

Statement of Financial Accounting Standards No. 56

Note: This Statement has been completely superseded

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Designation of AICPA Guide and Statement of
Position (SOP) 81-1 on Contractor Accounting
and SOP 81-2 concerning Hospital-Related
Organizations as Preferable for Purposes of
Applying APB Opinion 20

an amendment of FASB Statement No. 32

February 1982



Financial Accounting Standards Board

of the Financial Accounting Foundation

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Statement of Financial Accounting Standards No. 56

Designation of AICPA Guide and Statement of Position (SOP) 81-1 on Contractor Accounting and SOP 81-2 concerning Hospital-Related Organizations as Preferable for Purposes of Applying APB Opinion 20

an amendment of FASB Statement No. 32

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FAS 56: Designation of AICPA Guide and Statement of Position (SOP) 81-1 on Contractor Accounting and SOP 81-2 concerning Hospital-Related Organizations as Preferable for Purposes of Applying APB Opinion 20 an amendment of FASB Statement No. 32

FAS 56 Summary

This Statement specifies that the specialized accounting and reporting principles and practices contained in the AICPA *Audit and Accounting Guide for Construction Contractors* and in AICPA Statements of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, and 81-2, *Reporting Practices concerning Hospital-Related Organizations*, are preferable accounting principles for purposes of justifying a change in accounting principles under APB Opinion No. 20, *Accounting Changes*.

INTRODUCTION AND BACKGROUND INFORMATION

1. FASB Statement No. 32, *Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters*, states that the specialized accounting and reporting principles and practices contained in AICPA Statements of Position (SOPs) and Guides on accounting and auditing matters that are listed in Appendix A of that Statement are preferable accounting principles for the purposes of applying APB Opinion No. 20, *Accounting Changes*.
2. Appendix B of Statement 32 contains a list of projects in process that the Accounting Standards Executive Committee (AcSEC) of the AICPA expects will result in the issuance of SOPs or Guides. Statement 32 states that the Board may designate the specialized accounting and reporting principles and practices in future AICPA SOPs and Guides, either related to AcSEC projects listed in Appendix B or undertaken by AcSEC at the Board's request, as preferable for purposes of justifying a change in accounting principles.
3. This Statement designates the specialized accounting and reporting principles and practices contained in the AICPA *Audit and Accounting Guide for Construction Contractors* (Guide), and SOPs 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, and 81-2, *Reporting Practices concerning Hospital-Related Organizations*, as preferable for purposes of applying Opinion 20 and amends Appendix A of Statement 32 by substituting the Guide for the AICPA Industry Audit Guide, *Audits of Construction Contractors*, and by adding SOP 81-1 and SOP 81-2. This Statement also deletes the Guide and those SOPs from the AICPA projects in process listed in Appendix B of Statement 32.

4. An Exposure Draft of a proposed Statement, *Applicability of FASB Statement No. 32 to AICPA Statements of Position and Guides on Accounting and Auditing Matters*, was issued November 6, 1981. The Board received 25 comment letters in response to the Exposure Draft, most of which expressed agreement.

5. A few respondents suggested that the Board not designate as preferable for purposes of applying Opinion 20 the specialized accounting principles in SOP 81-1 and the Contractor Guide because they object to certain provisions in those documents. Their primary concern is that application of SOP 81-1 and the Guide will restrict the use of the completed-contract method to circumstances more limited than from application of ARB No. 45, *Long-Term Construction-Type Contracts*.

6. The percentage-of-completion and completed-contract methods are not intended to be free choice alternatives for the same circumstances under either ARB 45 or SOP 81-1. ARB 45 states that "when estimates of costs to complete an extent of progress toward completion of long-term contracts are reasonably dependable, the percentage-of-completion method is preferable" and "when lack of dependable estimates or inherent hazards cause forecasts to be doubtful, the completed-contract method is preferable." SOP 81-1 states that the two methods "should not be acceptable alternatives for the same circumstances" and specifies criteria for choice of method similar to those in ARB 45. In applying either ARB 45 or SOP 81-1, a contractor should evaluate the facts and circumstances pertaining to contract work performed and decide which of the two methods is appropriate.

