March 13, 2012

Technical Director-File Reference No. 2011-230
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

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

Dear Technical Director:

We appreciate the opportunity to respond to the proposed Accounting Standards Update (ASU) *(Revised), Revenue Recognition (Topic 605), Revenue from Contracts with Customers* ("the Update (Revised)" or "the 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 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 its own individual perspective, we are all unified in our view that there are aspects of the Update (Revised) that require revision, for the reasons expressed herein. 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.

We have worked very closely with the Staff of the FASB over the past few years helping to fashion a standard we believe will improve and clarify the key principles for recognizing revenue. We have met numerous times as a group to discuss this area of accounting, and we greatly appreciate the input we have received from the Board and Staff as well as their active participation in several of our meetings. We believe the proposed standard has evolved in a positive way since it was first issued and thank the Board for their patience. We would also like to extend an offer to meet with you and discuss the specifics of the Update (Revised) and our response in more detail at the convenience of the Board and its Staff.

In October 2010, we submitted a comment letter (comment letter No. 260, hereinafter referred to as our "Original Response") to the FASB in response to the original proposed update dated June 24, 2010 (the "2010 Update"). Because we refer to our Original Response in certain sections of this letter, and in order to help the Board appreciate our perspectives on the matters discussed herein, we have attached our Original Response as Exhibit I.

As stated above, we believe much progress has been made in identifying and defining the overarching principles that drive when revenue should be recognized as it applies to construction-type contracts. However, there are some aspects of the Update (Revised) that continue to concern us. We view our concerns as being either very significant (deserving of further deliberations by the Board), or are less significant (warranting, we believe, clarifying language in the final Standard).

The following is a list of the areas of the Update (Revised) for which we provide detailed comments, broken down by degree of significance:

Matters We View as Being Very Significant:

- Contract modifications;
- Accounting for separate performance obligations;
- Certain disclosure requirements;
- Retrospective application; and,
- Consideration of the time value of money.

Matters We View as Requiring Clarifying Guidance / Language:

- Measuring progress towards satisfying performance obligations (specifically, the treatment of uninstalled materials);
- Customer-furnished materials;
- Accounting for onerous performance obligations; and,
- Wasted materials.

Contract Modifications

Although we believe paragraphs 18 through 22 of the Update (Revised) adequately address the accounting for contract modifications that have been agreed to by the parties to the contract, at least as to scope, we also believe the Update (Revised) is unclear about the accounting for contract modifications that are unapproved as to both scope and price or that are in dispute (both of which are referred to as claims in ASC 605-35-25-30).

Contracts are frequently modified in our Industry due to a variety of reasons including:

- Changes in scope;
- Changes in conditions unforeseen at the inception of the contract; and,
- Incomplete or inaccurate specifications provided to the contractor.

Contract modifications (i.e., "change orders") are so prevalent in our Industry that it is virtually impossible for us to recount any construction project of a meaningful size that did not have associated with it a significant amount of revenue recognized as a result of change orders. The nature of the projects we perform is such that virtually every construction contract begins with both parties (the owner and the contractor) knowing that the contract will *not* be performed precisely as planned, as estimated, or as budgeted at inception. Although a complete list of issues that can impact the performance of a construction project is too long to provide, we list below a small sample of such issues in order to impress upon the Board the fact that contract modifications occur in the "normal course of business" in our Industry and hence, should be addressed accordingly in the new Standard:

- Precise depth of water tables that impact the excavation and subsequent drainage that occurs in preparing a site;
- The quality of feedstock that is actually available and which will be used in the operation of a process plant;
- The existence of contaminated soil or water which requires remediation prior to beginning construction;
- Design errors in drawings provided by a consulting engineer to the owner and the contractor and which the contractor relied upon to plan and estimate the project;
- Variations in actual underground conditions versus geotechnical test results; and,
- Changes in owner's plans for the site that arise during engineering or construction.

Given all of the variables that an owner and contractor understand and expect may impact a project during its construction, contracts in our Industry typically allow owners to direct the contractor to continue work even though the scope and price of an issue (which will eventually give rise to a contract modification) has not yet been agreed between the parties. Other aspects

of contracts (e.g., penalty provisions as well as the risks of litigation) often lead contractors to give notice of potential contract modifications to owners with the understanding that the scope and price of the contract modification will be negotiated later, while the contractor continues providing services.

