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KPMG INTERNATIONAL

Adapting to an uncertain environment

Global Construction Survey 2010

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Foreword

As with many industries, the depth and length of the worldwide economic downturn has meant another trying year for the engineering and construction sector. Management teams in most parts of the world have had to cope with continued declining backlogs and profits, with many unable to see beyond the next six months, let alone make longer-term plans.

In response to these conditions, some companies have striven for greater efficiency, emerging leaner in size and structure, with more sustainable business models. This growing maturity is reflected in an increasingly sophisticated approach to managing risk, to prevent contract performance problems. Talent management is also on the agenda to develop and retain a high quality employee-base that is ready for the upturn, reducing future recruitment and training costs.

But have contractors evolved sufficiently to cope with an increasingly complex marketplace? Uncertainty continues to rule, with fears of a double-dip recession in certain economies and concerns over public sector spending reviews in light of the serious deficits facing governments around the world. This threatens to derail stimulus spending and further deter financing available to clients.

Corporate governance is another key focus, as business leaders deal with the additional complexities and risks associated with regulatory compliance. This impacts both government and commercial contractors in a heightened anti-corruption environment. Investors are increasingly judging contractors on how they run their business. And with competition becoming more global,

many operators are considering new markets and geographies, or integrating vertically, which entails learning new skills and possibly restructuring the organization.

The industry as a whole is apprehensive about proposed changes to accounting for revenue recognition, believing that current financial reporting standards work well enough. The new guidelines could potentially increase the work load for finance and accounting departments and operations personnel, without significantly improving financial disclosures.

In this, the fifth KPMG Global Construction Survey, we spoke to 140 of the world's leading engineering and construction companies. Our findings offer a revealing insight into decisions taken by contractors and their customers during this difficult period, as well as providing a lens into their future expectations.

As you might expect, the responses differ from one geographic region to the next, particularly regarding the decline in construction activity. The Asia Pacific region has been relatively unaffected, whereas the U.S. and Europe have suffered far more, with the UK witnessing the collapse of two of its major players. The results also vary

according to the size of organization and the markets served, notably when it comes to governance and compliance.

There does however appear to be one constant: executives remain frustrated with the slow economic recovery, but at the same time are cautiously hopeful that a return to growth is not too far off. Is this optimism justified – or is it simply wishful thinking?

I would like to thank all of the industry executives participating in the 2010 survey. Their insights have been augmented with specialist commentary by experienced advisors from KPMG member firms around the globe.



Geno Armstrong
International Sector Leader,
Engineering & Construction
KPMG in the U.S.



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Executive summary



In 2010, KPMG interviewed executives from 140 engineering and construction companies around the world. The respondents' annual revenue varied in size from USD250 million to over USD5 billion, and served a range of markets including energy, power, industrial, healthcare/pharmaceutical, manufacturing, mining, education, and government.

Justified optimism – or false hopes?

After two of the most difficult economic years in memory, many global engineering and construction companies appear to be somewhat optimistic about their immediate prospects. Around half (48 percent) of the respondents to this year's survey are forecasting rising backlogs in 2011.

Such a positive view is at odds with the sluggish pace of recovery and the general business outlook, particularly in light of declining government spending. The responses suggest that growth will come either from pent-up demand or from expanding into new services, sectors or geographies. Although a small majority expects flat results or further declines, there is a widely held feeling that it can't continue to get worse. Only time will tell if this optimism is justified.

Interestingly, almost four out of ten (38 percent) survey participants reported a growing order book in 2010. However, even for these respondents, margins are still suffering in a highly

competitive marketplace, with a large majority of contractors continuing to cut prices or hold them at current levels.

The much-heralded government stimulus packages have had little or no tangible impact in many parts of the world, including the Americas, Europe, Middle East and Africa. Those contractors heavily focused on power and energy expect little from such projects, as the money seems to be flowing elsewhere. The exception is Asia Pacific, where China and Hong Kong have benefited considerably from some major infrastructure projects. This region in general has enjoyed significantly greater volumes and margins.

48 percent of respondents expect backlogs to increase in 2011.

A third of respondents plan to take on more direct labor in 2011.

77 percent believe their risk systems and controls are sophisticated.

A growing focus on risk and efficiency

Engineering and construction companies – particularly from the Americas – seem determined to avoid some of the pitfalls of the past, by applying more rigorous analysis at the bidding and planning stages as part of an evolving risk culture. Seventy-seven percent believe their systems and controls to be fairly or very sophisticated, reflecting increasing investment over a number of years.

Far fewer respondents have made job cuts than in the previous year,

and around a third say they're now looking to take on more direct labor in 2011 (not unexpectedly, this figure correlates closely with the proportion whose backlog has increased). The attitude toward recruitment is cautious, however, with managers aware of the need to maintain a leaner, more efficient business. Having rationalized and in some cases restructured, they may feel they're strong enough to take on more work without having to recruit as heavily as in the past.

A mixed response to emerging challenges

Despite well-publicized anti-corruption initiatives, almost half of the organizations taking part in the survey acknowledge that their own defenses could be stronger. It is likely that some are simply relying on personnel to demonstrate appropriate business ethics. On the other hand, many executives are responding positively to demands for greater accountability and transparency when working on public sector contracts. Thirty-five percent of companies surveyed in the Americas

region have taken on more government compliance staff to address this issue.

Financing continues to be a major challenge for clients of construction companies. Half of the respondents say it is a struggle for project owners to get funding even for low-risk projects. For contractors in Europe, Middle East and Africa, there is a dearth of shareholder equity and debt, which has and could continue to seriously hold back progress in this region.

Cautious optimism

Sales, margins and future prospects

Despite the slow economic recovery in many regions, the global engineering and construction industry retains a surprisingly positive outlook. Almost half of the companies in the survey expect their backlog to rise over the next year, although intense competition continues to take its toll on margins. Contractors also appear to be widening their horizons by expanding overseas into the Middle East, Asia, Australia, Africa and India, and by broadening their services.

Four out of ten (38 percent) respondents claim to have increased their backlog in the past year. The larger companies (those with more than USD5 billion turnover) fared least well, possibly because many are heavily focused on the power and energy sectors. Having worked off much of the backlog during the past year, many proposed projects in these markets have either been canceled or deferred.

Margins on the other hand, continue to take a beating, with very few respondents seeing improvements and a third experiencing declines. However, the impact has been cushioned to some extent by lower overhead costs, reflecting strenuous cost-cutting efforts. Companies in Asia Pacific appear to have enjoyed higher average margins than those in other regions. In the Americas, half of all those involved in the survey state that margins have come down, reflecting the competitive business conditions, especially in the U.S. Some contractors in this region have cushioned the blow by cutting overhead spending to compensate for lower prices.

In this buyer's market, only a tiny proportion of businesses around the world have managed to avoid price reductions, and even these fear their prices could fall in the future, unless efficiencies can be found elsewhere in the business. In Asia Pacific, for example, close to half of respondents admit to pricing at or below break-even level. Some have chosen to scale-back activity rather than get pulled into a price war, as one Japanese respondent testified, "We changed our key performance indicator from sales volume to profitability, as many projects we took on after the bubble burst turned out to be unprofitable."

