

September 11, 2009

**Financial Accounting Standards Board**

401 Merritt 7  
PO Box 5116  
Norwalk CT 06856-5116



Attn: Technical Director – File Reference No. 1660-100

**Re: Additional Comments/Survey Responses to the FASB and IASB’s Preliminary Views on Revenue Recognition in Contracts with Customers (File Reference No. 1660-100)**

On June 19, 2009, CFMA submitted the attached comment letter that comprehensively addressed the FASB and IASB’s efforts to improve financial reporting with respect to revenue recognition. The comments expanded on the perceived strengths and weaknesses of the Discussion Paper in order to provide the appropriate feedback on the impact of the proposed changes to revenue recognition as it relates to the construction industry.

CFMA represents the professionals who specialize in financial reporting within the construction industry; as such, CFMA is particularly qualified to supply the FASB and IASB with feedback as they work to establish accounting standards that impact construction contractors.

As requested by the Private Company Financial Reporting Committee (PCFRC), CFMA surveyed a targeted group of its members – general contractors with annual revenues of \$50 million or more. The survey was conducted from August 5, 2009 through August 21, 2009, using the online survey tool Zoomerang. A total of 201 member responses were received (189 full and 12 partial).

Respondents reported that the current approach to revenue recognition specified in SOP 81-1 was:

- Very easy to understand (82%),
- Provided a consistent method of revenue recognition regardless of contract type (92%), and
- Was well understood by company banking (75%) and bonding agent (94%) vendor partners.

In addition, 43% of respondents reported that assigning selling prices to performance obligations required under FASBs proposed rules would be developed using a combination objective/subjective approach with no sure means for independent external verification.

A large majority of respondents expected FASB proposed rules to have a significant negative impact on their companies’ overall ability to conduct business, as well as their company banking and bonding agent partner relationships.

To provide a better understanding of the overwhelming opposition to the proposed revenue recognition changes, please review the Contractor Revenue Recognition Survey Report (below), which also includes open-ended comments to several questions. (CFMA’s survey questions are also included at the end of this document for your reference.)

If the FASB would like further information regarding CFMA's survey or would like to contact survey respondents for more information, please contact James Bartsch, CFMA's Director of Research & Analysis (609-452-8000 or [jbartsch@cfma.org](mailto:jbartsch@cfma.org)).

For all other questions and comments, please contact Peter Schwartz, CFMA's President and CEO/Co-Chair, Emerging Issues Subcommittee ([pschwartz@cfma.org](mailto:pschwartz@cfma.org)).

Respectfully submitted,

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# CFMA Contractor Revenue Recognition Survey

August 2009

# CFMA Contractor Revenue Recognition Survey

- Background
  - In August 2009 CFMA initiated a survey research study among a member segment to measure attitudes toward FASB proposed changes to the way in which contractors recognize revenue.
  - The study was in response to a suggestion from the PCFRC (Private Company Financial Reporting Committee) a FASB & AICPA appointed group.
  - Approximately 1700 CFMA General Members, General Contractors with annual revenues of \$50 million or more were invited to participate.

# CFMA Contractor Revenue Recognition Survey

- Background
  - The survey was conducted from 8/5/2009 through 8/21/2009, using the online survey tool Zoomerang.
  - 201 (189 full and 12 partial) member responses were received.

# CFMA Contractor Revenue Recognition Survey

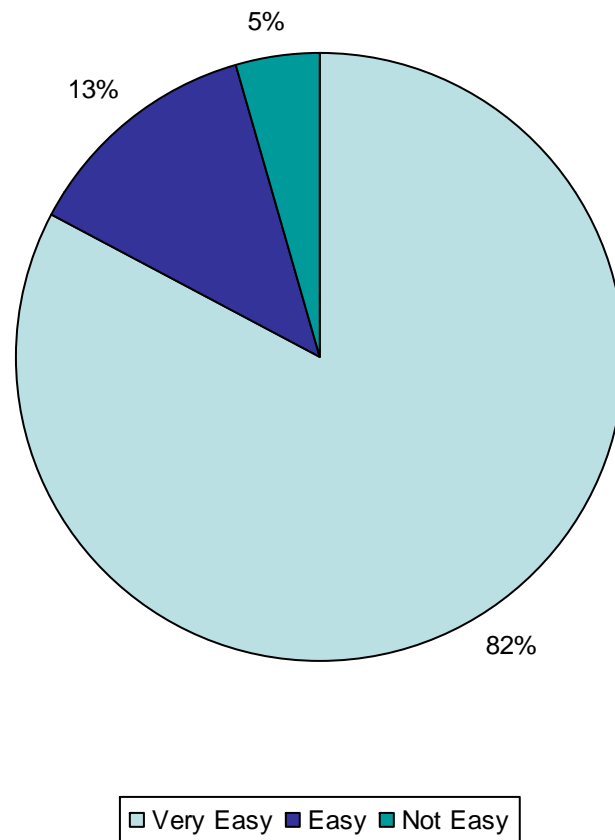
- Summary of Findings
  - Respondents reported that the current approach to revenue recognition specified in SOP 81-1 was
    - Very easy to understand (82%),
    - Provided a consistent method of revenue recognition regardless of contract type (92%), and
    - Was well understood by company banking (75%) and bonding agent (94%) vendor partners.
  - 43% of respondents reported that assigning selling prices to performance obligations required under FASBs proposed rules
    - Would be developed using a combination objective/subjective approach with no sure means for independent external verification.