Accordingly, and for the sake of clarity and the consistent application of revenue recognition principles across our Industry and other industries, the Board should modify the Update (Revised) to include the principles currently contained in ASC 605-35-25 (including the issue of contract modifications that are in dispute, also referred to as claims in ASC 605-35, which we believe are simply a different form of a contract modification). We respectfully suggest that the Board include the following guidance (either within the Standard or within the Basis for Conclusions):

> Within certain industries (e.g., construction and defense contracting), it is sometimes not practicable to obtain agreement with the customer as to both the scope and price of a modification in advance of the entity providing services. Provisions within the contract and other factors often require the entity to continue to proceed with contract performance irrespective of the fact that the modification has not been completely agreed to by the customer. Contracts within these industries typically contain provisions requiring the entity and the customer to negotiate and resolve unapproved contract modifications, including modifications that are unapproved as to scope and price, or those that are in dispute. In these situations, the entity shall continue to recognize revenue for such unapproved contract modifications consistent with the provisions of this Standard provided (i) the contract or other evidence provides a legal basis for the entity to recognize additional revenue with respect to the unapproved contract modifications; (ii) the amount of such additional revenue can be reliably estimated; and (iii) collection is reasonably assured.

Accounting for Separate Performance Obligations

In general, we are pleased with the guidance provided in the Update (Revised) relating to the identification of separate performance obligations. At the time we submitted our Original Response, we felt very strongly that the 2010 Update was too prescriptive and, if not modified, would lead to accounting that would not reflect the underlying economics of many of the engineering, procurement, and construction contracts we perform.

However, an issue remains regarding paragraphs 28 and 29 of the Update (Revised) which concerns us, but which we are hopeful can be resolved through either making certain minor edits to the paragraph itself or by including a supplemental discussion in the Basis for Conclusions ("BC") of the final Standard, or both.

The issue involves the implication in paragraph 29 that there *cannot* be multiple performance obligations in *any* engineering, procurement, and construction (collectively, "EPC") contract (i.e., long-term contracts requiring the providing of engineering, procurement, and construction services to customers) because the various services are almost always provided in a bundle and

"transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services". We are concerned that if this interpretation (i.e., there cannot be multiple performance obligations in any EPC contract) survives implementation, it will represent a departure from current GAAP (one that we do not believe the Board intends), which may result in incorrect accounting for certain EPC contracts, as well as presenting a burdensome change for certain members of our Industry to implement.

As we stated in the last paragraph of page 3 of our Original Response, "we agree that multiple performance obligations may exist in certain long-term contracts for engineering (design), procurement, and construction (collectively, "EPC") services." Therefore, we do not agree that *every* EPC contract must *always* consist of a single performance obligation. Accordingly, we believe that the language in paragraph 29 is too prescriptive by not properly considering that certain EPC contracts may contain more than one performance obligation.

Given how strong the language was in the original exposure draft regarding the definition of "distinct" and the requirement that the distinctive nature of a good or service drive the determination of performance obligations, we were naturally concerned that the 2010 Update would force *every* EPC contract to be accounted for using numerous, arbitrary performance obligations that would be practically impossible for us to comply with (from a process and systems perspective), and which would greatly distort the underlying economics of the contracts we have with many of our customers. Accordingly, our Original Response focused on explaining how, "many, if not most, long-term EPC contracts consist of a single performance obligation." Perhaps our Original Response did not make it sufficiently clear that there are situations where an EPC contract consists of more than one performance obligation.

Currently, each of the undersigned companies look to ASC 605-35-25-12 and -13 for guidance in determining when a contract should be segmented (i.e., broken down into separate performance obligations). We believe the principles in ASC 605-35-25-12 and -13 are sound, and truly help us account for long-term EPC contracts in a manner that accurately depicts (i) how EPC contracts were negotiated with the customers; (ii) the underlying economics of the contract with the customer; and, (iii) how the individual services are provided *and* managed and monitored internally.

We believe the Board did not intend to forbid a determination that an EPC contract may consist of more than one performance obligation. We observe that:

- At BC77, the Board correctly points out that the manner by which goods and services are bundled with other goods and services promised under a contract and are delivered is an important consideration in determining separate performance obligations, but it is not the only consideration.

- And at BC78, the Board acknowledges that "separable risks" were an indicator of separate performance obligations, but that it was perhaps impractical to include as criterion for determining whether a good or service is distinct.

We are sensitive to the difficulty of this issue. As a group, we have spent numerous hours trying

to craft language that properly describes those aspects of a typical EPC contract that point to multiple versus single performance obligations.

In our Original Response, we noted that "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 continue to believe that this statement asserts the correct principle as it relates to long-term contracts. We recommend that the Board consider including the wording in quotations above in the final Standard.

Suggested Revised Paragraph 29:

In addition, in consideration of the above, we respectfully offer the following two alternatives to existing paragraph 29. We believe both alternatives retain the principles contained in the Update (Revised), and would also provide for both multiple and single performance obligations in EPC contracts within a principles-based environment grounded in a careful assessment of the facts and circumstances surrounding the contract with the customer.

Alternative 1:

> 29. Goods or services that are distinct pursuant to the guidance in paragraph 28 may be combined and treated as a single performance obligation based on the relevant facts and circumstances including:
>
> (a) Whether the contract requires the entity to provide the goods or services as a bundle of goods or services;
>
> (b) Whether the goods or services represent separate phases of a single project (asset or "deliverable") for the customer that are overlapping, concurrent or highly interrelated;
>
> (c) There is evidence that the prices for the individual goods or services were not negotiated separately by the entity and its customer;
>
> (d) Whether transferring the goods or services to the customer requires that the entity also provide a significant (i.e., more than incidental) service of integrating the goods or services into the combined item(s) for which the customer has contracted;
>
> (e) Whether, within the context of the project or asset to be delivered to the customer, the bundle of goods or services has been significantly modified or customized to fulfill the contract.