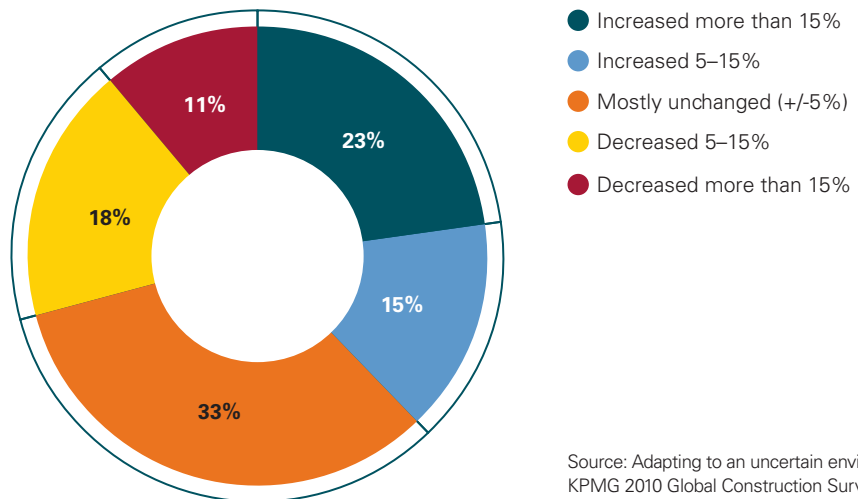
Interestingly, 39 percent of the larger organizations said they were reducing prices to near break-even levels – more than their smaller rivals. Some are hopeful of making up such shortfalls further down the line through change orders and greater internal efficiency, and by demanding lower sub-contractor pricing.

38 percent of contractors have increased their backlog in the past year.

"We changed our key performance indicator from sales volume to profitability, as many projects we took on after the bubble burst turned out to be unprofitable."

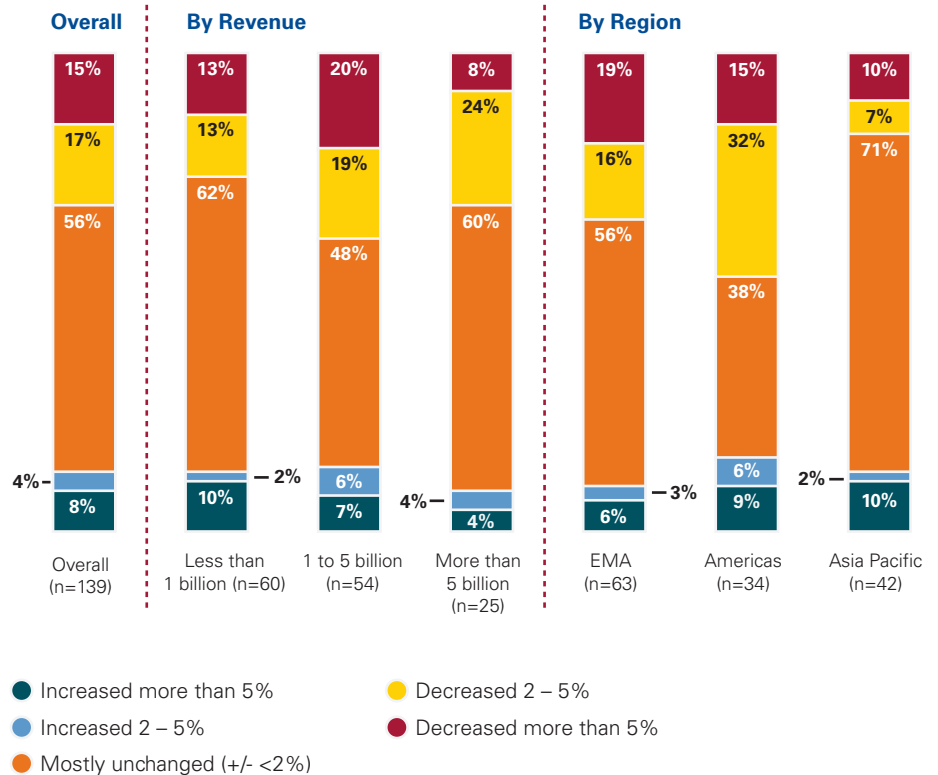
Respondent, Japan

Change in backlog over past year



Only one in eight respondents (12 percent) improved backlog margins over 2009.

Back log margin compared to prior year



Note: # Percentages may not add up to 100 due to rounding off

Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey

Varied views of the future

Some respondents are surprisingly optimistic about the coming year, with virtually half expecting an increase in their backlog and only a small minority predicting a fall. This positive outlook is particularly prevalent amongst the mid-sized companies. With government spending being tightened considerably and many commercial customers still on the decision-making fence, such confidence appears to be hopeful. Even if some contractors manage to expand into new markets, or outbid competitors, the total pie is probably not big enough to satisfy everyone.

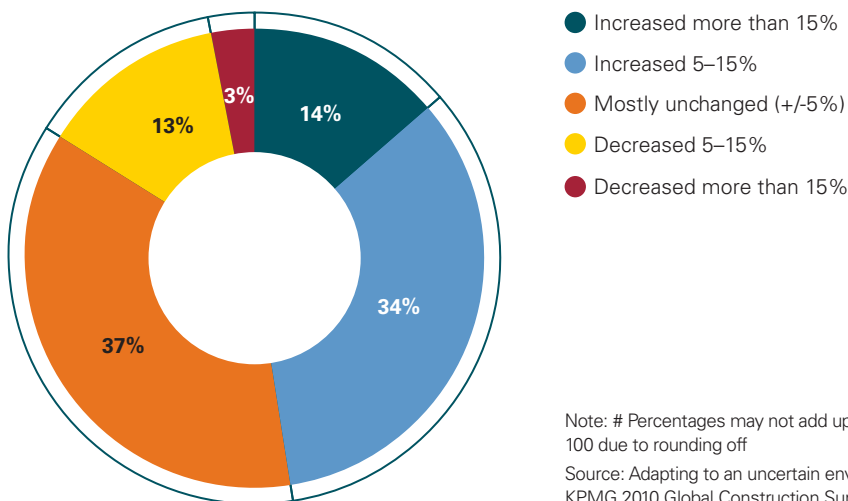
Such high hopes are common across the three global regions, especially

in Asia Pacific, where a fifth of all respondents (21 percent) believe that their organization's backlog will go up significantly.

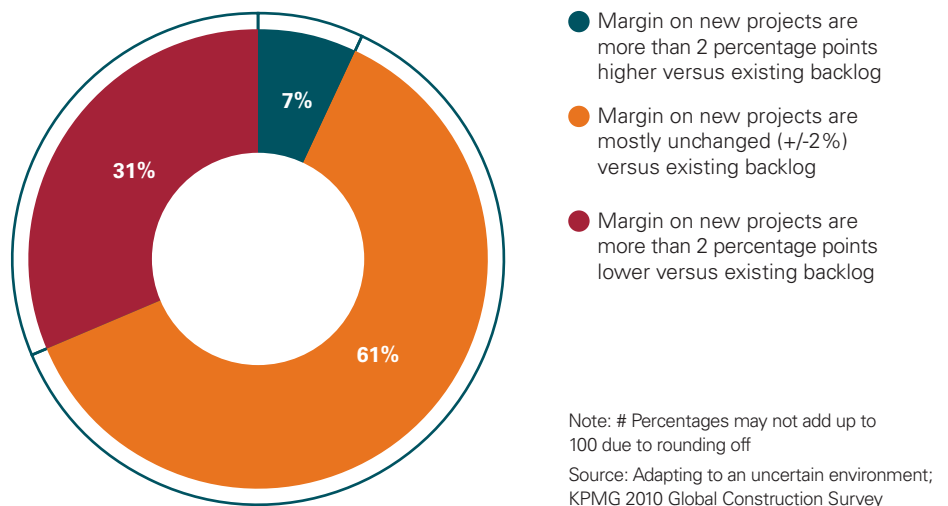
However, there is a more measured prediction on profits over the next 12 months. The environment remains highly competitive in all markets served, and almost a third (31 percent) of engineering and construction companies report that they are bidding for new business with lower margins – even in the more robust Asia Pacific markets. Pricing in Hong Kong was described by one respondent as “extreme.”