# CFMA Contractor Revenue Recognition Survey

- Summary of Findings

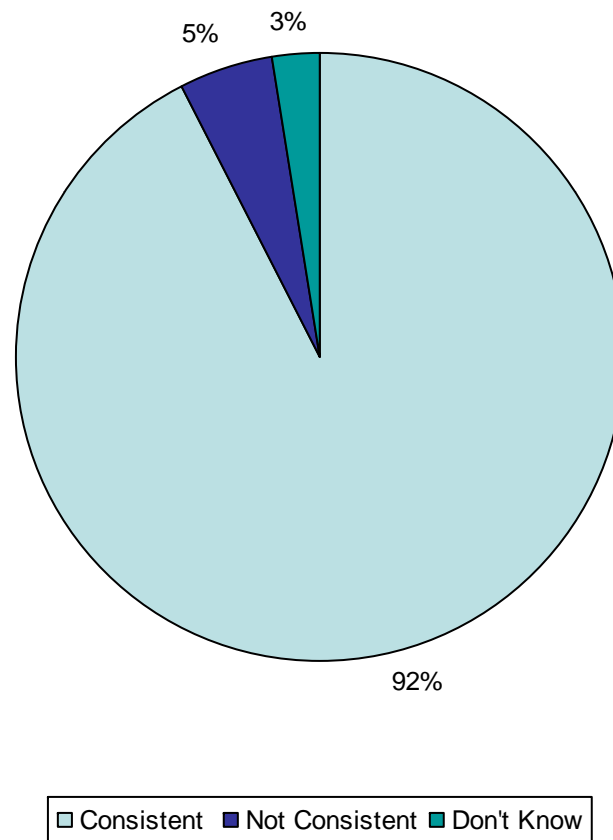
- Large majority of respondents expected FASB proposed rules to have a significant negative impact on,
  - Company overall ability to conduct business and
  - Company banking and bonding agent partner relationships.

# Ease of understanding revenue recognition approach specified in SOP 81-1





# Is revenue recognition approach in SOP 81-1 consistent regardless of contract type



## **Why do you say that the current approach does not provide a consistent method of revenue recognition**

Matching principle - we would have expenses to recognize without the revenue earned in the same period. Some of our jobs extend over a period of years. This would have a tremendous negative impact on our financials, with huge swings.

Because every customer may have a different basis of when contract obligations are met.

I believe the current approach does provide a consistent method of revenue recognition.

This method assumes that the process of calculating percent complete is consistent from superintendent or project manager to superintendent or project manager. We have a large number of jobs in process at any given time and I can tell you that some individuals produce more accurate percent complete calculations than others, especially on smaller jobs. It works better for GC than subcontractors.

Customer control of the completed asset is not required to satisfy performance obligations, as there may be many interim performance milestones, depending on the size and duration of the contract. While customer control of an asset is clearly an identifiable and measurable event and non-billable milestones should also be considered.

If nothing else, you have the potential to spend years working on a project and "making" money but have no profit to show until the end.

## **Why do you say that the current approach does not provide a consistent method of revenue recognition**

It is like going back to completed contract method. You will never have a true picture of where you are at any time. If there are certain aspects of revenue recognition, such as warranties, which are problems, why not address those issues rather than destroy the entire system.

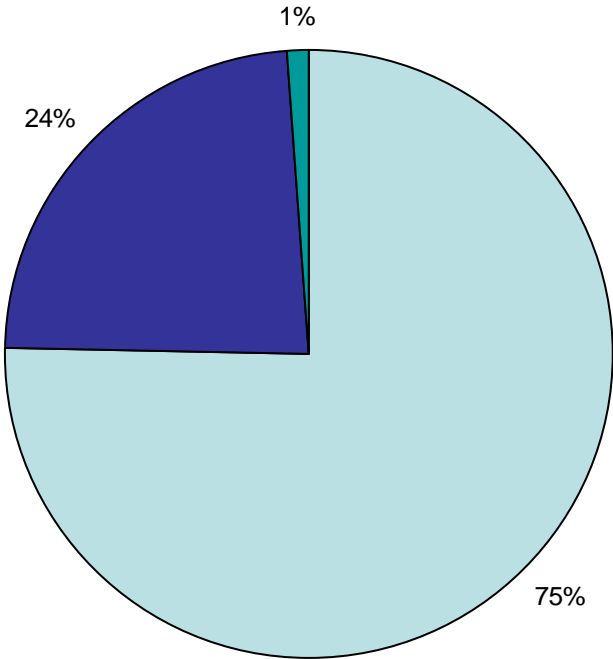
When large purchases of Materials are required to be purchased at inception of contract- even before mobilization, purchased, paid for, billed to customer, paid by customer, and taken possession of by customer at beginning of construction is not adequately addressed.

Cost are easily identified and are verifiable with third party documents.

There are a limited number of people that now understand the revenue recognition process for the construction industry. However, generally the critical people (bankers, insurance and bonding agents) with construction experience do understand the process. Why go through the process having to reeducate not only the financial people working in the construction industry but also the banker, insurance agents and bonding companies about new methods of recognizing profits. Especially true if the revised method actually creates a less standard method of revenue recognition. Construction is a unique industry and can not be made to conform to other industries by people who do not understand the industry they are trying to change.