Alternative 2:

> 29. Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services *may* not be distinct and, therefore, the entity shall account for the bundle as a single performance obligation. Factors to be considered in determining whether goods or services delivered in a bundle

comprise separate performance obligations include:

(a) Whether the goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted.

(b) Whether the bundle of goods or services is significantly modified or customized to fulfill the contract.

Disclosure Requirements

Reconciliation of Contract Balances (paragraph 117)

The reconciliation table required by paragraph 117 will be too costly for us to prepare and, in the end, fail to achieve the Board's goal of providing users of our financial statements with a meaningful understanding of the relationship between contract balances (appearing in the balance sheet) and the revenue recognized during the period (BC 254).

As discussed in detail in our Original Response and vetted further elsewhere in this letter, the issues, transactions, and events that affect the financial performance of the projects we perform are so diverse and complex that to assume their effects on contract balances can be neatly summarized in a movement table without incurring substantial costs is, unfortunately, not realistic. For many of us in the Industry, the information required by the movement table will have to be gathered manually by applying broad assumptions to large pieces of information that are captured by our accounting systems. To illustrate our point, consider the following real life changes that routinely occur over the life of a project:

The nature of contract modifications and their interplay with paragraph 117(a)(ii) — As discussed above, contract modifications occur on projects for a myriad of reasons. They are so prevalent in our Industry that it is virtually impossible for us to recount any construction project of a meaningful size that did not have a significant amount of revenue recognized as a result of multiple (sometimes hundreds) of contract modifications. Additionally, the costs related to specific contract modifications typically are not tracked separately from the costs originally estimated to complete the contract. Costs are tracked based on the operations being performed, rather than whether they were funded by the original contract or by a modification. For example, excavation costs are tracked without regard to whether they are being incurred based on what was originally planned or as a result of an unexpected differing site condition that will lead to a contract modification. The costs (those incurred under the base contract and those incurred pursuant to a pending or agreed-to change order) relate to the same activity and our accounting systems track them identically, without differentiation. Additionally, it is not uncommon for contract modifications to be resolved in reporting periods other than the period in which the related services were performed. In this situation, the Update (Revised) would require disclosure of the amounts earned in each period. Since costs are not tracked by contract modification, determining the amount of revenue that relates to each period for each modification is not possible. Our accounting systems do not have that capability, and we are very concerned that

they cannot be modified at a reasonable cost, if at all, in order to efficiently extract such information. It is important for the Board to understand that, as of the end of any given reporting period, we are providing services that may be covered by several thousand contract modifications (the services, therefore, span two-or-more reporting periods).

The nature of our business relies heavily on estimates that affect revenue. Accordingly, our contract balances will change for reasons that (i) do not fit precisely into the movement table described in paragraph 117, and (ii) will be very costly to summarize and audit — To illustrate this point, consider the fact that when we do business with the U.S. federal government, we are allowed to include in our revenue and billings an amount for overhead recovery. This rate, however, is a provisional rate that is based on the results of government audits conducted up to at least a year earlier, and will be subject to adjustment at some point in the future based on yet another government audit. As the year progresses and we monitor our actual overhead costs and expenses, we typically adjust our revenues and the associated contract balances to reflect what our actual, expected rate recovery amount will be. All the while, however, the government has been reimbursing us the provisional overhead rate.

Provisional overhead rates are one example of how estimates and their changing values can affect contract balances. Unless we devote substantial money and resources to modify our systems to extract the precise information required by paragraph 117, we will undoubtedly estimate such activity and include it in some "Other" line in the reconciliation table. This "Other" amount will assuredly become a hodgepodge of numerous, routine movements in the contract balance accounts included in entities' balance sheets.

Finally, we would be remiss if we did not point out the volume of data that currently exists in annual financial statements and we find it difficult to understand how yet another table of data would enhance the user's understanding of the financial condition, results of operations, and cash flows of the entity, especially if the users do not have a full appreciation for the composition or interrelationship of the balances within the table and are thus, unable to interpret them effectively.

In its April 2011 report "*Cutting Clutter – Combating Clutter in Annual Reports*", the Financial Reporting Council of the UK cited "movement tables" (i.e., the type of table proposed at paragraph 117) as a common source of "clutter" (i.e., data that obscures important information thereby inhibiting a clear understanding of the information which is intended to be conveyed).