7. In designating as preferable for purposes of applying Opinion 20 the specialized accounting principles in SOP 81-1 and the Contractor Guide, this Statement provides justification for a contractor to make an accounting change from the completed-contract method in a circumstance not specifically provided for in ARB 45. That circumstance occurs when a reasonable estimate of the final profit cannot be made but a loss is not expected. In that case, the contractor may adopt the percentage-of-completion method with a zero estimate of profit. The income reported is the same; but, the percentage-of-completion method reports revenues and costs from construction activity as they occur, whereas the completed-contract method does not report revenues and costs from construction activity until contracts are completed. This Statement also justifies a change from estimating a profit to estimating a zero profit under the percentage-of-completion method when a profit cannot be reasonably estimated, but it does not provide justification for a change of accounting method to the completed-contract method beyond that in ARB 45.

8. The FASB will consider adopting the accounting and reporting principles and practices in SOP 81-1 and the Contractor Guide and issue them in an FASB Statement only after appropriate due process. Such plans have not been completed but do include allowing sufficient time for the documents to be used in practice to provide a basis for determining their usefulness. In the meantime, ARB 45 provides authoritative requirements for accounting for long-term construction-type contracts and the Board is clarifying the status of the specialized accounting principles in SOP 81-1 and the Guide by designating them as preferable for purposes of applying Opinion 20.

9. The Board has concluded that it can reach an informed decision on the basis of existing information

without a public hearing and that the effective date specified in paragraph 12 is advisable in the circumstances.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

10. The specialized accounting and reporting principles and practices contained in the following AICPA Guide and AICPA Statements of Position are preferable accounting principles for purposes of applying Opinion 20:

- a. *Audit and Accounting Guide for Construction Contractors*
- b. *SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts*
- c. *SOP 81-2, Reporting Practices concerning Hospital-Related Organizations*

Amendment to FASB Statement No. 32

11. The references to the Guide and SOPs listed in paragraph 10 are deleted from the AICPA projects in process listed in Appendix B of Statement 32 and added to Appendix A of that Statement. The AICPA Industry Audit Guide, *Audits of Construction Contractors*, is deleted from Appendix A of Statement 32.

Effective Date

12. The provisions of this Statement shall be effective for financial statements for fiscal years beginning after December 31, 1981.

**The provisions of this Statement need
not be applied to immaterial items.**

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. March and Walters dissented.

Messrs. March and Walters dissent from this Statement principally because they believe SOP 81-1 substantively changes the application of the criteria established in paragraph 15 of ARB 45 for selecting the preferable accounting method. SOP 81-1 states that it "does not amend" ARB 45. This is literally true because the issuer of the SOP does not have the authority to amend ARBs. Nonetheless, the tone and thrust of the SOP suggests that the completed-contract method is seldom acceptable. This is not done directly but rather by establishing a presumption (paragraph 24) and taking positions that effectively limit the completed-contract method to cases where the choice of method makes no difference or where unusual "inherent hazards" raise serious questions about the outcome of the contract or the ability of the contractor or the customer to perform.

They believe the expression of preferability for the percentage-of-completion method with a zero estimate of profit in the circumstances described in paragraph 7 of this Statement (1) is a direct contradiction of paragraph 15 of ARB 45, and (2) entitles the user to assume that the contractor estimates a break-even, which is

not a fact.

The Board has not considered a need to amend ARB 45. Messrs. March and Walters believe it is inconsistent and confusing for the Board to confer preferability on accounting principles that, in their view, substantively modify existing and continuing generally accepted accounting principles. The Board has a process for considering and interpreting or changing existing principles. This is not it.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*

Frank E. Block

John W. March

Robert A. Morgan

David Mosso

Robert T. Sprouse

Ralph E. Walters