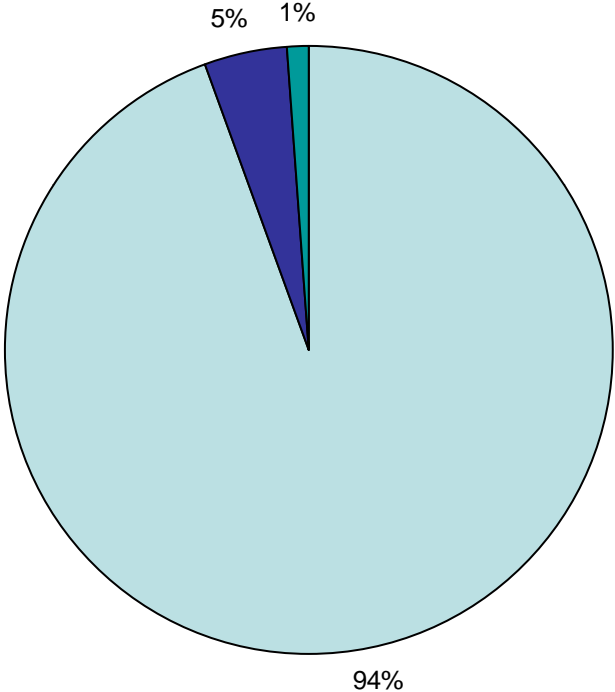
Some "performance obligations" will be hard to determine from the contract and completed contract has never been an accurate way of judging entity profitability due to the lack of matching revenues earned with costs incurred.

# Does your banker understand current approach to revenue recognition



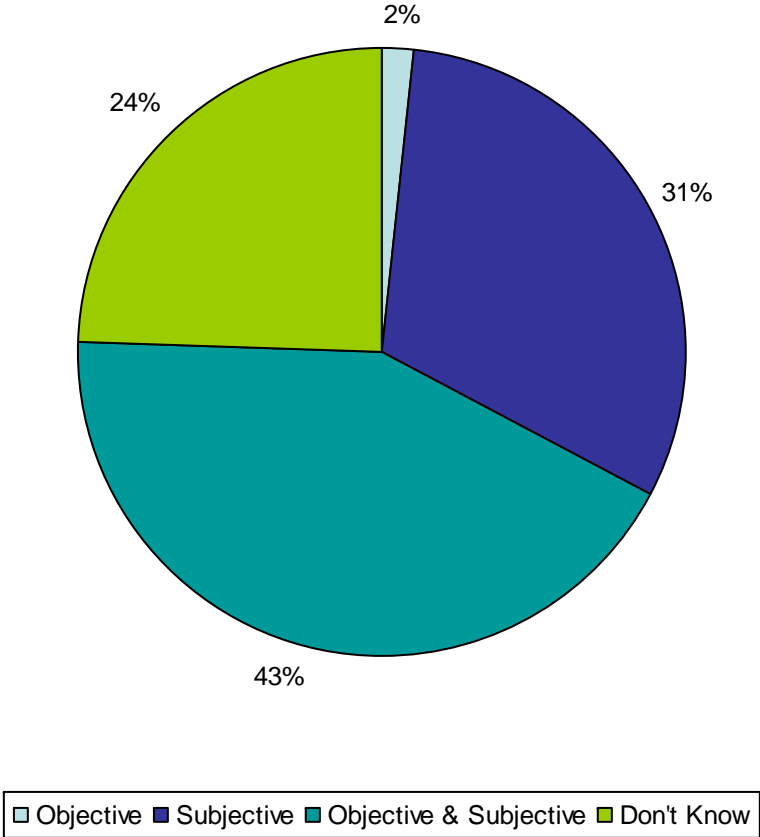
Understands Well Understands Does Not Understand