A similar sentiment was expressed by SEC Commissioner Troy A. Paredes in an October 2011 speech when he said, "Too frequently, investors do not bother carefully studying the information that is available and get overwhelmed or distracted, misplacing their focus on less important matters. In short, the sheer amount of information can frustrate its effective use. The trouble is that when information is not processed and interpreted effectively, decision making may not improve with additional disclosure. Ironically, if investors are overloaded, more disclosure actually can result in less transparency and worse decisions."

Accordingly, we suggest that paragraph 117 be revised to read as follows:

Suggested Revised Paragraph 117:

> 117. An entity shall disclose qualitative information to enable users to understand the entity's revenue recognition policies and practices and how such policies and practices affect the movement in the entity's aggregate contract assets and contract liabilities. Such information should facilitate users' understanding as to how an entity's contract assets and liabilities are affected by the recognition and derecognition of revenues; variable consideration and subsequent changes in the value assigned to such consideration; advance payments; noncash consideration received; contractual terms and conditions that may be unique to the entity relative to the entity's peers, if known; and business combinations.

We believe the key advantage of a qualitative discussion of the transactions that affect an entity's contract balances is that it provides the most useful, management-oriented information about an entity's contract-related asset and liability accounts and how revenues affect those balances. (It is worth noting that management in our Industry does not currently use such a reconciliation table to review or manage these balance sheet accounts.) A qualitative discussion will be much more useful to the financial statement users and will be more cost-effective disclosure to prepare.

<u>Remaining Performance Obligations (paragraph 119)</u>

Although we appreciate the changes the Board made to the 2010 Update relating to the disclosure of remaining performance obligations, we firmly believe that the disclosures required by paragraph 119 will result in very confusing information for the readers of our financial statements, and that the disclosures will be very costly to prepare and to audit. Accordingly, we strongly recommend that the Board consider abandoning this disclosure.

Consistent with existing AICPA or SEC guidance, we currently disclose backlog as well as the methods and assumptions used to measure backlog. Irrespective of the Board's intentions, our investors, as well as the analysts, bankers, sureties, and others who rely on our financial statements, will interpret the disclosures required by paragraph 119 as a disclosure of backlog. Accordingly, because the information required by paragraph 119 is so different from the backlog disclosures we currently make and have made for over 30 years, the readers of our financial statements will undoubtedly be confused by the data disclosed pursuant to paragraph 119.

In addition, there is no question that the Standard, through paragraph 119, will be introducing future revenue as an audited disclosure. We believe it is very risky and misleading to include future revenue in a set of audited financial statements because of the weight investors will undoubtedly assign to the amounts disclosed, without fully appreciating the inherent uncertainties and other factors that could cause the amount *<u>to never be recognized by the entity as revenue</u>*, or recognized in amounts that differ materially from the values that were disclosed. Currently, this information is already fully and fairly disclosed in our annual reports on an unaudited basis, along with a discussion of the policies and practices we use to estimate backlog

and the risks associated with it.

In addition, we believe the cost of compiling "the aggregate amount of the transaction price allocated to remaining performance obligations" in sufficient detail, together with the support we believe our auditors will require to audit and certify the disclosure, will be so high as to make this disclosure prohibitively expensive. As we explained in our Original Response and as elaborated on elsewhere in this letter, our backlog (i.e., the value of our total remaining performance obligations) is heavily influenced by estimates and judgments that cannot be audited efficiently, if at all.

In order for the Board to appreciate the difficulties paragraph 119 presents for our industry, we provide the following discussion. Its purpose is to demonstrate the benefits of existing guidance, as well as the problems that certain specific contract types or projects will present if we are required to include their associated backlog values in a paragraph 119-type disclosure:

For our industry, the current disclosure requirements relating to backlog provide decision-useful information to our financial statement users. Changes prescribed by the Update (Revised) will not achieve the degree of comparability the Board seeks — As mentioned above, we currently disclose backlog as well as the methods 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. In fact, this guidance permits companies in our industry to fit backlog method and assumptions to the specifics of their businesses. While a variety of backlog methods exist, users are able to understand how and when different types of increases and decreases in backlog occur. It is the trend in backlog (measured on a consistent basis by each entity in our Industry) that our investors and analysts pay particular attention to in forecasting our future results.

It is because current guidance in this area is so well understood by our investors and the analysts who follow our companies that we believe the disclosures prescribed by the Update (Revised) will be confusing to our constituents and may lead to divergent disclosure practices. Take for example the practical expedient exception discussed in paragraph 121. There are certain companies within our Industry where time-and-material ("T&M") contracts and cost-reimbursable contracts comprise a significant portion of their total backlog. Some companies may choose to avail themselves of the paragraph 121 exception, while others may not. This situation will result in comparability issues that will be very confusing to investors and analysts. And unfortunately, due to the issues discussed in the next section of this topic, simply removing the paragraph 121 exception will create more problems due to issues relating to estimates and judgments (and the auditability of such estimates and judgments) inherent in measuring backlog relating to T&M, cost-reimbursable, and other types of contracts.