48 percent of respondents forecast a higher backlog in 2011.

Expected backlog in 2011



Trends in margin on new bids



A third of companies in Asia Pacific said stimulus packages had a “significant” impact.

Stimulus brings mixed fortunes

The only region claiming to enjoy real benefits from the various government stimulus packages was Asia Pacific, where more than a third of respondents reported a “significant” impact. China has enjoyed massive state investment in the past year, which has filtered down to infrastructure projects typically carried out by the mainly government-owned construction companies, some of whom participated in this survey.

This was in stark contrast to the situation in the Americas, Europe, Middle East and Africa, where a substantial majority feel the stimulus has had no effect whatsoever on market opportunities (although many would also probably acknowledge that things may have been even worse without such intervention). A UK survey participant observed that, “In the UK, the stimulus has ... unlocked blocked contracts, but

not seen new ones come to market.” This sentiment was echoed by a number of his contractors in other countries.

Looking forward to the next two years, companies in the Americas and Europe, Middle East and Africa are highly skeptical about whether government funding will trickle down to their businesses. They are likely concerned about imminent cuts to reduce the large public borrowing levels, bureaucratic red tape, or a lack of momentum for existing efforts. The view from a Spanish contractor was that, “The majority of stimulus programs have been cancelled or delayed due to public deficit troubleshooting.” Asia Pacific on the other hand continues to exhibit a healthy optimism, with Hong Kong hopeful of further government business in the next year.



Although stimulus packages have created some significant projects in Australia, contractors are concerned that as these wind down there may be a lack of new work to replace them.

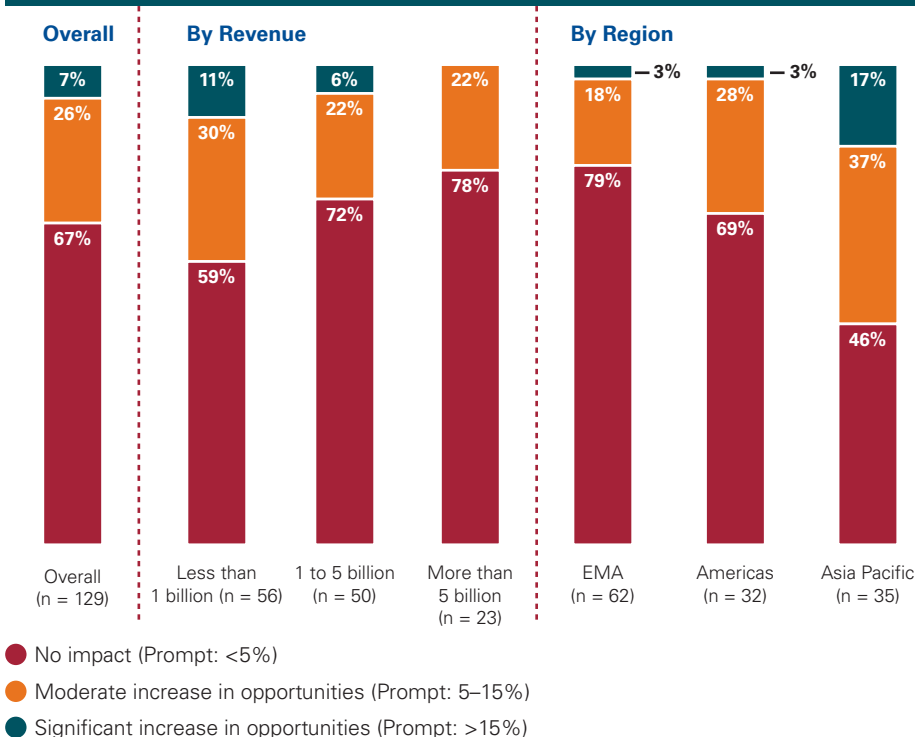
The smaller companies taking part in the survey – and a few large ones with significant infrastructure business units

– have higher expectations that stimulus spending will bring rewards over the next 24 months, perhaps feeling that essential work such as roads, bridges and airport runways may be the main focus of such investment.

“Most of the stimulus funds seemed to go to existing projects that were under-funded.”

Respondent, U.S.

Expected impact of stimulus in next 12–24 months



Note: # Percentages may not add up to 100 due to rounding off

Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey



Taking on new challenges

The responses to our survey suggest that many contractors are considering moving out of their comfort zone into new sectors or regions. On a global basis, there is a shift away from heavy infrastructure projects such as railways, roads, and bridges towards power, energy, mining and water, particularly amongst the larger companies. The exception to this trend is Asia Pacific, where there is a significant push in railway building, as evidenced by the high-speed rail project underway in mainland China and rail development in Hong Kong.

Retail, industrial, commercial and residential property continues to suffer the after-effects of the credit crisis. In the Americas, construction professionals have little or no expectation of seeing projects in private residential housing or retail anytime soon. In North America, new construction for power and refinery projects is at a near stand-still, due to an abundance of cheap natural gas, stiff regulatory standards, and uncertainty over oil extraction activities in the Gulf of Mexico.

Facing stiff competition in their home markets, a number of businesses are developing an appetite for expanding overseas. There is strong interest in the Middle East, Asia, Australia, Africa and India; and the larger players in particular appear to be avoiding the

economically challenged European market in favor of Australia and Africa. Several opportunities were mentioned, including PPP (public-private partnerships) in Spain, Italy, Russia and Poland; education in some areas of Europe (via the academies program); as well as potential mining projects in Mongolia and Indonesia.

Interestingly, respondents believe that growth is more likely to be organic, rather than through mergers and acquisitions.

Expansion is not just about new markets and geographies, as one Spanish construction company explained, "We're moving to an integrated offering, which may include financing, management and other services." A U.S. contractor offered a similar outlook, explaining that, "We have reinvigorated a higher-end consulting business, and are mostly an E (engineering) not a C (construction) business." One firm involved in the survey is now offering free services for three years post-project, to point out maintenance issues and advise clients on maintenance. Others spoke about moving into program management and facilities management.

The increased importance of sustainability is also generating new strategic options via environmental businesses such as bio-electricity production, solar power technology, nuclear and water.

"We're moving to an integrated offering, which may include financing, management and other services."