# Does your bonding agent/underwriter understand current approach to revenue recognition

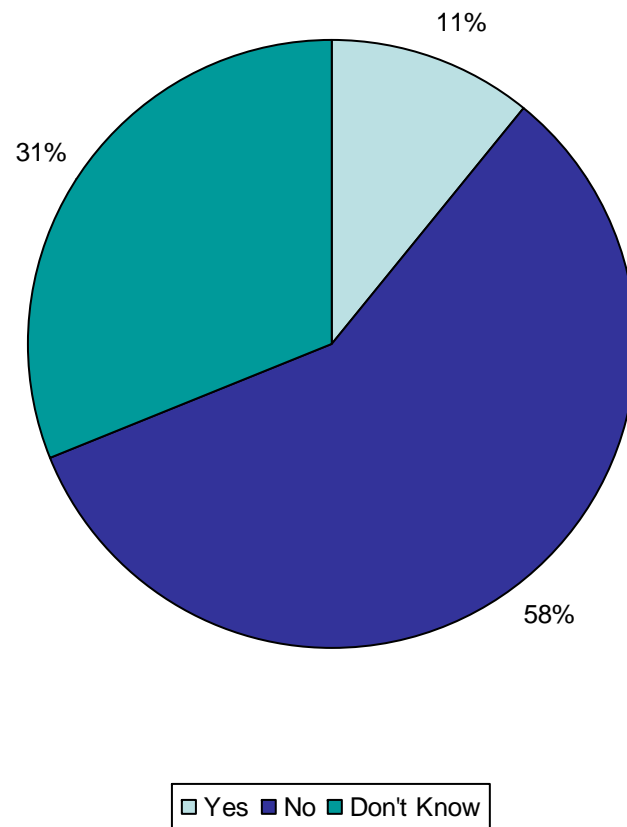


Understands Well Understands Does Not Understand

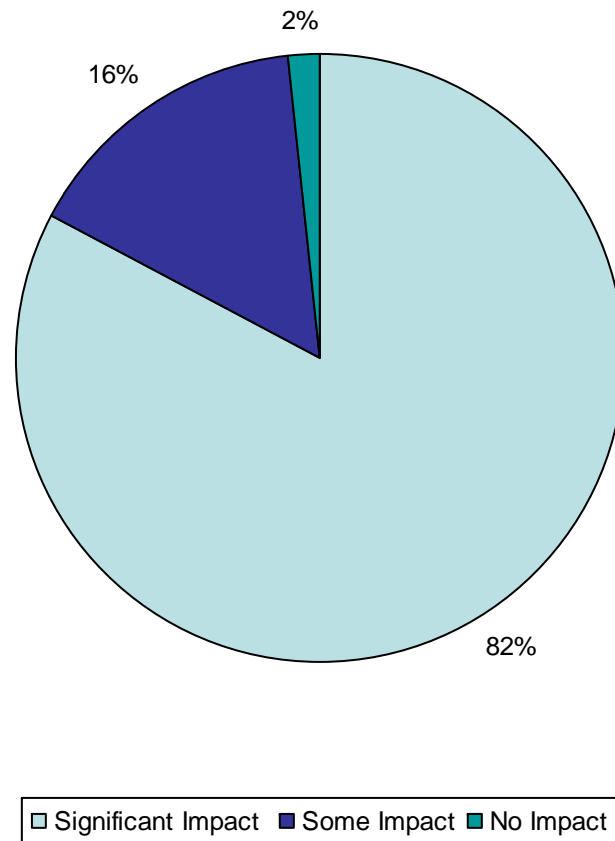
# Description of approach to developing individual obligation pricing under FASB's proposed rule