Another example to consider are indefinite delivery/indefinite quantity (or, "IDIQ") contracts. IDIQ contracts provide for an indefinite quantity of goods or services for a fixed period of time. They are used when the customer cannot determine, above a specified minimum, the precise quantities of goods or services that the customer will require during the contract period. The customer places delivery orders (for goods) or task orders (for services) against a basic contract

for individual requirements. Minimum and maximum quantity limits are specified in the basic contract as either number of units (for goods) or as dollar values (for services). IDIQ contracts are performed by us and are tracked within our accounting systems much in the same way as T&M contracts. For purposes of reporting backlog currently, many of us estimate the total value of the base contract and reduce it by the value of task orders completed. Existing detail descriptions of methodologies provide users of our financial statements with a clear understanding because of the disclosures regarding our backlog practices. Under the Update (Revised), however, we see the potential for considerable divergence in practices regarding the treatment of IDIQ contracts.

The disclosures described in the Update (Revised) will be costly to audit — Inclusion of backlog as an audited metric in our financial statements will increase our audit costs. Such an increase is not justifiable considering that the current (AICPA or SEC) unaudited disclosure requirements adequately meets the needs of the users of our financial statements.

In spite of the expedient exception allowed in paragraph 121, many of the undersigned will include T&M contracts and cost-reimbursable contracts in their disclosure of remaining performance obligations. We will include these contracts in our disclosure for a number of reasons including: (i) our processes and systems are already designed to accumulate backlog information for such contracts, and it seems counterintuitive to modify our systems to exclude contracts that, for many of us, will constitute a significant portion of our backlog, and (ii) the users of our financial statements are accustomed to seeing such contracts included in backlog, and they find such information useful.

Such T&M and IDIQ contracts underscore the difficulties auditors will face in auditing backlog, which will assuredly result in higher costs to preparers.

Consider the complexities involved in auditing the backlog associated with a $200 million, T&M (with a fixed fee) contract to build a new independent power plant for a refinery. Assume that this contract is material to the contractor. Also, assume that the plant will require a substantial amount of steel and other materials, the costs for which are estimated by the contractor (at the time the contractor prepares its backlog disclosure) to increase significantly over the life of the project which will result in an estimated 9% increase in the final cost of the plant.

In this situation, we believe it is appropriate for the contractor to include this contract in the total amount of backlog the contractor discloses as well as, consistent with existing guidance, a discussion of its methods for determining backlog amounts. However, it would be very costly and impractical in this situation to require backlog to be audited. The judgments the contractor must make in deriving backlog for this contract cannot be audited easily, if at all.

IDIQ contracts (discussed previously) are another example of a type of contract prevalent in our industry which will be very difficult – if not impossible – for auditors to audit efficiently and cost effectively. However, within the existing accounting and disclosure regime, IDIQ contracts are estimated and disclosed efficiently.

The last example of a type of contract the backlog for which will be extremely costly and difficult to audit and which the Board needs to consider in formulating its final disclosure requirements pertaining to remaining performance obligations are large, management and operations (or, "M&O") contracts.

M&O contracts require contractors to manage, operate, and maintain, typically on a cost-reimbursable basis, large, complex facilities and installations on behalf of their customers. The contractor can employ thousands of employees dedicated to these sites at a cost of hundreds of millions of dollars per year. Services the contractor provides include those needed for the day-to-day operations of the facility as well as all specialized services required to advance and fulfill the mission of the facility (e.g., developing and testing new jet propulsion systems).

M&O contracts are typically awarded for a base period (e.g., three years) with options to extend the contract for additional periods after the base period (e.g., three, one-year terms after completion of the base period).

Judgment is required to determine when to include an option period in backlog. For example, if the incumbent contractor at a large M&O installation is aware that the customer would need, say, at least one year to re-compete the base contract, and the contractor is already within such one-year window, the contractor may conclude that it is reasonable and prudent to include the next option period (or a portion thereof) in its backlog disclosure. The shareholders, analysts, and other users of the contractor's financial statements understand that it is unrealistic to assume that the facility that the contractor is operating would suddenly stop functioning (e.g., that the U.S. government would abruptly cease the development and testing of new jet engines, or that the U.K. government would suddenly abandon its initiative to decommission old, nuclear reactors). Therefore, and consistent with current guidance, entities in our Industry use their best judgment to measure the remaining backlog on such contracts and include the amounts (together with a discussion of its policies and practices regarding the measurement of backlog) in its periodic reports to shareholders.

Accordingly, because of the significant judgments required in measuring backlog we firmly believe that the most practical approach is to make the disclosures required by paragraph 119 unaudited.

For our industry, backlog is fundamentally a forward-looking disclosure, and thus inappropriate for inclusion as an audited metric in a set of financial statements — Backlog for our Industry is similar to reserve information currently disclosed by companies operating in the oil and gas industry. It is important and very useful information to users of those companies' financial statements, but remains an unaudited metric due to the complexities and costs of requiring auditors to examine and test such information.