Respondent, Spain

KPMG comment: Fragile hopes

Having suffered declines or stagnation for two years, many engineering and construction companies feel that the worst is over. However, the optimism displayed by the respondents to this year's global survey may be more fragile than it appears. Although there are hopes for an improved order book, much of this hope rests on the confidence of commercial project owners, and the various government spending reviews taking place, with a number of projects on hold until these have been clarified. According to one European survey participant, "Tender activity increased ahead of summer 2010 but the 'big axe' is now beginning to fall in autumn." Issues such as tax policy and reform of public sector services will have an inevitable impact on future prospects.

The highly competitive commercial environment is putting strong downward pressure on bid prices and margins, and forcing construction companies to consider newer niche markets where the opportunities are greater. Rather than simply fight it out over more standard building work, a number are choosing to focus on oil, gas, nuclear energy, power generation, water and infrastructure. This may entail developing new

skills, or vertical integration to acquire specialty knowledge.

Energy and commodities continue to be volatile and unpredictable sectors. Although mining has enjoyed a boom in areas such as Australia and South America, project owners are not convinced that the recent surge in demand for oil and gas will last and are reluctant to give the go ahead to new initiatives. Such uncertainty may prevail until residential and commercial construction recovers.

For many, the much-heralded stimulus packages have been something of a non-event, confined largely to smaller local contractors carrying out more basic projects, with little impact upon the infrastructure market (roads, bridges and water works). In the U.S., a lot of the money has gone to the civil service sector to save jobs in public education, police and fire services. In some markets such as Australia, the revenue entered the market through bigger organizations, and was subsequently sub-contracted to smaller companies. Bureaucracy has also played a part, with some respondents remarking on the excessive number of procedural

steps and time taken for government programs to come to fruition.

However, regardless of such criticisms, most involved in the industry would probably agree that the government aid has prevented an even more serious crisis.

The increasing complexity of decision-making creates greater uncertainty for contractors, making it harder to forecast future sales. One survey participant from Japan said that, "Because of the economic downturn, it takes longer for our clients to make decisions on major projects that have been in the pipeline for a while." Against such a background, it is not a surprise that few are investing in R&D, capital expenditure or, software system upgrades.

The willingness of contractors to move into new markets, and possibly to evolve their value proposition, could be the difference between thriving and merely surviving. With margins unlikely to rise for traditional business, such a repositioning could be vital. However, in a sluggish economic climate, there is only so much work to go around, and the coming year will most likely see some consolidation.

KPMG comment: Public-private partnerships—Oasis or mirage?

Public-private partnerships (PPPs or P3s) are a growing feature of the global construction landscape, as governments seek additional ways to stretch their finite resources across a myriad of infrastructure investment needs.

PPPs encompass both the renewal or rehabilitation of existing assets and the construction of new assets.

But where are the greatest opportunities? Contractors looking to a mature PPP

market like the UK may be deterred by the cuts in the 2010 Comprehensive Spending Review. However, these were shortly followed by a USD200 billion National Infrastructure Plan, which could lead to some healthy opportunities.

Although Canada also has a well-structured and robust pipeline of PPP projects, this does create stiff competition. An alternative is to seek out markets where PPP is less-

developed – such as the U.S. and the Middle East – to try to gain early-mover advantage. The likely downside here is heightened bidding risks, as governments are still formulating their approach to such partnerships.

Despite these uncertainties, the continued lack of client funding for projects means that PPPs could be an increasingly important source of new business.



An evolving view of risk and efficiency

The survey results indicate a desire to create a more sustainable business model, with a professional approach to risk management and a longer-term view of talent. Although the worst of the job losses appear to be behind them, contractors are recruiting prudently.

Past KPMG Global Construction Surveys have reported increasing attention paid to managing risk in projects. The 2010 results show that this remains a high priority, with more than three-quarters of respondents (77 percent) believing their organization's systems and controls to be well-developed. Given their resources and the size of projects undertaken, it is not surprising that the larger organizations rate themselves the highest in this respect.

The Americas region appears to be ahead of the curve in managing risk, which reflects the degree of regulatory pressure applied to U.S. companies. Even so, only a quarter (24 percent) of engineering and construction companies from this region considers their practices to be "highly sophisticated."

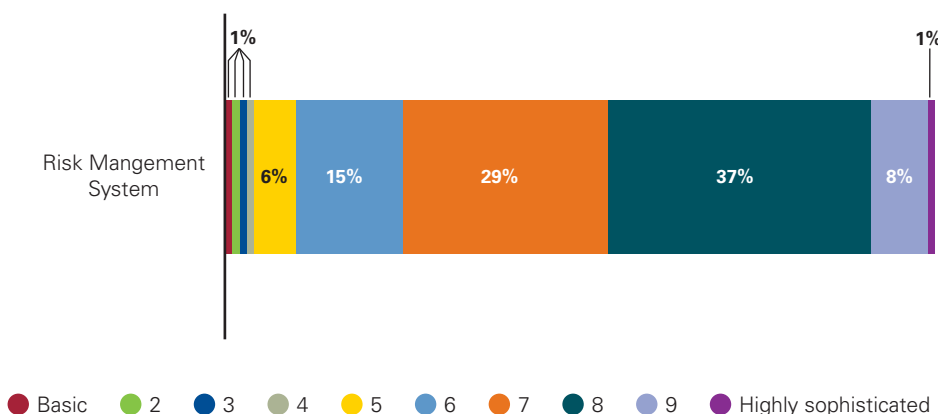
Some of the key risk management initiatives adopted by respondents include educating and training

employees, increasing analysis at the bidding and planning phases, and standardizing processes. Other common approaches include a more formal risk framework, more frequent reviews, ERM integration, and hiring of risk practitioners. There was also an acknowledgement of the need for risk committees, external reviews of major projects and peer risk reviews. One engineering and construction company taking part in the survey retained its former CEO to conduct independent audits of projects.

When asked about the causes of underperformance against financial forecast, the most common response was poor planning, bidding and estimating, followed by inadequate project team performance and design changes. These are all factors that could be mitigated to some extent by robust risk management controls.

77 percent claim to have sophisticated risk systems and controls.

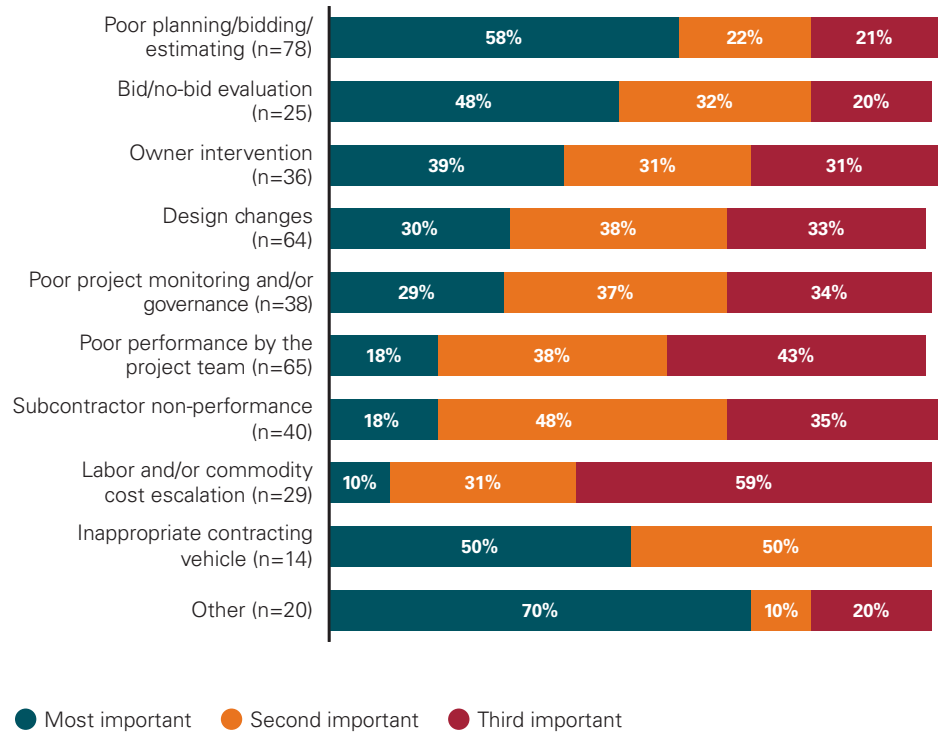
How respondents rate their risk management