# Availability of means for independent external verification of obligation selling prices

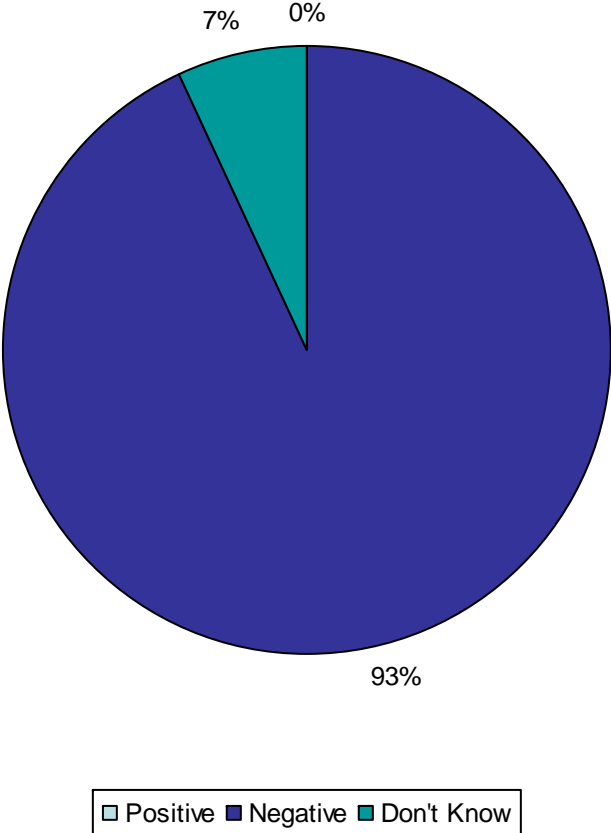


# Potential impact of FASB's proposed revenue recognition rules

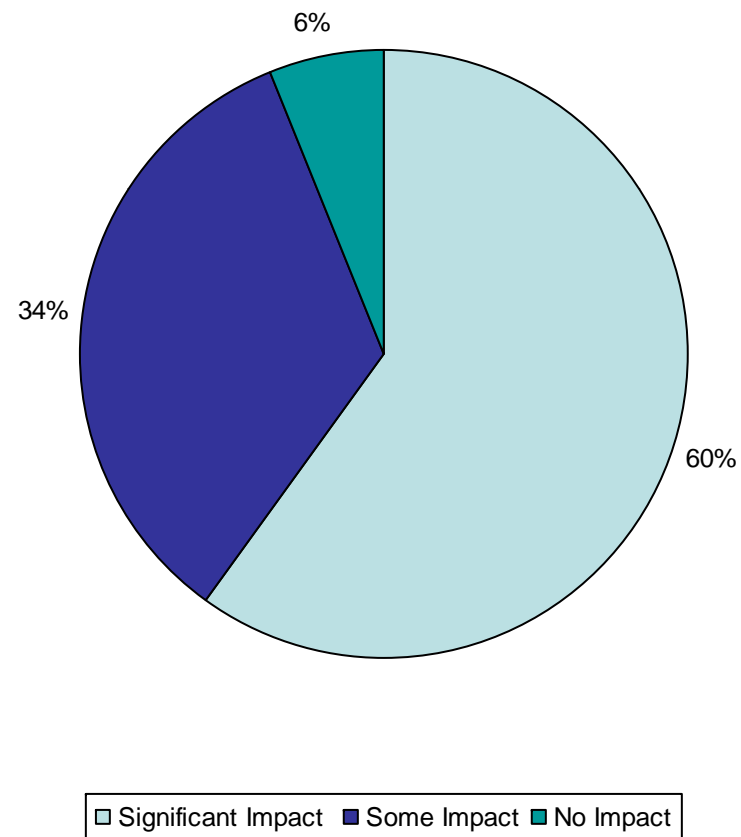




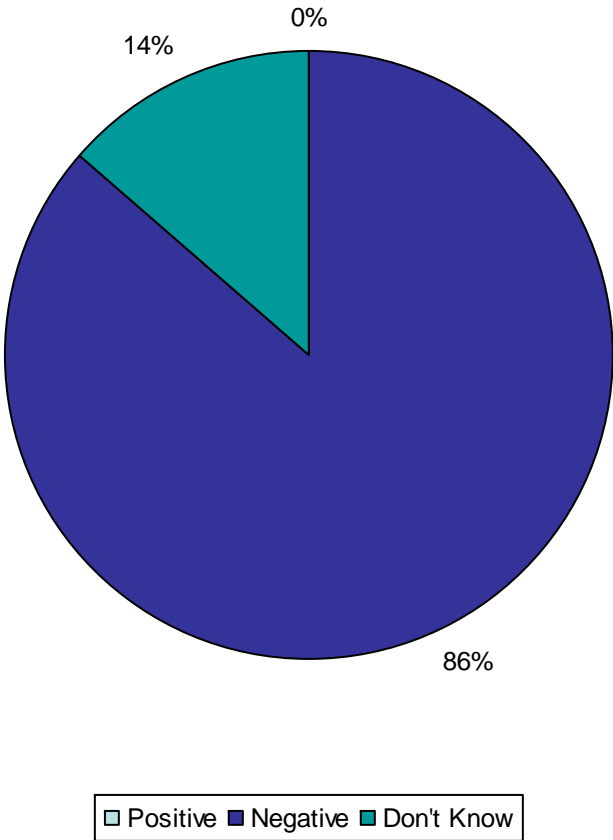
# How characterize impact of FASB's proposed rule



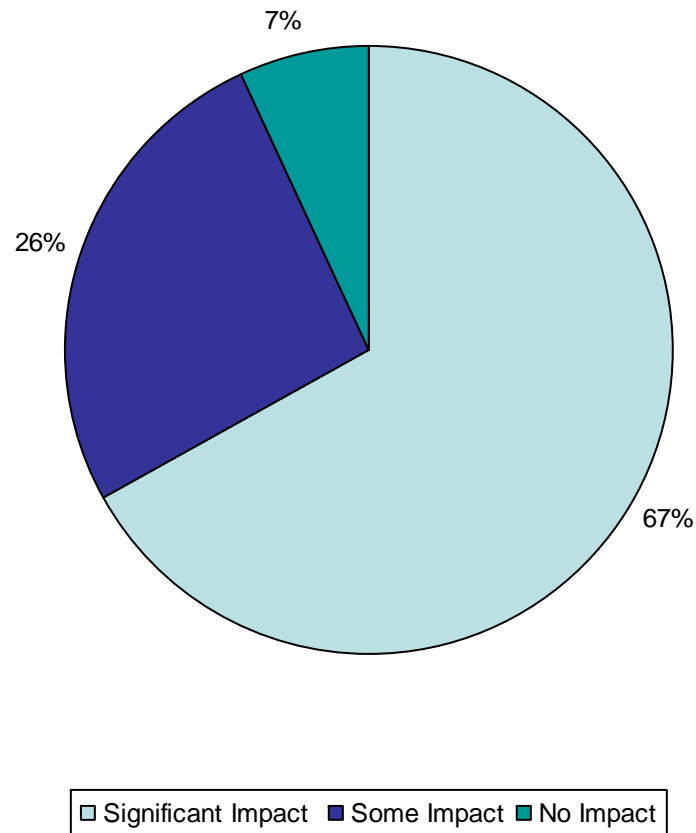
# Impact of FASB's proposed rule on banking relationship



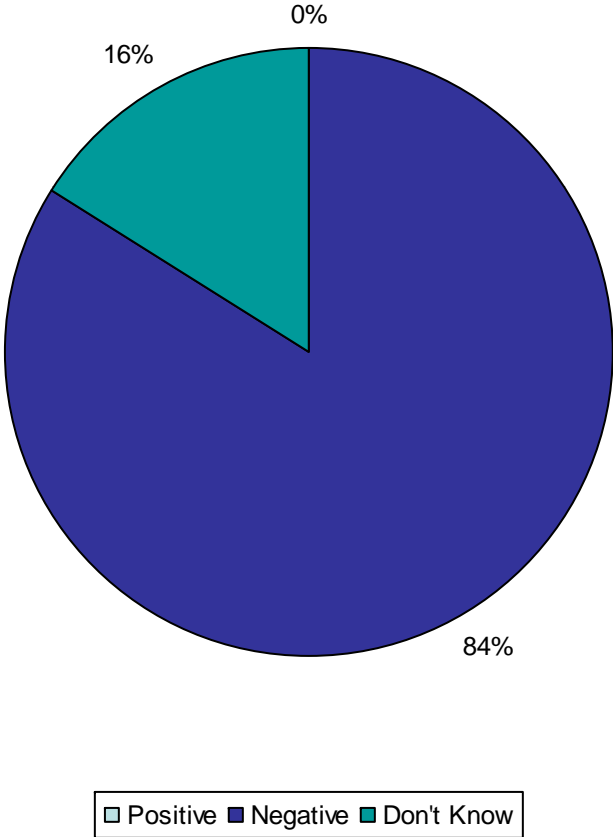
# How characterize impact of FASB's proposed rule on banking relationship