Backlog in our Industry is a much more complicated measurement due to the judgments and estimates required to measure it. Contracts in our Industry may be cancelled, terminated or suspended by customers for any reason. In addition, contracts included in backlog are subject to changes in the scope of services to be provided as well as adjustments to the costs relating to the contract.

In summary, to make backlog an audited value would be to imply a level of accuracy to the number that is not inherent in our Industry or currently intended. The costs to have such value audited cannot be justified by any cost/benefit analysis considering existing disclosure requirements. However, if the final Standard includes the current proposed disclosure requirements for remaining performance obligations, the Board should provide additional clarity, to the point of describing what should and should not be included in the disclosure, to allow for consistency in practice and comparability between entities, realizing that in doing so, the required disclosure may not be reconcilable to the backlog that industry participants will likely continue to disclose.

Retrospective Application

Paragraph 132 of the Update (Revised) indicates that the Standard would be applied retrospectively upon adoption, subject to the expedients specified in paragraph 133. Retrospective application would require an entity to restate the results of its financial statements for the past one to five years, depending on whether the entity is a public company. Since many contracts in our Industry have a long duration (often 5 years and in some cases up to 15 years or more), the entity may be required to look back 10 or more years in order to determine the appropriate retrospective adjustments to make. For public companies, if a 5 year contract ended 5 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 Update (Revised) 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 Update (Revised) through retrospective restatement as we will likely encounter 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 contracts acquired in business combinations 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 same issue exists relative to contracts that were entered into, executed and closed using accounting systems that have been replaced. It is extremely rare for an entity to convert onto its accounting systems the historical

financial information relating to contracts of an acquiree that have been completed and closed prior to the acquisition.

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. As explained in our Original Response, numerous companies within the Industry 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 contracts may be required to review, at several different points in time, as many as 100,000 or more contracts in order to comply with retrospective application currently required in the Update (Revised). Subsequent to an entity determining the adjustments to be made to the accounting records as a result of the Update (Revised), 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 Update (Revised) prospectively, by applying the proposed accounting to any new contracts entered into or commenced after the effective date or to all uncompleted projects as of the effective date. We believe the final Standard should be modified as discussed below, should retrospective application be required.

We believe the practical expedient in paragraph 133(a) should be modified to include all contracts that were completed before the date of initial application, regardless of whether the project began and ended in the same period, as we believe this will help reduce the level of hindsight management applies to understand the "intent" for each of potentially thousands of project at a given point in time. Also, if retrospective application is required and if paragraph 46 of the Update (Revised) is retained as currently drafted, we ask the Board to include a practical expedient with respect to uninstalled materials which could read as follows: "For contracts completed before the date of initial application, an entity need not evaluate the application of paragraph 46 to those contracts."

Also, for any contracts to which retrospective application is required, we ask the Board to provide further guidance with respect to contracts where performance obligations are satisfied over time. Significant estimates are a critical element in the accounting for long-term construction contracts resulting in profit margin fluctuations over the life of a project. We believe the changes in profit margin due to changing estimates are similar in nature to the change in transaction price due to variable consideration.

Consistent with the practical expedient related to changes in transaction price, we believe a practical expedient for the ultimate profit margin on the project should read as follows:

"For contracts completed before the date of initial application, if not scoped out, and for which the performance obligations are satisfied over time, an entity may use the final profit margin at the date the contract was completed".

Regardless of the transition method, we believe that the Board should provide sufficient time between the issuance of a final Standard and the effective date of the Standard 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 Standard. We suggest that the earliest date that the Industry would be ready to adopt retrospectively would be no earlier than 2016 assuming a final standard is issued during 2012. Allowing or requiring adoption by prospective application will also reduce the amount of time required between the issuance of a final Standard and the effective date thereof.

Consideration of the Time Value of Money

As currently drafted, we believe paragraphs 58 through 62 and Example 9 lack clarity as to how an entity should account for situations where continuous transfer of control occurs.

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 differ from the timing and cost of work as the project is being completed. Throughout the life of the long-term contract, the contractor can be in a position of billing and collecting payments 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). At contract inception, progress billings are typically scheduled to coincide or pre-date costs incurred and to mitigate collection risk (prior to the outflow of cash) and are not considered a financing measure. Due to changes in timing over the life of the contract, the billing position will often alternate 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 described in paragraphs 58 through 62 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. As a result, most companies within our Industry do not consider the time value of money as a component of the bid evaluation and contract terms for our long-term contracts. 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.

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 omits 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 58 through 62 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.

We considered the language included in paragraph 60, but do not believe the practical expedient would apply to the majority of our contracts. We reached this conclusion as our customers rarely pay "all or substantially all of the promised consideration" within one year of project completion on long-term contracts. As previously noted, payments are generally received from the project

owner at times and in amounts that generally coincide with the timing and cost of work as the project is being completed by the contractor and that timing is typically less than one year.

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 at contract inception to match the delivery of service over the course of the contract.