Note: # Percentages may not add up to 100 due to rounding off

Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey

Causes of underperformance



Note: # Percentages may not add up to 100 due to rounding off

Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey

“We have not made cuts within internal controls, which remain of paramount importance in an increasingly competitive environment.”

Respondent, Bahrain



Cost control vs. investing in talent

In past years, the sector struggled to attract good people, and then quickly let them go when the going got tough. More recently, companies have acknowledged the need to nurture a more permanent talent pool that can grow with the business.

Many of the worst headcount cuts seem to have been made in the previous two years, when the credit crunch was at its height. In the corresponding 2009 survey, two-thirds of respondents had made some staff reductions, whereas this year, the figure was less than a third for both direct (project-based) and indirect labor (general and administrative).

The larger companies taking part in the survey laid off more staff than their smaller counterparts. This is probably due to longer-term contracts coming to an end, and clients delaying decision-making on proposed new projects. It is also possible that some of the mid-sized or smaller contractors are picking up some of the more basic road

or bridge building projects contained in government stimulus packages.

Asia Pacific's positive market was again reflected in the headcount figures, with only one in seven companies in this region making any type of job cuts at all. Indeed, 35 percent of respondents said their organization had increased its direct labor force. In Hong Kong in particular, there is a severe shortage of certain trades such as tunnel blasters. Contractors in Europe, Middle East, Africa and the Americas have been far less active in hiring new talent.

Looking ahead to 2011, very few respondents said they expect to lay off workers, and 31 percent claim they are going to take on more direct labor. The bigger players are taking a slightly more cautious attitude to recruitment. Having undergone some severe cuts, and possibly restructured into a leaner organization, they may feel they are strong enough to take on more work without having to recruit additional resources.

Spending for growth

Having weathered the economic storm, a healthy proportion (37 percent) of survey participants foresee an increase in their expenditures for R&D, capital projects and software system upgrades. More than a fifth of the bigger companies are planning to spend significantly more as they attempt to improve their capabilities and possibly expand into new markets and regions.

Twenty-four percent of respondents from Europe, Middle East and Africa expect to cut investment this year, which may reflect poor prospects in Europe. Once again, Asia Pacific is the most bullish – almost half of the contractors in this region say they will be investing more than a year ago.

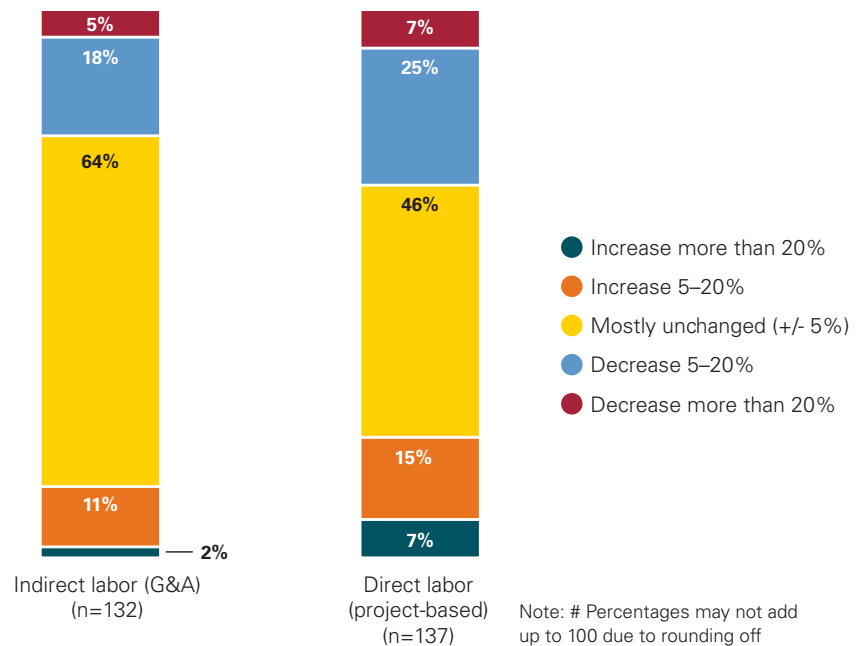
31 percent of contractors plan to take on more direct labor in 2011.

Only one in seven companies in Asia Pacific have made job cuts in the past year.

“We have taken out as much as necessary and now feel right-sized for the market ahead.”

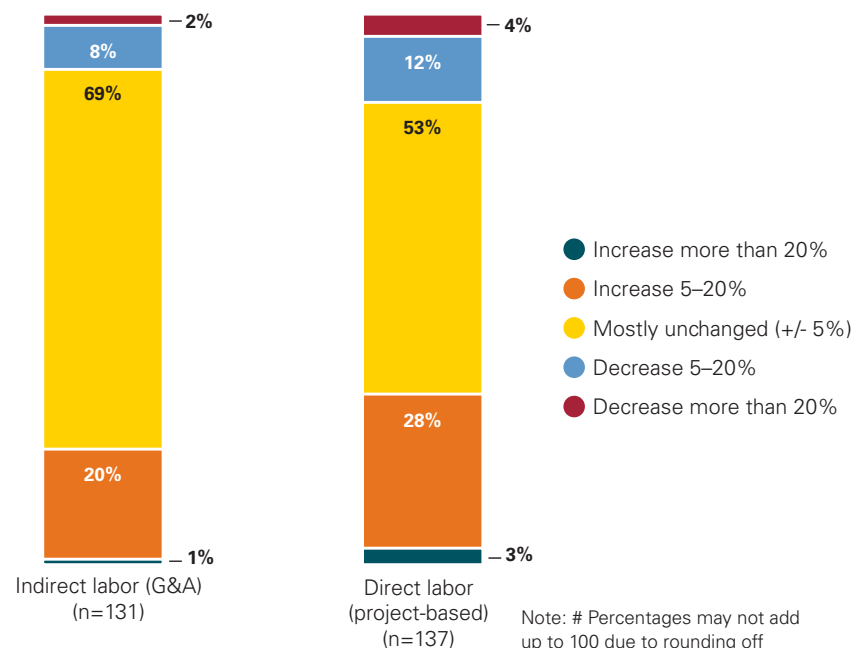
Respondent, Europe, Middle East and Africa

Change in headcount over past year



Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey

Changes in headcount in next 12 months



Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey

KPMG comment: A more measured approach to business

Although practices vary considerably around the world, and between different types of companies, the majority of contractors do not appear to be taking the risks they did 10 or even five years ago. Bigger, more sophisticated players – particularly in the U.S. – are far less likely to bet the company by taking on lump-sum turnkey projects. Such behavior is a gradual evolution towards a more sustainable, financially stable business model.