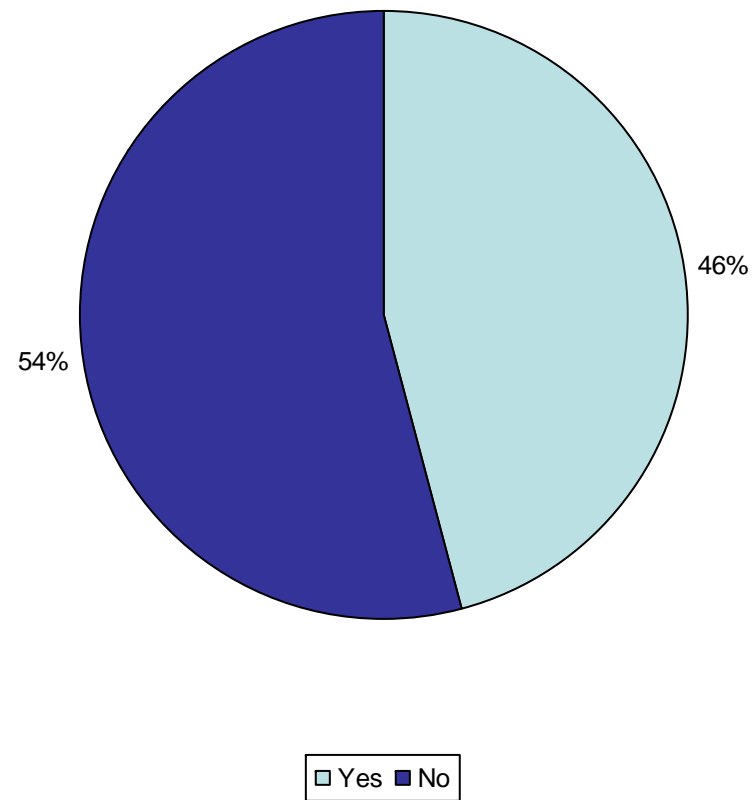
# Impact of FASB's proposed rule on bonding relationship



# How characterize impact of FASB's proposed rule on bonding relationship



# Willingness to be interviewed by FASB or PCFRC



## Do you have any other comments on this matter

Don't see how this improves financial reporting it would be difficult to implement and more subjective than percentage of completion.

I don't understand the logic behind the proposed change. The industry and those who support it, banks and bonding companies, understand current financial reporting methods. If its not broken, don't fix it.

I think assigning sales price to obligations and re-measure are the two biggest sticking points

The proposed method is contrary to International Financial Reporting Standards, under which public companies are required to move to by (I believe) 2014

A lot of our contracts are based on a set contract amount. Based on the set amount our cost drive the amount we can collect, therefore the cost to complete works to cover our cost and recognize revenue based on what has been completed.

My guess is that FASB's motivation is to fix reporting problems that exist in industries other than construction. I have been applying SOP 81-1 for over 20 years and my bank and surety are very comfortable with it. The old adage applies here -- "If it ain't broken, don't fix it." SOP 81-1 is NOT broken. FASB should leave it alone.

## Do you have any other comments on this matter

Specific to long-term construction contracts, deferring the revenue recognition will impact a contractors ability to bond, to finance, and/or to prequalify for work. This will create significant swings the operational results of a company to the point that examination of historical data will not provide relevant information for decision making for internal or external users.

After a contract is executed, US lien laws establish a legal obligation of the property owner to the contractor / subcontractor once materials or labor from a have been installed or are used to improve a project. The percentage of completion method, recognizes revenue based on the satisfaction or transfer of these goods and services to the property owner.

81-1 Allows input and output measures of percent complete. We currently use an output measure. Based on measurement of units completed, both fully and partially, and originally estimated cost for each unit, we measure percent complete.

To say that US GAAP is simple is to ignore the options approaches available under 81-1. However, the potential variability arising from judgmental definition of and allocation of revenue to performance obligations removes any comparability between construction firms. It also allows for potential manipulation of revenue.

This is appears to be yet another case of someone trying to fix something that for the construction industry does not need fixing

The proposed rule would lead to more manipulation of results - it would also increase the disparity between book and tax income in an industry where increasingly taxes are paid by individuals as income flows thru Sub S and LLC entities. That disparity would create greater tax administration burden and expense

Not having studied the matter closely it would appear to me that this introduces a whole new realm of possibilities as far as revenue and earnings recognition especially around timing.



## Do you have any other comments on this matter

I believe that most contractors are reporting properly under the current rules and regulations. The proposed standards would be too cumbersome for the smaller firms and only would serve the interests of the external auditors.

I heartily disagree with the FASB's proposed revenue recognition rule.

Frankly the current system using % of completion works very well, assuming a firm can reasonably estimate the cost at completion. Any change the rules that ends up deferring revenue and therefore results in a revenue stream that is lumpy or significantly different from that generated by % completion is going to be a major problem for all contractors.

A significant portion of our work comes from construction projects that overlap financial periods (6 months - 3 years). This would definitely create hardships and confusion for us, our bankers, and bonding company.

Major implication on software packages and the options to administrate desired financial reporting results ..... very few, if any, would support the proposed revenue recognition method.

This proposed rule would result in wildly varied financial statements from year-to-year, reflecting only those contracts completed each year. It makes no sense and could severely harm that ability of contractors to stay in business. This is a ridiculous solution to a problem that does not exist.

