1.0 PURPOSE

This policy establishes standards for revenue recognition related to long-term projects. The policy also establishes guidelines for how retention receivables are handled in the calculation of the allowance for bad debt and DSOs. Below are the specific questions we are addressing in this Brink's Accounting Policy:

1. How should we recognize revenue on long-term projects such as the design, construction and installation of security systems?
2. Should retention receivables not expected to be paid until after project completion be included in the allowance for bad debt calculation?
3. Should retention receivables be included in the DSO calculation?

2.0 RELEVANT U.S. GAAP

2.1 U.S. GAAP Considered

1. AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts**
2. EITF 00-21, *Revenue Arrangements with Multiple Deliverables**
3. SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*

* This guidance can now be found under Accounting Standards Codification Topic 605, *Revenue Recognition*.

3.0 BRINK'S ACCOUNTING POLICY

3.1 Summary of Policy

Under this policy, there are two methods of revenue recognition allowed for long-term construction contracts:

1. Percentage-of-completion method;
2. Completed-contract method

Under the percentage-of-completion method, revenue shall be recognized over the life of the construction contract based on the degree of completion: 50% completion means recognition of one-half of revenues, costs, and gross profit. Under the completed-contract method, all revenues, costs, and gross profit are recognized only at the completion of the project.

The two methods are not alternatives. One method should be used based on specified circumstances as noted below.

3.2 Criteria for Percentage-of-Completion Method

The percentage-of-completion method shall be used when all of the following conditions are present:

1. Reasonably reliable estimates can be made of revenue and costs;
2. The construction contract specifies each party's rights as to the goods and services to be provided, consideration to be paid and received, and the terms of payment or settlement;
3. The buyer can be expected to satisfy all obligations under the contract (for example, make scheduled payments as they become due); and

4. The contractor can be expected to meet all contractual obligations.

3.3 Criteria for Completed-Contract Method

The completed-contract method shall be used in any of the following circumstances:

1. Construction is expected to take less than 3 months and total estimated contract revenues are less than $50,000. A lower monetary threshold may be used if approved by local and regional management. Approval of the lower threshold should be documented and maintained;
2. The contract does not meet any one of the items 1 through 4 in the "Criteria for Percentage-of-Completion Method" above; or
3. The contract's project exhibits documented extraordinary, nonrecurring business risks.

4.0 PROCEDURE - APPLICATION OF PERCENTAGE-OF-COMPLETION METHOD

4.1 Profit Center

Each construction contract shall be treated as its own profit center with its own revenues, costs, and gross profit. This basic rule may be overcome if a series of contracts meets certain conditions (described in Section 4.2) which would allow that group of contracts to be treated as a combined profit center. Corporate approval must be obtained in order to combine contracts.

4.2 Combining Contracts

Contracts may be combined for purposes of profit recognition and for determining whether a loss needs to be recorded if all of the following criteria are met and Corporate approval is obtained:

a. The contracts are negotiated as a package in the same economic environment with an overall profit margin objective.

b. The contracts constitute in essence an agreement to do a single project with different elements, phases, or units of output that are closely interrelated or interdependent in terms of their design, technology, and function or their ultimate purpose or use.

c. The contracts require closely interrelated construction activities with substantial common costs that cannot be separately identified with, or reasonably allocated to, the elements, phases, or units of output.

d. The contracts are performed concurrently or in a continuous sequence under the same project management at the same location or at different locations in the same general vicinity.

e. The contracts constitute an agreement with a single customer.

Documentation related to combining contracts must be completed at the time the contracts are executed and must be forwarded to the BCO Controller for approval in treating the contracts as combined for accounting purposes. Documentation and approval must be maintained.

4.3 Revenue, Cost and Profit Elements

A. Revenues

Total revenues shall be estimated at contract inception based on the terms of the contract and basic contract price. Estimated revenue shall be the total amount expected to be realized from the contract. The estimate must be assessed each quarter throughout the life of the contract to determine whether total estimated revenue should be revised as events occur and uncertainties are resolved. This quarterly assessment must be documented and the documentation must be maintained.