Even in a buyer's market, there is a greater desire to spread the risk via cost-reimbursable arrangements, even if it means a lower margin. Through target-based deals, at worst

contractors may lose a proportion of their fee if they do not meet the agreed objectives. One of the highest risks on a project comes from maintaining the schedule, which, if not managed properly, can result in punitive liquidated damages. And there is more sharing of risk on upfront design work – if the project progresses, the contractor may be asked to absorb a portion of this component.

Through greater analysis of the bid at the opening stage, and more time spent on the planning phase, project risk can be reduced substantially. And risk management goes well beyond the bid phase, with many construction companies evaluating

the financial stability of sub-contractors and assessing the quality of directors on subsidiary boards.

Macro-economic risks are also a big consideration in an unstable world, as the following U.S. respondent explained, "We address the risks according to each country and situation. We have major concerns in the Middle East and Asia, regarding the political situation and safety concerns. We've also invested in internal audit and have legal advisory firms on contract."

Other risks being considered are tax, environmental, publicity, and credit. Some of the companies involved in the research are active in the Engineering & Construction



Risk Institute, an international risk management consulting forum focused exclusively on the sector.

Despite cost-cutting programs, many organizations have actually increased their investment in risk management personnel. Where reductions have occurred, the business has often adjusted by refocusing on the most important controls, with less emphasis on lower risk processes.

However, risk cultures vary widely. In some companies, where risk management is ingrained and second nature, management may feel less need for independent assessors. In this respect, all employees effectively become risk managers, as one

UK respondent commented, “It’s everyone’s responsibility to make a contribution based on our strong and embedded values culture.” Other contractors may however see such an approach as too informal, and seek a more objective review of projects by dedicated risk professionals, often on a quarterly basis. Another example of a new level of professionalism is the growing number of business development managers devoted to contractors’ major global clients – a task traditionally given to operating personnel. Some companies are re-training project managers in such skills. Others are reorganizing key accounts by market sector and linking incentives

to margins rather than volume to stimulate more profitable business.

Many engineering and construction companies have moved a couple of notches up the maturity scale, yet it can be hard to resist even lump-sum contracts when conditions are bad. However, one recent incident in the U.S. is a sign of a more sustainable future. During bidding for multi-billion dollar nuclear projects, the main competitors were repeatedly asked to lower the price. Despite this pressure, none of them felt they could sustain quality service at or below break-even levels. Although the final margins were tight, they were all perceived as commercially sustainable.



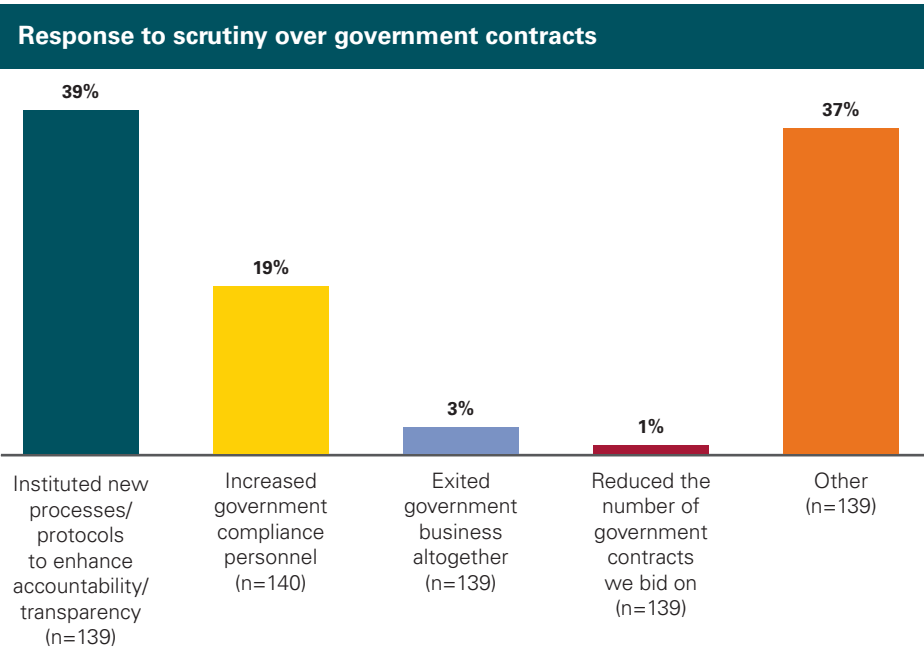
Adapting to a changing environment

The survey suggests that engineering and construction companies are becoming more open and accountable, and reacting positively to the increased scrutiny over government contracts and local regulations. However, the response to heightened corruption laws in certain countries has been less clear. Almost half of the participants believe their policies and procedures are not effective enough. If such gaps are not addressed, these organizations could potentially violate laws, harming their reputation and suffering financial penalties.

In the more developed economies, many government agencies have increased their scrutiny of government contracts due to tight fiscal and monetary policies, and 4 out of 10 respondents have enhanced their accountability and transparency in response by bringing in new processes and protocols. As a U.S. respondent remarked, “The scrutiny over the completeness of a proposal has increased, and government agencies are looking for any reason to kick you out of the bid process.” However, it seems that contractors are prepared to live with such demands, as only a tiny minority

has felt the need to exit or scale down their government business.

The U.S. has been at the forefront of compliance in the past decade, so it is no real surprise that more than a third (35 percent) of engineering and construction companies in the Americas have felt the need to take on additional government compliance staff, with some of these individuals focusing specifically on potential corrupt practices. Their counterparts in Europe, Middle East and Africa, on the other hand, have been far less active in recruiting in this area.



35 percent of engineering and construction companies in the Americas region have taken on more government compliance staff.

Note: # Percentages may not add up to 100 due to rounding off
Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey

46 percent of contractors say they do not have appropriate anti-corruption policies and procedures.