The problem with percent complete is the inability for the auditor/contractor to be honest about potential issues with the project; this can be determined by comparing CIE & A/R plus management interview; to instead create peaks and valleys based on the assertion that no profit has been generated is dangerous as it will result in earnings management;

## **Do you have any other comments on this matter**

Based on the example in the appendix, it doesn't appear to me that this is a significant change in the accounting if the contract is written so upon installation, each piece of material becomes an asset of the owner and estimates are continually updated, as they should be. I did not read all of the detail, so the example may or may not agree with the literature.

Revenue recognition is well understood by industry professionals and their financial partners. New rules will not replace the need to understand what contractors do, the risk they undertake and the inherent unknowns of the construction process. I think the new rules would introduce an absurd amount of volatility and inconsistency to contractors financial statements.

To change the revenue recognition method as I understand the proposal, the basic principle of matching would be severely compromised in many instances.

If this would return us to the completed contract method, I wonder if we would get an accurate accounting. We would probably have to go back to keeping an extra set of books.

I think it would be extremely difficult to determine and price performance obligations on a long complex construction contract, like the new Dallas Cowboys stadium for example.

## **Do you have any other comments on this matter**

Is the IRS going to be happier or will they even allow deferral of income to a later date. I don't need another calculation of income. It also sounds as if the new method would cause large swings in revenue. We and everyone who is reviewing our statements prefer to not have large swings in statements. Level earnings and consistent growth is what we all want. The idea of changing this seems absurd.

Instead of changing the revenue recognition rules, consider periodic impairment testing on contracts in progress.

I think the CFMA response letter was excellent. Thanks!

This does not improve quality of information being provided to readers of financial statements and in fact makes them harder to understand because milestones upon which revenue is recognized could differ with different types of projects and contractors.

This proposal needs much more deliberation

NO

This would introduce a tremendous amount of complexity into the revenue recognition process. As a specialty contractor we may do 500 contracts a year, and the proposal would be nigh to impossible to implement for us. I do not see how it would be a better measure of revenue as compared to the current method of percentage of completion.

Current % of completion method is not broken...don't try to fix it!

## Do you have any other comments on this matter

A significant weakness of SOP 81-1 is the lack of guidance on how to measure the cost to complete for a contract in process. This leads to significant variation from company to company and is very difficult to audit. Auditors are not qualified to review estimated contract costs. However, experts are seldom used to verify the estimates. Auditors use a gross profit gain/loss analysis to determine historical accuracy of estimating but this does not provide assurance of the current year's estimates and in cases of large swings in gross profit, the auditor is in a difficult position when presenting the results to management. If the contractor consistently faded 10% on all contracts in the past, should the auditor force the contractor to reduce the gross profit on all current contracts?

Not all industries are alike. While it is commendable that an attempt to standardize revenue recognition, such standardization among different industries is almost impossible. Complete standardization of revenue recognition can be compared to fitting many different size and shape of items into one standard size box. It can be accomplished, but the box would have to be unreasonably large with a lot of wasted space.

I think the new proposed way to recognize revenue would be so subjective that there would be no consistency in the industry and internally evaluating each job and being able to explain to third parties the reasons and methods on the different jobs would create an absolute mess.

Any proposed changes must consider: 1) the construction industry is a fragmented, mostly privately owned, small & medium sized business industry, 2) the practicality of implementing the changes and ongoing incremental costs associated with the changes, and 3) performance of a contract's obligations include costs incurred (such as acquiring bonds or purchasing materials) in addition to the installation of materials

This would increase the need for working capital funding and contract management personnel. The costs of this would be extreme.

no

## Do you have any other comments on this matter

SOP81-1 is understood in the construction industry. I don't see the added benefit in making a change

This is a economic time when relationships with banks and bonding companies are complicate due to matters outside our control. The timing of a revenue recognition change couldn't occur at a worst time. The banks and bonding companies will only become more conservative and require more complicated and onerous rules to follow. It will add to construction company overhead to adhere to the new rules with little or no improvement.

no

Keep 81-1

leave well enough alone. we've used 81-1 as an industry standard for so long that everyone understands that the consistency make financial statements withstand the wild fluctuations of completed contract accounting.

These FASB people need to live in the real world in order to understand how this stuff works. My prior comment about addressing the problem areas of percent of completion makes much more sense than this idea. The milestones are not definitive in most contracts, and would be arbitrarily assigned, creating another problem area.

## Do you have any other comments on this matter

Revenue recognition for the contractor is far from perfect; However, should be replaced with something that seeks a more fair presentation. It seem the conformity to other industries will have a very significant impact on a contractor causing 80% variance in revenue recognition over current standards, causing much confusion for readers of these entities financial statements.

"It if ain't broke, don't fix it!"

Long term contracting accounting is long established, well understood, and provides a very good method to recognize revenue over the life of a contract. It also prevents earnings manipulation.

STUPID STUPID STUPD STUPID!!!!!!!

Partial completion of a construction contract will, in most cases, create an obligation on the customer to pay. On the provider (seller) side, there is a receivable created. If that receivable is greater than the cost of the efforts to create that receivable, income is created. Uncertainties may affect the process, and, it could be argued, for small contractors, the additional effort and cost in calculating income that way may not be cost effective in relationship to the increased accuracy, but otherwise, trying to change from percent complete is downright STUPID!!!!

The proposed method is just too subjective

Keep the system in place...it works.

## **Do you have any other comments on this matter**

I believe in the old saying that if something ain't broke - don't fix it. My bank and bonding company clearly understand current accounting regulation - if forced to change we'll all figure out how to do it and how to measure ourselves. That said it sure looks like some folks in the ivory towers really do not understand how this business operates.