During the term of the contract, total revenues earned to date shall be calculated by multiplying total estimated contract revenues by the percentage-of completion (as described at Section 4.4 below) on the project. See calculation below:

$$\text{Total revenues earned to date} = \text{Percentage-of-completion} \times \text{Total estimated contract revenues}$$

The excess of the total revenues earned to date as calculated above over cumulative earned revenues reported in prior periods shall be the amount recognized as revenue in the income statement of the current period.

B. Costs

Total estimated contract costs shall be comprised of (a) total contract costs incurred to date plus (b) total estimated costs to complete the contact.

Total contract costs incurred to date should include:

- cost of materials - once materials are transferred to the job site, they are considered costs of the project. However, if a significant amount of inventory is stored at the job site without being used, these inventory costs should not be included in total contract costs to date
- direct labor costs incurred
- subcontracting costs incurred
- indirect costs considered allocable to the contract such as supervisory costs, equipment costs, supplies, repairs and maintenance or insurance. Methods for allocating indirect costs should be systematic and rational.

Total contract costs incurred to date should not include:

- materials acquired for the project which have not yet been transferred to the job site
- general and administrative expenses
- selling costs unless incurred for a specific anticipated contract and recoverability from the contract is probable.

Total estimated costs to complete the contract must be assessed each quarter throughout the life of the contract. Estimating procedures should provide for expected wage and price increases as needed. The quarterly assessment of total estimated contract costs should be documented and the documentation must be maintained.

C. Gross Profit
The gross profit earned to date shall be the excess of total revenue earned to date over total contract costs incurred to date.

NOTE: Revisions to revenue, cost and profit estimates as well as adjustments to the extent of progress toward completion are often required. These changes in estimates shall be accounted for prospectively.

4.4 Calculation of Percentage-of-Completion

The percentage-of-completion at the end of each period will be based on the cost-to-cost method using the calculation below:

$$\text{Total contract costs incurred to date} \,/\, \text{Total estimated contract costs} = \text{Percentage-of-completion}$$

NOTE: Total estimated contract costs in the above calculation shall be the most recent estimated amount. See Section 4.3B above.

4.5 Accounts to Use in Applying the Percentage-of-Completion Method

As contract costs are incurred, the amounts should be recorded to the applicable expense accounts. However, they must be tracked by project/contract in order to calculate percentage-of-completion.

As billings are sent to the customer, accounts receivable is debited and the offsetting credit should be recorded to HFM account 2040_290 - deferred revenue. Once the period revenue is calculated using the percentage-of-completion, the calculated amount is reclassified from deferred revenue to revenues. Any billings in excess of recognized revenues should be reported as deferred revenue.

If the reclassification entry results in a debit remaining in the deferred revenue account, that debit should be reclassified to HFM account 1300_15 – Accounts Receivable-Accrued (“AR-Accrued”). The amount reclassified to the AR-Accrued account represents the unbilled receivable on the contract. Any amounts which are not due to be received within the next 12 months should be reclassified to HFM account 1820_90 – Long Term Retention Receivables.

See Exhibit A for an example of the accounting for a contract under the percentage-of-completion method.

4.6 Provisions for Losses on Contracts

If a loss is estimated for the entire project, the total estimated loss (not a percentage of that loss) must be reported in the quarter in which it becomes apparent that a loss will be incurred. The costs used in estimating the total loss should include all costs of the type allocable to the contract. Losses should also include provisions for performance penalties, as applicable.

5.0 PROCEDURE - APPLICATION OF COMPLETED-CONTRACT METHOD

Under the completed-contract method, revenues shall be recognized only when the contract is completed. During the period in which the contract work is performed, the billings and costs are accumulated on the balance sheet.

5.1 Accounts to Use in Applying the Completed-Contract Method

An excess of accumulated billings over related costs shall be shown as deferred revenue in HFM account 2040_290, a current liability on the balance sheet. An excess of accumulated costs over related billings shall be recorded in HFM account 1400_100 – Costs of Uncompleted Contracts in Excess of Billings. Contracts shall be segregated such that all contracts where costs exceed billings shall be grouped together as an asset and all contracts where billings exceed costs shall be grouped together as a liability.

See Exhibit A for an example of the accounting for a contract under the completed-contract method.