The fight against corruption

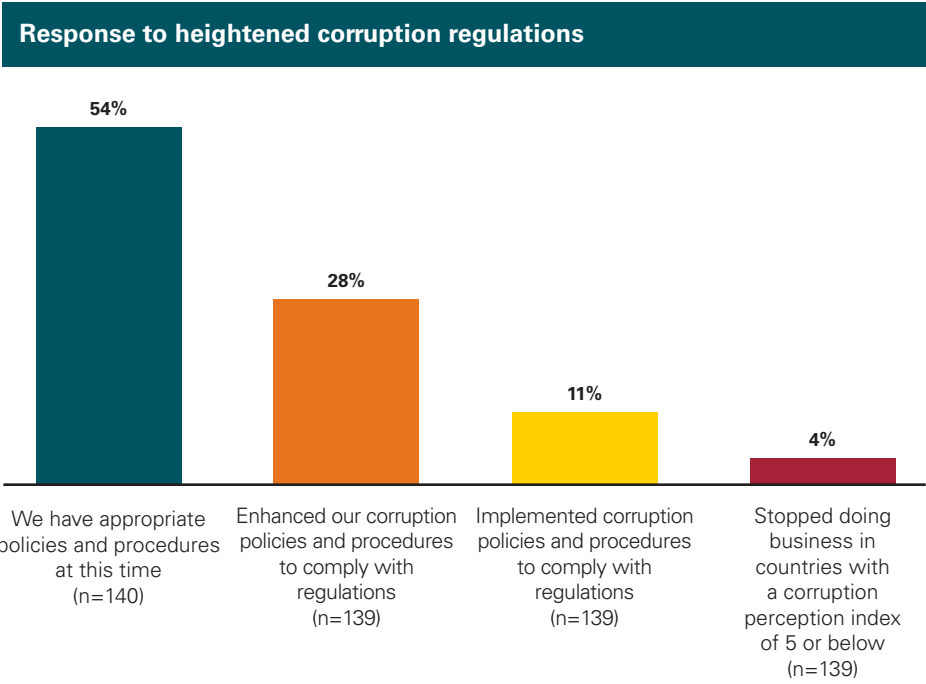
Around the world, regulatory bodies are trying to eliminate corruption and ensure fair competition. According to our survey, engineering and construction companies still have some way to go, as close to half of the respondents (46 percent) state that their current policies and procedures can and need to be improved.

A number of respondents are striving to overcome such weaknesses, particularly the mid-sized and larger companies. Contractors from the Americas are also more likely to be enhancing their anti-corruption controls, fearing financial penalties and damage to their reputation. When asked what measures were being used, participants mentioned awareness campaigns, training in local country laws, improved audit procedures (including anonymous surveys), and strict policies to report corruption, such as hotlines, where calls are monitored and formally investigated.

The Corruption Perceptions Index measures the perceived level of public-sector corruption in 180 countries and territories around the world, using a scale of 0–10, where 10 indicates low perceived corruption. However, to date, high perceived corruption has not proven a deterrent in the construction sector; only four percent of all those involved in the survey said they would cease doing business in a country where the index was five or below.

In an effort to combat global corruption, the World Economic Forum's Partnering Against Corruption Initiative (PACI) was formally launched by CEOs from the engineering and construction, energy and metals and mining industries in January 2004. However, only 10 percent of companies participating in this survey say they are actively involved in implementing PACI's best practices, and more than half are not even aware of its existence.





Only 4 percent of contractors said they would cease doing business in a country with a high perceived corruption score.

Note: # Percentages may not add up to 100 due to rounding off
Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey



Just 6 percent of respondents feel that clients can get financing for speculative projects.

Funding expansion

In the wake of the credit crisis, how are project owners planning to finance their future operations? Even for low-risk initiatives, close to half of the survey participants (47 percent) say that financing was either challenging or not available to their clients. The picture was considerably bleaker for speculative projects: only 6 percent of the entire survey population feels that such backing was readily available, with mid-sized companies suffering the most from lack of client funding.

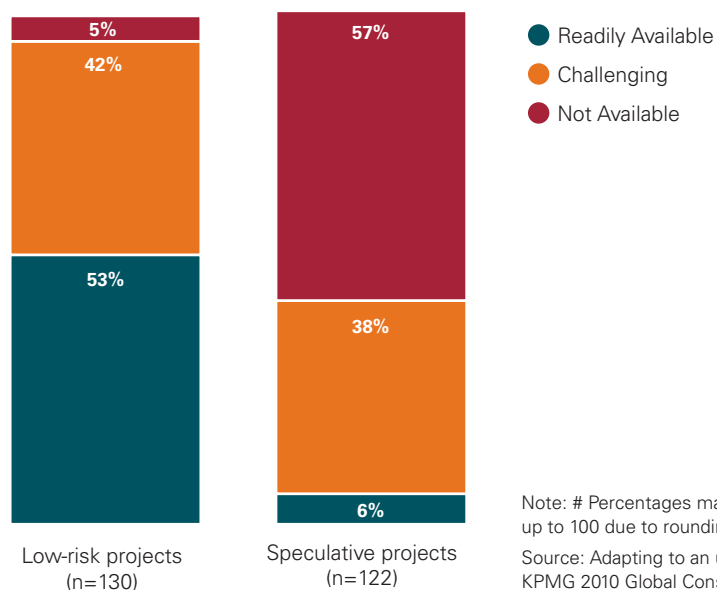
Debt and equity appears to be more readily available in the Americas, while much less so in Europe, Middle East and Africa.

When asked about the preferred means of funding major infrastructure

projects, respondents, particularly those outside the U.S., expressed strong support for public-private partnerships (PPPs), where the government takes the bulk of the risk and provides a substantial proportion of the capital. An Australian respondent remarked that, "There is a construction sector role in PPPs, provided government takes the demand risk and the contractor takes the availability risk. Governments will have to support and guarantee debt. PPPs are the future as they're efficient, cost-certain and time-certain." PPPs have been slow to take off in the U.S., and many respondents from that country admitted they had no previous experience with such structures.

There is a distinct lack of shareholder equity available in Europe, Middle East and Africa.

Availability of project financing for client projects



Note: # Percentages may not add up to 100 due to rounding off

Source: Adapting to an uncertain environment; KPMG 2010 Global Construction Survey

KPMG comment: Compliance as a competitive tool

Regulatory pressures are forcing engineering and construction companies to show that their internal controls, risk management and anti-corruption measures are up to the task.

However, more enlightened operators are realizing that a strong set of values can enhance their reputation and help win new business. Shareholder value is increasingly linked to intangible assets, such as a company's safety program, environmental practices and a transparent control environment. Additionally, customers are looking closely at whether contractors are responsible corporate citizens.

One of the organizations involved in the 2010 survey has integrated its compliance with energy-saving and soil-contamination laws into its marketing, and others have built strong safety and sustainability

credentials into their proposition, linking specific bids to corporate social responsibility initiatives.

A Japanese respondent took a holistic view, "We're aiming to be number one for environmental operations and strive to develop comprehensive services and technologies for the environment. We employ a transparent method where we disclose a breakdown of all our costs and margins and it helps to gain credit from our accounts."

The low awareness of PACI (Partnering Against Corruption Initiative), and the indifference to countries with high perceived corruption, suggests that more could be done to demonstrate good ethics and sound risk management practices.



KPMG comment: Revenue recognition – the unknown threat

From a financial reporting perspective, one of the biggest challenges facing the global engineering and construction industry is the proposed new accounting standard on revenue recognition. In June 2010, the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) published a joint exposure draft on the subject.

The basic premise of the new proposal is that revenue can only be recognized when control of the goods or services is transferred to the customer. There was initial widespread concern that this would put an end to percentage-of-completion accounting. However, the exposure draft contains a provision acknowledging that in some contract arrangements, control may be transferred continuously during the performance period. This provision

could result in revenue and profit recognized in a manner similar to the percentage-of-completion method currently in use (albeit with some new and challenging differences).

However, if the criteria for using a continuous transfer model are *not* met, revenue and profits from construction would only be recognized when performance obligations are completed and the goods or services are accepted by the client. In such cases, income for contractors may not flow through smoothly over time, but in lumps, which may not reflect the volume of work that has taken place. This would constitute a significant change in practice.