The current method of revenue recognition specified by SOP 81-1 has served the construction industry well for a number of years. The estimates required by SOP 81-1 are more objective than those in the proposed standard and are easier to audit and verify. The proposed standard attempts to fix a problem that does not exist when it comes to revenue recognition in the construction industry. Although SOP 81-1 is more rule based than principle based, the standard is well understood by financial statement users. Finally, due to the complexities of the estimates required by the proposed standard, it seems unlikely that "inconsistency and vagueness" would improve as a result of the new standard.

This change, in simple terms, would allow contractors total subjective discretion in determining revenue thereby distorting what is a reasonable basis that 81-1 has established with the Percent Complete Basis using Cost to Cost. Almost as bad as Mark to Market has been to our financial markets.

The current cost-to-cost PCM seems to be an accurate reflection of the financial condition of both the contract and the construction company.

## **Do you have any other comments on this matter**

Although bankers & sureties would eventually understand the change, deferring all or portions of a construction contract's revenue until completion creates unnecessary & confusing volatility in internal reporting used to manage the business. As financial managers measuring work in place by contract would require that we keep two sets of books -- one to report under GAAP & another to manage the daily operations.

Percentage of completion method is the most accurate way to recognize revenues on construction contracts. It most accurately matches revenues with expenses and will not allow for create use of "performance obligations" in contracts to manage the income statement. The percentage of completion method is widely used as a standard in our industry and to my knowledge there is not many arguments that it is not the most accurate.

The % of completion method is really ideal for commercial construction contracts. Both revenue and profit recognition parallel the actual work (cost) put in place in any given period.



# Contractor Revenue Recognition Survey

## CFMA Contractor Revenue Recognition Survey

Page 1 - Question 1 - Rating Scale - One Answer (Horizontal)

Using a 10 point scale, where 1 is Not At All Easy and 10 is Very Easy, how easy to understand is the current approach to revenue recognition as specified in SOP 81-1?

Not At All Easy	2	3	4	5	6	7	8	9	Very Easy
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Page 1 - Question 2 - Choice - One Answer (Bullets)

In your opinion, does the current approach as specified in SOP 81-1 provide a consistent method of revenue recognition regardless of contract type?

- Provides consistent method (Go to Q#4)
- Does not provide consistent method (Go to Q#3)
- Don't Know (Go to Q#4)

Page 1 - Question 3 - Open Ended - Comments Box

Why do you say that the current approach does not provide a consistent method of revenue recognition?

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Page 1 - Question 4 - Rating Scale - One Answer (Horizontal)

Again, using a 10 point scale, where 1 is Does Not Understand and 10 is Understands Very Well, how well would you say your banker understands your company's current approach to revenue recognition?

Does Not Understand	2	3	4	5	6	7	8	9	Understands Very Well
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Page 2 - Question 5 - Rating Scale - One Answer (Horizontal)

Again, using a 10 point scale, where 1 is Does Not Understand and 10 is Understands Very Well, how well would you say your bonding agent/underwriter understands your company's current approach to revenue recognition?

Does Not Understand	2	3	4	5	6	7	8	9	Understands Very Well
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Page 2 - Question 6 - Choice - One Answer (Bullets)

Under FASB's proposed rule, contracts would be comprised of individual performance obligations, each with an assigned selling price. How would you describe the approach you would use to develop individual obligation selling prices?

- Objective
- Subjective
- Combination Objective & Subjective
- Don't Know

Page 2 - Question 7 - Choice - One Answer (Bullets)

In your opinion, would there be a means for independent external verification of the individual obligation selling prices you develop?

- Yes
- No
- Don't Know

Page 3 - Question 8 - Rating Scale - One Answer (Horizontal)

Again, under FASB's proposed rule, some contracts would provide for periodic revenue recognition, while others would defer revenue recognition until project completion creating the potential for earnings volatility over time. Using a scale of 1 to 10, where 1 is No Impact and 10 is Significant Impact, how would you describe the potential impact this would have on your company's overall ability to conduct business?

No Impact	2	3	4	5	6	7	8	9	Significant Impact
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Page 3 - Question 9 - Choice - One Answer (Bullets)

If a Significant Impact, how would you characterize the impact?

- Positive
- Negative
- Don't Know

Page 3 - Question 10 - Rating Scale - One Answer (Horizontal)

Again, using a scale of 1 to 10, where 1 is No Impact and 10 is Significant Impact, how would you describe the potential impact FASB's proposed rule would have on your company's banking relationship?

No Impact	2	3	4	5	6	7	8	9	Significant Impact
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Page 3 - Question 11 - Choice - One Answer (Bullets)

If a Significant Impact, how would you characterize the impact?

- Positive
- Negative
- Don't Know

Page 4 - Question 12 - Rating Scale - One Answer (Horizontal)

Again, using a scale of 1 to 10, where 1 is No Impact and 10 is Significant Impact, how would you describe the potential impact FASB's proposed rule would have on your company's bonding relationship?

No Impact	2	3	4	5	6	7	8	9	Significant Impact
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Page 4 - Question 13 - Choice - One Answer (Bullets)

If a Significant Impact, how would you characterize the impact?

- Positive
- Negative

Don't Know

Page 4 - Question 14 - Yes or No

If asked, would you be willing to be interviewed by FASB or PCFRC on this subject?

Yes

No

Page 4 - Question 15 - Open Ended - Comments Box

Do you have any other comments on this matter?

Page 4 - Question 16 - Open Ended - One Line

Please enter your email address for verification purposes only.

Thank You Page

Thank you for your participation.

