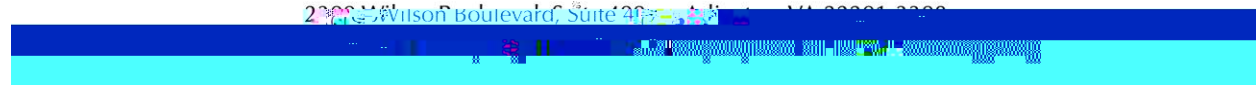


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- Cost/benefit challenges to adoption of the standard

We have referred to existing standards throughout this letter using both codification and pre-codification references.

Subjectivity and Comparability

While we appreciate that the Board believes that a single revenue recognition standard will create

and accounted for a single performance obligation. The Boards need to create an exact mirror image in the separation criteria to correspond with the guidance for the combining criteria. Otherwise, internal inconsistencies will exist within the standard.

Alternatively, we believe that the original segmentation criteria from SOP 81-1 in paragraphs 41(a) through (g) should be retained in its entirety as a suitable alternative to the above approach. Right now, the standard only seems to retain the guidance from paragraph 41(c), yet retaining this guidance alone is insufficient.

Concerns Regarding Variable Consideration

Participants in the construction industry frequently engage in contracts which provide both incentives for early completion and disincentives for late completion. Sometimes the incentives are binary (i.e., an “all or nothing” bonus arrangement if a specified target is hit). Other times, the bonus or penalty accrues at a rate that coincides with a time continuum (i.e., a fixed amount per day for each day early or each day late). Finally, contractors may share in bonus incentives for controlling project costs and/or can be penalized for the failure to do so (present in many “CM at-risk” arrangements).

We believe that the ideas contained in the guidance related to variable consideration are inappropriate in that the guidance not only permits but requires contractors to make estimates about the amount of variable consideration that they will receive. Even though the Boards have attempted to provide operational guidance as to how variable consideration should be measured in paragraphs 36-42, we believe that the guidance, particularly when taken in conjunction with further guidance in paragraphs BC81 through BC83, can and will lead to inappropriate accounting. This goes back to our concerns about the enhanced opportunity for manipulation and the potential for confusion about the intent of the standard which may create misapplication of this proposed method.

As you can appreciate, under the proposed guidance, it is almost certain that two contractors with very similar contracts (and very similar experience) will reach different judgments and will thus account for incentives differently which will result in reporting two different rates of profitability on similar contracts.

Moreover, the auditability of these assertions is extremely difficult, and can lead to substantial differences in judgment between a reporting entity and its auditors.

As others have suggested, the alternative of estimating a probability-weighted amount to be recognized seems arbitrary and the feedback we have received from financial statement users indicates significant reservations to recognizing revenue before its realization becomes at least „reasonably assured“.

Further, there is a conformity rule under U.S. tax regulations which requires that incentive compensation be included in taxable income once the incentive compensation is recognized for book purposes. This imposes an added cost the contractor by requiring them to pay tax on variable

respected and followed in practice by eliminating probability-weighting and instead use a high threshold for recognition, such as „reasonably assured .

Concerns Regarding Continuous Transfer Concept

We generally agree with the guidance related to continuous transfer and customer acceptance as outlined in paragraphs 32 and 33, IG63 through IG73 and BC73 through BC75. However, we believe that there are key concepts from the original SOP 81-1 document which should be carried over as well. While we know that many of these concepts do not apply outside of construction-type or production-type contracts, this guidance is still essential in those contexts. Specifically, the guidance from paragraph 50 regarding uninstalled materials should not be lost under the new standard. While the Boards may believe that they have implicitly dealt with this consideration, within the context of paragraph 33(b), it seems logical the some readers could reach a conclusion that costs incurred on materials, whether installed or not, could be counted in the calculation of contract progress. We believe that the Boards should clarify their intentions regarding such costs.

Further, the guidance in the Exposure Draft contains a clear bias in favor of output measures vs. the use of input measures. While input measures are not prohibited in the guidance, they are certainly not recognized as favored status.

The overwhelming majority of contractors today utilize input measures to measure contract progress as this is the only practical expedient for determining ongoing revenue recognition.

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User Concerns

We recognize that the Boards have already started hearing significant feedback from the user community of contractor financial information, most significantly being the surety industry. With many sureties also being members of AGC, we simply echo those concerns.

There is an overwhelming sense within surety community that the Boards should not attempt to fix something that isn't broken and that the way the proposed changes could be applied to the construction community would result in a significant step backwards in financial reporting. We could not agree more with these views. The tenets that exist from the original SOP 81-1 continue to meet the needs of financial statement users very well and the proposed standard must retain these key provisions as it relates to the construction industry.

In fact, the overriding concerns expressed by the sureties in their letters is that the contract is the profit center, that they bond contracts, not performance obligations, and that they want to see statements presented where percentage of completion accounting is determined at the contract level. We fully support the concerns they have expressed.

If these user concerns are ignored, the Boards risk taking something that is considered very good accounting and replacing it with bad accounting.

Practical Limitations and Cost/Benefit Challenges to Applying the Proposed Standard

Contractors will incur substantial incremental additional costs if they are required to apply this standard as it is currently written.

First, the Boards need to clearly understand that contractors manage their businesses around the contract itself. Right now, the accounting requirements under SOP 81-1 square very closely with underlying business practices. The proposed rules would significantly alter this course by substituting arbitrary performance obligations for the contract as the primary accounting profit center.

Contractors will not alter their business practices to fit U.S. GAAP accounting rules, so the clear result is that substantial additional overhead will be created in order to have information that meets the needs of the business and to provide reporting under the proposed revenue recognition rules. Such costs come with no justifiable benefit whatsoever since the industry is being asked to adopt a standard that is inferior to existing accounting guidance. On its face, the cost/benefit argument of a new standard that departs from SOP 81-1 has failed.

Disclosures

disaggregate revenue. For example, some companies might choose to disclose a revenue disaggregation based on geographic region, while another similar company might choose to disaggregate revenue based on performance obligations type and another perhaps by customer. The resulting variances between the types of disclosures presented by similar companies would render the financials statement less useful to the users of the financial statements, such as banks and sureties who rely heavily on comparability and benchmarking to make business decisions.

Potential Issues with Taxing Authorities

Contractors who undergo field audits or desk audits of long-term contracts are, under today's accounting rules, able to rely on book and financial statements to support computations of revenue for tax purposes. Under the proposed rules, the disconnect between the two methods would be so significant that it would not be practicable for a revenue agent to rely on financial statements for comparison. This potentially will open contractors to time-consuming revenue reconciliations or some other type of additional proof or documentation to substantiate tax return positions.

It would also exacerbate the current problems found in disclosures required by U.S. tax reporting related to book-tax differences. For most contractors, these disclosures are made on Form M-3. This form has a line that is specific to long-term contracts where a summary of book-tax differences must be shown. On audit or examination, contractors are, under today's accounting standards, frequently asked to prove or reconcile the book-tax difference that is shown. With the adoption of the new revenue recognition rules, a similar request would put a significant burden on contractors to provide satisfactory reconciliations.

In conclusion, AGC is committed to working with the FASB/IASB in arriving at workable solutions that result in improved financial reporting and transparency. We will continue to offer our assistance in working to im(t)-2(ha7-30046>3)-2(c)Ssistaeng t