



Big Change Coming...

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A Major Change In Revenue Recognition for Contractors?

It could happen.... In an effort to standardize and simplify revenue recognition on contracts internationally, the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB), issued a discussion paper "*Preliminary Views in Revenue Recognition in Contracts with Customers*" in December 2008.

If the proposed changes in recognizing revenue contained in the paper are implemented, it will substantially change construction accounting and, in fact, make it much more complex expensive, and time consuming!

In construction, revenue recognition for accounting purposes is generally done for each individual project on a "percentage of completion basis." A contractor's accounting staff keeps separate books on each project to track the costs incurred on that particular project. Currently, this is the generally accepted, if not demanded, method of contract accounting by owners, sureties, architects, CPA's, and the IRS.

However, the new IASB/FASB standards would require that each project be subdivided into individual "performance obligations." The way in which a performance obligation within a project is determined would vary from project to project. Revenue on each performance obligation would only be

recognized when the owner "takes control" of the performance obligation. As a result, the contractor's accounting staff would now have to keep individual books on each performance obligation within a particular project. For example, for a contract with five performance obligations (varying from site work to mechanical work) to be completed; instead of there being one book for the Contract as whole, there would now be an individual accounting book for each specific obligation within that one project.

An additional result may well be, a contractor who is 90% or more complete on a project cost basis on several projects at year-end, but the owners on each have not taken control of any of the individual performance obligations will mean the contractor has earned no revenue on any of those projects. Looks like a dramatically piecemealed version of the old completed contract method doesn't it?

Many industry associations such as the CFMA, AGC, and NASBP have filed objections to this proposed new method to recognize revenue requesting that construction be exempt. The current percentage of completion method is not perfect, but the proposed performance obligation method could well be a nightmare.