5.2 Provisions for Losses on Contracts

Similar to the percentage-of-completion method, if a loss is estimated on the entire project which is being accounted for under the completed-contract method, the entire loss should be recognized in the quarter in which it becomes apparent that the loss will be incurred.

6.0 OTHER POTENTIAL ISSUES RELATED TO LONG-TERM PROJECTS

6.1 Customer Contracts with Multiple Revenue-Generating Activities

Long-term construction contracts may also include provisions for services that are not within the scope of contract revenue accounting. An example would be when a contract provides for the construction of a security system as well as the maintenance of the system after construction. Another example would be a contract which calls for the installation of a security system and the providing of monitoring services after installation.

If a Brink’s entity enters into a long-term contract which includes multiple revenue-generating activities, please consult Corporate Accounting and Control for revenue recognition guidance.

6.2 Contracts in which Brink’s retains Ownership of Installed Assets

Long-term contracts to construct or install assets based on the specifications of a customer may provide that the installed assets continue to be owned by Brink’s after installation. If a Brink’s entity enters into a long-term contract which includes this provision, please consult Corporate Accounting and Control for revenue recognition guidance.

7.0 RETENTION RECEIVABLES

7.1 Definition

A retention receivable refers to the portion of revenues on long-term contracts retained by the buyer until after the contract is completed. At some point after contract completion, the retention amount is settled. For example, a construction contract may call for a 10% retention. In this case, for every $10,000 recorded as a receivable from the customer, $1,000 of the receivable amount is not actually due until after project completion.

7.2 Allowance for Bad Debt Calculation

The purpose of the bad debt provision is to assess the collectability of the receivable. Local management should have an adequate process to evaluate the collectability of each receivable individually and record a provision if there are reasonable grounds for believing it is not collectable. For long-term retention receivables related to construction projects, the review of the collectability of the applicable receivable should be documented.

If a construction contract specifies clearly that a portion of the progressive billing receivable is to be retained and will not be settled until after contract completion, the balance not yet due should be excluded from the bad debt provision calculation. However, once the retention receivable is actually due to be paid, the receivable should be recorded in the bad debt allowance if it exceeds 120 days from the specified due date for settlement.

7.3 DSO Calculation

In the current DSO calculation, all revenue and receivables recognized after service has been provided are taken into account. DSO is supposed to measure how long it takes to collect cash (from the date service was rendered, not when invoiced). As such, retention receivables should be included in the calculation. Unbilled receivables recorded at HFM account 1300_15 due to using the percentage-of-completion method should also be included in the DSO calculation.

This will incentivize management to ensure that appropriate margins are being charged (to compensate for the delayed collection times). This should also motivate management to negotiate as low a retention percentage and as quick a payment as possible.

8.0 EFFECTIVE DATE

This guidance is effective for all long-term projects entered into on or after January 1, 2011.

EXHIBIT A – ACCOUNTING EXAMPLES

1.0 Accounting Example - Percentage-of-Completion Method

Background
During the first quarter, an entity enters into a construction contract meeting all criteria at Section 3.2 of the accounting policy for revenue recognition on long-term projects. Therefore, the entity uses the percentage-of-completion method for this contract. At contract inception, estimated revenues are $100,000 and estimated costs are $80,000.

End of 1st Quarter
In the first quarter, $20,000 in contract costs were incurred and a $40,000 invoice was sent to the customer. The percentage-of-completion is calculated at 25% ($20,000 costs to date / $80,000 estimated costs) at the end of the 1st quarter. Therefore, cumulative revenues recognized are $25,000 (25% of $100,000 total estimated revenues). The accounting entries for the quarter are as follows:

AR-Trade	$40,000
Deferred revenue	(40,000)
Bill customer $40,000	

Expenses	$20,000
Inventory	(20,000)
Record 1st Qtr expenses related to the contract	

Deferred revenue	$25,000
Revenue	(25,000)
Recognize period revenue	

At the end of the 1st quarter, the entity has recognized $25,000 in revenues and $20,000 in expenses. Deferred revenue of $15,000 is on the books which represents billings in excess of revenues recognized.

