Obligation 2	Total
Costs incurred	90,000	56,000	146,000
Total est cost	150,000	280,000	430,000
% complete	60.0%	20.0%	34.0%
Revenue to be recognized	120,000	60,000	180,000
Costs incurred	(90,000)	(56,000)	(146,000)
Profit	30,000	4,000	34,000
Profit %	25.0%	6.7%	18.9%

Second Reporting Period

The Company performs services under the contract through the second reporting period, June 30, 20X1, which primarily relates to the delivery of the remaining activities for Obligation 1 and a significant portion of activities for Obligation 2. During the performance of these activities, the project owner expands the scope of Obligation 2 resulting in an additional \$300,000 in contract price and an estimated increase in the expected costs of delivering Obligation 2 of \$200,000.

The transaction price was allocated 40% to Obligation 1 and 60% to Obligation 2 at contract inception. As such, in accordance with paragraph 53 of the proposed Update, the additional revenue is allocated \$120,000 to Obligation 1 and \$180,000 to Obligation 2.

Subsequent to the change and allocation, as required under the proposed Update, the following are the allocated transaction prices and expected costs for each of the performance obligations related to the contract:

	Obligation 1	Obligation 2	Total
Allocated Transaction Price	320,000	480,000	800,000
Estimated Cost	(150,000)	(480,000)	(630,000)
Estimated Profit	170,000	-	170,000
Estimated Profit %	53.1%	0.0%	21.3%

As of June 30, 20X1, the Company has expended a total of \$120,000 of costs related to Obligation 1 and \$120,000 related to Obligation 2. As of June 30, 20X1, the following would be recorded:

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	Obligation 1	Obligation 2	ITD Total	Previous YTD Total	Recognized PTD
Costs incurred	120,000	120,000	240,000		
Total est cost	150,000	480,000	630,000		
% complete	80.0%	25.0%	38.1%		
Revenue to be recognized	256,000	120,000	376,000	180,000	196,000
Costs incurred	(120,000)	(120,000)	(240,000)	(146,000)	(94,000)
Profit	136,000	-	136,000	34,000	102,000
Profit %	53.1%	0.0%	36.2%		52.0%

This is in contrast to the allocation of the transaction price to only the relevant performance obligation, which would produce the following result:

	Obligation 1	Obligation 2	Total
Allocated Transaction Price	200,000	600,000	800,000
Estimated Cost	(150,000)	(480,000)	(630,000)
Estimated Profit	50,000	120,000	170,000
Estimated Profit %	25.0%	20.0%	21.3%

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Assuming the same costs have been expended for each activity, Company A would recognize the following in revenue and profit for the period:

	Obligation 1	Obligation 2	ITD Total	Previous YTD Total	Recognized PTD
Costs incurred	120,000	120,000	240,000		
Total est cost	150,000	480,000	630,000		
% complete	80.0%	25.0%	38.1%		
Revenue to be recognized	160,000	150,000	310,000	180,000	130,000
Costs incurred	(120,000)	(120,000)	(240,000)	(146,000)	(94,000)
Profit	40,000	30,000	70,000	34,000	36,000
Profit %	25.0%	20.0%	22.6%		27.7%

Finding: As illustrated above, allocating contract modifications to only the relevant performance obligations of a contract will result in recognition of revenue and profit that is more in line with the economics of the underlying modification and will also prevent recognition of revenue from unrelated performance activities that have substantial progress, which we believe would be inaccurate and inappropriate.