One of the key issues is that of performance obligations. The exposure draft states that revenue will be recognized only after these obligations are satisfied (i.e., goods or services

are transferred to the customer). When this actually takes place may depend on the specific legal form of the contract, as well as local legal interpretations. Additionally, the proposal would require each obligation to be treated as a separate contract, which could vastly increase the administrative workload – especially if there are multiple obligations identified within a contract.

To make matters more complex, retrospective application of the standard is proposed, which would be a huge logistical task involving a wide range of personnel in and outside of the accounting function. Given the size and duration of many construction-related contracts, many in the industry believe this requirement to be impracticable.



Conclusions: Next steps

Despite the optimism demonstrated by many of the respondents to KPMG's 2010 Global Construction Survey, the future is far from certain. While the research highlighted some real progress, it also identified a number of key concerns. To evolve further and achieve profitable growth, engineering and construction companies should address the following:

Continue to invest in risk management

By placing an emphasis on the upfront elements of a project – bidding, planning, estimating and design – and monitoring team performance, contractors can control quality, avoid errors and preserve margins.

Develop a permanently leaner business

In a world where prices are consistently under pressure, greater efficiency is the key to achieving profitability in the face of shrinking margins. By carefully managing all elements of the supply chain, and increasing productivity, it is possible to create a lower-cost operation.

Expand horizons

By looking beyond traditional markets and geographies, contractors can find valuable new niches. Higher margins may await those prepared to vertically integrate into financing, program management and facilities management, or alternatively to specialize in bio-electricity production, solar power technology, nuclear or water.



Contractors should be thinking about how these possible changes would impact the accumulation, tracking and reporting of project data used in the revenue recognition process.

Build the right skills

To move into new markets, and achieve successful vertical integration, engineering and construction companies should nurture talent in key positions, invest in necessary training, and strive to retain the best people during adverse conditions.

Demonstrate good corporate ethics

Compliance, sustainability and safety can be key differentiators and are increasingly valued in the marketplace. Businesses that can show they are leaders in the fight against corruption, and that they are good corporate citizens, can emerge victorious in both the public and private sectors.

Get ready for change

Although the current revenue recognition accounting standards used by the industry have served it well for decades, the accounting standard setters' proposed changes could significantly alter accounting and operational procedures. And while many in the industry provided constructive feedback on the proposed changes during the comment period, it remains to be seen how the rule makers will address those comments in the final pronouncement. Contractors should be thinking about how these possible changes would impact the accumulation, tracking and reporting of project data used in the revenue recognition process.



About the survey

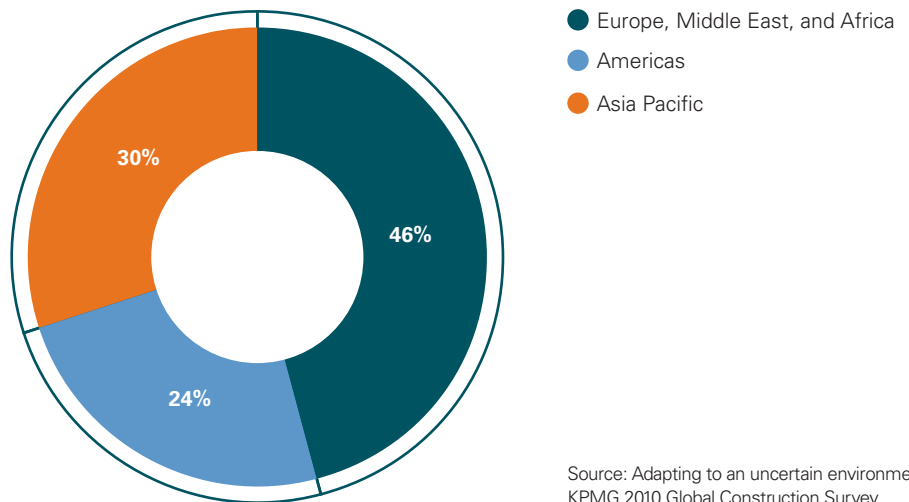
All survey responses were gathered through face-to-face interviews in 2010 with 140 senior leaders – many of them Chief Executive Officers – from leading engineering and construction companies in 25 countries around the world.

The interviews were carried out by senior representatives from KPMG member firms specializing in the engineering and construction industry, with the questions reflecting current and ongoing concerns expressed by clients of KPMG member firms.

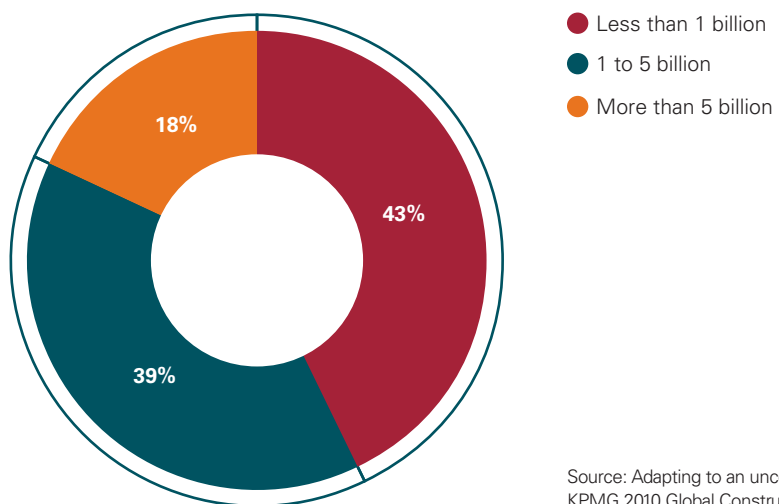
Respondent companies' turnover ranged from less than USD250 million to more than USD5 billion, with a mix of operations from global through regional to purely domestic.



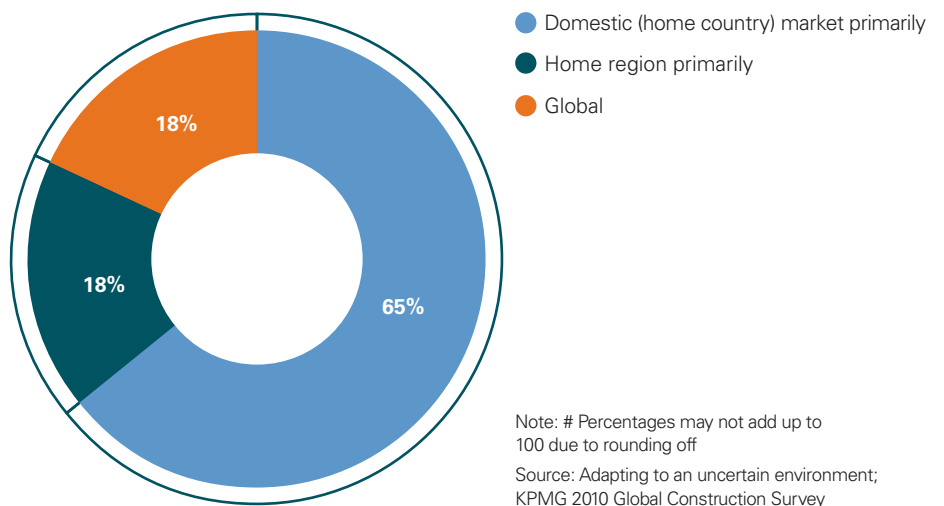
Regional breakdown of participants



Turnover of participants (USD)



Scope of operations of participants



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