Alternatively, the Board should consider providing a practical expedient to assess the transaction price of a contract for the time value of money ***only*** at contract inception for entities that satisfy performance obligations over time. We believe this alternative is crucial, as it will otherwise be impractical to apply the guidance in paragraphs 58 through 62 over the life of a long-term construction contract due to constant changes in a customer's overbilled/underbilled position.

As another alternative, the Board could include 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 defining material financing components as financing arrangements that are considered to be outside the entity's normal business practice or typical operating cycle.

Measuring Progress Towards Satisfying Performance Obligations (specifically, the Treatment of Uninstalled Materials)

Projects in our Industry are executed through the use of internal and external resources (e.g., vendors, subcontractors, etc.). At times, external parties engineer, and/or fabricate, and/or construct goods specifically for a project and ultimately deliver these goods to the project site. These goods could remain uninstalled for a significant period of time, due to long lead times to engineer, fabricate, or construct these goods or due to changes in the sequencing of tasks for a project. Paragraph 46 prescribes how an entity is to apply an input method when the customer is expected to obtain control of goods significantly before receiving services related to those goods ("uninstalled materials") if two conditions are met at the inception of the project.

We believe the guidance provided in ASC 605-35-25-76 provides a reasonable and consistent application of measuring progress toward completion when an input method is used. ASC 605-35-25-76 states:

> "The cost of uninstalled materials specifically produced, fabricated, or constructed for a project shall be included in the costs used to measure extent of progress. Such materials consist of items unique to a project that a manufacturer or supplier does not carry in inventory and that must be produced or altered to meet the specifications of the project."

We propose that the Standard be conformed to ASC 605-35-25-76 to allow for the cost of uninstalled materials specifically produced, fabricated, or constructed for a project (i.e., "specialized" or "unique to a project") be included in the costs used to measure the extent of

progress. The inclusion of this type of material as it is fabricated/constructed is akin to an output method in the current literature, where progress may be indicated by such other measure of progress toward completion as may be appropriate having due regard to work performed (ASC 605-35-25-52).

We also believe that the profit recognized on this material should be determined in a manner consistent with the contract as a whole, as this highly customized equipment is specific to a particular project and is transferred to the owner (and in some cases, title transfers upon delivery to the project site) in a manner consistent with the project as a whole. The majority of our contracts are bid with an overall profit margin in mind, as we often do not bid on work with separate, distinct margins for different phases of the project. We consider the costs of specifically-produced, fabricated, or constructed materials in our overall profit margin considerations prior to negotiation and acceptance of a contract. As such, we believe the specialized equipment would not typically represent a separate performance obligation for our highly interrelated projects based on the criteria included in paragraphs 29 (a) and (b).

In addition to the concerns noted above, paragraph 46 appears to imply that the conditions listed are only to be determined at the inception of the contract. However, an entity's initial plans for execution of a project often change, including whether a portion of the contract will be sourced internally or through the use of external resources. Neither paragraph 46 nor Example 8 provides sufficient guidance as to how to account for changes in the execution of the project after contract inception. The following paragraphs illustrate how an entity could recognize different results throughout the life of a project (except at completion), even if the project were to be executed in the same manner.

Assume an entity is engaged to design and manufacture or fabricate a significant component of a project at the inception of the project. If the project is considered to comprise a single performance obligation, profit would be recognized over the life of the project as the customer obtains control of the significant goods and services (e.g. profit is recognized evenly over the life of the project). Now, assume that, due to various circumstances occurring after contract inception, the entity decides to have a third party design and manufacture the significant component. Margin recognition would be the same as if the entity manufactured or fabricated the significant component, since the decision to outsource the work occurred after contract inception.

However, profit recognition would be different if, at contract inception, the entity planned for the significant component to be sourced by a third party (e.g. as depicted in Example 8). Example 8 illustrates how an entity should apply the Update (Revised) with respect to measuring progress when uninstalled materials meet the conditions outlined in paragraph 46. We believe this method of measuring progress does not provide company management or the users of the financial statements with an accurate account of the progress, and related operating results, of a project. We generally assess profitability based on the contract as a whole and margin is recognized over the life of the project, exclusive of any modifications to the contract price or projected costs.

Paragraph 46 and Example 8 state that there is no margin on this type of material and that margin on this material is to be spread to all other elements of the project. Again, we disagree. Often, we add value to the materials, either during the installation process or by fabrication. As previously stated, we believe that the profit recognized on this material should be consistent with the contract as a whole. If the alternative outlined above is not provided for in the Standard, we believe paragraph 46 should be updated to clarify how an entity should account for uninstalled materials when there are changes in how a contract is executed, or remove the implication that the decision with respect to accounting for uninstalled materials only be made at contract inception.

Customer-Furnished Materials

At times, our customers may have more leverage with vendors or be more capable of carrying out the procurement function for our long-term construction projects. This fact pattern raises questions as to the appropriate accounting for the recording of revenue on either a gross versus net basis. ASC 605-45-45 includes several indicators for both the gross and net reporting of revenues when determining whether an entity is acting as a principal or an agent. Also, ASC 605-35-25 paragraphs -22 through -24 provide additional guidance for "customer-furnished materials" or materials "purchased by the contractor as an agent for the customer".