End of 2nd Quarter
In the second quarter, additional contract costs of $40,000 were incurred to bring the total costs to date to $60,000. A $20,000 invoice was sent to the customer. The percentage-of-completion is calculated at 75% ($60,000 costs to date / $80,000 estimated costs) at the end of the 2nd quarter. Therefore, cumulative revenues recognized are $75,000 (75% of $100,000 total estimated revenues). As $25,000 was recognized through the end of the 1st quarter, an incremental $50,000 should be recognized in the 2nd quarter. The accounting entries are as follows:

AR-Trade	$20,000
Deferred revenue	(20,000)

Bill customer $20,000

Expenses	$40,000
Inventory	(40,000)

Record 2nd Qtr expenses related to the contract

Deferred revenue	$50,000
Revenue	(50,000)

Recognize period revenue

AR-Accrued	$15,000
Deferred revenue	(15,000)

To reclass debit in deferred revenue account to AR-Accrued. Beginning deferred revenue balance was a $15,000 credit and an additional $20,000 credit was recorded when the customer was billed. Then, a $50,000 debit was recorded when revenue was recognized. The resulting $15,000 debit is reclassified to AR-Accrued.

At the end of the 2nd quarter, the entity has recognized $75,000 in revenues cumulatively ($50,000 in the 2nd Qtr). The entity has also recognized $60,000 in expenses cumulatively ($40,000 in the 2nd Qtr). A $15,000 debit in deferred revenue was reclassified to AR-Accrued as it represents unbilled revenues (revenues in excess of billings).

End of 3rd Quarter

The contract is completed in the third quarter and an additional $15,000 in contract costs were incurred to bring the total costs to date to $75,000. The total amount is $5,000 less than initially estimated and the change in estimate should be reflected in the 3rd quarter. A final $40,000 invoice was sent to the customer. Cumulative revenues recognized are $100,000 with $25,000 recognized in the 3rd quarter ($100,000 less the $75,000 recognized to date through the end of the 2nd Qtr). The accounting entries are as follows:

AR-Trade	$40,000
Deferred revenue	(40,000)

Bill customer $40,000

Expenses	$15,000
Inventory	(15,000)

Record 3rd Qtr expenses related to the contract

Deferred revenue	$25,000
Revenue	(25,000)

Recognize period revenue

Deferred revenue	$15,000
AR-Accrued	(15,000)

To close out $15,000 credit in deferred revenue and $15,000 debit in AR-Accrued from the end of the 2nd Qtr.

2.0 Accounting Example - Completed-Contract Method

Background
An entity enters into a construction contract meeting all criteria at Section 3.3 to use the completed-contract method. Estimated revenues are $20,000 and estimated costs are $15,000. The project is expected to take two months and will start at the beginning of June with completion at the end of July.

End of June (end of 2nd Qtr)
In June, $10,000 in contract costs were incurred and a $15,000 invoice is sent to the customer. The accounting entries are as follows:

AR-Trade	$15,000
Deferred revenue	(15,000)

Bill customer $15,000

Costs of Uncompleted Contracts	$10,000
Inventory	(10,000)

Record June expenditures on project

As the cumulative billings ($15,000) exceed the cumulative costs ($10,000), a net liability balance of $5,000 exists at the end of the quarter. An entry should be posted to debit deferred revenue for $10,000 and credit Costs of Uncompleted Contracts in Excess of Billings for $10,000 so only the net liability is reported on the balance sheet. See below:

Deferred revenue	$10,000
Costs of Uncompleted Contracts	(10,000)

Record entry so that only net liability is reported on balance sheet

End of July
In July, the contract is completed and additional contract costs of $7,500 were incurred. The change in estimate is reflected in the July income statement. A final $5,000 invoice is sent to the customer. The accounting entries are as follows:

AR-Trade	$5,000
Deferred revenue	(5,000)

Bill customer $5,000

Cost of Uncompleted Contracts	$7,500
Inventory	(7,500)

Record July expenditures on project

Expenses	$17,500
Deferred revenue	10,000
Revenues	(20,000)
Costs of Uncompleted Contracts	(7,500)

As contract is completed, recognize $20,000 in revenues and $17,500 in expenses. Remove balances in deferred revenue ($5,000 at beginning of July plus $5,000 recorded in July) and Costs of Uncompleted Contracts in Excess of Billings ($7,500 recorded in July).