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Questions about accounting practices drive SEC investigation into Fluor, internal probe for Granite

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Two of the country's largest contractors have delayed their full year 2019 financial reporting in order to more fully look into accounting and estimating practices.

The Securities and Exchange Commission is investigating Fluor Corp. in relation to large charge-offs the company took in the second quarter of 2019, and Granite Construction has launched an internal investigation into prior-period accounting in its heavy civil division.

According to an analysis from Seeking Alpha newsletter provider GS Analytics, the Fluor charges revolve around "unrealistic estimates" of project costs under its previous executive management team and not its ability to execute its projects. Potential issues include overly optimistic assumptions and aggressive bidding on fixed-price projects as well as how the company recognized revenue using the percentage-of-completion method of accounting.

Also at issue could be project estimates that did not take into consideration the full scope of potential cost and schedule changes, change orders, liability claims and other adverse events.

Granite's charge-offs, according to GS, look to be the result of a switch to a more conservative accounting approach after CFO Jigisha Desai took over in June 2018. This approach, GS said, should serve the company and its stock price well in the future. GS noted that most of the company's charges and other issues in its heavy civil unit are from projects in which the company was a minority partner in joint venture projects bid before 2017.

Construction guidelines

The SEC investigates public companies for a variety of issues like misrepresentation, omission of important information and insider trading, according to James Miller, partner and member of Marcum LLP's national construction industry group, who did not comment on the specifics of any investigation.

"Specific to construction," he said, "the contractor's ability to properly estimate a job is a basis for recognition of revenue based on the percentage of completion or consistent with overtime recognition, where there is not a significant reversal of revenue in the future. In the case of construction estimates, constant profit changes challenge a company's ability to properly estimate a job, and, in turn, would not support the method of recognizing revenue based on the percentage of completion or over-time."

For public construction companies, big changes in contract estimates impede financial analysts' ability to fully forecast earnings, which can impact the confidence of an investment in the stock of a publicly traded company, he said.

However, whether a contractor is a private or public company, it's important to have the proper controls in order to be able to manage construction contracts properly, Miller told Construction Dive. This includes:

- Tracking job costs.
- Monitoring contract change orders, claims and delays.
- Ensuring the completeness and accuracy of the original bid.
- Tracking costs associated with scope changes.
- Monitoring extended overhead due to owner, weather and other delays.