We believe paragraphs IG16 through IG19 incorporate a portion of the guidance noted above; however, they do not clearly articulate what we believe is a critical element in the evaluation of gross versus net reporting. Paragraphs 23 and 24 of ASC 605-35-25 state the following:

> "If the contractor is responsible for the nature, type, characteristics, or specifications of material that the customer furnishes or that the contractor purchases as an agent of the customer, or if the contractor is responsible for the ultimate acceptability of performance of the project based on such material, the value of those items shall be included as contract price and reflected as revenue and costs in periodic reporting of operations.
>
> As a general rule, revenues and costs shall include all items for which the contractor has an associated risk, including items on which his contractual fee was based."

We believe the language in paragraphs 23 and 24 of ASC 605-35-25 should be incorporated into final Standard to provide further clarification as to the application of the "principal versus agent considerations" implementation guidance. We believe these paragraphs are principles based and will assist in providing consistency in application across our Industry.

Accounting for Onerous Performance Obligations

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. There are a myriad of variables that render each project unique and could cause the timing of execution of a project to vary from its original schedule of completion. A project may be expected to be completed within one year at the inception of the

contract but ultimately extend past one year due to changing conditions during the execution of the contract. Paragraph 86 is unclear with respect to whether an entity is required to record an onerous performance obligation liability in those instances when changes in circumstances cause an onerous contract to subsequently extend beyond one year.

Also, paragraph 86 is unclear as to whether the Update (Revised) precludes an entity from recording an onerous performance obligation liability if the contract is expected to be less than one year.

We believe the occurrence of either of these two scenarios could mask significant losses on contracts by deferring the losses to future periods if an onerous performance obligation liability was not recorded when the loss became known, simply due to the expected length of the project. The Board should modify the Update (Revised) to make clear if an onerous performance obligation liability is precluded from being recorded for contracts less than one year (or if this can be a policy election) and to clarify the accounting treatment for a contract that is ultimately expected to extend past one year when, at the inception of the contract, the project was expected to be completed in less than one year.

Wasted Materials

Paragraph 93b directs entities to expense as incurred the "costs of wasted materials, labor, or other resources to fulfill the contract that were not reflected in the price of the contract". Because of the inherent uniqueness of each long-term EPC contract we perform and the myriad of variables that affect the cost and schedule of the services we provide and ultimately the revenue we realize, we are concerned that this guidance may be misinterpreted and potentially misapplied by companies performing long-term construction and performance-type contracts that use input methods to measure progress towards satisfying contract performance obligations.

As discussed previously, the nature of the projects we perform is such that virtually every construction contract begins with both parties (the owner and the contractor) knowing that the contract will *not* be performed precisely as planned, as estimated, or as budgeted. It is not untypical for us, when determining the total estimated cost at completion of a project, to include a factor for certain cost overruns. As the job progresses, we continuously refine our estimated costs to complete our contracts and change the original budgeted amount to account for contract modifications and other matters that arise, including cost over-runs. These refinements are part of the routine process of accounting for long-term construction contracts and are reflective of the contract as a whole; as such, we believe removing these costs from our projects' estimates does not provide an accurate or realistic accounting for our projects.

Accordingly, we believe the Board should revise paragraphs 45 and 93b to scope out contracts where performance obligations are satisfied over time such as our long-term construction-type contracts. Otherwise the Board should clarify in greater detail how this guidance should be applied to construction-type contracts.

* * * * *

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 Reed N. Brimhall, Vice President and Chief Accounting Officer – URS Corporation, at (415) 774-2752.

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

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

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

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

Nazim G. Thawerbhoy, *Senior Vice President and Controller, 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, Senior *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.*

Dennis S. Baldwin, *Senior Vice President and Chief Accounting Officer – KBR, Inc.*

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

Gary J. Brauchle, *Vice President and Chief Accounting Officer – McDermott International, Inc.*

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

Steven Burdick, *Executive Vice President, Chief Financial Officer and Treasurer – Tetra Tech, Inc.*

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

Ron Gatto, *Vice President and Controller – Granite Construction Inc.*

Exhibit I

Original Response dated October 21, 2010

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

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

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

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

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 prepares 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

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.**

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

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

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;

- 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.

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

> 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

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

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

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.**

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

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.

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

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

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.

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.

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.

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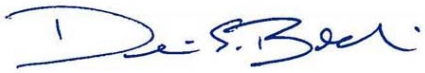
We would be happy to further discuss the specifics of these issues in more detail at the request of the Board. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Dennis S. Baldwin, Chief Accounting Officer – KBR, Inc., at (713) 753-3635.

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*

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.*

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 1on 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:

	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.

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 1on 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:

	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:

	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%

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.