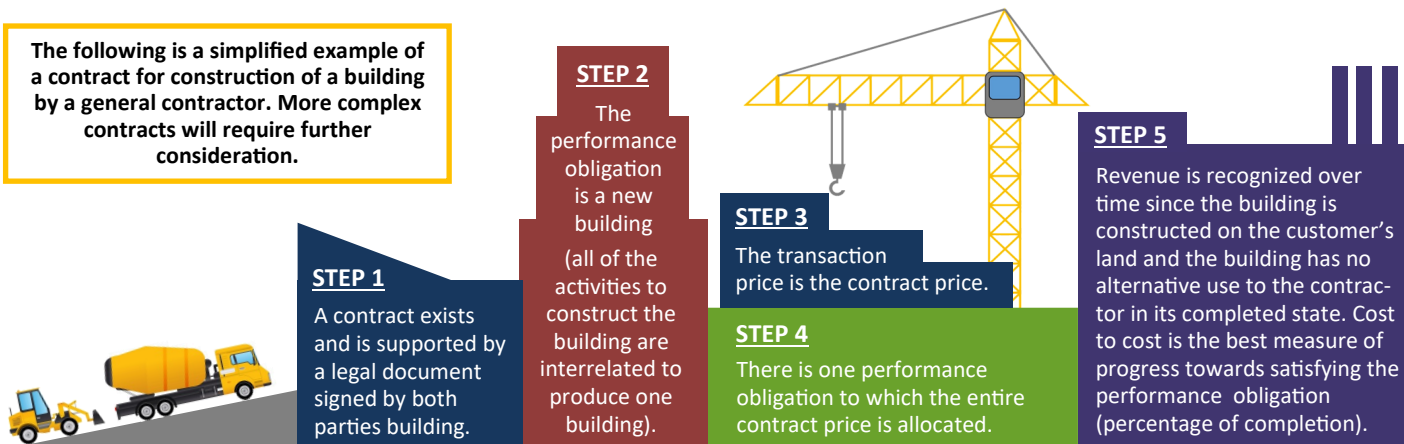


The following is a simplified example of a contract for construction of a building by a general contractor. More complex contracts will require further consideration.



The following are special considerations for construction entities:

INCENTIVE AND PENALTIES

Certain contracts contain provisions that reward or penalize a contractor for specified actions, such as completing a job early or delivering a job late. These amounts are considered variable compensation, and the transaction price will include the contractor's estimate of these amounts based on a probability-weighted or most likely amount approach, provided that a significant reversal of revenue will not occur when the price is finally settled.

PRE-CONTRACT COSTS

Incremental costs of obtaining a contract are capitalized if they relate to a specific contract (e.g. sales commission), have future benefit (e.g. drawings) and are expected to be recovered. They are amortized to expense over the same basis as revenue is recognized.

MOBILIZATION

Mobilization costs are necessary costs to fulfill a contract but do not represent progress towards satisfaction of the performance obligation. They are expensed as incurred and now **excluded** from the cost-to-cost calculation to determine the percentage complete.

UNINSTALLED MATERIALS

These are additional costs that do not represent progress on the contract, and revenue is recognized equal to the costs incurred. Consequently, these costs are removed from the cost-to-cost calculation to determine percentage complete and removed from the transaction price when applying the percentage complete to calculate revenue earned.

CONTRACT MODIFICATIONS (CHANGE ORDERS)

Changes to a contract in either scope or price or both are treated as follows:

- 1) If a new distinct performance obligation is added, and,
 - a. if priced at its stand-alone price, it is treated as a new contract or,
 - b. if not priced at its stand-alone price, reevaluate the contract from Step 2.
- 2) If it is not a new distinct performance obligation, a cumulative catch-up adjustment is made by adjusting the total estimated costs and transaction price for the modification

Modifications where the price is not yet determined are considered variable considerations, and the contractor will estimate the transaction price based on a probability-weighted or most likely amount approach, provided that a significant reversal of revenue will not occur when the price is finally settled.

INEFFICIENCIES

Occasionally, contractors incur costs related to inefficiencies that are not recoverable through a contract modification. These costs are expensed to the job as incurred and now **excluded** from the cost-to-cost calculation to determine the percentage complete.

CONTRACT ASSETS AND LIABILITIES

Costs and earnings in excess of billings will now be referred to as contract assets and represent the contractor's performance that exceeds the billable amount. Conversely, billings in excess of costs will now be referred to as contract liabilities and represent the customer payments that exceed the contractor's performance.

ADDITIONAL RESOURCES

This is by no means a complete list of the new standard's effect on construction contractors. Please consult your financial partners at Ellin & Tucker or one of our Construction Services team members to review the impact of the new standard on your company. Visit us at ellinandtucker.com or call 410.727.5735.